Volume Title: Trade with Japan: Has the Door Opened Wider?

Volume Author/Editor: Paul Krugman, editor

Volume Publisher: University of Chicago Press, 1991

Volume ISBN: 0-226-45458-4

Volume URL: http://www.nber.org/books/krug91-1

Conference Date: October 19-20, 1989

Publication Date: January 1991

Chapter Title: U. S .-Japan Trade Negotiations: Paradigms Lost

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Chapter URL: http://www.nber.org/chapters/c8668

Chapter pages in book: (p. 305 - 328)

10 U.S.-Japan Trade Negotiations: Paradigms Lost

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10.1 The Political Setting

The NBER Conference on which this volume is based took place in a climate of increasing and changing interest in the U.S.-Japan economic relationship. Four years before, in the high-dollar days of 1985, the Senate had voted 92–0 to condemn Japan as an unfair trader, and the administration had been pushed into a new trade policy of aggressive bilateralism. A year before, Congress had passed by a veto-proof margin a massive trade bill, featuring "Super 301" provisions aimed at the U.S.-Japan trade relationship. In Japan, 1989 had brought the death of Emperor Hirohito, the Recruit bribery scandal, and three prime ministers in as many months. For both countries, the U.S. implementation of Super 301 and the debate over sales of the FSX fighter brought sharp debates on the nature of the U.S.-Japan trade and defense relationship. And 1989 was the year when revisionist views on the U.S.-Japan relationship became respectable and even mainstream in Washington, D.C. In Tokyo, revisionists emerged as well, urging a Japan that could "say no" to American demands.

Both Japan and the United States had operated since 1945 on the basis of a bilateral, special relationship. The terms of this relationship were formed in the American occupation of Japan: Japan would become the Switzerland of the Pacific, and America would be its protector and major export market. This

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The views expressed in this paper are personal and do not represent the position of USTR or the GATT Secretariat. The author gratefully acknowledges the support of the Council on Foreign Relations and the U.S. Trade Representative's Russell Long Fellowship. The author thanks the following individuals who offered helpful comments on this manuscript at various points: Thomas Bayard, C. Randall Henning, Paul Krugman, Joseph Massey, Marc Noland, David Walters, and especially David Schultz.

relationship was overwhelmingly important to each in its dealings with the other. Trade problems were dealt with inside the relationship by bilateral negotiation, and concerned primarily case-by-case appeals by Japan for access to the U.S. market for labor-intensive goods or by the United States for access to the Japanese market for U.S. products or investors. Both parties in the relationship had a strong interest in Japan's prosperity and political stability. Both in defense matters and in the sphere of trade relations, the United States intervened on Japan's behalf with third parties: for instance, U.S. commercial diplomacy was the key factor for Japan's entry into the GATT in 1955 and for its reentry into the world trading system.

The old paradigm of the special relationship was strained to the point of rupture by the economic events of the 1980s: the U.S. budget deficit, the recession of the early 1980s, the high dollar, and the ever-increasing bilateral trade deficit. Japanese competition, and U.S. appeals for trade relief, had moved from textiles to steel to semiconductors. In this climate, then, there were competing attempts to establish a new paradigm and new mechanisms for U.S.-Japan trade relations.

Economic and political revisionists have offered a critique of the Japanese political system, the Japanese economy, and Japan's relationship with the world. Their claim has been that Japan's political and social system makes this relationship different in nature from those with other U.S. trading partners and competitors. The political revisionists, Chalmers Johnson (1982), Clyde Prestowitz (1988), James Fallows (1989), and Karel van Wolferen (1989) present a picture of Japan as a neomercantilist society. Prestowitz critiques the way that the U.S. government deals with Japan trade issues. He and van Wolferen present a picture of Japanese society as totally oriented toward production, the source of national strength. Van Wolferen describes Japan as a vast and undemocratic "System" that exalts the producer at the expense of the consumer. Fallows simply says that Japan has different values: like Prestowitz, he argues that the United States has to find some new and different way to deal with Japanese trade. Meanwhile, economists such as Robert Z. Lawrence (ch. 1, in this volume) and Bela Balassa and Marcus Noland (1989), have pointed to the continuing low level of manufactured imports or intra-industry trade.

The economic critique was picked up by the CEO-level USTR Advisory Committee on Trade Policy and Negotiations in its February 1989 report on U.S.-Japan trade. Then the free-trade economist Jagdish Bhagwati was quoted (by Minard 1989) on the subject of Japan: "I think we are absolutely right in kicking the Japanese government a little. . . . Just as our government tells people to buy American, it would be a good idea to get the Japanese to buy foreign." And Rudiger Dornbusch of MIT—who in 1985 had testified that "an import surcharge is an awful idea" that would drive up the dollar (Dornbusch 1985)—came out for aggressive bilateralism and use of an import surcharge to force reduction in the U.S.-Japan trade deficit (Dornbusch 1989b). A report

for Kodak by Dornbusch, Krugman, and Park (1989) rejected GATT in favor of aggressive market opening via bilateral deals.

In the year of *perestroika* and the fall of the Berlin Wall, 79% of respondents in a *Business Week* poll (1989) favored mandated targets for U.S. exports to Japan, 69% favored limiting imports from Japan, 61% favored raising tariffs on Japanese products, and 59% favored restricting technology outflow to Japan. A Washington Post–ABC News poll found that Americans now viewed Japan as the world's leading economic power, yet believed strongly that the U.S. government should do more to correct the perceived imbalance in the bilateral economic relationship. By May 1990, 75% of Americans in the same poll saw Japanese economic power as a greater threat to U.S. security than Soviet military power (Morin 1989, 1990).

Candidates for a new working paradigm have included bilateral balancing of trade, sectoral reciprocity, managed trade, Super 301, the Structural Impediments Initiative (SII) talks on basic imbalances, and the Uruguay Round of multilateral trade negotiations. This paper provides a legal and political perspective on trade talks between the United States and Japan, on the possible mechanisms for structuring negotiations, and on U.S. trade policy in the wake of the 1988 Omnibus Trade Bill. It suggests that the real challenge may come after the Final Act of the Uruguay Round is signed, as both countries turn to the issues they have not settled in the Round.

10.2 Negotiating with Japan: Background

The first step in evaluating the options for framing the trade relationship between the United States and Japan is to appreciate the setting and the two players. Negotiations themselves have usually (but not always) been conducted bilaterally, between governments, in the absence of their client industries. The world of GATT is significant as a framework for expectations in this bargaining, but many of the most sensitive issues are dealt with aside from, contrary to, or in evasion of GATT, as discussed below.

Crucial differences between the environment and the perceptions of the participants influence their behavior in negotiations. U.S. negotiators work for a government marked by congressional-executive conflict, a fluid, entrepreneurial political system in which fast decisions are possible, and in which there is antipathy to overt industrial policy as such. Japanese negotiators work for a government marked by stability, coincidence of interests (usually) between the Diet and the bureaucracy, a political system in which consensus is slow to emerge but solid, and a tradition of state involvement in the economy. Under current conditions sometimes these differences create synergy; sometimes they have created gridlock.

The U.S. negotiator works for the executive branch in a government with a strong executive constantly bargaining with a strong Congress. By giving for-

eign policy-making to the president and regulation of foreign commerce to Congress, the Constitution creates inherent conflict, which becomes one of the trade negotiator's central concerns. Various conflict-management devices have been tried over the years—such as the bargains involved in "fast-track" treatment for multilateral trade agreements. This conflict became sharper and sharper during the Reagan years, as interbranch struggle over arms control, the Contras, and other foreign policy issues intensified.

Separation of powers enables an executive branch negotiator to use pressure from Congress as an effective threat: either a threat of a known event (such as the threat that a quota on Japanese automobiles will be enacted by a veto-proof margin) or a threat of an uncertain but risky event (the threat of unspecified and drastic protectionist legislation). Among the many examples, a Danforth resolution condemning Japan, which passed the Senate 92–0 in March 1985, was immediately put to use by Commerce Undersecretary Olmer as leverage in telecommunications talks with the Japanese government; a Danforth bill in 1981 mandating a selective import quota on Japanese automobiles was the lever for Japanese agreement to the voluntary export restraint (VER) on automobiles.

Congress may determine not only the negotiator's threats but also his or her ability to make promises. For instance, "fast-track" treatment under the House and Senate Rules guarantees expedited, no-amendment treatment for the Uruguay Round results and for bilateral free trade agreements and, by extension, guarantees that a negotiator can deliver on implementation of deals made. The condition attached is that the trade committees in Congress be consulted regularly along the way and (implicitly) that their concerns be satisfied.

The U.S. negotiator works within a pluralistic trade policy system capable of making quick decisions and overriding minority views. Since the second Reagan administration, the focus for big-ticket decisions on trade has been the cabinet-level Economic Policy Council, now run on the Porter (1985) model of pluralism. One strength of this open system is the lack of barriers to new information and the large number of policy options that may be under consideration at any time. It has also been the stage for such stock Washington phenomena as lobbying by foreign interests, leaks, disinformation, and bureaucratic war by memorandum, as noted by Choate (1990, pp. 49–105) and Prestowitz (1988, 228).

The U.S. negotiator's environment has generally looked toward private parties to define the size and shape of the government's agenda of trade complaints, since industrial policy as such has been repeatedly rejected by the political process—from the failure of the National Industrial Recovery Act in the New Deal (Hawley 1966) through the early 1980s. Negotiators may know trade policy, but are seldom equipped to judge independently which microeconomic problems should be strategically important in the marketplace. Despite much rhetoric concerning "self-initiation" (initiation by government on its own motion) of cases under the unfair trade laws, self-initiation has hap-

pened almost always in response to industry requests; true volunteerism by the U.S. government has sometimes not been successful (Odell and Dibble 1988). Business stated on many occasions during the debate on the Omnibus Trade Bill of 1985–88 that it did not want wide-scale self-initiation of Section 301 cases. It follows therefore that a negotiator's success or failure is influenced not just by his or her own abilities, but also by the industry-client's ability to proactively define a set of workable goals.

The Japanese negotiator's job appears to be in some ways easier and in some ways more difficult. The negotiator starts with a parliamentary system in which one party has been in power for over 40 years and in which there is a high degree of coincidence of interests between Dietmen and the bureaucracy. Because legislation (generally drafted by the bureaucracy) gives the bureaucracy broad discretion in implementation, the bureaucracy has chips to trade with the Diet and the Diet has chips to trade with its constituencies.

To this picture, then, add the legal weakness of the state. Japanese administration is famous for the well-known tool of "administrative guidance": government by hints and persuasion and informal controls that fuzz the line between public and private spheres (Yamanouchi 1977; Samuels 1987). Haley (1986; 1987, p. 188) has pointed out that administrative guidance fills a gap left by the lack of other legal tools: Japanese ministries lack subpoena power, civil discovery powers, mandamus, or the other legal tools that U.S. bureaucrats can use to make private parties obey. From inability to order comes the need to induce compliance by less formal or visible means, such as by using discretionary statutes or other leverage such as licenses, permits or subsidies. The ministries' "turf-consciousness" creates paralyzing jurisdictional battles; the lack of means to settle interministry disputes may delay negotiating instructions or reduce them to the least common denominator.

Constitutionally, the prime minister and his cabinet are in charge of trade policy, but they are answerable to their party. Those who, like Johnson (1982, 1989), see Japan as a "capitalist developmental state" stress the leadership role played by an elite bureaucracy in composing industrial policy, formulating plans, writing legislation, and shepherding industry forward. A second view, from van Wolferen (1989), sees Japan as a grouping of overlapping and conflicting power centers, none of which has the power to make real change: in short, there is nobody to bargain with because nobody is in charge. The current Japanese consensus, represented by Muramatsu and Krauss (1987), Inoguchi (1987), and others, sees bureaucratic rule as a concept outdated by the rise of organized interest groups, within the Liberal Democratic Party (LDP), known as *zoku* or "tribes." This analysis of Japanese politics as "patterned pluralism" sees control as held by shifting alliances between the bureaucracy and *zoku* politicians.

The growth in power of *zoku* has been the major political development of the last 15 years. *Zoku* (such as the agriculture *zoku* or the construction *zoku*) are centered around LDP policy-making committees, and bind together those

Dietmen active in a policy area. They have become the major channel for policy-making and the route for climbing the ladder as an LDP politician. Pempel (1987) argues that the rise of *zoku* has been paralleled by changes in the relationship of government and business—as rising Japanese businesses escape from regulation and declining industries go to MITI for structural readjustment—and that these have in turn been paralleled by a decline in the power of the bureaucracy. Interministry disputes have increasingly gone to the LDP and the *zoku* for their resolution and not to mediation by senior ministries such as finance.

To the extent that *zoku* create a more efficient means of interest aggregation, they facilitate decision making for trade negotiations. At the same time they concentrate power in the hands of politicians most tied to domestic interests. In *zoku* and the Diet the most powerful groups are those least interested in trade liberalization: small business, agriculture, and construction. Farmers may be only 6% of the population, but through unequal apportionment of Diet districts, the strength of the farm vote is inflated to 18% of the whole, and it actually elects 25% of the Diet (*Economist* 1988). The system of allocating 2–6 Diet seats per medium-sized constituency makes Dietmen run against party colleagues and makes them vulnerable to negative-bullet voting by interest groups such as agricultural cooperatives. The opposite pull on the LDP has been its role in maintaining Japanese relations with the United States, Japan's largest market and its sponsor in the world trading system. The bilateral relationship is an important domestic political issue, and the LDP has a monopoly of the experience and political opportunities generated by dealing with it.

The result, according to Blaker's (1977) study of military negotiations, is a distinct "Japanese style of international negotiation . . . dominated by a philosophy of risk minimization and confrontation avoidance. Japanese policymakers seem to prefer doing nothing when it is safe to do nothing and act only when the pressure of events forces them to act" (pp. 98–99). Japanese negotiators do not use the threats or histrionics that characterized classic Soviet bargaining behavior; they prefer deals worked out behind the scenes. The "Japanese game plan for bargaining victory" starts by probing the other side to set obtainable goals, then mobilizing resources to push and push again for them. Japanese offers are preceded by elaborate negotiations within the Japanese side apportioning the consequences. Positive demands tend to be modest, but since the opening position resulted from painful negotiations on the Japanese side, it is hard for the negotiator to budge. Japanese negotiators are "relentless and tenacious," relying on persistence and on arguing the rightness of their position. Concessions are late, are dribbled out bit by bit, and contingent on concessions by the other side; and the Japanese side keeps pushing (Blaker 1977, 100–1). The strategy described is one of Schelling-type precommitment both with respect to the opposition and with respect to the Japanese negotiator's own side. As Hiroya Sano, the Agriculture Ministry's lead

negotiator on beef and citrus in 1984, puts it, "If you draw the other side's attention to your own freedom of action, you will be thought a clumsy negotiator and your mandate will be taken away" (1987, p. 14), noting that his best tactic in gaining U.S. acceptance of continued beef and citrus quotas in 1984 was to argue force majeure—that the Diet would veto liberalization.

The final key concept for understanding bilateral trade negotiating behavior is *gaiatsu*, a word translating literally as "outside pressure." A common Japanese view sees negotiations as a "*gaiatsu*-concession cycle" (Funabashi 1987, p. 6) of foreign pressure pulling unilateral concessions. The other side of the coin is the manipulation of *gaiatsu* by those in Japan who want to break gridlock, to accommodate important foreign relationships, or to serve their own purposes. Sometimes the really important stakes for the players inside Japan are not competition from foreigners, but the bureaucratic and political balance of power inside Japan. Johnson (1989) discusses the use by MITI (and its allied *zoku* politicians) of U.S. pressure in 1985 against plans by the Ministry of Posts and Telecommunications (MPT) (and its allied *zoku*) to regulate value-added telecommunications networks. MPT and its *zoku* wanted to regulate the software-telecommunications interface and capture the associated industry; MITI opposed MPT by deploying Dietmen from MITI's *zoku* and a study-group of proderegulation economists, and by mobilizing *gaiatsu* from the United States.

A phenomenon of the last few years, breaking former stereotypes, has been the increasing prominence of leading *zoku* Dietmen in trade negotiations and *zoku* groups as the place where the LDP leadership works out the political deals necessary for liberalization. This higher profile for the *zoku* has brought a bigger substantive role for specialized ministries such as Construction, MAFE, or MPT, breaking the Foreign Ministry's monopoly on negotiations. Tsutomu Hata, who was twice Minister of Agriculture, Forestry, and Fisheries and has held a range of LDP agriculture policy posts, was a key player in brokering the deals on the plywood tariff in 1985, cigarette imports in 1986, and beef and citrus in 1988. Ichiro Ozawa, prominent (like then–Prime Minister Takeshita) in the construction and telecommunications *zoku* and related to Takeshita by marriage, was sent as Takeshita's personal emissary to Washington to settle the construction issue in March 1988, and in spring 1989 was the LDP representative at talks settling the U.S.-Japan dispute over mobile telecommunications. The U.S. side showed its recognition of the importance of *zoku* politics when former Prime Minister Takeshita visited Washington in spring 1990; in a round of meetings, Cabinet officers discussed with Takeshita the commitments Japan might undertake in the Structural Impediments Initiative.

The prominence of political figures reflects a number of factors: the inevitable connection between market access issues and domestic Japanese politics; the power of *zoku* within their policy areas (and the bureaucracy's need for them as messengers for policy initiatives); the need of specialized *zoku*

members for broader exposure in order to rise to high posts; the attractiveness of the political opportunities generated by brokering U.S.-Japan trade problems; and brokerage opportunities in mobilizing compensation for affected domestic interests. *Zoku* groups (such as the LDP Agricultural Products Liberalization Countermeasures Committee) are the place where antiliberalization Dietmen can publicly attest zeal, and the LDP leadership can quietly find out their real flexibility. Once a liberalization deal is made with a foreign government, the *zoku* can mobilize to obtain an impressive compensation package. After the beef and citrus deal of 1988, leaders in the beef and citrus caucuses, backed by the *zoku*, got subsidies raised to ¥106 billion for citrus and obtained a commitment that beef tariff receipts would be set aside for beef subsidies—an amount that may reach ¥100 billion per year or ¥22,000 per head per year for the entire beef and dairy herd (*Nihon Keizai Shimbun* 1988; *Mainichi Shimbun* 1988; Porges 1991).

10.3 How Can the United States Negotiate with Japan?

The next section describes the range of strategies and negotiating modes that have been used or proposed for trade negotiations between the United States and Japan, arranged from general to specific, from multilateral to bilateral, from less to more interventionist.

10.3.1 Macroeconomic Approaches

If the central trade problem between the United States and Japan is the trade imbalance, and that, in turn, is a function of savings-investment ratios, exchange rates, and economic growth, then macroeconomic approaches are the most appropriate. These have been tried: from the Carter Administration's 1978–79 "locomotives policy" of encouraging Japanese and German fiscal stimulation, to G-7 policy coordination, and the macroeconomic aspects of the SII. Yet this is not really a trade negotiation strategy and does not answer revisionist complaints that the Japanese market is closed.

10.3.2 Multilateral Negotiations under GATT

Multilateral rounds, such as the Uruguay Round of trade negotiations in GATT, offer the chance to solve problems that Section 301 or bilateral talks are unlikely to reach. One simple example is the tariff cut on an item for which the United States is not Japan's major supplier: Japan is only likely to make a binding tariff commitment on such an item in the context of a multilateral trade round where Japan can get credit for it. Because a round can produce a bigger package of gains, it can induce more liberalization and bigger domestic changes. Multilateral rounds can also serve as a negotiating forum for issues that a government believes to be too large and politically sensitive to be dealt with through unilateral action or even a bilateral deal—such as the Japanese internal support and border protection regime for rice.

The multilateral context also makes it possible for each participant to pool interests with other countries. In the Uruguay Round, Japan has found support from other countries for its positions (for instance) favoring agricultural import restrictions to protect food security, opposing certain antidumping practices of the United States and European Economic Community (EEC), and seeking discipline on trade-related investment measures (TRIMs). The United States has allied itself with the Cairns Group of agricultural exporting countries in seeking an end to Japan's ban on rice imports, has supported the antidumping practices opposed by Japan, but has taken positions similar to Japan's on TRIMs.

The changes made multilaterally in a successful Uruguay Round will affect the rules for bilateral relations as well. Antidumping offers an example: the antidumping rules on sales at "less than fair value" were a key part of U.S. leverage in negotiations for the 1986 U.S.-Japan semiconductor arrangement. Changes in the rules would therefore affect future such negotiations.

10.3.3 Bilateral Free-Trade Agreements

After a flurry of excitement in late 1988, during the issue vacuum after the trade bill, U.S. interest in a free-trade agreement (FTA) with Japan appears to have subsided. Critics, including Lawrence, Prestowitz, and Dornbusch/Krugman/Park, have pointed out that significant problems perceived by the U.S. side would not be touched by an FTA.

The strongest backers of the FTA concept were Japanese exporters, noted Stokes (1988, p. 3056). Japan's import-competing sectors were much less enthusiastic about an FTA which would, under GATT Article 24:6, be required to include "substantially all the trade," and which might lead to deregulation of financial services and an increased inflow of agricultural products. While there has been one FTA in GATT history that has excluded agriculture (the EFTA Convention), it is not clear that the U.S. Congress would agree to exclusion of such a large share of U.S. exports to Japan from the benefits of a U.S.-Japan FTA, or that the Diet could agree to an FTA that would include agriculture.

10.3.4 Structural Impediments Initiative

As described below, from July 1989 through mid-1990, the Japanese and U.S. governments engaged in discussions exploring the full range of structural impediments to trade and investment flows. These talks discussed practices of the governments and private businesses of both countries and are clearly only the start of a continuing bilateral process.

10.3.5 GATT Dispute Settlement

GATT Article 23 permits a GATT contracting party to seek redress for "nullification or impairment" of its GATT benefits in two contexts: either a violation by another contracting party of GATT rules or actions by another

contracting party that are consistent with the rules but still nullify or impair a tariff concession.

To date, almost all GATT disputes under Article 23, including all U.S. cases against Japan, have focused on violation of GATT rules in the context of specific cases. The case is heard by a dispute settlement panel of neutral experts, whose panel report, if it finds a violation, recommends that the party in violation bring itself into compliance. The recommendation, if adopted, is legally binding and, if it is not complied with, the GATT contracting parties acting as a decision-making body may authorize retaliation. Because dispute settlement is a legal process in which panel decisions have some precedential effect, recourse to GATT dispute settlement in one case may have unforeseen results in others. A 1987 GATT dispute on a mere $100 million in Japanese agricultural import quotas triggered a finding that meant that Japan could no longer assert that its beef quota was consistent with its GATT obligations. This, in turn, was key to the 1988 liberalization of the beef and citrus quotas.

Still, a contracting party can only enforce the GATT rules as they are. For instance, the General Agreement requires that the products of contracting parties be accorded national treatment: treatment no less favorable than that accorded to like products of domestic origin. All the national treatment rule provides is a guarantee of nondiscrimination. If like products are given like treatment, GATT offers no recourse, even if the treatment is all equally bad. Furthermore, discrimination against foreign companies as such is a matter for bilateral treaties, not GATT. The remedies in GATT dispute settlement are also limited. GATT dispute settlement offers a means of getting another sovereign government to change its behavior and eliminate those measures that violate GATT rules—no mean feat. However, GATT offers no damage compensation for past acts.

GATT provides recourse not just in cases of rule violation but also when a government nullifies or impairs its tariff concessions through measures that are not explicitly prohibited by GATT norms (one classic example is nullification of a tariff binding by giving a subsidy to a competing domestic producer). A "nonviolation" challenge of this sort capturing the "U.S.-Japan trade problem" has been suggested in some quarters, including the Gephardt-Rostenkowski-Bentsen surcharge proposal (H.R. 3035). But aside from the strain such a case might put on the GATT, there are limits on what it could accomplish. First, GATT only addresses *government* measures, not private barriers, and is oriented toward specifics; a GATT action could not reach the range of measures discussed in SII. Furthermore, the remedies in "nonviolation" cases are limited. Since the measures complained of are already GATT consistent, the defendant need not change them. It need only provide compensation (in tariff cuts) for the concessions it has impaired. From 1983 to 1986, the EEC pursued initiation of a global case against Japan in the GATT but eventually switched to bringing complaints alleging violation of GATT norms in connection with specific products.

10.3.6 Problem Solving by Negotiation over Individual Cases

This has been the dominant mode of negotiation between Japan and the United States, whether in regularly scheduled encounters with set agendas or in specific negotiations such as those on agriculture or construction. The U.S. objective has usually been a unilateral market opening by the Japanese side. Issues get onto the U.S. agenda through contact by firms or industry associations with the U.S. Trade Representative (USTR), Commerce, Agriculture, and/or members of Congress. This bilateral negotiating format offers great flexibility and is not limited by the need to make a legal case. However, there are no deadlines built in.

Because remedies for unfair measures tend to be given a higher priority, complaining exporters may attempt to jump the queue, force U.S. government action, or improve their leverage by changing categories. They may point to evidence of Japanese unfairness or structure their complaints so as to fall under the unfair trade laws. This is not necessarily constructive for the bilateral relationship, as Prestowitz has repeatedly emphasized. It may not serve the exporter either, when it leads to management-by-law—emphasizing the aspects of a complaint that look the most unfair, rather than the aspects that address the core competitive problem.

10.3.7 Market Opening on a Systematic Industrywide Basis (MOSS)

At the January 1985 Reagan-Nakasone summit, both sides initiated a series of intensive market-oriented sector-selective (MOSS) talks on four sectors: telecommunications, electronics, forest products, and medical equipment and pharmaceuticals. The objective was for both sides to identify, and for Japan to unilaterally remove, all barriers to imports in those sectors. The talks consumed a major amount of attention and time for each government in 1985. The proposal for MOSS was itself a compromise between some on the U.S. side who urged the setting of import targets, and free trade "white hats" (Prestowitz 1988). The U.S. framed its goals by consulting U.S. firms active in the Japanese market. In 1986 another MOSS was initiated for transportation machinery (auto parts): these talks broke new ground by focusing on *keiretsu* and other private business practices and on U.S. firms' sales to Japanese-owned firms even in the United States.

A General Accounting Office (GAO) follow up (GAO 1988a, 1988b) found firms' reaction generally positive, though many still reported problems doing business in Japan. Though exports to Japan in the four original MOSS sectors rose 45% from 1985 to 1987 it was difficult to distinguish the effects of MOSS and the exchange rate. Prestowitz (1988, pp. 296–99) criticizes the entire enterprise as fundamentally misguided: the U.S. would never identify all the barriers in the Japanese regulatory state, much less get them peeled away; better to lay out specific goals and negotiate results.

In any event, a repetition of MOSS appears quite unlikely, because of the

overwhelming expense and burden of the 1985 talks relative to their limited coverage. The baton has now passed from the micro-macro approach of MOSS to the macro-micro approach of SII.

10.3.8 Bilateral Negotiations under Section 301

Section 301 of the Trade Act of 1974 (19 U.S.C. 2411ff., as revised) provides a window for a private group to press the U.S. government to bargain on its behalf with a foreign government, under a deadline and with the threat of retaliation. Grievances of certain specific types can trigger the initiation of an "investigation" (the start of a negotiation): alleged violations of the GATT or other trade agreements or other foreign government acts, policies, or practices deemed "unjustifiable, unreasonable, or discriminatory" which burden or restrict U.S. commerce. The statute deems that certain specific types of foreign government action fit under one of these categories: for instance, industry targeting or denial of worker rights are each deemed to be unreasonable (and potentially punishable through trade retaliation). Over the years, successive revisions of Section 301 have oriented it more and more toward enforcement of U.S. rights, adding retaliation clout because of weaknesses perceived by Congress in international dispute settlement.

The USTR has complete discretion over whether or not to accept a Section 301 petition and initiate an investigation. Almost all petitioners consult with USTR before filing, so few petitions are filed and then rejected. USTR may also "self-initiate" an investigation, but, as noted above, true self-initiations have been rare. Once an investigation is started, Section 301, as revised in the 1988 Omnibus Trade Bill, requires the USTR to determine by a set timetable whether the act, policy, or practice complained of is unjustifiable, unreasonable, or discriminatory or violates or is inconsistent with a trade agreement. This determination is known as the "unfairness determination."

If the USTR's unfairness determination finds the act, policy or practice violates or is inconsistent with a trade agreement, or if USTR binds that it is unjustifiable and burdens or restricts U.S. commerce, then the law mandates retaliation (subject to presidential direction). If the act, policy, or practice is found to be unreasonable or discriminatory, then retaliation is discretionary. In practice, retaliation has been carried out by raising the tariff on specific products of the target country to a prohibitive level; in theory the USTR could impose quotas, reject further service-sector access licenses, or impose fees or restrictions on services. Significant exceptions are provided to the requirement to retaliate, but the statute makes their use transparent, and subjects it to close congressional supervision.

Congress has intended Section 301 not just as a remedy for existing unfair trade barriers but as a bargaining tactic in itself—to create leverage for Congress in its bargaining with the administration over the conduct of trade negotiations and for U.S. industry and the U.S. government in their dealings with foreign governments. The 1988 amendments announced a congressional man-

date that certain types of behavior be subject to retaliation, by reducing the administration's discretion and creating a precommitment to retaliate. Schelling (1960, p. 24ff.) states that in a contest of precommitments, the gaming advantage goes to the first party that makes a commitment (such as mandatory retaliation) perceived as irrevocable by the other side; this advantage remains only as long as the commitment stays credible (p. 40).

In the Uruguay Round, a number of contracting parties have made clear their objections to bargaining conducted under threat and have demanded that, as a condition for agreement to new rules on intellectual property or dispute settlement, the use of unilateral enforcement measures such as Section 301 be foregone as well. Moreover, the scope for reciprocity and retaliation is being progressively eroded by the trend toward interpenetration of the U.S. and Japanese (and global) economies. Gilpin (1987) refers to this phenomenon as the "*nichibei* economy." Retaliation through tariff increases is ineffective when products can be resourced from another country or from U.S. production. Retaliation can create domestic political problems when the customer for a target product is a sensitive business or group or when the product is made abroad by U.S.-based multinationals. And retaliation against services is many times more difficult to implement; all Section 301 cases on services trade barriers have involved retaliation (or threats of retaliation) not against services but against products.

10.3.9 Super 301

The 1988 Omnibus Trade Bill instituted an additional mechanism for an aggressive trade policy, "Super 301," for the years 1989 and 1990 only. The basis for the Super 301 process as the National Trade Estimates (NTE) report on trade barriers, required to be published on 31 March 1988 and each April 30 thereafter. The NTE is an inventory of trade and investment barriers in every country, which is required to quantify the cost of barriers in terms of trade or investment forgone.

In the years 1989 and 1990, the USTR was required within 30 days after the appearance of the report NTE to identify a set of "United States trade liberalization priorities," including priority practices, priority countries, and the dollar cost of the practices in exports forgone. The choice of priority countries was to take into account both the number and pervasiveness of trade barriers and the export gains to be expected from full implementation of trade agreements to which each foreign country was a party. Within 21 days after the naming of priority countries and practices, USTR had to self-initiate Section 301 investigations against each practice: hence the name "Super 301." The Section 301 cases would operate just like standard Section 301 cases under the law as revised in 1988, with the exception that a greater degree of flexibility was provided for settling cases.

The 1989 Super 301 package led to six Section 301 investigations and the launching of the Structural Impediments Initiative with Japan, as described

below. By 1990, attention had shifted to the Uruguay Round. After the release of the SII midterm report, and intense discussions that resolved the supercomputer and satellite issues, the administration went for the "zero option" and named no new practices or countries. The future of Super 301 remains to be seen. Congressional enthusiasm remains high for this mechanism of requiring the administration to take a militant approach on trade. Yet Super 301 gave rise to a strong reaction among U.S. trading partners, who have demanded a rollback of 301 as the quid pro quo for progress on dispute settlement in the Uruguay Round.

10.3.10 Managed Trade including VERs

Voluntary export restraints (VERs) in particular industries are a phenomenon of over 50 years' history, but recently economic writers such as Robert Kuttner (1989) have suggested the use of managed trade to achieve "systemwide reciprocity."

If the U.S. sought to achieve systemwide reciprocity through managing Japanese trade into the United States, there might be three routes to do so. All are unpromising. The first would be restriction of imports by the U.S. government by import quotas or import licensing. Aside from the welfare costs, such measures would be contrary to U.S. GATT obligations under almost any circumstances; even in the unlikely event that Japan waived (or refrained from claiming) its GATT rights, third countries could raise claims. The second path would be for the United States to obtain Japanese VERs for all bilateral trade. Such VERs would strengthen the Japanese bureaucracy and give the lion's share of quota rents to Japanese exporters; the VERs would also be open to challenge in the GATT. Finally, the parties to such a bilateral arrangement might ask the contracting parties to the GATT to authorize managed trade on the basis of a waiver; after all, the Multi-Fiber Arrangement has been legally provided for over the years, coexisting with GATT. There is, however, no reason to suppose that the GATT would cheerfully agree to such an arrangement, either now—when it would prejudge the outcome of Uruguay Round negotiations on textiles and grey-area measures—or at any time in the future.

The legal aspects of VERs deserve a fuller discussion. They have long been recognized to function as a rent-producing collaboration between the firms whose exports are restrained, their competitors in the importing country, and the governments, at the expense of the consumer. While the fiction is maintained that a VER is "voluntary," in fact it is often implemented by the exporting country as an alternative to import restrictions by the destination country; compliance by the exporting firms is then often compelled by the exporting country's government, in order to insulate the exporters from accusations of an antitrust conspiracy (Waller 1982). As seen in the history of textile trade, the exporting country has an incentive to seek expansion of the VER to cover competing suppliers elsewhere.

Much of the economic literature neglects the legal status of VERs or places them in the category of "grey-area measures" assumed to be quasi legal; see, for instance, Dornbusch, Krugman, and Park (1989, p. 33). This is incorrect. The dispute settlement panel that examined Japanese measures under the Japan-U.S. Semiconductor Arrangement concluded, in essence, that where a VER is enforced by government export restraint measures, or where a VER scheme could not exist without a government role, it is a quantitative restriction on trade contrary to the General Agreement (GATT 1988; Porges 1989). The major reason why VERs have so rarely been challenged in the GATT is that neither exporter nor importer has an incentive to complain. Challenge is nonetheless possible; the Semiconductor Arrangement measures were attacked by a third party, the EEC, whose interests had been affected by the Arrangement's provisions raising semiconductor prices in the European market. The wider a country's network of VERs expands, the more likely that VER effects on third parties would provoke such challenges.

The institutional aspect of VERs is also worth considering. Discretionary foreign exchange control legislation dating back to the Occupation has facilitated the making and enforcement of VERs by the Japanese bureaucracy (Haley 1986). In accounts of the 1981 U.S.-Japan automobile VER negotiations such as Amaya's (1982), MITI is depicted as persuading a reluctant auto industry to go along with little or no intervention from the political level, and the consensus view is that the auto VER only strengthened MITI in dealing with the Japanese auto industry. The conclusion would be that the broader the VER, the more that U.S. manufacturers are dependent on Japanese inputs, the more MITI's influence over the Japanese and U.S. economies could be expected to grow.

10.3.11 Managed Trade based on U.S. Export Expansion

The idea of a "voluntary import expansion" (VIE) has most often been linked to the U.S.-Japan Semiconductor Arrangement, but the concept is not unique to the high-technology sector. At various times since 1978, Japan, Korea, and Taiwan have tried to fix their trade figures through purchases of big-ticket items by the government or by state-owned enterprises: nuclear fuel, aircraft, turnkey plants, big construction projects, or gold for the mint. Since 1985, MITI has jawboned large companies to increase imports. Politically aware Japanese firms have expanded their U.S. sourcing of visible components, such as automobile seat leather. And the U.S. government has held concrete discussions on sourcing with Japanese automobile firms in the context of the auto parts MOSS mentioned above, in response to strong pressure by Rust Belt congressmen; USTR Carla Hills testified in April 1990 that "the United States and Japan will hold regular [government-industry] conferences to promote growth of strong business and sales relationships between American auto parts suppliers and Japanese auto manufacturers" (Hills 1990).

VIEs have been proposed most often as a solution to particular product-sector problems. Semiconductor-specific issues aside, VIEs have been proposed as an appropriate means of:

- *Affirmative action.* Breaking through a buyer's "taste for discrimination" against imports (Dornbusch, 1989a, p. 14) by forcing the buyer to get to know a new supplier and make the commitment to use a foreign component.
- *Market failure situations.* Abandoning fruitless arguments about "unfairness" in favor of frank discussions about sales and market share, in markets where government presence is strong (Prestowitz 1988).

However, picking sectors and negotiating VIE levels is not a scientific process. Even a VIE that looks neutral will have distributional implications for specific suppliers. Negotiations over the Japanese import quotas on citrus, for instance, have involved trade-offs between the interests of California dessert oranges, Florida juice oranges and juice, and grapefruit from Florida and Texas—each of which is a distinct product, marketed differently, with different interests and different political backing (Porges 191; Kusano 1983). The VIEs would seem most likely to be compatible with the U.S. political system in those sectors where government intervention is pervasive and accepted by the U.S. public—agriculture and defense, the only sectors with active government sales forces abroad (in the Agriculture and Defense Departments).

Talk of VIEs raises another subject, however: trade discrimination. In the EEC's GATT challenge to Japan's semiconductor measures, the EEC took up the VIE aspects of the Semiconductor Arrangement as well, asserting that its benefits were reserved for U.S. semiconductors in violation of the GATT's most-favored-nation clause, Article 1. The dispute settlement panel found no actual evidence of discrimination in that case, but VIEs that expand imports from only one country or one bloc would clearly be at odds with Article 1, the cornerstone of the GATT system. Such VIEs would discriminate in favor of the powerful to the detriment of smaller and developing countries. Those excluded could then legally attack such a preferential arrangement (GATT 1982). A trading regime based on VIEs would be quite different from the GATT regime: in a VIE system, small and weak countries would not share in the benefits of deals that would be made by the strong for the strong.

Moreover, if VIEs were to become a normal aspect of trade policy, like Food for Peace sales under P.L. 480 and the USDA's other agricultural sales programs, VIE priorities would be set on a political basis. Exporters could then be expected to respond by investing in lobbying, with the result that VIE rents would go not just to the (beleaguered) domestic industry but at least in part to its trade lawyers and lobbyists.

10.4 Trade Legislation, Super 301, and Onward

Japan and the "Japan trade problem" have been a recurring theme on Capitol Hill since the late 1970s. In 1985, when political pressure and the dollar

hit twin peaks, concern with Japan was overwhelming. In the three years that followed, the Japan issue became cemented into law in the Omnibus Trade Bill of 1988, left to the new Bush administration to implement in spring 1989.

In a sense, the 1988 trade bill was one of the political costs of the high dollar of 1985. The business community, unable to persuade the administration of the need to take action to achieve a more favorable exchange rate, went to Capitol Hill instead. The result showed in the tactics of 1985—the Motorola and Gephardt Japan-trade-surcharge bills and the Danforth anti-Japan resolution, which was explicitly tied to the yen-dollar rate. Groups such as the Business Roundtable, supporters of the GATT process who had vocally opposed trade reciprocity two years before, began to urge Congress to revise the trade laws in favor of opening foreign markets through aggressive reciprocity.

Congress started with two approaches to dealing with Japan: fixing the aggregate figures (as in the initiatives of Congressmen Gephardt of Missouri) or case-by-case reciprocity tied to Section 301 (as proposed by Senator John Danforth, also of Missouri). Gephardt's key proposal, an amendment attached to the House trade bill in 1986 and 1987, would have had the U.S. government negotiate an agreement with an "excessive and unwarranted trade surplus country" to put its surplus on a 10% diet each year; otherwise, the United States would cut the surplus unilaterally through various means with import quotas as a backup. The proposal's major backers were organized labor and Chrysler and its suppliers, all of which saw automobile trade as an obvious place to begin surplus reduction. The Senate responded with its own alternative, adopted in the final trade bill: Super 301, a more-and-better version of the revised Section 301. For 1989 and 1990, the Super 301 provisions would require an aggressive program of Section 301 cases, picked to advance a trade strategy.

Japan also became an issue in another context: the Toshiba-Kongsberg trade sanctions legislation, punishing these companies for sales of advanced machine tools to the Soviet military. The Toshiba issue provoked a firestorm of anti-Japanese sentiment—members of Congress taking sledgehammers to Toshiba products for the network news and competing to pass trade sanctions. This, in turn, projected to the Japanese public as a rejection of the special relationship or perhaps of any relationship at all. The issue was inflammatory precisely because of its connection with national security. In the old paradigm of the U.S.-Japan relationship,the United States had tolerated Japanese economic success in its market because Japan was its junior partner against the common enemy, the Soviet Union. The allegations against Toshiba—that its subsidiary had violated CoCom export controls for profit—were a blow at that paradigm. Toshiba reacted with a life-or-death lobbying effort, and its customers joined in, underlying the growing dependence of U.S. high-technology companies on Japanese components. By Senator John Heinz's estimate, Toshiba and those associated with it spent $9 million on lobbying (Auerbach 1988; Dryden 1988). Toshiba and Kongsberg ended up subject to

short-term sanctions on federal procurement, contracts, or imports of their products, but they benefited from significant loopholes.

The other "Japan issue" in the trade bill was the Exon-Florio proposal screening of foreign investment. Although the proposal was neutral, and the political battle against it was fought largely by European-based foreign investors, the issue had first arisen in the context of Fujitsu's attempt in late 1986 to acquire the semiconductor firm Fairchild Industries. At that time, U.S. law provided no means of blocking even a foreign takeover directly threatening national security, except if there were a presidential declaration of economic emergency. Once passed and implemented, Exon-Florio became the first investment-screening mechanism ever instituted in the United States.

The following spring, the trade world in Washington shifted its attention to the new administration and its trade strategy—with the implementation of Super 301 as the most closely watched indicator of that strategy.

The political mandate in the Omnibus Bill put trade—unusually—on the Cabinet agenda early in the new Bush administration. In long debates in the Economic Policy Council, some cabinet officers pushed for a long list of targets, and some pushed for none. Some pushed to cite Japan as a Super 301 country; Treasury and State pushed for a Structural Impediments Initiative as an alternative. The final White House strategy reflected both the administration debate and White House soundings that had indicated that Congress would not accept a decision not to cite Japan.

Ambassador Hills announced the package on 25 May 1989 at a press conference in the presence of 19 video cameras and hundreds of reporters. She listed as U.S. trade liberalization priorities first the Uruguay Round; then five priority trade liberalization practices were mentioned in general and with respect to a specific country and sector. Japan was named with respect to government procurement (for supercomputers and satellites) and technical standards (for imports of forest products); India was named with respect to services trade and investment restrictions, and Brazil, for import licensing. Three specific Section 301 investigations on Japan—on satellites, supercomputers, and forest products—were initiated 16 June 1989 together with those on India and Brazil.

On the same day, President Bush announced the Structural Impediments Initiative for Japan, separate from Super 301 and to be jointly led by USTR, State, and Treasury. The SII was launched in July 1989, and focused on problems identified by Japan and the United States in each other's economies. The U.S. side made 240 suggestions identifying Japanese savings and investment patterns, land use, the distribution system, exclusionary business practices, *keiretsu* relationships, and pricing mechanisms. The Japanese side made 80 suggestions in return identifying U.S. savings and investment patterns, corporate investment activities and supply capacity, corporate behaviour, government regulations, R&D, export promotion, and work force training and education. The groups met to explore this massive agenda; they took a joint survey of prices, which established (to nobody's surprise) that prices were

higher in Japan for both foreign and domestic products. The working group bore down and produced its interim report on 5 April 1990, including a long list of commitments by both sides.

Meanwhile, the Japanese government kept a formal distance from Super 301 as such, maintaining the position that it would not discuss these issues in that context. Discussions eventually took place on the substance of the supercomputer, satellite, and forest products issues. The supercomputer and satellite issues were resolved with elaborate agreements providing in detail for opening of procurement. Both deals were essentially done by April 4. The forest products case was resolved later in April with an agreement on tariff cuts and changes in standards and building codes. On April 27, USTR Hills's second and final Super 301 package gave first and foremost place to finishing the Uruguay Round and did not name Japan.

The SII was a negotiation that went beyond national treatment—discussing not just the elimination of discriminatory rules, but the content of the rules themselves. Never before had there been a bilateral negotiation of this type. Some in Japan predicted that SII would make Japan more efficient. Other observers, including van Wolferen (1990), were less sanguine; in their view, although the Japanese government's promise to spend billions on public works was of obvious interest to contractors and politicians, it was less likely that the SII would disrupt the tight buying arrangements of *keiretsu* or loosen distribution channels.

10.5 Japan and the U.S. in the 1990s?

Viewed from Tokyo, 1989 was a year of political and social turmoil, and of upheaval of greater magnitude than ever experienced in the political lives of most Dietmen: the sheer scale of the Recruit scandal, the popular revolt against LDP incumbents, the "Madonna factor" and the revival of the Socialist Party, and the rapid passing of Prime Ministers Takeshita and Uno. Most interesting in the long run may be the extent of middle-class discontent with the quality of life, and resentment of the undeserving rich—real-estate millionaires, Recruit's politicians, and businesses that did not pass on the profits from yen revaluation to the consumer. It was as if there were a two-track Japan in which some owned real-estate and others never would be able to. Some Japanese, at least, connected this discontent with trade and the SII issues. The following spring, a poll in connection with the SII by Japan's leading business daily, the *Nihon Keizai Shimbun*, showed that nearly half of all Japanese at least basically agreed with the United States' demands that Japan review its economic structure and open its markets; three-quarters thought their government ought to try at least somewhat to listen to U.S. demands, and most cited the reason that such measures would be good for Japan and would improve the quality of daily life. Over sixty percent supported at least a partial opening of rice imports (Japan Economic Journal 1990).

Meanwhile, revisionism broke out in Japan as well. In the best-seller, *A*

Japan that Can Say No (1989), conservative politician Shintaro Ishihara and Sony CEO Akio Morita criticized the shortsightedness of American business, advocating that Japan learn to say no to American trade demands. Ishihara suggested that if, as the Soviet Union ceased to be the great common enemy, the United States decided that Japan was no longer needed as a partner, Japan could demonstrate how much U.S. defense hardware depended on Japanese technology, by selling semiconductors to the Soviet Union instead (p. 3–4).

Since 1989, trade policymakers in Washington and Tokyo have become increasingly preoccupied with the Uruguay Round. After closing of the Round, the first task will be the enactment of implementing legislation in each participating country. Both Japan and the United States will have to revise a long list of existing rules and devise domestic rules to implement agreements in areas such as services and intellectual property where trade policy has never gone before.

Recent Congresses have vigorously debated the more bilateral and interventionist options listed above for structuring trade bargaining. From a political perspective, the near-term benefits of brining maximum trade leverage to bear through retaliation may exceed the long-term costs to the multilateral trading system. Yet the globalization of manufacturing makes retaliation less effective as a tactic and trade remedies less effective as a strategy—as U.S. firms like Motorola increase their presence in Japan, for instance, and Japanese firms decrease their dependence on exports to the United States by investing there and elsewhere. In the Uruguay Round's new issue areas of services and intellectual property, there is hardly anything left of the traditional link between trade agreements and things grown or made within the national territory: they, like the corporations that will benefit from them, are borderless. Recession in the United States is only likely to increase the cleavage between globalized corporations manufacturing products and supplying services on a global basis, and those industries that remain localized in the United States. Even the revisionist van Wolferen has urged that the framework for trade with Japan be set by rules negotiated multilaterally.

Revisionism in U.S.-Japan relations has also affected, and will change, American trade relations with Korea, Taiwan, and other countries in Asia. The 1992 process in Europe is still another example of self-generated revision: the Community is redefining itself, and the rest of Europe (and the world) is being compelled to redefine its relationship with the Community. And the revision process in Eastern Europe and the Soviet Union is even broader. The direction that the United States and Japan take and the example they set in managing their relationship will have immediate effects on the interests of each in each of these other areas.

Will the 1990s be a decade of revision, then, leading to a new paradigm for the relationship between Japan and the United States? If this is only the beginning for revision, no one could now predict for sure when and where it would end or what the results might be—or whether it would come to rest in a new

and better equilibrium for the United States and Japan, for the rest of the world, or for the multilateral trading system.

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