

# US–Japan Trade Frictions: The Past, the Present, and Implications for the US–China Trade War

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The United States and Japan have been involved in trade frictions over a number of products including textiles, steel, automobiles, semi-conductors, and agricultural products over the last 50 years. US–Japan trade frictions have taken basically two forms: (i) the United States attempting to restrict Japan’s exports to the United States; and (ii) the United States attempting to increase its exports to Japan by “opening” the Japanese market. By putting pressure on Japan to adopt necessary measures, the United States sought to achieve two main objectives: (i) to reduce its trade deficit vis-à-vis Japan; and (ii) to protect and/or promote US industries. The United States failed to achieve the first objective, while some success was achieved for the second objective. The United States triggered a trade war against China with the objectives of: (i) reducing the bilateral trade deficit; and (ii) stopping unfair trade practices by Chinese firms such as violations of intellectual property rights and forced technology transfer. Based on the experiences from the US–Japan trade frictions, the United States may achieve some success for the second objective, but not for the first. The chances of achieving the second objective would increase if the United States cooperates with countries such as Japan and the European Union, which are faced with similar problems.

**Key words:** protectionism, trade friction, trade war

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## 1. Introduction

The US–China trade war has been under way since the middle of 2018. The United States triggered the trade war by imposing additional tariffs on imports from China in July 2018. China retaliated immediately by imposing additional tariffs on imports from the United States. The situation worsened as the exchanges escalated, resulting in a full-blown trade war. The negative economic impacts of the US–China trade war have begun to be felt not only in these countries, but also in other countries.

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The global economy will experience serious damage if the US–China trade war continues and escalates, as the United States and China are the world’s two largest countries in terms of economic size. Furthermore, the US–China trade war raises a risk of damaging the global trading system that has developed under the GATT and its successor the World Trade Organization (WTO), which have contributed enormously to the high growth of the world economy since the end of World War II (WWII), adding more pessimistic elements to the future prospects of the world economy. Recognizing the negative impacts of the US–China trade war, it is important to manage the situation appropriately by avoiding an escalation and ending the trade war.

For the United States, the US–China trade war is not its first major trade friction. Since the end of WWII, the United States has been involved in a number of trade frictions. Among them, its frictions with Japan have been the most severe. US–Japan trade frictions began with textiles in the 1950s, and they are still continuing in other areas such as automobiles and agricultural products.

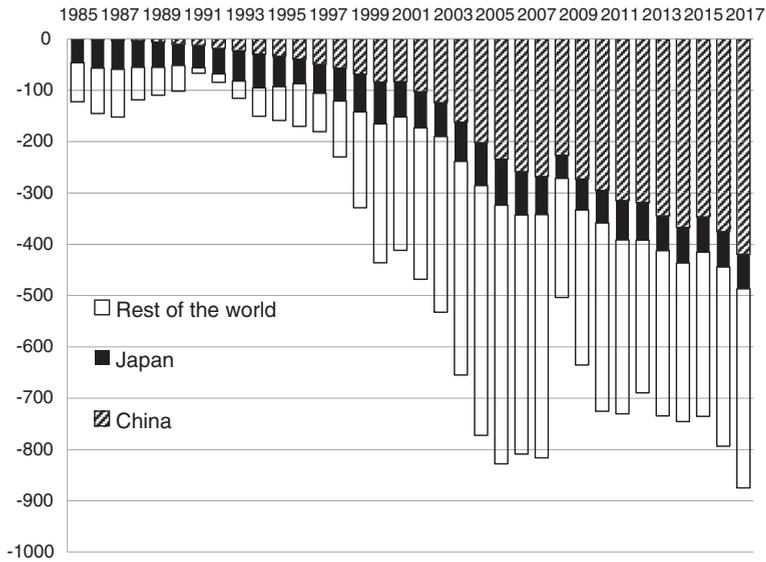
In the light of these developments, it is an opportune time to review the experiences of US–Japan trade frictions to learn and draw lessons from them. Such an analysis will contribute to the formulation of appropriate policies for not only Japan, the United States, and China, but also for other countries, for the realization of a free and open trading environment.

The remainder of the paper is structured as follows. Section 2 examines briefly the changing economic environment during the last 50 years, which has had an important influence on the formulation of trade policies. Sections 3 and 4 analyze the US–Japan trade frictions, with a focus on developments in the 1960–2000 period.<sup>1</sup> Section 3 takes up the frictions concerning Japan’s exports to the United States, while Section 4 examines the frictions concerning US exports to Japan. Section 5 analyzes the contemporary trade frictions between the United States and Japan, while Section 6 presents some lessons and suggestions for the US–China trade war.

## **2. Changing Economic Landscape Surrounding Japan, the United States, and China**

The last 50 years have seen some remarkable changes in the economic environment surrounding Japan, the United States, China, and in other parts of the world. This section examines some of the important changes that have taken place since the 1980s, in order to set the stage for the analyses in the following sections.

One of the most important factors affecting US trade policy is its trade balance. Figure 1 shows the United States’ overall trade balance as well as its bilateral balances with Japan and China from 1985 to 2018. The United States registered a trade deficit throughout this period. After maintaining a level around \$100 billion from 1985 to the mid-1990s, the US trade deficit began growing rapidly to reach \$800 billion in 2005. Since then it has remained at about the same level with some fluctuations until the mid-2010s. The ratio of the trade deficit to gross domestic product (GDP) fluctuated between 1% and 3% from the mid-1980s to the end of the 1990s. Entering the 2000s, the ratio began to increase to hit a peak of 6% in 2006. Since then it has declined and has stayed around 4% in the 2010s.

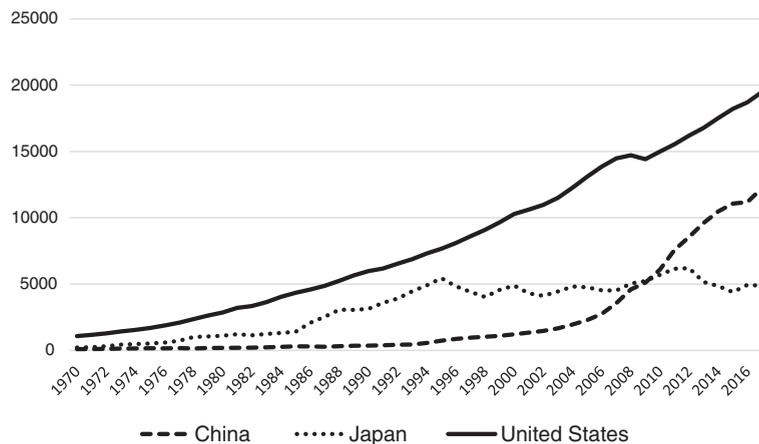


**Figure 1** US trade deficit (\$billion).

Source: US Census Bureau. U.S. Trade in Goods by Country. Available from URL: <https://www.census.gov/foreign-trade/balance/index.html>. Accessed on 30 June 2019. The figures for the rest of the world for 1985 and 1986 are obtained from the US Census Bureau, U.S. Trade in Goods and Services-Balance of Payments (BOP) Basis, Available from URL: <https://www.census.gov/foreign-trade/statistics/historical/gands.pdf>. Accessed on 30 June 2019

The United States' bilateral trade deficits with Japan, China, and the European Union (EU) accounted for large proportions of its total trade deficit. From the mid-1980s through to 2018, both Japan and China continuously recorded trade surpluses vis-à-vis the United States. In terms of the shares of Japan and China in the US trade deficit, Japan's share was very large fluctuating between 35% and 65% from the mid-1980s to the mid-1990s. Japan's share began to decline in the 1990s to register around 10% in the late 2000s. Since then, it has stayed around 7–10%. A contrasting pattern is observed for China. China's share was very small at less than 10% until the end of 1980s. From the early 1990s, it increased continuously and rapidly to reach 45% in 2009. China's share in recent years has stayed around 45–50%.

The relationship among the United States, Japan, and China in terms of GDP changed notably from the 1980s to the 2010s (Figure 2). The United States has remained as the largest economy in the world in terms of GDP. Japan was catching up very fast from the mid-1980s to the early 1990s, thanks to rapid economic growth and the emergence of the bubble economy, but Japan's GDP stopped growing after the burst of the bubble economy in the early 1990s. The ratio of Japan's GDP to US GDP increased sharply from below 40% in the early 1980s to 70% in 1995, but it has declined sharply since then to record a level of 25% in 2017. A contrasting pattern is observed for China. The ratio of China's GDP to US GDP was around 10% until 1995, but then it increased very fast to reach 63% in 2017.



**Figure 2** Gross domestic product (\$billion): Japan, China, and the United States.

Source: World Bank, World Development Indicators on line. Available from URL: <https://databank.worldbank.org/reports.aspx?source=world-development-indicators>. Accessed on 29 June 2019.

The importance of the United States in Japan's exports is an important factor in determining Japan's trade policy toward the United States. The larger the importance of the United States, the more limited is Japan's maneuverability in its trade policy toward the United States. The share of the United States in Japan's total exports increased from 33% in 1980 to 47% in 1985, and then it declined to 14% in 2011 before showing a slight increase. These observations indicate that Japan's maneuverability in dealing with the United States has increased since the mid-1980s, as the importance of the United States for Japan's exports declined. A similar pattern is found for China, but the degree of dependence on the United States has never been as high as that for Japan.

Two important events should be noted in analyzing the US–Japan trade frictions. One is the end of the cold war in the late 1980s. Since the end of WWII until 1989, there was geopolitical tension between the Eastern Communist Bloc led by the Soviet Union and the Western Liberal Democratic Bloc led by the United States. Japan was under Soviet threat, and relied on the United States for its national security. Thanks to the end of the cold war which removed/reduced the threat from the Soviet Union, Japan's maneuverability in dealing with the United States increased. The other development is the establishment of the WTO with a more effective dispute settlement mechanism compared to that of the GATT. Under the WTO, WTO members can resort to the WTO's dispute settlement mechanism rather than bilateral trade negotiations to deal with trade disputes. The availability of an alternative method for dispute settlement improved Japan's position in its trade negotiations with the United States.

### 3. Restriction of Japanese Exports in the US Market: Voluntary Export Restraint

Japan and the United States have had a series of trade frictions in a number of products for many decades dating back to the 1950s (Table 1). Japan's trade frictions with

**Table 1** History of US–Japan trade frictions

1957	Cotton textiles, VER
1962	Short term agreement on cotton textiles
1963	Long term agreement on cotton textiles (–1974)
1966	Steel, VER (–1992)
1974	Textile agreement, wool and synthetic fiber textiles (–1991)
1977	Color TV, OMA (–1980)
1878	Steel, trigger price (–1982), machine tools, minimum price (–1987)
1981	Automobiles, VER (–1994)
1984	Steel, VER (–1990)
1985	Market-Oriented Sector-Selective (MOSS) talks
1986	1st Semiconductor agreement
1988	Machine tools, VER (–1993)
1989	Structural Impediments Initiative (SII.–1990)
1991	2nd Semiconductor agreement
1993	Framework talks (until 1996)
1995	Automobile negotiations

Source: Ministry of International Trade and Industry, Tsusho Hakusho (White Paper on International Trade), and various issues.

MOSS: telecommunications equipment and services, electronics, forest products, pharmaceuticals and medical equipment (1985), automobiles and auto parts (1986), super computers (1987); SII, savings-investment pattern, land usage, distribution, exclusive trade practices, keiretsu; VER, voluntary export restraint.

the United States until the mid-1980s mostly took the form of the United States attempting to restrict Japan’s exports to the United States. Products subject to trade frictions changed remarkably from textiles, steel, automobiles to semi-conductors, to name some. This section reviews some of the serious trade friction cases to see how Japan and the United States were involved in trade frictions.

### 3.1 Textiles

In the post-WWII period, Japan–US trade frictions began with a textile dispute in the mid-1950s.<sup>2</sup> During the late 40s and early 50s, American textile manufacturers began to feel competitive pressure from increased textile imports from Japan. Faced with growing Japanese imports, textile associations started to file “escape clause” applications in 1956. Several pieces of legislation designed to limit Japanese imports were introduced into the US Congress. The US government, which wanted to avoid protectionism in the form of tariffs and quotas to support freer global trade under the GATT, decided to negotiate a voluntary export restraint (VER) with Japan. Japan had no choice but to accept the request, as the United States was its major market. The result of the negotiations was Japan’s VER for cotton textile products for 5 years starting in 1957. Japan accepted a VER without much resistance as it realized that cotton

production was on the decline as production of wool and synthetic textile products was beginning to increase.

In 1961 President John F. Kennedy decided to negotiate an international agreement on cotton textile products, as part of his promises during the presidential campaign. An international agreement would cover imports from exporting countries other than Japan including Hong Kong, Korea, and Taiwan, which had increased their exports at the expense of Japan's exports which were restricted under the VER. Negotiations resulted in a 1-year agreement, the short-term arrangement (STA). The STA was a quantity restriction arrangement. For the United States, the STA was deemed a success in limiting cotton textile imports, and, thus, it was extended in the form of the long-term arrangement (LTA) for 5 years in 1962 and then later for a further two 3-year periods until 1973.

Quantity restrictions on the cotton textile trade under the US–Japan bilateral agreement, and the STA and LTA arrangements had interesting impacts on Japan's exports of textiles to the United States. Faced with a limit on export volumes, Japanese cotton textile producers upgraded the quality of their exports by shifting their exports to high-priced items, in order to increase export revenue. Another response was to shift their exports from cotton textiles to noncotton textiles, that is, wool and synthetic textile products. It should also be noted that some Japanese producers relocated production to countries which were not subject to export restrictions by undertaking foreign direct investment.

In 1969, President Richard Nixon decided to negotiate a multifiber textile arrangement with Japan and three other East Asian major exporters. This negotiation was to fulfill a Nixon presidential campaign promise. Negotiations were very difficult as Japan's textile industry was strongly opposed to the US demand. Japan's industry accepted the US demand after the Japanese government promised to provide relief to the industry for the injuries caused by restraints on exports to the United States (Maeda, 2000). The negotiations ended and the agreement was formally signed in January 1972. This textile negotiation was likely to be linked to the negotiation of Okinawa's reversion to Japan. The other countries signed the agreement following Japan. The agreements with four countries were transformed into the multifiber arrangement (MFA) under the GATT in 1974. The MFA expired in 2005.

### 3.2 Steel

In the mid-1960s, the US steel industry began to feel competitive pressure from increased imports, as the import ratio increased from 10% in 1966 to 17% in 1968.<sup>3</sup> Among increased imports, imports from Japan registered a rapid increase and they accounted for 40% of total imports in 1968. Aware of rising protectionist sentiment in the United States, the Japanese steel industry implemented a voluntary restraint arrangement (VRA) for 3 years starting in January 1969. In 1972, the Japanese steel industry announced an extension of VRA for 2 years, but it was not implemented as a

consumer association in the United States filed an anti-monopoly suit against the Japanese steel industry.<sup>4</sup>

In 1977, the US steel industry, which experienced a rapid expansion of imported steel, filed a series of anti-dumping petitions against Japanese steel. To resolve matters, the US government imposed a minimum price for steel imports, the so-called “trigger-price mechanism.” Under the trigger-price mechanism, a reference price, or minimum price, is set based on the lowest production cost of Japanese steel on a quarterly basis and a dumping investigation is triggered without anti-dumping charges when the import price is found to be lower than the reference price. The trigger price mechanism was instituted from January 1978 to January 1982 with a short break period from March to October 1980. In return, the US steel industry agreed to refrain from filing countervailing duty, anti-dumping, or escape clause petitions. Steel producers again began filing petitions for special protection, ultimately inducing the reinstatement of the VRA from October 1984 to March 1992 not only by Japan and the European Community (EC), but also by Brazil, Mexico, South Africa, and Korea (Flath, 1998). The US government tried to establish a multilateral export quota system similar to the MFA for the textile trade, but it failed because of strong opposition from the affected countries.

Japan’s VRA officially ended in March 1992. The US steel industry continued to file anti-dumping and safeguard petitions during the 1990s, while bilateral talks also continued. Japan took the anti-dumping and safeguard actions to the WTO dispute settlement mechanism for the judgment.

US steel imports from Japan increased substantially from the early 1960s and then declined after reaching a peak around 1980. The decline continued until around the turn of the century, but then imports began to increase again. This decline is surely affected by a series of restrictions imposed on imports from Japan. However, the decline in the competitiveness of Japanese steel products is also likely to be an important factor behind this decline. To protect the US industry, the United States imposed additional tariffs on steel imports in March 2018.

### 3.3 Automobiles

The US automobile industry was in a difficult situation in the late 1970s. The US economy was in recession, which was caused largely by the second oil crisis in the late 1970s. US consumers shifted their preference from large to small cars in response to increased gasoline prices, which were due to the first and second oil crises in the 1970s. In response to this change in US consumer demand, imports of Japanese small cars increased sharply.

The US automobile industry and the United Auto Workers (UAW) did not actively promote protectionism at first, as they were favoring free trade because the US automobile industry had enjoyed competitive position for many years and it had expanded its operations overseas.<sup>5</sup> However, the situation changed dramatically. The number-three car maker, Chrysler, almost failed and only survived as a result of government

assistance. As many as 650,000 workers were out of jobs in auto-related industries in 1979 (Yoffie, 1983). Faced with this difficult situation, the UAW conducted a strong campaign for trade restrictions and for investment in the United States by Japanese automobile producers. In May 1980, the UAW together with the Ford Motor Company filed a petition for import restrictions with the International Trade Commission (ITC) on the ground that the surge of imports caused a serious injury to the US automobile industry. The automobile issue became emotional and hysterical in the United States, and the expression “Japan bashing” was frequently used and reported in the Japanese media. This flaring up of the automobile issue was partly due to the Presidential race in 1980.

The ITC rejected the UAW-Ford petition by a three-to-two vote. The ITC concluded that increased imports were not a substantial cause of injury to the automobile industry. High interest rates, the recession, and a change in consumer demand were the most important reasons for the industry’s problems. Now that the negative ITC decision made it impossible for President Jimmy Carter to take actions against increased imports, the US automobile industry and the UAW relied on the Congress to restrict imports. In response to industry’s pleas, a quota bill was introduced into the Congress in January 1981. Amidst growing support for the bill, newly inaugurated President Ronald Reagan decided to negotiate a VER with Japan.

The Japanese government announced the introduction of a VER in May 1981 to limit Japan’s passenger car exports to the United States to no more than 1.68 million units annually starting on April 1, 1981 for the 3 year period to March 31, 1984. The VER was renewed by an independent decision of the Japanese side with a higher ceiling of 1.85 million, in order to avoid conflict with the US industry. The VER continued with a ceiling of 2.3 million after April 1, 1985, and it was finally lifted in 1994.

Faced with the VER, Japanese automobile firms adopted mainly two strategies. One strategy was to start the production of automobiles in the United States. In 2017, 3.8 million cars were produced by Japanese firms in the United States, while 1.7 million cars were exported from Japan to the United States. Behind Japan’s automobile manufacturers’ decision to engage in local production, in addition to an economic calculation of costs and benefits, a strong request from the UAW was a key factor. The other strategy was to shift exports to higher priced categories. For Toyota’s sales in the United States, the proportion of new car sales in the \$4500–\$6000 range in total sales declined from 36.5% in 1981 to 24% in 1982, while the corresponding shares for new car sales priced over \$12,001 range increased from 0.5% to 12%, respectively.<sup>6</sup>

### 3.4 Analysis

VERs were implemented to deal with the US–Japan bilateral trade deficit problem and to protect US workers to maintain employment opportunities and to protect industries to maintain and recover their competitiveness. A rigorous examination of whether these three objectives have been achieved is beyond the scope of this paper as it requires detailed data. However, casual observation indicates that VERs contributed to

protecting workers and industries from structural adjustment, but they did not contribute to improving the US trade deficit or improving the competitiveness of the US industries. A US bilateral deficit vis-a-vis Japan still exists and the industries protected by VERs are still protected by other means such as import tariffs despite the fact that VERs on Japanese products were enforced and, thus, restricted their exports to the United States. In this sub-section, we review some studies on the impacts of VERs and other protective measures on the US and Japanese economies.

The VER had different impacts on the US and Japanese industries and economies. Both US and Japanese industries appear to have benefited from the VER, although their benefits are quite different. First, the VER enabled the US industry to survive and maintain/expand production and employment.<sup>7</sup> It should be noted that the VER relieved the industry/labor from adjustment, and thus provided benefits in the short run, but it incurred costs by delaying the necessary adjustment for achieving economic growth in the long run. The Japanese industry also benefited in several ways. Their profits increased as they were able to raise their export prices. Indeed, the VER created a “cartel” among US and Japanese producers by controlling the quantity of sales. The VER benefited Japanese producers as the VER forced them to upgrade the quality of their products and to diversify their product range, so that they could increase their profits. The biggest losers were the US consumers because the VER forced them to pay high prices and narrowed their product choices.

Hufbauer *et al.* (1986) empirically analyze the impacts of trade protection on the US economy for 31 cases. Specifically, they estimate the impacts on domestic and import prices, trade, employment, consumption, production, and government revenue. According to their analysis of the impacts of VERs for automobiles, the prices of imported and domestic autos increased 11% and 4.4%, respectively. From the restraints, producers gained \$2.6 billion, while consumers lost \$5.8 billion. The restraints induced 55,000 jobs. After subtracting the costs from the benefits, Hufbauer *et al.* estimate the welfare cost to the United States was \$2.4 billion. They also show a very interesting figure that indicates the cost of the restraints to the US economy per job saved amounted to \$100,700 in 1984. This figure is significantly higher than the median income of males at \$24,000 (US Census Bureau, 1987). These findings indicate that export restraints imposed a substantial cost on the US economy in order to save jobs. Hufbauer *et al.* also estimate the gains to Japanese automobile producers at \$2.2 billion.

#### 4. Opening of the Japanese Market

Faced with a continuing trade imbalance despite the application of a series of export restricting measures such as the VER, the United States began to look at a possible expansion of its exports to Japan. To achieve this objective, the US government organized a series of initiatives/talks with the Japanese government in the mid-1980s. One of the policies adopted to correct trade/current account imbalances was the Plaza Accord adopted at the G-5 Finance Ministers’ Meeting in October 1985. The Plaza

Accord called for a readjustment of the major currencies (a depreciation of the US dollar and an appreciation of the Japanese Yen and West German Mark).<sup>8</sup> In this section, we take up the initiatives on trade and regulatory policies involving the United States and Japan with the objective of correcting trade imbalance.

#### **4.1 Market-oriented sector-specific talks**

The Market-Oriented Sector-Specific (MOSS) talks were formed by an agreement between President Reagan and Prime Minister Yasuhiro Nakasone at the bilateral summit meeting in January 1985. The purpose was to remove barriers to the entry of products of US interest by regulatory reform, tariff reduction, and other policy measures (Abe, 2013). There were different views on the MOSS inside the US government. The United States Trade Representative (USTR) and the Department of Commerce were eager to set numerical targets on Japan's imports, while the Departments of the Treasury and State opposed numerical targets and argued that the talks should focus on deregulation and trade liberalization, or a process-oriented approach. The expression, Market-Oriented, was given, in order to make it clear that the talks were not about setting numerical targets (Abe, 2013).

Initially, four sectors, telecommunication, medicine and medical equipment, electronics, and forest products, were selected, and discussions on the current market situation including entry barriers were conducted for each sector. MOSS talks included plenary sessions as well as meetings of experts and working group meetings. Plenary sessions were attended by senior officials, while meetings of experts and working group meetings were attended by directors and staff, respectively. Several meetings at the three levels were held, and the results of the discussions were reported by Minister of Foreign Affairs, Shintaro Abe, and Secretary of State, George Shultz, in January 1986. According to the report, the MOSS talks made important progress in terms of increasing market access and paved the way for further market opening. Some of the market opening measures agreed to included the reduction and elimination of tariffs on electronics products.

#### **4.2 From Section 301 to Super 301**

The Reagan administration adopted an aggressive export promotion policy, in order to correct the trade imbalance. The main instrument of this new trade strategy was Section 301 of the 1974 US Trade Act. Section 301 authorizes the President to retaliate against a foreign country that maintains an unjustifiable or unreasonable tariff or other import restrictions or export subsidies, substantially reducing the sales of the competitive US products.<sup>9</sup> Section 301 is a powerful instrument for opening foreign markets, but it was rarely used because it would be a possible violation of the GATT rule against unilateral action. However, the Reagan administration applied Section 301 in a number of cases involving not only Japan, but also other countries such as Canada and the

EC. The main target was apparently Japan, and the US government applied Section 301 to a number of cases including cigarettes, leather products, and semi-conductors.

One of the important developments concerning Section 301 was the US–Japan semiconductor agreement in 1986.<sup>10</sup> Faced with limited exports of semiconductors by US producers to Japan, the Semiconductor Industry Association (SIA) of the United States filed a Section 301 petition against Japan for its exclusionary market structure in June 1985, resulting in the US–Japan semiconductor agreement. The agreement contains a section indicating the need to increase market access in Japan. One controversial issue concerning this agreement was a side letter stating that the Japanese government recognized the US semiconductor industry’s expectation that semiconductor sales of foreign-affiliated companies in Japan will grow to at least slightly above 20% of the Japanese market in 5 years. It further stated that the Government of Japan considers that this can be realized and welcomes its realization. The United States interpreted this letter as meaning that the Japanese government accepted the numerical target.<sup>11</sup> Based on this understanding, the United States claimed that Japan violated the agreement by failing to make ample progress toward the goal of an expanded foreign market share in Japan, and imposed sanctions in the form of retaliatory 100% tariffs on laptop and desktop computers, color televisions and power hand tools (Flath, 1998). The Japanese government thought that it only expressed an expectation and it had not agreed to achieve the numerical target. The semiconductor agreement was renewed for 5 years in 1991 as the 20%-target was not achieved. The foreign market share increased to around 30% in 1995. The US side considered this as a successful case of a numerical target. However, there was a view that the increase in foreign market share was due to a decline in the competitiveness of Japan’s semiconductor industry. It should be noted that one of the reasons that the US government was very anxious to deal with the semiconductor problem was its recognition that semiconductors are very important for the US economy. The Japanese learned a lesson that it had to be clear about its non-involvement in numerical targets in the future negotiations.

The US Congress was irritated by the lack of progress on correcting the trade imbalance vis-à-vis Japan, and this resulted in the introduction of the so-called “Super 301.” The objective of the Super 301 was to mandate the threat of trade sanctions against foreign countries that are deemed to have undertaken unjustified and unfair trade practices.

In 1989, under the newly inaugurated George H.W. Bush administration, the USTR took up Japan’s exclusionary government procurement of super-computers and satellites, and its barriers to trade in forest products as a Super 301 agenda. From the point of the US government, these cases were satisfactorily resolved, as Japan agreed to abolish discriminatory features of government procurement of supercomputers, enforce non-discriminatory and transparent procurement of commercial satellites, reduce tariffs on wood products, and relax regulations on building standards for wooden buildings.

Bayard and Elliott (1994) conduct a detailed examination of the effectiveness of Section 301 and Super 301 for market opening. They analyze 72 cases, of which 12 were

Japanese cases, and evaluate the cases in two ways. One is to investigate if the negotiation objective is achieved, and the other is to evaluate the degree of market opening resulting from Section 301 and Super 301. They conclude that, on balance, Section 301 and Super 301 have been reasonably successful in achieving the US goal of opening foreign markets and that aggressive unilateralism has made a modestly positive contribution in moving the global trading system toward significant reforms (Bayard & Elliott, 1994). Having made these remarks, Bayard and Elliott propose that the United States pursue a strategy of aggressive multilateralism under the newly established WTO.

### 4.3 Structural impediment initiative

The US and Japanese governments shared a view that in order to solve the external imbalance problem not only macroeconomic coordination such as the one introduced in the Plaza Accord, but also structural adjustment was needed. Based on this understanding, President Bush proposed setting up the Structural Impediments Initiative (SII) to discuss structural problems in May 1989. Prime Minister Sosuke Uno and President Bush agreed to start discussions under the SII framework in July 1989. The objective of the SII was to identify and solve structural problems in both countries that stand as impediments to trade and balance of payments adjustment with the goal of contributing to the reduction of payments imbalances. The US side hoped that the SII would make Japan realize the importance of dealing with structural problems in the Japanese economy in order to reduce external imbalances. Japan demanded that structural impediments in both countries be identified and dealt with because Japan had the view that the solving the problems required structural adjustment on the US side as well. The first meeting was held in September 1989. Discussions were held more or less every 2 months, and the final report was released in June 1990. Some important points concerning Japan's impediments which were agreed to include the following:

1. Distribution system: Deregulation of the distribution system by deregulating a variety of laws and regulations such as the Large-Scale Retail Store Law.
2. Exclusionary business practices: The enhancement of the Antimonopoly Act and its enforcement, and the encouragement of transparent and non-discriminatory procurement procedures by private companies.
3. Keiretsu relationships: A strengthening of the functions of the Fair Trade Commission; a revision of the take-over bid system; and the enhancement of disclosure requirements.
4. Pricing mechanism: The implementation of measures to adjust price differentials between domestic and overseas markets; the continuous implementation of domestic and overseas price surveys, and the dissemination of information to consumers and industries.

The evaluation of the SII talks seems to be rather positive. Noboru Hatakeyama, Vice Minister of Ministry of International Trade and Industry (MITI) remarked that the SII

talks and follow-up talks contributed significantly to the reduction/improvement of the structural problems by various measures including revising the Large-Scale Retail Store Law (Hatakeyama, 1996). Schoppa (1997) concludes from his study of the SII talks that *gaiatsu* (foreign pressure) was successful in market opening in Japan for the cases where domestic support existed within Japan.<sup>12</sup> Abe (2013) argues that in the SII talks the United States let Japan formulate its own policy measures to deal with the structural problems (impediments) rather than forcing Japan to adopt US demands.

#### 4.4 US–Japan framework talks

Newly inaugurated US President, Bill Clinton, was eager to reduce the trade imbalance vis-à-vis Japan. In order to achieve this objective, he was determined to open the markets of the US' trading partners, especially Japan, by applying the objective criteria or results-oriented approach instead of the process-oriented approach adopted by the previous administrations.

At the first summit meeting between Prime Minister Kiichi Miyazawa and President Clinton in April 1993, they agreed on the establishment of a new comprehensive bilateral framework on economic issues. In July 1993, Miyazawa and Clinton released a joint statement entitled “Framework for a new economic partnership between Japan and the United States,” with a view to promoting trade and investment between the two countries. The following items were agreed to. In the macroeconomic area, Japan was to apply fiscal and monetary policies to reduce its huge current account surplus, while the United States was to adopt measures to reduce its fiscal deficit. In the area of specific issues, government procurement, deregulation, automobile and auto-parts were to be taken up. In September 1993, the framework talks began with more than 30 working groups including those on the macroeconomy and sector-structural issues.<sup>13</sup> The following principles were agreed to concerning the framework talks: a two-way dialogue between the two countries; benefits to be given to other countries on a most-favored nation (MFN) basis; matters to be limited within the scope and responsibility of government; disputes to be settled in a manner consistent with international rules such as the GATT; the application of unilateral measures (such as sanctions under Section 301 of the US Trade Act) would be avoided; and managed trade approaches such as the setting numerical targets would be avoided.

The talks did not go smoothly. The contentious issue was the introduction of “objective criteria.” The United States insisted on its introduction because Japan could not be trusted to truly open up its markets (Schoppa, 1997). The Japanese government refused to accept the US demand because the government cannot influence private-sector decisions such as those having to do with automobiles and auto parts. Because of these differences in opinions on objective criteria, Prime Minister Morihiro Hosokawa and President Clinton decided to observe a “cooling off period” at their first summit meeting in February 1994. The talks resumed in March 1994 and finished in February 1996 at the Hashimoto (Ryutaro) – Clinton summit. The United States did not get its objective criteria because of strong opposition from Japan, which was

committed to avoiding managed trade, and because of its bitter experience with the semiconductor agreement. Japan's persistent refusal of the US demand may be attributable to two new developments, the end of the cold war and the creation of the WTO, both of which were discussed in Section 2. Besides, the United States could not find supporters within Japan, unlike in the SII case (Schoppa, 1997).

## 5. Resurgence of US–Japan Trade Frictions

The United States and Japan experienced a quiet period regarding trade frictions in the 21st century until Donald Trump assumed the presidency of the United States in 2017. Several reasons may be pointed out for the rather favorable bilateral trade relationship. One is macroeconomic performance. The US economy registered strong economic growth driven by the IT (information technology) revolution except for the period of the Global Financial Crisis. By contrast, Japan experienced a long period of recession since the burst of the bubble economy in the early 1990s. These contrasting patterns in economic growth performance resulted in reduced demands for trade protection by the United States. Besides, as part of their trade policy, both the United States and Japan were busy negotiating free trade agreements (FTAs).

One of the most important FTAs involving the United States and Japan was the Trans-Pacific Partnership (TPP). The TPP negotiations began in March 2010 with eight members of APEC including the United States. Japan joined the negotiation in July 2013. Prime Minister Shinzo Abe had to overcome strong domestic opposition which consisted mainly of farmers and agricultural groups, by promising that protection will be maintained for five “sacred” agricultural products, rice, wheat, beef and pork, sugar, and dairy products. With the strong leadership of the United States, the TPP negotiations were concluded and the TPP Treaty was signed in February 2016. The TPP was considered to be a very ambitious agreement, and recognized as a “21 century trade agreement,” with a high level of trade and investment liberalization and comprehensive issue coverage including e-commerce, state-owned enterprises (SOEs), government procurement, labor, and the environment in addition to trade in goods, services, investment and other standard items in typical FTAs.<sup>14</sup> In the negotiations, for Japan the most controversial and sensitive item was trade liberalization in agricultural products. For the United States, the elimination of tariffs on automobiles was a difficult negotiation item.

President Trump withdrew the US from the TPP on his third day in office in January 2017. Trump does not like trade agreements with multiple countries like the 12 countries in the TPP, and he believes that bilateral trade agreements will give larger benefits to the United States because the United States can exercise greater negotiating power. After the US withdrawal, the remaining 11 TPP members went ahead to form an FTA without the United States. The Comprehensive and Progressive TPP (CPTPP), or TPP11, negotiations began in May 2017. Negotiations progressed smoothly and an agreement was reached in January 2018. The CPTPP was signed in March 2018 and entered into force in December 2018.

Since Trump became President, he has actively introduced additional tariffs on several products for several reasons. One of the policies that affected Japan was additional tariffs on steel and aluminum products (25% and 10%, respectively), which were introduced in March 2018 to protect national security (Section 232 of the US 1962 Trade Expansion Act). Trump asked the Department of Commerce to investigate the case of automobiles for the possible application of Section 232 tariffs in May 2018. The Department of Commerce found the case for applying 232 tariffs in February 2019, and, therefore, it is up to the President to decide on the application of additional tariffs. In May 2019, he announced that he would postpone the decision for 6 months.

Using Section 232 tariffs as a threat, the United States persuaded/demanded Japan to negotiate a bilateral trade agreement. One of the objectives was to reduce/eliminate the bilateral trade deficit. President Trump and Prime Minister Abe agreed to start bilateral trade negotiations in September 2018, and the negotiations began in April 2019. For the United States, the priority areas include agriculture and automobiles. Specifically, the United States is eager to obtain greater market access in agricultural products, in order to rectify its disadvantageous position vis-à-vis CPTPP members such as Australia and Canada. The United States wants to restrict the number of Japanese car exports to the United States, while it wants to increase US car exports to Japan.<sup>15</sup> In order to achieve these objectives, the United States is likely to use tariffs on automobiles as a threat. Indeed, the United States obtained a favorable outcome in its renegotiation of the Korea–US FTA as well as North American Free Trade Agreement by using threats and greater bargaining power.

The Japanese government has made it clear that the maximum that they can offer in the negotiations are those it committed to in the earlier FTAs including the TPP. This position has to be maintained in order to avoid the power-based trading environment. If the United States imposes additional tariffs on imported automobiles, Japan should take the case to the WTO's Dispute Settlement Mechanism. It should be noted that Japan has not brought the case of additional tariffs on steel and aluminum to the WTO, while China, India, the EU, Canada, Mexico, and Turkey have done so. Japan should cooperate and coordinate with the EU, which is faced with the same situation, in dealing with the United States on trade issues. In addition to these reactionary measures to the US action, Japan should increase the membership of the CPTPP by persuading other countries to join, and work hard to establish the Regional Comprehensive Economic Partnership (RCEP), which involves 16 East Asian countries including Japan, China, India, and Australia. The establishment of mega-FTAs such as the CPTPP, RCEP, and the Japan–EU Economic Partnership Agreement, which entered into force in February 2019, would impose negative impacts on US firms and farms, possibly putting pressure on the Trump Administration to change its policy of bilateralism to regional/multilateralism.

## 6. Implications for the US–China Trade War

The United States and China are currently involved in a trade war triggered by the United States imposing additional tariffs on its imports from China in July 2018. The

objectives of the US action are twofold. One is to reduce its trade imbalance vis-à-vis China, in order to save employment in the United States, and the other is to deal with China's unfair trade/economic practices such as the violation of intellectual property rights (IPRs) and the forced technology transfer from foreign companies investing in China.

There is a fear in the United States that China is rapidly catching up with the United States in the area of advanced technology. To achieve the “Chinese dream of the great rejuvenation of the Chinese nation,” China has set a target to become a global economic, military, and cultural superpower alongside the United States by the time of the centenary of the founding of the People's Republic in 2049. On the economic front, China has launched the Made in China 2025 industrial policy with the aim of becoming a manufacturing superpower. It is also working on the construction of a China-centered economic sphere by implementing the Belt and Road Initiative. The United States sees China's system of state capitalism as a challenge to the American-led market capitalism, and is seeking to shift the direction of China's policy through protectionist measures.

In this section, we attempt to find policies to stop the US–China trade war by drawing on the implications from the US–Japan trade frictions. In order to achieve this objective, we first identify similarities and differences between US–Japan and US–China trade frictions/war.

Beginning with the similarities, one important similarity is that both Japan then and China now have a huge trade surplus vis-à-vis the United States. Another similarity is that both Japan in the earlier periods and China at present was/is catching up fast with the United States in terms of economic power when measured by GDP. Yet another similarity is the differences in economic systems between the United States on the one hand, and Japan and China on the other hand. This does not mean that the economic systems in Japan and China are the same. They are quite different. During the period of the US–Japan trade frictions, the United States accused Japan of not practicing a free market economy. The United States claimed that in Japan exclusionary business practices such as the Keiretsu and government interventions in the form of industrial policy spread widely across economic activities made the entry of foreign firms and imports difficult. In the case of China, government intervention is pervasive and, in particular, important industries are dominated by SOEs. SOEs financially supported by the government do not compete with other firms such as foreign firms on a level-playing field. The Chinese economic system is characterized as state capitalism, as opposed to the market capitalism in the United States. In both trade frictions/war, the United States perceived the opposing countries, Japan and China, as competitors in terms of their economic systems.

These three factors pushed the United States to target Japan and China in trade frictions/war. There are also differences between the US–Japan and US–China trade frictions. One is the political system. Both the United States and Japan are democratic states, and share fundamental values such as human rights and the freedom of speech, whereas the United States and China have different political systems, as China is an

authoritarian political system ruled by one-party, the Communist Party. Indeed, the United States and Japan are allies, whereas the United States and China are in adversarial relationship. These differences make the US–China trade war much more severe in terms of competition than the US–Japan trade frictions. Another difference is the response to US actions. Japan did not retaliate, while China has retaliated. Japan did not retaliate mainly because it depended on the United States for its national security. Because of these differences in the two types of trade frictions/war, the US–China trade war is much more serious and probably long-lasting compared to the US–Japan trade frictions.

Another difference is the external economic environment under which the two trade frictions took place, the 1980s for the US–Japan friction and the 2010s for the US–China friction. Compared to the 1980s, global value chains (GVCs) have developed more intensively and extensively in the 2010s. Through widely spread GVCs, the countries, including the United States and China, are more closely connected in the 2010s, making the negative impacts of the US–China trade war more serious compared to the US–Japan trade frictions.

Let us think about the way the United States achieves two goals, that is, the reduction/elimination of the trade deficit, and the correction of China’s unfair trade/economic practices without resorting to protectionism, or trade wars. First on the trade deficit, trade policy such as trade protection is not an effective way to deal with the trade deficit problem, as we saw in the case of the US–Japan trade frictions. The United States has to change its strategy, from trade protection to macroeconomic adjustment. Specifically, as a trade deficit indicates overspending, that is, an imbalance between spending (expenditure) and earnings (income), the US government needs to cut spending to reduce its trade deficit. Certainly, China’s macroeconomic coordination in the form of an expansionary monetary and fiscal policy would help these two countries reduce their trade imbalances.

Turning to the problem of unfair trade/economic practices by China, the United States should find it more effective if it cooperates/coordinates with countries such as Japan and the EU, which suffer from the same problems. In this regard, in addition to putting pressure on China, the United States can work jointly with the EU and Japan to set up appropriate international rules in the WTO. Based on US experiences from the US–Japan trade friction, specifically the SII, US pressure would become effective when the US government allies with the pro-change constituency in China. In this regard, it is encouraging to observe the emergence of Chinese companies that complain about the violation of IPR protection by other Chinese companies, leading to stronger enforcement of IPR protection.

As for China, retaliation is counterproductive, especially in the medium and long term, as it will lead to a deterioration of the economic situation in the United States and other countries, which in turn would affect the Chinese economy negatively by reducing China’s exports. Instead of resorting to retaliation, China should use the WTO’s dispute settlement mechanism and participate in mega-regional FTAs without the United States, with the objective of changing US trade policy. Specifically, China

should make efforts to conclude the RCEP negotiation and realize a trilateral FTA involving China, Japan, and Korea. In addition, China should consider joining the CPTPP. It should be emphasized that China can use the US pressure and commitments in mega-regional FTAs to improve the economic system in China, contributing to an improvement in economic efficiency, which in turn would promote economic growth.

## Notes

- 1 Ito and Hoshi (2020) and Abe (2013) provide detailed analyses of the US–Japan trade frictions.
- 2 This discussion of the textile dispute draws on Yoffie (1983). See also Maeda (2000), and Destler *et al.* (1979).
- 3 The import ratio here is defined as the ratio of imports to apparent consumption (production + imports – exports). The figures are taken from Abe (2013).
- 4 The consumer association lost the case.
- 5 This section draws on Yoffie (1983); pp. 221–230.
- 6 Yoffie (1983), table 6.2. Feenstra (1984, 1988) also find a quality upgrading and price rise of Japanese automobiles.
- 7 Batistich and Bond (2019) find that increased competition from Japanese imports had negative impacts on black manufacturing employment in terms of job opportunities and earnings.
- 8 Substantial currency realignment did not seem to reduce/eliminate the US trade imbalances vis-à-vis Japan or Germany, as their trade imbalances continued to exist.
- 9 The discussion of Section 301 and Super 301 draws on Flath (1998). Bayard and Elliott (1994) provide a detailed discussion and analysis of Section 301 and Super 301.
- 10 Irwin (1994) provides detailed analysis on this issue.
- 11 This policy is called a “voluntary import expansion (VIE).”
- 12 See Ito (1993) and Bayard and Elliott (1994) for similar arguments.
- 13 Ito and Hoshi (2020) presents a detailed account and analysis of the US–Japan Framework Talks.
- 14 On the TPP, see Urata (2018)
- 15 See United States Trade Representative (2018) for the objectives of the US–Japan Trade Agreement.

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