The U.S.-Japan Auto Trade Accord: Blueprint For Conflict

Japan Finally Says, "No."

By Stanton D. Anderson and Thomas P. Steindler

The drama played out in Geneva this summer between Japanese Minister of International Trade and Industry (MITI),Hashimoto Ryutaro, and U.S. Trade Representative Mickey Kantor in the auto trade dispute was the culmination of a decade of change in the U.S.-Japan economic relationship. The agreement that was ultimately concluded, however, is a blueprint for continued conflict which could further damage the bilateral relationship if not handled wisely in Tokyo and Washington.

Origins of the dispute

The origins of the auto dispute can be traced back more than a decade.

In the early 1980s, the U.S. auto industry sought protection from Japanese auto imports. Ultimately, this protection took the form of "voluntary" export restraints imposed by the government of Japan on Japanese automakers.

The export restraints had two significant effects. First, they afforded the U.S. auto industry time to retrench and to work on increasing the quality and competitiveness of its automobiles, which had diminished markedly over the previous decade. Second, the restraints caused Japanese automakers to shift a significant portion of their production for the U.S. market to the U.S.

While Japanese assembly was now increasingly taking place at transplant operations in the U.S., a large percentage of the parts used by the transplants was either imported from Japan or purchased from Japanese-owned parts companies which had migrated to the United States to follow the auto companies.

Throughout the 1980s, Detroit largely ignored the Japanese market and was content with the protection it had received in the form of the export restraints. As the decade progressed, however, another segment of the U.S. automotive industry, the auto parts companies, became increasingly frustrated by its inability to break into what was perceived as the closed circle of suppliers to Japanese auto companies.

The 1986 Semiconductor Arrangement

In 1986, the U.S. and Japan entered into the Semiconductor Arrangement. In a famous but supposedly secret side letter, the two governments stated the "expectation" of the U.S. semiconductor industry that foreign market share in Japan would reach 20%. While the arrangement contained many other indicia for success, the U.S. focused almost exclusively on the market share figure.

With the success enjoyed by U.S. chip manufacturers in the Japanese market in the 1990s, the Semiconductor Arrangement was hailed within U.S. trade policy circles as the model of a successful, "results-oriented" trade agreement with Japan. The arrangement and "numerical indicators" were to have an important impact on U.S. policy makers in the auto trade dispute.

End of the Cold War

The end of the Cold War also played a role in shaping U.S. trade policy towards Japan. Since the end of World War II, America's bilateral relationship with Japan has rested on the three pillars of political, economic and security relationships. Throughout the Cold War, particularly in periods of heightened tension in the Asia-Pacific region, the political and security relationships have been dominant. Within the U.S. government, the State and Defense Departments always managed to ensure that trade disputes with Japan did not escalate to unacceptable levels where they might jeopardize the political and security relationships.

With the end of the Cold War, however, came a lessening in the dominance of the political and security relationships in inter-agency U.S. government deliberations and an increase in the freedom accorded U.S. trade negotiators to risk confrontation in trade negotiations, which have become increasingly acrimonious.

Policy in transition

U.S. trade policy towards Japan was in transition in the end of the Bush administration. President Bush's Trade Representative, Carla Hills, placed increasing emphasis in her public statements on opening foreign markets, with Japan being the focal point of much of her criticism.

In January 1992, President Bush took an ill-fated trip to Tokyo, where he was struck by an unfortunate bout of intestinal flu. The public relations disaster aside, while Bush was in Tokyo, Japanese auto companies, responding to pressure from U.S. parts companies that had been building for several years, took the occasion to announce voluntary plans to double their purchases of U.S. auto parts from $9 billion in fiscal year 1990 to $19 billion in fiscal 1994.

The Clinton administration

When the Clinton administration came into office in January 1993, many of the trade policy ingredients that had been bubbling beneath the surface by the end of the Bush administration now came to full boil.

President Clinton had identified the domestic economy as his number one priority during the presidential campaign. The success or failure of his administration would hinge on his record in improving economic conditions for the American people. Trade policy was seen as an arm of overall economic policy by the Clinton economic team.

By the time President Clinton assumed office, common wisdom in the Washington trade community had coalesced around several basic tenets.

The first was that Japanese markets continued to be closed to foreigners in many sectors.

The second was that consumer influence in Japan was weak and that Japan would not change of its own accord in the near term. While political change was underway in Japan, this would be unlikely to produce fundamental changes in Japan's external relations in the near term, and likely not for at least another generation.

As such, for the foreseeable future, Japan would open its markets to foreign goods only in the face of external pressure. Keeping the pressure on Japan was thus a central strategic objective of the Clinton administration's Japan policy.

Finally, based on its manifest success, the Semiconductor Arrangement and its numerical target was determined by the Clinton administration to be the most effective way to keep the pressure on the Japanese. Setting aside some pesky concerns about managed trade, numerical targets were widely seen in Washington as the way to go in future trade agreements with Japan.

The Clinton administration set about implementing its new Japan policy in July 1993 through its newly-devised "Framework" negotiations. The automotive negotiations within the Framework context began in earnest in October 1993.

The auto negotiations

The auto negotiations, which ultimately lasted more than a year and a half, were beset from the outset by the problem of numerical targets. From the U.S. perspective, numerical targets were the key to achieving the ultimate objective of putting pressure on Japan. From the Japanese perspective, however, the experience of the Semiconductor Arrangement had been that the U.S. side treated the numerical target as a Japanese guarantee, even in the face of specific language to the contrary.

The semiconductor experience haunted Japanese negotiators, who did not wish to see a repeat in autos. In January 1994, MITI Vice Minister Okamatsu Sozaburo wrote to his U.S. counterpart, Commerce Undersecretary Jeffrey Garten, indicating that quantative indicators would be difficult to accept. In the same month, the U.S. auto industry, through its trade association, the American Automobile Manufacturers Association (AAMA), was calling for sales targets to be included in an agreement with Japan, with U.S. automakers to be selling 100,000 units a month in Japan within three years.

The AAMA was led by former Bush Secretary of Transportation Andrew Card, who became an outspoken advocate for a hard-line position against Japan. Card had been given this assignment in part because of disagreement between the Big Three on the issue, and also as an opportunity for Card to establish a profile in his new position as the top lobbyist for the auto industry. Clinton administration trade officials also welcomed Card's involvement, since having a former Republican cabinet member involved in the issue provided a certain degree of political cover.

The early negotiations came to a head on February 11, 1994, when Prime Minister Hosokawa Morihiro and President Clinton met in Washington. The negotiations broke down over the Clinton administration's insistence on numerical indicators.

The February 11 summit was a watershed in U.S.-Japan trade relations. It marked the first occasion in which a Japanese prime minister had said "no" directly to an American president. Leading up to the meeting, the Japanese government had done an effective job of painting the Clinton administration as being in favor of managed trade and numerical targets, winning this round of the public relations fight. The summit marked the beginning of Japan taking a clear and forceful position against government involvement in the marketplace, which in turn has forced the U.S. to modify the manner in which it negotiates with Japan.

The talks were resumed in May after the U.S. side agreed to drop its insistence on numerical targets. However, progress was not sufficient from the U.S. perspective thus, to increase the pressure on Japan at the bargaining table, the U.S. initiated a Section 310 investigation on aftermarket parts on September 30, 1994.

Another six months went by without any visible results. On May 16, 1995, after what the U.S. perceived as the failure of meetings in Vancouver, the U.S. announced its intention to impose $5.9 billion in sanctions against 13 luxury vehicles imported from Japan. The sanctions were to be imposed on June 28, though, if imposed, would take effect retroactively for entries as of May 20. The U.S. also announced a parallel action of taking its case to the newly-formed World Trade Organization (WTO).

The strategy of picking luxury cars for sanctions was carefully chosen. Historically, trade sanctions have always presented a difficult problem, as tariffs on imported goods cannot escape hurting some group of American consumers. In this case, however, the Clinton administration's choice of luxury car owners showed a deft political touch, since luxury car owners would receive little sympathy from the general public and, in any event, there were other, non-Japanese luxury cars for upscale customers to chose from. As a result, the affected consumer groups provided little in the way of a political counterbalance in this dispute.

In response to the sanctions threat, the Japanese government brought its own action against the U.S. at the WTO. This step played a major role in bringing about a willingness on the part of the Clinton administration to negotiate an inferior package from what the U.S. originally sought. Senior officials within the administration were concerned that an adverse decision in this case at the newly-formed WTO could spell doom for the organization that President Clinton had fought so hard to establish.

Ultimately, at the eleventh hour, MITI's Minister Hashimoto and U.S.T.R. Kantor reached an agreement on June 28, 1995, in time to stave off the sanctions.

The auto agreement

The agreement covered the three areas the U.S. had been concerned with since the early days of the negotiations: (1) voluntary purchasing plans announced by Japanese car companies; (2) greater access to dealers in Japan for U.S. vehicle manufacturers and (3) deregulation of aftermarket parts sales in Japan.

More important, perhaps, than what the two governments agreed on was their agreement to disagree on the issue of numerical targets. The U.S. issued a series of unilateral numerical targets at the time of the announcement of the accord. Japan specifically and explicitly disavowed those numbers.

With respect to the voluntary plans, the U.S. said they showed that the Big Five Japanese auto companies would increase their vehicle production in North America by $6.7 billion, and would purchase $6 billion of foreign parts for production use in Japan by 1998.

On the issue of dealerships, the U.S. announced that it expected U.S. companies to open an additional 200 outlets in 1996 and 1000 new outlets by 2000, to support the U.S. industry's objective of exporting 300,000 vehicles a year by the year 2000. This was significantly below the 100,000 vehicles per month originally stated by the U.S. side in 1994.

The auto accord was ultimately signed on August 23, but not before there was additional wrangling between negotiators over monitoring provisions. The U.S. issued a 13-page summary with its interpretation of the agreement. The Japanese government subsequently released a 24-page rebuttal of the meaning of the document.

On September 6, the administration announced that it would keep pressure on Japan to implement the agreement by issuing semi-annual, public reports on the extent of increased sales by U.S. producers under the agreement. The first report will be issued March 15, 1996, while the second report is to be issued on September 15, 1996, at the height of the U.S. presidential campaign.

Politics, as usual

What caused this dispute to escalate so dramatically? Certainly, the central importance of the auto industry to the U.S. economy and the overall bilateral trade deficit was a major factor. So, too, was the new environment in the post-Cold War era, coupled with the Clinton administration's emphasis on economic issues. However, one should not overlook the importance of domestic U.S. political considerations in influencing the final result.

The Clinton administration sought to shore up the president's political support in the traditional auto manufacturing states of the Rust Belt, particularly with the United Auto Workers (UAW), by taking a tough stand against Japan on the auto trade issue. Mr. Clinton's standing with the UAW had been severely damaged in the bruising, bare-knuckle debated over NAFTA and the Uruguay Round, in which organized labor bitterly opposed the president's support of expanding free trade.

Based on conversations we have had in Washington, the president's political advisors in the White House made a very calculating move that "beating up on Japan" would prove to be a popular move. This was an overwhelming factor in determining the administration's approach on this issue, the importance of which cannot be overemphasized.

In the end, the White House political operatives were right. The president's popularity ratings bumped up noticeably after the June 28 announcement.

The future

Two factors will determine the future of the U.S. approach to the auto accord over the next 12 months: (1) marketplace and (2) domestic politics.

With respect to the first, the most important questions will be whether parts sales to Japanese auto companies are increasing, and whether the U.S. meets its goal of signing up 200 new outlets in 1996. Early indications are that things are pretty much on track, and no one in Washington expects to see serious fireworks when the first U.S. monitoring report is issued on March 15.

What happens on the political front, however, is likely to be far more volatile, particularly with the second report being issued only six weeks before the U.S. presidential election.

The Japanese auto industry in the U.S. has been sensitive to the political calculations being made by the administration. At the time sanctions on Japanese luxury imports were announced in May, the transplant industry hastily assembled a coalition of California businesses to try to act as a counterweight to the political strength of the U.S. automotive industry in the Midwestern states. Called The Alliance To Save California Jobs, this coalition was made up of companies that were dependent on the Japanese transplant auto industry for their livelihoods. The coalition was in the process of initiating a campaign to lobby against the sanctions when sanctions were averted.

Recognizing that there will be continued political pressure associated with the implementation of the accord, the transplant industry is seeking to assemble a permanent coalition, to be called The California Auto Industry Alliance. The coalition, which is expected to be up and running by the start of the year, will work to increase public awareness of the impact the Japanese auto industry has in California.

How the administration handles the politics of this issue will largely be dependent on what is happening in the marketplace. If things are going well for the American automotive industry under the agreement, then the Clinton administration can be expected to use the September 15 report to take credit for such success. If, however, the market is not living up to U.S. expectations, we are likely to see well-orchestrated criticism of Japan's performance under the agreement led by the administration and supported by domestic industry.

In the end, there is a serious question whether the U.S. can legally enforce the auto agreement. The most likely prospect for enforcement are the provisions for deregulation of the replacement parts market, since this is under the direct control of the Japanese government. An enforcement action based on the unilateral U.S. targets for dealership and sales is far more questionable, particularly in light of Japan's explicit repudiation of these numbers. In any event, we can expect to see a great deal of agitation short of enforcement threats in the event that the marketplace does not live up to the U.S. industry's expectations. In light of the explosive potential for controversy contained in this agreement, the manner in which the issue is handled over time in both capitols will have an important impact on the outcome of any crisis that develops under the accord.

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