

CHAPTER FOUR

THE IMPACT OF THE ALLIANCE ON ECONOMIC ISSUES IN U.S.-JAPAN ECONOMIC RELATIONS

0. Introduction

During the Cold War, the effects of the alliance on U.S.-Japan economic issues generally varied according to the prominence of security concerns involved. For example, the alliance impact was most prominent in the nuclear energy issue and less prominent in the coal trade issue area. With rising U.S. trade deficits with Japan, the alliance impact was sometimes most prominent and at other times modest or even minor. Then, the U.S. trade and political officials sought reciprocal access to Japan's market in the late 1980s and in the 1990s through bilateral negotiations and cooperation. Despite obstacles such endeavors have faced from domestic politics in both countries or from business organizations and economic interests groups, both governments were able to resolve some economic and trade issues, particularly when the trade issue area could have threaten alliance relations. The overriding mutual interests that both allies shared in maintaining the alliance, constrained the choices available to decision makers and promoted the resolution of some conflicts.

Although alliance maintenance was not as prominent as in the territorial or defense issues, the mutual interests both sides shared in maintaining and strengthening the alliance facilitated the resolution of serious economic disputes during the 1980 as and the 1990s, by mitigating a search for relative gains. Despite major structural

changes in the post-Cold War period, the scope of U.S. –Japan trade cooperation and exchanges continued to expand throughout the period. This represents a potential anomaly for neorealist theories of international politics and alliance relations, which would expect declining cooperation in the post-Cold War era.

4.1. The Importance of the U.S.-Japan Economic Relations

The economic relationship between the United States and Japan is also both the most important and the most complex in the world. The two countries represent approximately 40 percent of the world's gross domestic product,¹ and their wealthy populations make them the world's largest markets.² Their firms compete aggressively for world leadership in numerous high-technology sectors, such as electronics, and in many other industries, such as automobiles, those employ large numbers of workers. Until 1997, America was the world's largest debtor nation and Japan the largest creditor. America's account deficits, representing trade in both goods and services, have cumulated to about \$1 trillion over the 1980s and till the beginning of 1990s, and Japan's account surpluses have accounted for two-thirds of that total at the same period.³ Japan's economic achievements since the end of World War II and the global prowess of

¹ Merit E. Janow, "Trading with an Ally: Progress and Discontent in U.S.-Japan Trade Relations," in Gerald L. Curtis (ed.), The United States, Japan, and Asia, New York: W.W. Norton and Company, 1994, p.51; See also Ryutaro Hashimoto, Japan-U.S. Relations: A partnership for the Twenty First Century. Speech at Columbia University. June 23, 1997.

² U.S. Department of State, Dispatch, Vol. 7, No. 4, January 22, 1996, p. 15; Masao Miyoshi, Off Center: Power and Culture Relations between Japan and the United States, Cambridge: Harvard University Press, 1991, p. 64.

³ G. Fred. Bergsten, Reconcilable Differences? United States-Japan Economic Conflict, Washington, DC: Institute for International Economics, June 1993) P. 1.; for more details on economic and trade statistics see Karen M. Holgerson, *Ibid.* pp. 197-205.

Japanese firms have raised fundamental questions about the relative competitiveness of the US economy and the appropriate role of governments in fostering or hindering competitiveness.⁴

Japan and the US have had huge trade flows in both directions. Conflicts over trade issues have emerged before the mid-1980s. But the nature of these conflicts dramatically changed in the mid-1980s. The most contentious and explosive problem have been a huge trade imbalance between the two countries. By the early 1990s, the political framework generated by the US-Japanese economic structure after the Pacific War- has seriously eroded; economic forces, particularly capital flows, have outgrown it. A fundamental structural transformation has taken place in US-Japanese relations.⁵ Although Japan's surplus has reduced remarkably after the 1997 economic crisis, it is expected that trade imbalances will emerge from time to time as long as there are structural differences and different trade policies.

The structural transformations in U.S.-Japan relationship can be traced to the end of the Cold War. At a time when the Soviet Union was seen as a common threat, security was the most important component of the U.S.-Japan relationship. It is important to indicate that the US-Japanese economic growth, exchange rates, trade, and account balances are deeply intertwined with what goes on in the rest of the world as well. Therefore, US-Japanese economic relations in the 1980s and 1990s need to be

⁴ Merit Janow, Ibid. p. 53.

⁵ Alan Wm. Wolff, U.S. Trade Friction with Japan, Japan's Economic Challenge, Joint Economic Committee, October. 1990), P. 438.

assessed, while giving attention to the bilateral trade imbalance issues and the impact of security alliance on economic and trade issue areas. Such assessment assists in exploring how political-security factors were clearly imbedded in economic and trade negotiations between the U.S. and Japan, and showing variations in the alliance's impact on economic and trade issue areas.

4.2. The Conflict before the Mid 1980s: A Historical Perspective

This section will set the stage for the discussion of historical and political events and national interest implications which have influenced economic and trade relations between the U.S. and Japan. The trade problems between the two countries are very old and start with the beginning of their relationship in general. Therefore, trade frictions can be traced back to the first contact in 1853 when the US and some Western European nations stripped Japan of its authority to impose tariff. From 1854 to 1894 the two countries signed several treaties to establish and strengthen their trade relationship. Some of these treaties widely known as the "unequal treaties"⁶ particularly the Kangaroo Treaty calling on Japan to open its ports to US ships.⁷ Despite the fact that Japan and the U.S. were facing difficulties in building their relations, trade between the two nations continued to grow throughout the nineteenth and twentieth centuries. This growth was disrupted in the 1930s with the Smoot-Hawley Tariff Act of 1930 at the

⁶ Abdul M. Turay, "The Economic Dimensions of US-Japan Trade and Trade Frictions," in T. David Mason and Abdul M., Turay (eds.), US-Japan Trade Friction: Its Impact on Security Cooperation in the Pacific Basin, London: Macmillan Academic And Professional Ltd., 1991, p.9.

⁷ Takatoshi Ito, The Japanese Economy, Cambridge: The MIT Press, 1992, P. 11.

outbreak of the World War II. This act raised US tariffs on imports by more than 50 per cent, which was partly responsible for fuelling of the 1929 Great Depression.

The Depression had a significant impact on the Japanese economy, but the drop in output was not as severe in Japan as in the US because of several reasons: (1) the year of 1929 was not the peak of the cycle in Japan; (2) a strong expansionary fiscal policy was pursued in 1931; (3) the devaluation of the yen after the abandonment of the just-reinstituted gold standard in 1931 helped the rate of Japanese exports recover quickly to its peak level of the 1920s; and (4) military expenditures grew very rapidly after 1933.⁸

According to liberalist explanations, states often resort to unilateral procedures to protect their economies in cases of crisis. After the depression, the major powers tried to secure their economies. As the Western powers raised tariffs to secure markets, Japan increased its dependence on Asian countries and territories as exports destinations and import origins. This policy only accelerated Japan's military expansionism. The military, especially the army, had increased its political power in 1930s. Japan has set up a puppet government in Manchuria in 1932. In 1937, Japan began a full-scale war against China, and in 1940-after the outbreak of war in Europe-Japan signed the Tripartite Pact with Germany and Italy.⁹ In the 1940s, Japan-US trade relationships moved to more difficult times. When the US, during Roosevelt's presidency, imposed an export control on items such as petroleum products and scrap metal being sold to

⁸ Lester C. Thurow, *Head to Head: The Coming Economic Battle Among Japan, Europe, And America*, New York: William Morrow and Company, Inc., 1992, P 18.

⁹ Takatoshi Ito, *Ibid.* P.15.

Japan, the imposition of the export control by the US government was in retaliation for Japanese militarism during the World War II.¹⁰

After the inevitable surrender of Japan in August 1945, the U.S. policy towards Japan was intended to contain the economic and military powers of Japan to "a bar minimum", but with the emergence of the Cold War, the US began to help reconstruct Japanese industry in earnest. Then, the trade relations between the two countries was centered around the reconstruction of the Japanese economy under the Marshall Plan. In 1950s, the US emerged as a sole economic superpower in the world while Japan was continued in reconstructing its economy. With the fall of China in the hands of communists and the breakout of the Korean War, the US provided Japan with financial and economic assistance in anticipation that Japan would become a valuable ally to the US to enhance its world strategy in the new war. In addition to that, the US opened its markets to Japanese exports and provided a great assistance to Japanese manufacturing sector. Moreover, the US strongly supported the reentry of Japan into international society and institutions. During this period, the US provided invaluable aid to Japan without which it would be difficult for the Japanese economy to recover so fast. This phase of the economic relations came to an end in the 1950s, as Japan imposed 'Voluntary Export Restraints'(VERs) on US products in retaliation for US pressure on labour-intensive Japanese products such as textiles, cotton, ...etc.¹¹

¹⁰ Turay, Abdul M. Ibid., P.10.

¹¹ Steven Berry, James Levinsohn and Ariel Pakes, "Voluntary Export Restraints on Automobiles: Evaluating a Trade Policy," American Economic Review, Vol. 89, No. 3, 1999, pp. 400-30; see also PERC Reports, Vol. 17, No. 4, September 1999.

economy grew rapidly.¹² During this period, the economic gap between both nations was reduced remarkably. However, Japan was able to compete with American products and even overtake the US industry.

To face this challenge, the US discarded the so-called “big brother-little brother” relationship and adopted a hard line by asking Japan for concessions. The Japanese need for the US protection was an important factor in the negotiations.¹³ In the beginning of 1970, trade imbalance started to rapidly decrease as the yen revalued against the dollar after the “Nixon Shock” in 1971 when the US president Nixon imposed “surcharge” and took other steps to defend the dollar as a part of his new economic policy.¹⁴ As a result of the yen’s appreciation in 1972 and 1973, after the major states shifted to floating exchange rates, the trade friction also decreased. Moreover, textile exports, which was a main issue in the 1960s, have been regulated by the Multi-Fiber Agreement since October 1974.¹⁵ In fact, in 1975, Japan suffered from trade deficit with the US, but in the following three years, Japan recorded trade surpluses.¹⁶ Unprecedented trade imbalance occurred on three fronts: trade imbalance in Pacific, American deficit with the world and Japanese surplus with the world. Therefore, a new era of trade conflict emerged again. In 1978, the Japanese trade surplus with the US exceeded 10 billion for

¹² By 1970 the Japanese economy was one fifth of the US; the US share in global GDP was 31.7 % while Japan’s share was 6.4 %.

¹³ The first important negotiations between Japan and the US was in the early 1960s and concerned textiles, while steel was addressed in the late 1960s and the early 1970s. see Frank Ching, “A Partnership Under Strain,” *Far Eastern Economic Review*, March 17, 1994. P. 33.

¹⁴ Memorandum From Secretary of State Rogers to President Nixon, Washington, December 2, 1971, in *National Archives*, Nixon Presidential Materials, NSC Files, Agency Files, Box 285, State Volume 13; For more details on Nixon’s New Economic Policy see Documents 168 ff.

¹⁵ ¹⁵ Takatoshi. Ito, *Ibid.*, P.370.

¹⁶ I. M. Destler, H. Sato, P. Clapp and H. Fukui, *Managing an Alliance: The Politics of U.S.-Japanese Relations*, Washington, DC: The Brookings Institute, 1976, p. 1-2.

the first time while the US world deficit reached 33 billion.¹⁷ Meanwhile, the Japanese world trade surplus recorded a new number (24 billion).¹⁸ These economic changes gave rise to the question of unfairness. Japan became a formidable rival. The US as a powerful economic state, insisted that Japan as an ally had to share the responsibility and called Japan to adjust its unfair policy. The problem again became a serious sensitive political issue that might negatively affect the security alliance. The US pressed Japan to amend and adjust its trade policy; otherwise section 301 of the Trade Act of 1974-which provides the ground for unilateral retaliation against states that its trade practices are deemed unfair- would be invoked. Actually many Americans believed that the US was the most competitive power in the world and Japanese companies would not successfully compete against American firms as long as the playing field was level. Because Japanese firms were successful, the Americans believed that such success must be due to unfair Japanese trade practices. As a reaction to this situation, the US launched an intensive attack against Japanese trade policies. However, a close look at the conflicts shows that the competitive advantage of Japanese industries was not resulted from unfair trade policies as the US claimed.¹⁹

Although economic frictions in the late 1960s and the 1970s have influenced both parties' perceptions of their alliance relationship, the problems during this period have been controlled. In 1983, however, the U.S.-Japan trade relations showed some signs of progress as the two nations cooperated in the field of high technology, and the

¹⁷ Karen M Holgerson, p. 29.

¹⁸ Mitoji Yabunaka, "Japan-U.S. Economic Relations: Past Frictions and Future Challenges," *Japan Review of International Affairs*, Vol. 15, No. 3, Fall 2001, pp. 191-193.

US was successful in getting Japan to lift some of its non-tariffs. However, 1984 was a difficult year for US-Japan bilateral trade relations, because both economies had to deal with significant domestic economic and political issues which had an influence on their alliance and on international politics as well.²⁰

4.3.The Nature of the U.S.-Japanese Trade Imbalance Issue

During the Cold War, relative gains concerns of trade frictions remained muted, because the main concern of the U.S. was to ensure its ally's reliability and commitment to the alliance against the Soviet Union. However, with departure of the Cold War and the absence of the common threat, trade frictions apparently surfaced and left varied impacts on the alliance relations.

As already noticed, the US and Japan have had strong flows in both directions. Since significant economic interests underlie the trade relationship, conflicts over these issues have emerged from time to time. Throughout the 1980s, tensions between the US and Japan increased. But the nature of these conflicts changed dramatically the mid 1980s. The traditional pattern of conflicts was this: a rapid increase in a particular type of Japanese export to the US sets off an alarm. This causes a shift toward Japanese trade policy. Anti-Japanese sentiment in the US Congress increased considerably as the trade imbalance between the two nations grew rapidly from 1984 to 1987. Trade conflicts were no longer sectoral issues concerning specific Japanese exports; they are now

¹⁹ Takatoshi. Ito, Ibid., P.370.

²⁰ Abdul M. Turay, Ibid., P.11.

national issues involving the US-Japan political-economic relationship in general and threaten the durability of their security relations.²¹

In many cases, particularly before 1985, the question of the U.S.-Japanese trade imbalance is treated as a trade policy issue. The main issue in this context from a US perspective was whether or not Japanese trade behaviors and practices were fair. These “unfair”²² Japanese trade practices were attacked by many American observers and Congressmen. Some even advance the ‘scientific’ argument that the Japanese economic system was so foreign to Western capitalist thinking that the US accordingly has to formulate a drastically different trade approach to this alien economic system.²³ From Japanese point of view, the economic problem from which the US was suffering were generated within the American economy and have nothing to do with Japan’s economy; the US was only picking a convenient scapegoat while avoiding facing the real cause of its predicament. Whether these two arguments are too narrowly focused at best or is seriously misleading at worst, the discussion across the Pacific following these lines of pleas has become increasingly emotional and was fueled by nationalist sentiments.²⁴

Since 1970s, the series of trade imbalance has lain a more profound political problem, which was central to the capitalist world economy in the modern age. To

²¹ Takatoshi. Ito, Ibid, P.371.

²² Tsuyoshi. Kawasaki, “Structural Transformation in the US-Japan Relationships,” in Henry Bienen (ed.), Power, Economics, and Security, Colorado: Westview Press, Inc. 1992, P. 286.

²³ Karel. G. Van Wolferen, “The Japanese Problem,” Foreign Affairs, Vol. 65, No.2, Winter 1986- 1987, pp.288-303.

²⁴ Tsuyoshi Kawasaki, Ibid., 269.

understand such a hypothesis, we first have to grasp the multifaceted nature of the US-Japanese trade imbalance problem. The task of both countries was to correct their unbalanced bilateral trade account through trade, financial, exchange rate, fiscal and monetary measures.²⁵ These measures show that the US-Japan trade imbalance crisis was not so much about the disagreements on how to adjust the bilateral trade payment by the combination of these economic measures. Many issues were involved in the payments-correcting process, so the US and Japan inevitably faced the issue of how to manage the economic relationships in their entirety. This means that the issue was a trade-payment problem more than a trade problem. To recognize the trade-payment crisis, we should understand the fundamental issue, which has been raised repeatedly during the crisis: Which country- the US or Japan- would compromise its economic sovereignty in order to correct the trade-payment imbalance? In other words, which nation would change its domestic economic policy to correct the trade imbalance and bear the political and security costs such economic adjustment would entail. Actually, the problem of adjustment politically is crucial in both countries, particularly because the issue of macroeconomic policy in general and that of fiscal policy in particular goes right to the heart of their economic sovereignty.²⁶ This means that one of the two nations has to adjust its fiscal policy, but neither has been willing to do that because of strong domestic opposition.²⁷ What was evident is that adjustment to deepening interdependence has been anything but easy. The demise of an automobile factory or steel mill, the closing of a textile or consumer electronics firms, news pictures of

²⁵ Michael W. Donnelly, "On Political Negotiation: America Pushes to Open Up Japan," *Pacific Affairs*, University of British Columbia, Vol.66, No. 3, Fall1993. Pp. 344-345.

²⁶ Tsuyoshi.Kawasaki, *Ibid.* p. 286.

²⁷ *Ibid.* p. 286.

unemployed workers furiously smashing goods “made in Japan”: all are evidence that adjustment is not easy. Growing economic interdependence is not a neutral process, benign in all respects. While market forces push for greater interdependence, troubled firms and industries often turn to politics for relief from foreign competition or in search of support for their commercial activities in overseas markets. Both governments confront the economic and political burdens of adjustment. Democratically elected politicians are often tempted to impose the burdens of adjustment upon other nations, while maintaining as much economic and political flexibility as possible.²⁸

Another facet of the same issue is the attitude of economists and policy-makers toward adjustments in the economy.²⁹ This involves a juxtaposition of the quantity of potential gain with the quality of potential pain.³⁰ For example, when semiconductors were being illegally dumped in the US market in the mid-1980s, many US economists opposed enforcing US antidumping laws on the grounds that it was below normal prices. Of course, dumping tends to harm producers, but because the number of consumers was larger than the number of producers, it was argued that gain for the many outweigh the losses of the few. However, the gain for any single consumer may be only a few cents as opposed to the pain of the producer who may lose his entire livelihood. Clearly the quality of the gain and the quality of the pain are quite different.³¹

²⁸ Michael W. Donnelly, *Ibid.*, pp.332-333.

²⁹ Clyde V. Prestowitz, Jr, “Japan and the United States: Twins or Opposites?” in Joseph Nye, Jr. and David M. Rowe, (eds.), *Harness the Rising Sun*, Lanham: University Press of America, Inc.1993, p.87.

³⁰ *Ibid.* p. 87.

According to this argument, how the two countries look at the fiscal adjustment? For Japan, fiscal adjustment for the sake of US often has meant employing expansionary fiscal policy by further aggravating Japan's already large budget deficit.³² The Ministry of Finance (MOF) has long spearheaded an anti fiscal expansion campaign; the ministry has consistently been against over-expansionary fiscal policy. The situation has been similar in the other side of the Pacific. For the US, fiscal adjustment for the sake of Japan means at best implementing active fiscal policy but targeting a lower economic growth than that of Japan, at worst, it means implementing deflationary fiscal policy, including raising taxes. The US executive power has long perceived substantial tax increases as political suicide.³³ In each country, powerful domestic groups want the other country-but not their own country- to make fiscal adjustments. In analyzing this significant phenomenon of the US-Japanese trade-payment crisis, we find a fundamental political conflict between the two nations over the question of who should adjust. Neither nation is ready to do this. Yet at the same time, neither nation is willing to abandon economic transactions with the other. Accordingly, each country has to pursue the delicate policy of forcing the other to accept a partial erosion of economic sovereignty while avoiding the total breakdown of the bilateral economic relationship. This issue is not a new phenomenon for capitalist nations. It is the classical liberal issue of how to strike a balance between the two fundamental organizing principles of the capitalist world economy: domestic autonomy and international economic

³¹ Ibid. p. 87.

³² Tsuyoshi Kawasaki, Ibid., p270.

³³ Ibid.

interdependence.³⁴ The United States and Japan have had to resolve the clash of these two conflicting principles. Thus, the trade-payments crisis between the two nations was not a trade crisis as such but was a broader and deeper crisis inherent in the capitalist world system which appears as a political struggle for the defense of economic integration and interdependence between the two economies.³⁵

Thus far, as neoliberals emphasize, integration and interdependence have been playing a significant role in maintaining the US-Japan economic structure. It can be argued that in order to explain the continuing stability of the US-Japan economic relations, we must focus on the role played by the US-Japanese political-economic structure that the US established in the early postwar period. But before that, it is important to examine the dimensions involved in US-Japan frictions that show the fundamental principles of interactions between economics and politics and how the erosion of political framework could lead to redefine security alliance. Meanwhile, we will see the security alliance leave direct and indirect impact on cooperative efforts in trade and economic issue areas.

4.4. The Various Dimensions of Economic Frictions

Neorealists argue that shifts in relative economic capabilities are always difficult to accommodate. Neoliberals do the opposite. But, in the case of the US and Japan, the

³⁴ See Richard N. Cooper, The Economics of Interdependence: Economic Policy in the Atlantic Community, New York: McGraw-Hill, 1968; and Robert Giplin, The Political Economy of the International Relations, Princeton: Princeton University Press, 1987.

³⁵ Tsuyoshi Kawasaki, *Ibid.*, p270.

two nations share a very complicated history of cooperation, conflict, war and racial hatred. Since the end of World War II, elites on the US and Japan have had profoundly different conceptions regarding their own nations, including responsibilities, roles and status in international affairs. Operating with very different global-strategic assumptions, national differences also exist regarding how best to shape the relationship between domestic and world markets. Variations in national values, economic ideology, institutional structures, geographical place, patterns of trade and investment, and business structures and practices make the transition towards more interdependence all the more difficult.³⁶

4.4.1. The Domestic Dimensions and Constraints

The pattern of trade conflicts, in which the U.S. makes demands and Japan concedes, can be understood as the result of domestic constraints in both countries. It is crucial to understanding the US-Japan trade conflict to realize that the problem is in fact macroeconomic and structural. Neorealists saw the growing trade friction between Japan and the US not as a temporary problem that would soon disappear but as a lasting, structural problem that requires the highest-level of attention in Japan and in the US.³⁷ Otherwise economic conflicts would threaten the durability of the alliance or even undermine it. Therefore, it is important to examine economic structures and trade patterns of both nations.

³⁶ Michael W. Donnelly, *Ibid.*, P.334.

³⁷ Nigel Holloway, "US-Japan Ties Survive Yet Another Trade Clash," *Far Eastern Economic Review*, October 13, 1994, P. 18.

4.4.1.1. Structural Differences

According to the structural differences between the two economies, neorealists argue that the U.S.-Japan economic relationship will always be a contentious one. The industrial output of the two countries is similar and they compete across a wide range of goods and services. However, the two countries' economies have been structured to achieve very different goals. For the US the strategy has been to create the world's greatest consumer society, while for Japan the goal has been to rebuild its economy after the Second World War by promoting production.³⁸

From liberal point of view, the root difference between the Japanese and U.S. economies is in their overall objectives.³⁹ In the US, the purpose of US economic structures and policy is to improve the welfare of the consumer.⁴⁰ Because it is much easier to measure this welfare of the short term than in the long term and because anything less than maximum short-term consumer benefits might be seen as harmful to the consumer, there is a strong bias in the US toward running the economy for the purpose of providing maximum consumer benefits at all times. Thus, an adversarial relationship between consumer and producer is fostered. Moreover, while the US recognizes the need for certain strategic military industrial capabilities, its explicit policy throughout the Cold War period has been to separate security from economic

³⁸ See, C. Fred Bergsten, and Marcus Noland, Reconcilable Differences? United States-Japan Economic Conflict, Washington DC: Institute for International Economics, 1993, pp. 2121-213; See also Lawrence B. Krase, The U.S.-Japan Economic Relationship?, San Diego: University of California.

³⁹ For details on economic behavioral patterns of both countries see Karen A. Holgerson, U.S.-Japan Trade Friction, Aldershot/ England: Ashgate Publishing Limited, 1998, pp. 64-81.

policy.⁴¹ This has been particularly true in the period when Japan, having renounced armed forces in its constitution, has defined its national security almost entirely in economic terms.⁴² An expression of this is Ministry of International Trade and Industry's "vision of Japan for the 1990s,"⁴³ which speaks of achieving technological autonomy and bargaining power with other nations through technological and industrial leadership. This security focus along with the basic view that consumers would have nothing to consume unless their product has led Japan to emphasize production rather than consumption as the main purpose of its subsidizes consumption and taxes investment and production, Japan does the opposite. There is, of course, implicitly an adversarial leadership between Japanese producers and consumers just as there is one in the US, but in Japan the history of rapidly rising consumption is seen as a consequence of emphasizing production, and a widespread consensus effectively dampens the potential conflict.⁴⁴

4.4.1.2. The U.S.-Japan Pattern of Trade

The economic relationship between the US and Japan goes far beyond the aggregate trade and financial relationship. The issue of the composition of output and the attendant issues of how a government promotes or restricts production in particular sectors are

⁴⁰ Richard Grant. *International Affairs*, Vol. 70, No. 3, July 1994. p. 552.

⁴¹ Prestowitz, Jr, Clyde V. *Ibid.*, 82.

⁴² See Yoshida Doctrine.

⁴³ Prestowitz, Jr. *Ibid.* p. 82.

⁴⁴ *Ibid.* pp.28-83.

issues for microeconomic analysis. This section analyzes the policies and institutions in both countries that effect the sectoral composition of trade.⁴⁵

Available technology, the quantity and quality of productive factors, and institutional organization all have impact upon the composition and competitiveness of the US and Japanese economies. Yet the US-Japan trade pattern is not solely a function of these market fundamentals. The governments of both countries intervene in the market in a variety of trade. Government involvement in the market tends to generate rents, and with them a set of incentives for firms to pursue these rents and the relevant bureaucracies to enlarge them. Government intervention can also encourage oligopolies.⁴⁶

4.4.1.3. Philosophy of Economic Structure

Different objectives have given rise to two dramatically different philosophies with regard to the structure of the economy. Because the US does not concern itself much with production, it has no view as to what should be produced and adopts a largely laissez-faire attitude toward structure.⁴⁷

⁴⁵ Paula Stern, and C. Fred Bergsten, "A New Vision For United States-Japan Economic Relations," in Joseph Nye, Jr. and Rowe, David M. (eds.), Harness the Rising Sun, Lanham: University Press of America, Inc. 1993, P.59.

⁴⁶ Ibid. p. 59.

⁴⁷ Richard Cronin, Japan. The United States, and Prospects for the Asia-Pacific century: the Scenarios for the future, Singapore: Institute of Southeast Asian Studies, 1992, P.91.

Since the time of the Meiji Restoration,⁴⁸ the Japanese “were concerned with such questions as establishing those industries which one might conveniently call strategic.”⁴⁹ In the postwar period they have emphasized development of capital intensive, high technology, high value added industries and have passed legislation and pursued industrial policies explicitly aimed at gaining leadership key industries. As the Ohira economic study group mentioned in their study⁵⁰, the Japanese government is an integral part of the “collegial groups” that constitute the Japanese economy, and its role in assuring an optimum structure for the Japanese economy is critical. Thus the development of economic “vision” and the use of administrative guidance to achieve them are among the most important activities of Japanese policy-makers. This is in stark contrast to the US view that government should not be involved in any way in picking winners and losers.”⁵¹

In primary products and in mature, non-high-technology manufacturing, both Japan and the US intervened in a fairly transparent way to protect politically influential declining industries. In high-technology manufacturing and in services, government intervention took the form of industrial support or regulatory control, and the

⁴⁸ *Meiji Restoration* refers to the period the Japanese young emperor Meiji who reigned from 1868 until 1912, a time period called the Meiji Period or the Meiji Restoration. Meiji was able to convert the entire country of Japan from a feudal state into an industrialized world power in less than half a century. Policies such as the formation of a centralized bureaucracy replacing the balance of power between autonomous domains and the Tokugawa, and the military authority of the Samurai being replaced with a conscripted modern army were both assumed under Meiji's reign.

⁴⁹ Clyde V. Prestowitz, Jr, *Ibid.*, P. 83.

⁵⁰ An economic study group appointed by the late 1970s by Japanese Prime Minister Masayoshi Ohira to analyze the secrets of Japanese success for the purpose of being able to provide better advice on the management of economy in the future.

⁵¹ Clyde V. Prestowitz, Jr, *Ibid.*, 83.

relationship between business and government created a far more complex political and economic terrain in which trade competition was played out.⁵² In these sectors, trade disputes typically took the form of complaints by US producers that Japanese public policy and private practices excluded them from what were essentially cartelized markets. These firms then enlisted the US government to assist them in playing open the market, and this foreign pressure or *gaiatsu* inevitably became entangled with the politics of regulatory reform in Japan.⁵³ Understandably, the response in Japan is often to co-opt the complaining foreign firm or firms, to minimize disruption to the status quo. This often suits the interests of the new entrants, since they too came to enjoy the benefits of Japan's cartelized markets. This set up a dynamic in which the US government was used as a lever to gain market entry, but as soon as entry was achieved, the government was encouraged to cease its liberalization pressures. This "privatization" of US trade policy posed important questions as how the US should define and prioritize its national interests in its relationship with Japan. Are US interests adequately served when a few US firms succeed in seizing a share of their rents, or only when the US government pursues true liberalization to the point of opening markets to all firms?

As known, the law of comparative advantage holds a country's pattern specialization is determined by the relative productivity rankings of its various industries. The two sets of rankings are more or less consistent: the US is relatively more efficient than Japan in natural resources- based manufacturing, and relatively less

⁵² G. Fred Bergsten, *Ibid.*, Pp. 59-60.

⁵³ *Ibid.*, p. 60.

efficient in the machinery industries.⁵⁴ These relative efficiencies are in turn determined by a number of factors: available technology, the quantity and quality of inputs, the degree of competition prevailing in the sector, openness in international trade, and so on.⁵⁵

Already by 1980, Japan's stock of physical capital per worker exceeded that of the US by a considerable degree, and the margin widened over the course of the decade. At the same time, Japan's human capital per worker was catching up to that of the US. Furthermore, since Japanese workers work longer than their US counterparts, Japan's physical and human capital has been applied more intensively than United States' capital. Balassa and Nolond (1988)⁵⁶ found that the rate of total factor productivity growth (the increase in overall productivity, taking increases in factor inputs into account) in Japan has been more than twice that of the US. This finding was undoubtedly due, at least in part, to Japan's continued exploitation of opportunities for technology catch-up and the more recent vintage of its capital stock.⁵⁷

These developments are reflected in the trade pattern of each country. The econometric analysis of Balassa and Nolond (1989) demonstrated that Japan has transformed itself from a country specializing in labor-intensive manufactures in the

⁵⁴ R. Jrant, "Trading Blocs or Trading Blows? The Macroeconomic Geography of US and Japanese Trade Policies." *Environment and Planning*, Vol. 25, A 1993, P. 275-279.

⁵⁵ Ibid. P. 272-275.

⁵⁶ Bela Balassa and Marcus Nolond, *Japan in the World Economy*, Washington: Institute for International Economics, 1988.

⁵⁷ G. Fred Bergsten, Ibid., P. 62.

1960s to one specializing in physical and human capital-intensive manufactures in the 1980s.

4.4.2. The Major Changes in the International Economy Since 1985

4.4.2.1. Plaza Agreement

Although U.S. alliance officials resisted domestic pressures to link trade and security issues, readjustments in the U.S.-Japan economic relationship during 1985 had important repercussions on the trade issues. On September 22, 1985, ministries of the Group of Five (G-5)⁵⁸ - the US, Japan, Germany, the UK, and France - gathered at the Plaza Hotel in New York to devise a plan to down the value of the U.S. dollar. The announcement by the G-5 that they regarded the dollar as overvalued and that they would take measures to correct the overvaluation created strong selling pressure on the dollar as soon as the market opened on September 23. This was the beginning of the dollar overvaluation. The yen appreciated from 240 yen/dollar just before the G-5 meeting to 150 yen/dollar nine months later. This 60 percent change in the value of the yen was the largest in magnitude in the yen's history.⁵⁹ The weekend of the Plaza Agreement is very illustrative of how the exchange rates response to the news. Despite such measures, the U.S. trade imbalance with Japan worsened. As a result, some members of Congress began calling for increased Japanese imports of U.S. goods particularly military equipment in order to remedy the trade imbalance and burdensharing inequities. The Plaza summit took place in a unique economic and

⁵⁸ G5 became Later on known as G7 and after the adherence of Russia it became known as G8.

⁵⁹ Takatoshi Ito, Ibid. p. 343.

political context. There were several factors that made this accord very important, including the void left by the collapse of the Bretton Woods system, and the overvalued dollar.

During the five years preceding the Plaza agreement, the value of the American dollar continued to rise. In fact, from June 1980 to March 1985, the dollar appreciated 60 percent.⁶⁰ One of the reasons the dollar rose so sharply was simply that the Reagan administration believed strongly in fiscal expansion. In fact, President Reagan claimed, "The strong dollar is a reflection of America's economic strength."⁶¹ This policy of economic growth had the effect of fueling the budget and trade deficits of the United States. Therefore, one of the aims of Plaza was to convince the U.S. to work on its twin deficit problem. Another cause of the high dollar was a large amount of foreign investment that accounted for the sale of many American dollars.

Until 1985, the US policy line had been that the strength of the US economy had created a strong dollar and high interest rates. But after America's economic problems increased in 1985, the Reagan administration began to insist that 'a strong US economy has not brought with it high interest rates and a strong dollar; rather, these high interest rates and the dollar's strength were weakening the US economy as industries in the US lost international competitiveness.'⁶²

⁶⁰ Robert Gilpin, 1987, *Ibid.*, P.156.

⁶¹ Roland Reagan, "Remarks at a White House Meeting with Business and Trade Leaders," Public Papers of President Reagan, Vol.2., 23 September 1985., Washington DC: GPO, 1988.P. 1053.

⁶² Yoichi Funabashi, Managing the Dollar: From the Plaza to the Louvre, Washington DC: Institute for International Economics, 1988, P.65.

To alleviate the problems of the US firms in trouble in overseas markets, US treasury officials browbeat the other finance ministers of the G-5 countries, principally the Japanese, into agreeing to co-operate in devaluing the dollar against the yen and other currencies.

Conflicts between the United States and Japan arose not only over the appropriate strategy to advance at Plaza, but also over economic policy in general. In the United States, for example, the protectionist Congress was reluctant to see the dollar depreciate, since this was politically unpopular. However, the Treasury Department saw the monetary benefits of letting the dollar depreciate relative to the currencies of America's trading partners. In Japan, similar internal disagreement reigned. Various political factions had different ideas about how Plaza would fit into the overall Japanese economic goals.

But the conflict at Plaza was most salient between the U.S. and Japan, probably because these two countries were the most involved in the negotiations. Of particular importance was the trade imbalance, whereby Japanese exports to the U.S. greatly exceeded its imports of American products.⁶³ When the U.S. urged Japan to fuel domestic demand so American imports into that country would increase, the Japanese reaction was hesitant. Japan's representatives at Plaza argued that the difficulty rested

⁶³ Funabashi. p. 88.

with the American budget deficit and unrestrained economic activity, and that the solution was for the U.S. to correct these problems.⁶⁴

In general, coordination at Plaza was rendered difficult by many seemingly obvious factors, such as differences in the individual nations' economic institutions, contrasting personalities of the actors, and pressure from outside political and private groups.⁶⁵

A. Liberalism and Nationalism

From a theoretical standpoint, the most salient and underlying conflict surrounding the Plaza agreement was the struggle between neorealist perspective of economic nationalism and free market mechanisms of liberalist perspective. Here we take economic nationalism to refer to any policy that is protectionist and self-serving to the country that propagates it.

Plaza represented an attempt to deal with the novel interdependence of the world. In this economic realm as well as in others, countries had difficulty renouncing their national sovereignty over policy to multilateral leadership, if only because this was a new need. When we examine Plaza in this context, we understand why the transition from national autonomy to international coordination was a source of such conflict as neorealists emphasize.

⁶⁴ Gilpin, 1987, *Ibid.*, P.163.

⁶⁵ Wendy Dobson, *Ibid.*, 26.

The case of Japan provides an illustrative example of mercantilism getting in the way of policy coordination. In an effort to build up their economy during the Bretton Woods period, the Japanese acted according to traditional realist explanation and designed self-sufficient economic policies that isolated Japan from the rest of the economic world.⁶⁶ Thus, classical perspective of isolation was a prime policy Japan intended to adopt. At Plaza, the Japanese were finally willing to leave this nationalistic policy behind. However, mercantilistic vestiges remained - Japanese landowners and small business proprietors preferred the closed system.

Likewise, the U.S. struggled with issues of national autonomy versus coordination. For the neoliberals, Plaza marked a shift in policy in favour of joint, rather than unilateral, strategy.⁶⁷ This new position was strongly opposed by many neorealist Americans, particularly members of Congress, who espoused a protectionist, "America First" view.

The fragility of this transition from self-centered economic policies to cooperative ones was evident in the mutual suspicion among the G-5 members that the countries would succumb to mercantilist pressures. For instance, the European and Japanese actors at Plaza feared that the Americans were not seriously committed to the

⁶⁶ Hopmann. Ibid. 4/13.

⁶⁷ Richard C. Marston, "Exchange Rate Policy Reconsidered," in Martin Feldstein (ed.), International Economic Cooperation, Chicago: U of Chicago, 1988, P. 106.

intervention effort.⁶⁸ Also, the participants' skepticism came through when they scheduled the Tokyo and Paris follow-up meetings. These post-Plaza conferences were intended to assure the G-5 that the countries had lived up to their promises. Another goal of the Tokyo summit was to monitor national policies to ensure that they were in accordance with the general good.

B. Politics and Economics

As we have seen, political factors were clearly imbedded in the Plaza negotiations. Domestic political conflicts and specific political cultures influenced both the unfolding and the outcome of Plaza. Both the Japanese and the Americans were hesitant to relinquish national control over economic issues to international scrutiny.⁶⁹ This might be understood as a move to deal with the issue in accordance with neorealist explanation. These Plaza actors were concerned about the legislative response to this shift. In the U.S., the conservative Reagan administration had a history of "benign neglect", and the Congress was overwhelmingly in favour of limiting trade. The US and the other Plaza participants had to take these powerful views into account.

Although Plaza marked the advent of multilateral economic management as neorealists argue, the U.S. was still the economic and political hegemon at this time, and the Plaza actors knew it. This political culture thus fueled their dominating behavior at

⁶⁸ Yoichi Funabashi, *Ibid.*, P.10.

⁶⁹ Joan Edelman Spero, *Ibid.*, 61

Plaza. For example, underlying the U.S. strategy at Plaza was the view that America's trading partners needed to adjust their economies to keep up with those that of the U.S.⁷⁰

A major political difficulty of coordinating economic policies lay in the neorealist view that every country wanted to enhance its national interests through achieving a trade surplus. Having a large export market brings economic and technological benefits, as well as higher employment.⁷¹ These are very important for the domestic welfare and national security goals. Plaza was the occasion for the U.S. and Europe to tell Japan that they felt the Japanese were benefiting too much from its trade surplus. One of the goals of Plaza, therefore, was to establish an international trade balance.

4.4.2.2. The Target Zone and the Criticism of the Floating-Exchange-Rate Regime

The U.S.-Japan conflicts over trade and monetary issues in Plaza were difficult to be solved. However, the alliance officials were concerned that the continuation of the conflicts would affect the durability of the US-Japan security alliance. Thus, both governments realized that there was a common interest to solve their issue areas, and therefore they reached joint agreements to reduce the negative effects of mercantilist policies. This indicates that when the maintenance of the alliance depends upon solving economic and trade issues, both governments had to sacrifice part of their interests to maintain the alliance. This institutionalist characteristic of the alliance shows that the

⁷⁰ Gilpin, *Ibid.*, P.164.

⁷¹ *Ibid.*, P.163

alliance served as a political framework to facilitate cooperation in economic and trade issue areas.

Before the floating-exchange-rate regime began, many economists thought that floating rates would restore the independence of domestic policies, since exchange rates would automatically equilibrate the trade balance. As the fundamental factors that determine the exchange rate moved, the exchange rate was supposed to adjust to a new equilibrium.⁷² The developments of the late 1970s and the early 1980s showed that this view was mistaken. A more serious challenge to the floating exchange rate came in the first half of the 1980s. Because of the combination of tight monetary policy and loose fiscal policy in the US, the dollar appreciated significantly from 1981 to the beginning of 1985.⁷³

As a result of the dollar overvaluation, the trade balance of the US worsened sharply. Hence, neorealists in both sides realized by the mid 1980s that a floating-exchange-rate system neither automatically maintains a trade-account balance nor prevents short-term volatility. But in the modern world of capital market integration, it is difficult to go back to the fixed-exchange-rate system. Under this circumstance, a proposal was made under which the governments of the G 7 countries would agree on

⁷² Giovanni Arrighi, *The Long Twentieth Century: Money, Power & the Origins of Our Times*, New York: Verso, 1994, pp. 310-311

⁷³ Takatoshi Ito, *Ibid.* p. 349.

central exchange rates and bounds around them, and then make a commitment to keep exchange rates within the bounds.⁷⁴

Hence, the idea of target zone appeared after the Miyazawa-Baker agreement of October 31, 1986. At the Group of Seven meeting of April 8, 1987, or sometime around it, the target zone must have been changed to reflect the new reality. When intervention cannot prevent appreciation and when no drastic change in fundamentals (such as the interest rate) is possible, the target zone should be rebated. Although target zone gave a reference range, the zone was rather "soft".⁷⁵ The range has been revised when it has not been defended easily. The existence of the zone was not announced officially. Hence, the experience since 1986 has been an ongoing experiment and the result of the experiment has not been established.

4.4.3. Trade Policy Initiatives Since 1988

Although few can agree on the reasons for Japan's economic success, and its impact on the US, many believe that, first, the condition of the US economy is primarily the result of actions taken in the US and will be in the future and second, despite the substantial opening of the Japanese economy that has occurred in the beginning of the last decade, the Japanese market remains by many important measurements closed to foreign goods

⁷⁴ Ibid. P.350.

⁷⁵ Ibid. P.355.

and services compared with the US economy and, from the American point of view, this should be corrected.

American revolutionists particularly in the Congress suggested that the US should deal with Japan according to neorealist explanations, which meant that the US had to enforce Japan to open its market and increase its burden. However, this behavior was not rational because it could undermine the alliance. Both Americans and Japanese thought that the issue areas could be solved through intensive negotiations at bilateral and multilateral levels.

This section focused on the specific trade policy initiatives that have been undertaken by the United States and Japan to improve access to the Japanese market. This objective was pursued through a three-pronged approach of multilateral, sectoral, and structural initiatives.

4.4.3.1 Multilateral Trade Negotiations

When the Bush administration came into office, trade tensions with Japan were near an all-time high. High deficits coupled with continuing allegations from US business group interests about the closed nature of the Japanese market were resulting in serious domestic political pressures for improved access to the Japanese market.

A. The Uruguay Round

In the Uruguay Round, negotiations covered four broad categories: agriculture; market access (e.g., traditional tariffs, non-tariff measures, textiles, and tropical products); the new issues of intellectual property rights, services, and investment; and the issue of the reform of GATT rules (e.g., those covering safeguards, balance of payments,⁷⁶ subsidies, antidumping, and dispute settlement).

At the political level, the government of Japan was an active participant in and supporter of the numerous Group of Seven (G7) economic summit declarations made announced in 1990, 1991, and 1992 that underscored the shared commitment of the G7 leaders to the successful conclusion of the Uruguay Round.⁷⁷ Including more than 100 countries, the Uruguay Round was unquestionably the most ambitious overall trade initiative pursued by the Bush administration. Although the Round made important contributions to the world trading system and to certain trade issues with Japan, the constraints faced in Japan tend so often to go beyond matters that are fully addressed by GATT system. (GATT was replaced by WTO).

B. Sectoral Negotiations

Sectoral trade negotiations are what trade officials usually do for a living, and the history of US-Japan trade relations has witnessed a seemingly constant stream of

⁷⁶ *Balance of payments* is an accounting concept to track the international economic transactions of states including inflows and outflows. It includes export and import of goods and services (balance of trade), capital investment and other invisible financial flows, and gold or other financial reserve transactions.

⁷⁷ Merit E. Janow, "Trading with an ally: Progress and Discontent in U.S.-Japan trade Relations," in Gerald L. Curtis (ed.), *The United States, Japan, and Asia*, New York: W.W. Norton and Company, 1994, p. 85.

sectoral negotiations. The 1988-92 period brought the negotiation and conclusion of thirteen new bilateral agreements with the government and numerous other undertaken by the Japanese government through bilateral negotiations.⁷⁸ During these negotiations, alliance officials intervened in order to reach sectoral agreements because they realized that the continuation of the conflict could seriously affect their security alliance.⁷⁹

The sectoral negotiations have been the most obviously successful part of the Bush administration's Japan trade agenda, although the sectoral agreements have not been uniformly successful, and specific improvements are often difficult to measure. By the end of the year 1992, serious questions were being raised about the Japanese government's implementation of the supercomputer and construction agreements, and continuing concerns remained regarding autos and auto parts, glass, legal services, paper products, and semiconductors, among others.

C. Super-301 and Structural Impediments Initiative

As mentioned before, after the tensions between the US and Japan increased, especially after the mid-1980s, anti-Japanese sentiment in the US Congress increased considerably.⁸⁰ Trade conflicts were now national issues involving the US-Japan political-economic relations in general. The change was symbolized by a resolution passed by the US Senate in March 1985 naming Japan as an unfair trading partner. In April 1987, the US announced that Japan was found to have been violating the

⁷⁸ Ibid. P. 60.

semiconductor agreement of 1986 and decided to impose retaliatory tariffs on various Japanese products. Despite improvements in the area of imports and overall trade, the political relationship between the US and Japan soured in 1988. Critics in the US continued to dwell on Japan's failure to increase imports, and some Japanese became irritated by what they interpreted as US bullying of Japan. In the summit of 1988, the Omnibus Trade and Competitiveness Act of 1988, the result of efforts put forth by congressmen over several years, was signed into law by President Reagan. The act contained the "Super-301" clause, which strengthened section 301 of the Trade Act of 1974. Under the new legislation, the US Trade Representative (USTR) can name countries as unfair trading partners. In May 1989 the USTR designated Japan as an unfair trading partner, along with India and Brazil, under the Super-301.⁸¹

Although the outcome of the 1989 Super-301 designation was less dramatic than had been feared, the episode left a significant mark on the recent history of US-Japan trade conflicts clause and it showed that the U.S. was willing to punish Japan unless it conduct important reforms to adjust.

It is notable that talks on the Structural Impediment Initiative between the US and Japan took place in parallel with the super-301 developments of 1989.⁸² The SII was

⁷⁹ U.S.-Japan Joint Report on Sectoral Discussions, January 10, 1986, in Department of State, Bulletin, march, 1986, p. 32.

⁸⁰ Karen M. Holgerson, *Ibid.* p. 77.

⁸¹ Takatoshi. Ito, *Ibid.*, p. 375.

⁸² Both sides announced the initiative (SII) in a joint statement on July 14, 1989; see American Foreign Policy: Current Documents, 1989, p. 541.

the broadest bilateral initiative between the US and Japan.⁸³ The SII was started in July 1989 to identify and solve structural problems that restrict bringing two-way trade between the U.S. and Japan into better balance. Both the U.S. and Japanese governments chose issues of concern in the other's economy as impediments to trade and current account imbalances. The areas, which the U.S. government chose as focus, included:

(a) Japanese savings and investment patterns, (b) land use, (c) distribution, (d) keiretsu (large groups of companies linked by cross shareholdings).⁸⁴ (e) exclusionary business practices, and (f) pricing. Areas which the Japanese government chose to focus upon included: (a) U.S. savings and investment patterns, (b) corporate investment patterns and supply capacity, (c) corporate behavior, (d) government regulation, (e) research and development, (f) export promotion, and (g) workforce education and training. In a June 1990 report, the U.S. and Japan agreed to G7 meetings in the following three years to review progress, discuss problems, and produce annual joint reports.⁸⁵ The SII talks was unique in the history of US-Japan negotiation in that Japan also pointed out what the Japanese see as problems of the US- for example, a lack of saving, a lack of worker training, and a deficient educational system. This aspect, however, was not publicized in the US. The result of SII for the US commercial interests are perhaps the most difficult to evaluate. One can identify numerous specific changes in Japanese law regulations, government practices, and even the nature of public discourse in Japan that would not have occurred but for SII. Actually, criticisms of Japan have provided a convenient

⁸³ Merit E. Janow, *Ibid.*, P. 67.

⁸⁴ Peter Tasker, "The Revisionists' Last Stand," *Far Eastern Economic Review*, Vol. 157, No. 28, July 14, 1994. P.24.

⁸⁵ Joint Report of the U.S.-Japan Working Group on the Structural Impediments Initiative, Tokyo, June 28, 1990, in *American Foreign Policy*, 1990, p. 712.

scapegoat in the US political arena and have served as much-needed “foreign pressure” [gaiatsu] to persuade Japanese vested interest groups to give in to deregulation proposal in Japan.⁸⁶

The Advisory Committee on Trade Policy and Negotiations (ACTPN) report recommended that where invisible barriers to trade exist, both countries should develop and use “temporary quantitative indicators” (TQIs) to measure progress toward achieving an open market. The report argued that such indicators would be used as tools for both countries to simulate market conditions, and should be mutually arrived at and eliminated once imports reached identified levels. Failure to reach such benchmarks would result in internal US government review and bilateral discussions to determine necessary actions. Retaliation is identified as one possible action.⁸⁷ In April 1993, the US trade representative (USTR) has stated that he will initiate trade actions against Japan under section 301.⁸⁸ Most important, President Clinton and Prime Minister Miyazawa called, in April 1993, for the negotiation of a broad based new framework for US-Japan economic relations. The Framework Agreement identifies necessary improvements in macroeconomic outcomes and areas of sectoral or structural problem. It contains commitments on macroeconomic policies, outlines and agenda on bilateral sectoral and structural negotiations, and outlines a timetable and structure for further meetings, which include meetings twice a year between the heads of governments.

⁸⁶ Statement by the U.S.-Trade Representative (Hills), April 25, 1990, in United States-Japan Trade Relations: Hearing Before the Committee on Finance, United States Senate, One Hundred First Congress, Second Session, Washington, DC: 1990, pp. 12-14.

⁸⁷ See Major Findings and policy Recommendations on US-Japan Trade Policy. Report of the (ACTPN), January 1993.

During the negotiations, the two parties faced difficulty of what to do with the legal status of the Framework and future agreements negotiated under it.⁸⁹

As usual, the government of Japan wanted an explicit exemption from US trade laws. This was rejected by the US government, although some accommodation to Japanese concerns appears to be reflected in language of the Framework that states that both sides intend to use the Framework as the principal means for addressing the various bilateral issues between the US and Japan. In public side letters, Ambassador Kantor stated that the US government reserved its right to use trade laws as it saw appropriate, and Ambassador Takakazu Kuriyama, the Japanese ambassador to US, stated that the Japanese government reserved its right to withdraw from any negotiation or nullify any measures it had previously agreed to if the US invoked its trade laws. Thus the Framework does not foreclose any number of approaches that might be available to policy makers in either country.⁹⁰

By the end of 1994, after 15 months of diplomatic capping, the US and Japan were able to announce that there would be no trade war between them. But the agreement was only partial and left the toughest nut Japan's auto-parts market still to be cracked. The unresolved issue of access to Japanese market, especially car market, however, remains the key source of friction.⁹¹

⁸⁸ Nigel Holloway, "U.S. Threatens Japan With Sanctions Over Procurement," *Far Eastern Economic Review*, August 11, 1994. P. 69.

⁸⁹ U.S. Trade Representative, *National Trade Estimate Report on Foreign Trade Barriers*, Washington, DC: 1993, p. 143.

⁹⁰ *Far Eastern Economic Review*, October 13, 1994, p. 18.

⁹¹ Nigel Holloway, *Ibid.* p. 69.

The United States decision to launch a year-long investigation (under Section 301 of its 1988 trade law) of Japan's imports of auto parts nevertheless promoted an indignant reaction if the investigation substantiates U.S. complaints, as "totally inconsistent with the objective of maintaining free trade."⁹² From these interactions between the US and Japan, we remark that despite the latest compromise, the two countries remain deeply suspicious of each other on trade.

4.5. The U.S.-Japan Economic Structure

By "structure" here is meant elements of the economic relationship which, over a period of time, have been relatively stable and enduring: the division of labor and location of economic activities; holdings of monetary assets and control of capital movements; the flow of trade; competitive position and market shares held by firms in various industries; the source of scientific and technological invention especially with relevance to industries of the future; the role of the dollar and the yen; and the norms governing economic exchange.⁹³

The initial proposition is that the bilateral economic relations is rooted in difficulties faced by politically divided governments of two economically interdependent but competitive and structurally different economies over how to deal with economic and political adjustments at a time when "in relation to each other, Japan

⁹² Nigel Holloway, "US -Japan Ties Survive Yet Another Trade Clash," Far Eastern economic Review, October 13, 1994, P. 18.

has gotten richer and the United States has gotten poorer.”⁹⁴ The US-Japanese economic structure consists of two specific economic relationships between the US and Japan- one in the trade relations and the other in monetary relations. This structure refers to a set of the two structural situations in which, first, Japan is dependent on US markets for its exports, and second, the US dollar is the dominant currency used in US-Japanese economic transactions.⁹⁵ After the end of Pacific War, Japan had lost its access to China’s huge markets and rich natural resources. When Japan regained its independence in 1952, it was literally cut off from its formal trade ties in Northeast Asia, which had been considerable in its prewar world trade.⁹⁶ Without natural resources, Japan had to survive economically. To do this, Japan had to import natural resources and export manufactured goods. But the question again, who could supply such resources and market access to Japan?

Actually the US economic assistance to Japan until 1951 intended to contain the Japanese economic to a bar minimum, but with the emergence of the Cold War and the breakout of the Korean War, the US began to help reconstruct Japanese industry in earnest.⁹⁷ The US, now the sole protector of Japan and determined to rebuild the Japanese industry for its global anticommunist strategy, had to face these critical questions. The US perceived their Cold War strategy in East Asia not only in purely

⁹³ For details see the discussion by Robert Gilpin, 1987, *Ibid*.

⁹⁴ Ellen I. Frost, *For Richer For Poorer*, New York: Council on Foreign Relations, 1987, p. ix.

⁹⁵ Tsuyoshi Kawasaki, *Ibid.*, P.271.

⁹⁶ Warren S. Hunsberger, *Japan and the US in World trade*, New York: Harper and Row, 1964, p. 184, Table 7-1 and p. 185, Table 7-2.

⁹⁷ Issei Nomura, *Japan’s Foreign Policy*, Kuala Lumpur: University of Malaya, 1997, P. 39.

military terms but also in political-economic terms. From the US point of view, the issue of Japan's economic recovery was essentially geostrategic in nature.⁹⁸ In specific terms, the US had two major policy targets. The first was to secure the supply of natural resources to Japan, particularly oil.⁹⁹ The second policy goal was to find export markets for Japanese industrial products. The US became the alternative to the prewar Northeast Asian markets. For the sake of Cold War strategy, the Eisenhower administration was ready to open US markets to Japanese products, despite opposition from competing US domestic industries.¹⁰⁰ The Allied Occupation ended in 1952, the Cold War was at its zenith. Japan depended on the US for its security from nearby menacing communist powers. The Japanese economy was still weak and highly dependent on US technology and markets.¹⁰¹

This basic character of Japanese dependence on US markets has remained essentially the same throughout the postwar period. The America's markets have been important for Japan as export markets-partly because Japan has to earn the dollar in order to pay for its imports. This means, in the perspective of the US-Japanese economic structure, it is not so much that Japan needs to export for its economic growth as that

⁹⁸ H. W. Brands, Jr., The US and the Reemergence of Independent Japan, *Pacific Affairs*, Vol. 59, No.3, Fall 1986, pp. 387-401.

⁹⁹ John Welfield, *An Empire in Eclipse: Japan in the Postwar American Alliance System*, London: Athlone Press, 1988, p. 97.

¹⁰⁰ Tsuyoshi Kawasaki, *Ibid.*, P.272.

¹⁰¹ Ezra F. Vogel, "Japanese-American Relations after the Cold War," in *Harness the Rising Sun: An American Strategy for Managing Japan's Rise as a Global Power*, Lanham: University Press of America, Inc., 1993, p.166.

Japan needs to export to pay for its imports since their imports mostly are denominated in the dollar.¹⁰²

In brief, in a long-range international perspective Japan's export drive was an imperative result of the fact that imported natural resources are denominated in the dollar. To understand this issue, it is necessary to examine postwar US-Japan monetary relations.¹⁰³ The yen was the dominant currency for economic transactions within Japan Empire before the Second World War. The yen bloc was shattered by the Pacific War. When Japan regained its independence in 1952, it was integrated into the dollar bloc. The dollar has been a linchpin of postwar US foreign policy. With the privilege of issuing the key currency the US could easily finance its hegemony role. The dominant global position of the dollar has given the US the privilege of holding unusually large current account deficits that do not have to be balanced immediately, and this privilege in turn has allowed the US to pursue active Cold War diplomacy in both military and economic realms.¹⁰⁴

In contrast to West Germany policy,¹⁰⁵ to challenge the US dollar as the key currency, Japan has shown no sign of challenge to the dollar's key currency in the US-

¹⁰² Tsuyoshi Kawasaki, *Ibid.*, P.273.

¹⁰³ *Ibid.*

¹⁰⁴ Joanne Gowa, Closing the Cold Window: Domestic Politics and the End of Bretton Woods, Ithaca, N. Y. CONELL University Press, 1983, p. 63.

¹⁰⁵ West Germany was drawn decisively into the orbit of the dollar in 1967 when the US threatened to withdraw its military commitment to West Germany unless that country continued to support the dollar. From their 1930s experience, the Germans loathed inflation, and holding the dollar_ as opposed to gold which France preferred _ had a significant inflationary effect on the German economy. Despite this, West Germany_ the frontline nation against the Soviet threat_ had to make a concession to the US pressure for its security interest. See C. Fred Bergsten, The Dilemmas of the Dollar: The Economics and Politics of United States International Monetary Policy, New York: New York University Press, 1975, pp. 65-79.

Japanese alliance. During 1970s, Japan basically took the dollar's dominant status as a given condition for its economic transactions with the US. In the mid-1980s, Japan's passive support for the dollar's dominant began to take more active form: Japan began to finance the "twin deficits"¹⁰⁶ (trade and budget deficits) of the US, which were created by the Reagan administration. We can conclude that most of Japan's imports unlike its historical predecessors - the US and the UK- Japan's emerging financial power is not based on its own currency; rather, it is still based on the dollar.¹⁰⁷

In sum, postwar Japan has been incorporated into the US- centered economic structure as a subordinate nation in both trade and monetary fields. After the end of the occupation in 1952, Japan emerged as an independent nation within the framework of the US-Japanese economic structure. Furthermore, Japan's structural dependence in trade relations on the one hand and in monetary relations on the other is mutually related in that together these relations form a tacit agreement with the US: The US provides Japan with market access, and Japan finances the consequent US trade deficits- whether indirectly by absorbing dollar and thus supporting the key currency role of the dollar or directly by financing US budget deficit through purchasing US treasury bills.¹⁰⁸ According to this argument, the US-Japanese economic structure is maintained by this fundamental political arrangement. Moreover, there has been a de facto geostrategic agreement between the US and Japan similar to the one just mentioned: Whereas the US provides Japan with security and markets access, Japan finances such services directly

¹⁰⁶ Tsuyoshi Kawasaki, *Ibid.*, P.274.

¹⁰⁷ *Ibid.* 275.

¹⁰⁸ *Ibid.* 275.

or indirectly. This means that the economic structure of the two nations is a part of a larger geostrategic structure centering around the US, or which Robert Gilpin calls the American System.¹⁰⁹ This fundamental agreement has laid the foundation for the postwar US-Japanese alliance.¹¹⁰

Throughout history, and according to traditional realist explanations, this kind of fundamental arrangement has been fairly common between Great Powers and their subordinate polities. For example, the relationship between Japan and its colonies was woven by such geostrategic arrangements. After the Pacific War, Japan began to take part in a similar geostrategic arrangement, but this time in a dependent position vis-à-vis the U.S.¹¹¹

4.6. Structural Transformation in the U.S. -Japan Economic Relationship

We mentioned that the “structure” means elements of the economic relationship, which, over a period of time, have been relatively stable and enduring. Therefore, structural transformation can be defined as alternations in these fundamental relationships. Of all the Cold War alliances that must now be refashioned to accord with new realities, none is more critical for world order than the one between the US and Japan, and none is

¹⁰⁹ Robert Gilpin, “American Policy in the post-Reagan Era,” *Daedalus*, Vol. 116, No.3, Summer 1987, pp.33-68.

¹¹⁰ Tsuyoshi Kawasaki, *Ibid.*, P.275.

¹¹¹ *Ibid.*, 276.

more burdened with complex psychological baggage.¹¹² The US Ambassador to Japan Mike Mansfield described the US-Japan relationship as "the most important bilateral relationship in the world, bare nofe,"¹¹³ This expression is even more true today than when he first uttered it in 1977.

At a time when the Cold War no longer provides a larger inducement for political restraint and as the US, particularly Clinton administration, moves towards results-oriented "managed trade," the two nations are headed towards new political frictions, which could damage their overall relationship of trust¹¹⁴.

As mentioned before, Japan and the U.S. have had huge and strong trade flows in both directions. After the Louver accord and following the extraordinary fiscal measures implemented in the spring of 1987, the US-Japanese trade-payment problem entered the stage of political stalemate. In the early 1990s, this stage endures. Contrary to the intentions of the US government, the dollar plunged drastically. At one point, the dollar fell below the yen=130 mark, reaching a historic low. This means that two decades after the advent of dollar devaluation tactics by President Nixon- at that time, one dollar equaled 360 yen- the value of the dollar against the yen has decreased by more than 60 percent.¹¹⁵ In the 1990s, the US no longer would employ "talking-down"

¹¹² Ezra F. Vogel, Japanese -American Relations After the Cold War, in Harness the Rising Sun: An American Strategy for Managing Japan's Rise As A Global Power, Published by the Aspen Strategy Group, 1993)

¹¹³ Nomura, Issei. Ibid., 51.

¹¹⁴ Vogel, Ezra F., Ibid., P.165-169.

¹¹⁵ Tsuyoshi Kawasaki, Ibid., P.279.

tactics; the dollar might free-fall. Yet at the same time, the US trade deficits with Japan remained persistent despite the drastic devaluation of the dollar against the yen that had occurred since September 1985. Indeed, we had witnessed a qualitative -as opposite to quantitative -transformation of the US-Japanese economic structure.

On the one hand, the credibility or utility of protectionist threats by the US against Japan has decreased considerably. One element of this change is the fact that in the 1990s, Japan was more dependent on its domestic demand than on US markets for its economic growth. Moreover, the increase in the yen's value- the direct consequence of dollar devaluation tactics by the US- has transformed the nature of Japan's trade relationship with the US.¹¹⁶

On the other hand, US-Japanese monetary relations have experienced a tremendous transformation. This transformation does not mean Japan has escaped the dollar orbit. Despite the dollar is still the key currency in US-Japanese relations, the qualitative nature of the bilateral monetary relationship has changed: The economic sovereignty of the US has been eroded considerably not by Japan but by economic factors in the global financial market. It is important to indicate the aspects of this change. Firstly, dollar devaluation tactics were no longer an effective policy tool for the US in solving its trade deficit problem. It would have to risk the free-fall of the dollar and the consequent inflation within the US economy. Secondly, as the October 1987 New York stock market crash shows, the global financial market was forcing the US to

¹¹⁶ For details on trade frictions in 1990s see Edward J. Lincoln, Troubled Times U.S.-Japan Trade Relations in the 1990s, Washington DC: Brookings Institution Press, 1999.

make a serious commitment to solve its twin deficits and was inducing the US to begin to make serious efforts to reduce the enormous budget deficit.¹¹⁷ This is what Japan never achieved during the three previous trade-payment conflicts. Thirdly, the US economic sovereignty also was seriously beleaguered by capital inflow from Japanese and other private institutions, which finances the US budget deficit. Finally, setting the prime rate in the US- another classical domestic economic policy tool in addition to fiscal policy- could no longer be immune to reactions from the global financial market.¹¹⁸ These aspects of a newly emerging US-Japanese economic relationship in the 1990s strongly suggest that economic forces, particularly financial forces, have outgrown the old framework of the US-Japan economic strategy and have caused its qualitative transformation.¹¹⁹

One of the most important origins of this change is the liberalization of Japan's financial market that has been occurring since 1979, particularly since the 1983-1984 Yen-Dollar agreement.¹²⁰ With this, more Japan's abundant capital- generated by high savings rates and trade surpluses- is easily set free. Thus, the nature of the US-Japanese economic relations was facing a historically unprecedented situation.

¹¹⁷ Tsuyoshi Kawasaki, *Ibid.* p. 280.

¹¹⁸ *Ibid.* p. 280.

¹¹⁹ *Ibid.* p. 280.

¹²⁰ On this agreement, see Geffery A. Frankel, *The Yen-Dollar Agreement: Liberalizing Japanese capital Markets*, Washington, D.C.: Institute for International Economics, 1984.

Relatively autonomous financial forces- which neither government can control effectively- are shaping the economic destiny of both countries.¹²¹ The old framework of the US-Japanese economic structure, which the US established in the early postwar period, was based on an implicit assumption that financial forces were within the reach of the government's control. The way, in which the US attempted to solve the series of trade-payment conflicts with Japan, as we saw earlier, also was based on this assumption. The fundamental challenge to US-Japanese economic relations in the 1990s and beyond comes from the fact that this old assumption is becoming increasingly less valid.¹²² Moreover, the problem of how to strike a balance between two conflicting desires for economic sovereignty and economic interdependence still exists. The magnitude of the global financial markets is losing political control over the financial market forces.

4.7. Redefining the U.S.-Japan Economic Relationship in Post-Cold War Era

As a result of the serious developments from 1975 to 1985, decisive trade conflict occurred during which many sectors were subjected to negotiations. Until that time, the Americans did not perceived the trade conflict as an issue with national importance or important security dimensions that could undermine the security alliance. This was due to the unclear direction of the Cold War. With the end of the Cold War, trade conflicts

¹²¹In 1983, Prime minister Nakasone surprised the Japanese with statement that the US and Japan shared a "common destiny." See, for example, Peter F. Drucker, "The Changed World Economy," *Foreign Affairs*, Vol. 64, No. 4 spring 1986, pp.768-791.

¹²² Tsuyoshi Kawasaki, *Ibid*, P.281

became national issues involving the US-Japan political-economic relationship in general.

In 1985, the US world trade deficit exceeded 100 billion. The trade deficit and federal budget deficit have become politically sensitive because the US became, for the first time, a debtor nation.¹²³ At the same year, the Plaza Agreement was concluded. While trade issues were escalated into national issues in the US, Japan was under strong attack.¹²⁴ It should be noted that in economics, bilateral trade imbalance does not represent a problem; but in the US, such an economic theory is not valid. There was a real fear that Japan might become a dominant power in the world, which absolutely would threaten the US hegemony and might endanger its national security interests. This period was a period of Market-Oriented Sector-Selective talks between both sides.¹²⁵ In 1989, the US waved the super 301 stick, which determined unfair trade partner, as a political means to increase pressure on Japan and to promote talks in the main sectors. Meanwhile, the US proposed the Structural Impediment Initiative (SII), which put the Japanese economy under microscope.¹²⁶ Public polls showed that American people viewed Japan as a greater threat rather than the Soviet Union. In many ways, the US-Japan relationship during the 1970s and 1980s has been transformed into a form of competition and extremely complex interdependence. By the early 1990s, with the continuation of trade friction, the political framework of the US and Japan has seriously eroded; economic forces, particularly capital flows, have outgrown it. Since then, a

¹²³ Karen Holgerson, *Ibid.* p. 29.

¹²⁴ S. D. Cohen, *Cowboys and Samurai: Why the U.S. Is Losing the Battle with the Japanese and Why it Matters*, New York: Harper Business, 1991, p. 43.

¹²⁵ Karen Holgerson, p. 29.

fundamental structural transformation began to take place in US-Japanese overall relations and the scope of conflict, which has driven the politics of economic adjustment, has expanded dramatically. This meant that the issue was more than a trade problem. The fundamental issue raised repeatedly during the crisis was: which country would adjust and compromise its economic sovereignty in order to correct the trade-payment imbalance? During the 1980s, and because of domestic opposition, neither nation has been willing to change its domestic economic policy to correct the trade imbalance and bear the political costs such economic adjustment would entail.¹²⁷ These make it difficult for the governments of the two countries to undertake a major restructuring of their economies, and until they do this, there remains a need for sectoral protectionism, which is considered illiberal action.¹²⁸

During the second half of 1990s, frictions originated from dramatic fluctuations in the relative economic power of both nations. Both sides were not prepared or willing to conduct structural adjustments. Thus, the US as a patron imagined that the “little bother” would become a main rival and a serious threat. Therefore, most Americans felt that Japan practices must be changed. Meanwhile, many Japanese elites and bureaucrats have not properly estimated the Japanese economic strength and, as a result, Japan failed to take the initiative in opening its market.¹²⁹ Economic frictions were regularly linked with security alliance, particularly by revolutionists on both sides. More seriously,

¹²⁶ Karen Holgerson, *Ibid*, pp. 29-30.

¹²⁷ Edson Spencer, U.S. and Japan: Collaborators and Competitors, Commission on U.S.-Japan Relations for The Twenty First Century. November 20, 1990.

¹²⁸ Walter F. Mondole, “U.S.-Japan Relations: Progress and Challenges,” Japan Update, January 1997, p. 14.

demands increased, especially in the Congress, to abrogate the security treaty with Japan.

Acting in accordance with realist perceptions, the US, as a hegemonic power, warned Japanese government that if it did not take certain procedures,¹³⁰ the criticism of Japan might pass the point of no return and the US might adopt protectionist policy. There was a real fear that such policies the US pursued could threaten the alliance or even undermine it. Unless the two nations agreed on a new structural framework to resolve their economic conflict, the security issues would strongly appear to be reviewed entirely. In this context, alliance officials were involved in negotiations to reach resolutions through SII. As a result, the Japanese government seriously attempted to find solutions in order not to reach mutual retaliation policies. The US wanted Japan to increase public investments, while Japan wanted the US to trim the federal budget deficit. Through Sector-Specific talks and with the intervention of alliance officials, both sides reached several agreements that reduced the intensity of the tension. In the 1990s, both countries faced challenges, particularly in the automobile sector.¹³¹

The unfairness of Japan led to sentiments among America people, in particular in the Congress. They started to question the viability of the alliance if Japan continued its unfair trade practices. Japan also felt that the US was unfair in its claims because – according to liberalist view—the Japanese economy was a result of liberal economic

¹²⁹ New York Times, April 26, 1997, p. 27.

¹³⁰ This warning was conveyed by the US president Bush to the Japanese Prime Minister Toshiki Kaifu in a summit meeting in March 1990.

¹³¹ The U.S.-Japan Auto Trade Agreement, June 28, 1995.

competitiveness. Moreover, the Japanese felt that there was a need to address the US military presence in Okinawa. The situation became critical and was addressed on high levels. Alliance officials intervened in the trade negotiations in order to reach a compromise and to prevent the issue from eroding the alliance framework. Although security interests affected the direction of mutual negotiations, it was so difficult to reach agreements over who should adjust, as interest groups on both parties would not accept any policies or transactions that might harm their business. In this context, a new era of friction began to drift.¹³² Japan was reviewed as a formidable rival because neorealist Americans believed that Japan was an “unstoppable” economic power.

This realist perception was overestimated by the US. The last decade witnessed unprecedented economic boom in the US, while Japan suffered from serious economic crisis. Therefore, the tensions between the US and Japan were remarkably reduced. However, while the American economic expansion lost its steam and strength at the beginning of 21st century, many Americans started to emphasize that the world economy would be in profound difficulties unless Japan, as a second largest economy in the world, would recover and reform its economy. This realization shows that Americans continue to act according to neorealist explanations and adopt superficial views that do not necessarily have roots in economic reality.

¹³² Lucian W. Pye, “The U.S.-Japan Alliance,” *Foreign Affairs*, Vol. 79, No. 3, May/Jun2000, p178.

In spite of all frictions and drawbacks in U.S.-Japan relations in the 1980s and the 1990s, both countries to resolve some of their conflicts and enhance their economic relations. This is mainly because the alliance has served as a political framework within which both nations were able to manage and overcome their problems, and strengthen their alliance relations.

CONCLUSIONS

The impact of alliance on economic and trade cooperation—which is usually described as “low or middle politics”—is quite different from its impact on cooperative efforts in “high politics” issues such as territorial conflicts or defense issues. The alliance concerns in bilateral defense relations were most prominent, while the alliance concerns in economic and trade issues vary according to the nature of the issue. The alliance actually promoted cooperation in various fields. For example, the maintenance concerns of the alliance were important in certain trade conflicts, particularly in energy affairs, although these concerns were less important during the territorial conflict. The impact of security alliance on trade conflict depends usually upon the nature of the conflict and the need to resolve it, particularly if such conflict could threaten the framework of the alliance. The impact of the alliance on some trade issue areas such as the gas and coal was low because these issues have less security dimensions. But the most important impact of the alliance on trade cooperation consisted of creating a favourable environment in which both parties could expect long run and peaceful interactions.

Normative Obligations

The normative alliance obligations, which set forth standards of behavior for resolving bilateral conflicts, had a positive impact on trade transactions. The most relevant norm was the mutual obligation set forth under Article II of the Security Treaty to promote economic cooperation and resolve bilateral economic conflicts. The importance of this norm is that the alliance increases the costs of illegitimate transactions, thereby discouraging the U.S. not to link trade cooperation or conflict with defense or security

cooperation. Meanwhile, the security alliance reduces the costs of legal bargainings because it provides a political-normative framework to resolve issues with important security dimensions. Therefore, this implication prevents the US from resorting to coercive tactics against Japan, which could create a chain reaction and undermine the alliance.

Theoretical Implications

An explanation focusing on the demands of interests groups provides a satisfactory account for some patterns of state behavior in the issues examined by the study. Neorealists argue that decision makers usually give primary concern to security interests, which can be sometimes on the expenses of interest groups. For example, the US pressure on Japan to import certain trade goods was more consistent with preferences of domestic economic interest groups. But the U.S. desire to reduce trade deficit with Japan for political and economic reasons was the main cause behind the American government to support some economic projects, which had few domestic support, such as the North Slope LNG project. The American government actually was seeking to protect the domestic industrial interests and maintaining certain levels of export to prevent a worsening of the bilateral trade deficits. Nevertheless, the US policies in the late 1980s and the beginning of 1990s--during Reagan and Bush's Administrations—remained wedded to an ideological foreign policy that was largely linked to national security interests rather than to domestic interests. However, the US pressed Japan to import more goods. But the Japanese government was frequently unable to press domestic economic interests to import more American goods because

this matter involved “the profit and lose process.” Realizing the significance of its alliance with the US, the Japanese government succeeded in reducing restraints to import more goods in an attempt to reduce trade deficit with the US.¹³³

Neorealist Approach

Neorealist views of obstacles and incentives for cooperation are not sufficient in explaining the absence or the presence of bilateral cooperation in certain trade issue areas, particularly in the field of energy (coal, gas, oil, nuclear energy). Neorealism argues that cooperation in this economic sector would be very difficult as long as relative gains concerns are prominent. Contrary to this argument, bilateral cooperation was most extensive in the energy field where relative gains were high for both parties. However, a conditional neorealist explanation of bilateral cooperation is more satisfactory. While security dimensions emerged as prominent in certain issues related to trade cooperation in particular those that involve energy cooperation, the salience of the perceptions of a common threat was expected to facilitate mutual cooperation. Because conditional neorealism argues that hegemonic state might be less sensitive to relative gains, the U.S.-Japan cooperation was expected to be less problematic during the 1950s and more problematic in the 1980s after the relative decline of the US hegemony. According to this analysis, neorealism encounters difficulties in explaining the presence of high levels of bilateral cooperation- particularly in issues that have important security dimensions such as energy trade, despite major power shifts in the international system at the end of the Cold War.

¹³³ For details on this issue see Diplomatic Bluebook, Ibid. 1997, 1998, 1999, 2000, and 2001.

On the other hand, some trade issues which were less important for security alliance (e.g. fishiers trade), were regarded as low politics issues. In the beginning, there were fears that trade conflicts over these issues might affect the security alliance. But on the contrary to this neorealist fears, these issues were not priorities for the security alliance, as they were not threatening the alliance. This is simply because trade cooperation in these issues do not depend on the continuation of the alliance. Therefore, these problems were not addressed on high governmental level. But when this problem took political dimensions, it was necessary to discuss it on high level, fearing its negative reflections on the alliance relations.

Neorealism and Neoinstitutionalism

Both neorealism and neoinstitutionalism are not efficient in explaining trade friction at low politics level. While mutual interests are low, neorealism is correct to assert that relative gains may be important for both allies. However, this approach expected that trade conflict over issues with low political importance were easier to be resolved as long as relative gains concerns be least prominent. Although results and outputs of transactions tended to reflect asymmetries¹³⁴ in capabilities as neorealists expected, the overall capabilities of both countries were sometimes irrelevant. The deficiency of using military power or threatened use of military force to resolve trade conflicts meant that the US had to resolve trade conflicts in its favour through asymmetries in conflicting issue areas. Asymmetrical interdependence in trade relationship in certain issues was

used by the US to strengthen its position during the late 1980s and 1990s. But with increasing US dependency on the Japanese market, such bargaining policies disappeared. This indeed prevented the US from using coercive procedures against Japan.

Prospects for the Future of the U.S.-Japan Economic Relations

In the 1990s the U.S. enjoyed an unprecedented economic boom while Japan experienced an economic crisis during that decade due to a severe slump. To explore the future, it is necessary to examine what happened in the 1990s. First, in terms of economic history the world economy has moved from an industrial age to a postindustrial age, in which the importance of service sector has substantially increased. Meanwhile, the American economy has recovered and consequently the US succeeded to lead the world economy by positioning itself to make maximum advantage through considerable restructuring.¹³⁵ The information technology revolution promoted this transformation of the economic structure.¹³⁶ In recent years, Japan started to make necessary changes to achieve such a transformation. Second, Japanese companies had grown complacent with their past success and were unable to implement needed changes and therefore, the entire economy was affected. Part of the problem was the aftereffects of the “bubble” economy, particularly the vertical decline in land prices and the

¹³⁴ Asymmetry indicates lacking precise correspondence or relation between or among components. An interdependence relation is said to be asymmetric if for example Japan is more dependent on the US than the US is on Japan.

¹³⁵ Bruce Cumings, “The American Ascendancy: Imposing a New World Order,” *Nation*, Vol. 270, No 18, pp. 13-19.

¹³⁶ For example, Japan's reluctance to open its economy to foreigners diminished a bit in 1999, according to figures from Japan's central bank. Foreign direct investment in Japan was, at \$12.3 billion, almost three-and-a-half times higher than in 1998. See *Economist*, March 25, 2000, Vol. 354, No. 8163, p7

mountain of bad loans.¹³⁷ Actually, the problem lies in the Japanese system itself. Though this system has served Japan to achieve the so-called Japanese miracle, it became an obstacle to reformation in the postindustrial age.¹³⁸ Meanwhile, Japan suffered from the problem of playing an effective role in international affairs commensurate to its economic strength. The shortcomings in the Japanese system were early recognized but no efficient procedures were taken to reform them until the new Prime Minister Junichiro Koizumi came to power in April 2001 and pursued structural reforms in both political and economic systems.¹³⁹

The form and substance of U.S.-Japan economic relations in 21st century hinge on how both countries address their problems and how Japan deals with the challenges it now faces. Both countries are expected to remain the world's largest economic powers in the foreseeable future. Moreover, trade and investments will continue to flow in both directions, thereby achieving a better balance and relegating the old type of trade frictions to the past. More importantly, economic globalization will expand in the future,¹⁴⁰ thus creating concerns about imbalances. The trade imbalance has shrunk substantially since the second half of the 1980s, when the bilateral discord was most vociferous.¹⁴¹ The world indeed enters an age in which many products' origin will be global rather than country-specific.

¹³⁷ Yoshiko Kojo, *Personal Communications*, Tokyo University, Tokyo. November 5, 2001.

¹³⁸ Yabunaka. Ibid. p. 198.

¹³⁹ Cheol Hee Park, "Factional Dynamics in Japan's LDP Since Political Reform," *Asian Survey*, Vol. xli, No. 3, May/June 2001, pp. 428-461.

¹⁴⁰ Diplomatic Bluebook 1999, Ibid. p. 9.

¹⁴¹ The ratio of the United State's imports from and exports to Japan decline from 3.6:1 in 1986 to 2.1:1 in 1998, according to U.S. Department of Commerce Statistics.

One important factor in the US-Japanese economic relationship is China. In April 2001, when ties grew tense over the U.S. spy plane incident in China, many realists cautioned that the U.S. would suffer economically if its relations with China worsened. The U.S. actually expressed such concern about the need to avoid disrupting smooth trade ties with China. To anyone familiar with the past record of the Japan-U.S. trade frictions, this is an unexpected reaction. China is a huge market and a very important power for regional and world security. The US imports from China exceeds its exports to China by 7 to 1, and the American annual trade deficit with China is approximately \$75 billion.¹⁴² Therefore, there is no doubt that the United State's expectation for future sales in the huge Chinese market is a factor. Furthermore, the American investments in China's market increase interdependence between both nations. Such interdependence is expected to contribute to bringing China to a regional security framework, thereby restructuring the bilateral security framework between Japan and the US. In these terms, China represents an economic and security challenge to Japan.¹⁴³ This gives rise to the question of how Japan addresses this issue.

If the old type of trade friction does reoccur, it will be when sunset industries that have been slow to make structural adjustments apply to the government for protection. If these industries have sufficient political clout, they will be capable of causing unproductive disputes. The two countries then are expected to attempt to settle any problems peacefully through bilateral channels or under WTO's rules, as what

¹⁴² For details on U.S.-China trade relations see U.S. Department of State, Fact Sheet, the Bureau of East Asian and Pacific Affairs, June 20, 1997, for updates see Department of State. www.state.gov U.S.-China Relations.

¹⁴³ Mataka. Kamiya, Pers. Comm. National Defense Academy, Nov. 2, 2001.

recently happened with regard to the conflict over steel protectionist policies adopted by the U.S in April 2002.

Another important perspective in U.S.-Japan economic relations is that the trend towards regional integration will have a great impact on the alliance relations. The US seeks to reach a new arrangement which covers both North and South America. The European Union¹⁴⁴ continues the process of integration to strengthen its role in world politics. Japan, for its part, has moved beyond its multilateral approach as it seeks bilateral economic integrations with some of its key trading partners in the region, particularly Asean countries. It is difficult to say whether such integration will eventually have a visible impact on economic recovery. However, with the projected decline in Japanese population, it is possible that stronger regional links will be forged with Asian countries, which may include not only economic integration and interdependence, but also new security arrangements to maintain peace and stability as a precondition to strengthen trade relations and increase multilateral flow of labor, capital and so forth. In spite of current developments in Asia, cooperation and competitiveness between American and Japanese corporations is likely to continue in the future. It is argued that the economic interaction between Japan and the US will play an essential role in the process of regional cooperation and integration. This means that current international rules and norms shall be subjected to revision. The government-level cooperation between the US and Japan is important in coordinating economic policies and creating rules for economic activities. Certainly, the difference in domestic

economic policies is affected by internal political situations in each country. Therefore, while these policies are being formulated, the international ramifications should be taken into account. Nonetheless, with the process of economic globalization, the task to create new international rules will become more urgent in order to create integrated regional security and economic frameworks. The role of U.S.-Japan cooperation will therefore gain even greater importance.

According to the preceding analysis, it is understandable that both countries recognize the importance of their alliance to enhance their economic relations and resolve their trade frictions in the post-Cold War era.

¹⁴⁴ In 1991 European countries took decision at Maastricht to go beyond customs union and common market to achieve economic and monetary union and coordinated foreign policy goals resulted in adopting a new name, European Union, for the European Communities.