Cornell International Law Journal

Volume 22
Issue 3 *Symposium 1989*

Article 10

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In 1970, as the bitter trans-Pacific conflicts of the early 1970s began to escalate, the U.S.-Japan trade deficit was $1.2 billion. It never rose above $3 billion at any point during that stormy period. By 1987 the U.S. bilateral deficit with Japan had reached forty times the 1970 amount; it was accompanied by large-scale deficits with Taiwan, South Korea, Hong Kong, and even Singapore, of which few observers in the early 1970s would have dreamed. The only remaining major U.S. trade surplus in the Pacific was with Australia. Eighty-six and a half percent of the expansion in U.S.-Japan trade between 1980 and 1986 had consisted of Japanese exports to the United States, and patterns with nations elsewhere in the region were generally similar.[1]

Trans-Pacific tensions in the 1980s remained remarkably muted, considering the magnitude of the economic imbalances. In 1982 Congress defeated local content legislation for automobiles, which proposed practices long prevailing in much of Western Europe, and in 1986 it failed to override presidential vetoes of protectionist textile-trade legislation. In the late 1980s the Executive Branch abandoned its insistence on voluntary Japanese restraints on exports of autos to the United States which it had demanded in 1981. Following the decisive defeat of Richard Gephardt in the strategic Super Tuesday regional presidential primary of 1988, Congress passed an Omnibus Trade Bill conspicuous for its lack of strong protectionist trade provisions.

As import penetration rose in the United States during the 1980s, interest groups, and even U.S. commerce and trade authorities, launched a rash of anti-dumping and unfair trading practice investigations in specific, narrow product lines, moving to an unprecedented retaliatory tariff on Japanese electronic products in early 1987. While the emergence of this so-called "Section 301 regime," named after the relevant unfair trading practices clause of the U.S. Trade Act of 1974, has attracted considerable media attention and conveys the impression

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1. *See generally* TSUSHO SANGYO SHO (MINISTRY OF INT'L TRADE AND INDUS.), TSUSHO HAKUSHO (WHITE PAPER ON INT'L TRADE) (1981-1987 eds.).

of a bitter and pervasive U.S.-Japan conflict emerging, the commercial stakes in the specific cases litigated are relatively small. Furthermore, the acceptance rate of domestic industry claims has remained low, and the remedies provided by the federal government modest, even as trade litigation, together with the U.S. trade deficit was steadily increased.[2]

The broader framework of trade and financial relations thus remains fundamentally stable, if often tense at the actual negotiating level. The Bush Administration continues to stand forthrightly for an open trade and financial system, despite the manifest economic costs, and for close diplomatic ties with Japan and other nations of East Asia. Increasingly, influential state and local authorities are also forging active links throughout the Pacific—links that in many cases did not even exist at the beginning of the decade. In short, the United States in the 1980s does *not* appear to have been on a clear "slippery slope" toward protectionism, despite periodic abridgement (less than most other major nations) of liberal economic principles.

I. Domestic Political Transformation (1970-1985)

At the root of the remarkably mild U.S. response to large trade deficits and the rapid build-up in foreign debt during the 1980s has been fundamental change, since the early 1970s, in the structure of the American domestic political economy. One development has been the nation's sharpening segmentation. Two oil shocks since 1973, the vast acceleration of defense procurements, with contracts favoring some regions over others, and the rapid pace of technological change over the past decade have all stimulated the emergence of different Americas, with both decline and new prosperity in evidence. As a consequence, opinion and interest concerning global trade issues has differed more and more along sectoral and regional lines.

Throughout most of the past twenty years, the South and the West of the United States, broadly speaking, have gained steadily relative to the rest of the country in both population and share of aggregate national wealth. By 1990 the combined populations of these areas are expected to account for around 56% of the U.S. total.[3] Despite deep recession in Texas and neighboring parts of the Southwest during the mid-1980s caused by the sharp fall in oil prices, inflation-adjusted incomes have grown twice as fast in the South and West as in the Northeast and Midwest over the past two decades.

During the 1980s new growth points have also emerged, tied to defense and service-industry development, in such states as New York, Connecticut, and Massachusetts. These developments, like the depression in the southwestern oil industry, have narrowed some of the broad,

2. *See* Goldstein, *The Political Economy of Trade: Institutions of Protection*, 80 AM. POL. SCI. REV. 161 (1986).

3. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, SERIES P-25, NO. 1010, CURRENT POPULATION REPORTS 1-3 (1987).

regionally specific contrasts between growth and prosperity, implicit in the "Sunbelt shift" pattern of the 1970s, to create a more nuanced picture. But the complex interweaving of prosperity and depression in Snowbelt states has complicated protectionist efforts there, as is clear, for example, in Ohio. While the heavy industries around Cleveland and Youngstown have been badly depressed, central Ohio has been more buoyant, stimulated by projects such as the new Honda auto plant in Marysville.

The continuing shifts in the locus of economic power in the United States have encouraged parallel shifts in patterns of political influence, which have in turn reinforced the ongoing economic shifts. Every president elected to office since Lyndon B. Johnson has had a substantial southern or western political background, including Richard Nixon, Jimmy Carter, Ronald Reagan, and George Bush. Gerald Ford, who does not fit that qualification, was not elected, but succeeded to office following the Nixon resignation. For a century before that a southern or western background was a rarity among chief executives. In addition, for the past two generations, the chairmen of major congressional committees have tended to be Westerners and, especially, Southerners. In the Super Tuesday regional presidential primary of March 1988 the South once again showed its strategic political influence, assuring the Republican nomination of transplanted Texan George Bush, and grievously wounding protectionist Democrat Richard Gephardt. In the November 1988 general election a solid Republican South was likewise central to the defeat of Michael Dukakis, who was more assertive on trade issues than his GOP rival.

The increasingly salient regional and sectoral divisions in the American political economy have, since the late 1960s, coincided ever more closely with attitudes concerning trade policy toward Japan. Generally speaking, protectionist sentiments have been concentrated in the relatively stagnant, heavily unionized, industrialized centers of the Northeast and Midwest, which have borne the brunt of competition with Japan. Unemployment rates during the first half of the 1980s across this so-called Rustbelt have frequently been double the national average, and anti-Japanese protectionist feeling has been high, as expressed in state-enacted "Buy America" legislation and strong support for federal domestic content legislation.

Despite the rising vehemence of anti-Japanese sentiment in these areas, there have been important regional counter-trends which have prevented a protectionist common front from emerging, even in relatively depressed Rustbelt areas. Several industrial states, including Ohio, New Jersey, and recently even Michigan, have sought and successfully attracted Japanese investment. In addition, the service industries rising throughout the country, especially banks, law firms, and consulting companies, have often had a major stake in transactions with Japan and other nations of the Pacific Basin.

The South and West, together with the financial centers of the United States, have generally favored free trade more strongly than other parts of the country. Underlying this relatively liberal orientation have been strong complementarities of economic interest with Japan and other manufacturers of the Pacific Rim. For example, there is not a single integrated steel mill on the entire American West Coast. The only auto plant there is the recently opened General Motors-Toyota joint venture plant at Fremont, California. Even in the semiconductor industry, Silicon Valley's relatively hard attitude toward Japan has been moderated by a broad market segmentation: California producers specialize in microprocessors and customized chips, while Japanese producers specialize in commodity RAM chips.[4]

Roughly one-third of the entire U.S. trade deficit with Japan is accounted for by the trade that passes through California ports. Yet this has stirred remarkably little antagonism in California, due to the trans-Pacific economic complementarity and the state's relatively rapid growth. Indeed, San Francisco, San Diego, and Long Beach—like Seattle and Portland—profit substantially from shipping to and from East Asia, regardless of which direction trade predominantly flows. In addition, the auto and electronics dealer networks, which have a substantial stake in a smooth flow of imports, are large and vocal. And across the West, union membership as a proportion of total employment (excluding agriculture) ranges from a low of under 13% in a right-to-work state like Arizona to around 25% in California and 33% in Washington.[5] This is lower than the 20% to 35% union membership ratios more common in the Midwest and Northeast.[6]

Like the West, the South tends, broadly speaking, to be economically complementary with Japan and has been relatively quiescent on trade issues, aside from textiles. Its lukewarm response in early 1988 to Democratic presidential hopeful Richard Gephardt's protection-oriented trade policy and the deindustrialization concerns of Michael Dukakis flowed in part from this underlying economic structure. The major southern exports are agricultural: soybeans, corn, cotton, sorghum, and tobacco. The beef and orange trade questions that have caused so much U.S.-Japanese political friction are not major issues in the South, except in Florida. Moreover, Japan imports nearly $6 billion annually in agricultural products from the United States—mostly from the South.[7]

Historically, the South has had a pronounced free-trade orientation. In addition, a great deal of Japan's rising investment in the United

4. For further details, see Calder, *The Emerging Politics of the Trans-Pacific Economy*, 2 WORLD POL'Y J. 593 (1985).

5. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1988, at 401 (108th ed. 1988) (1982 figures).

6. *Id.*

7. In 1987 U.S. agricultural exports to Japan were over $5.7 billion. *See* KEIZAI KOHO CENTER, JAPAN 1989: AN INTERNATIONAL COMPARISON 19 (1989). Statistics are drawn from U.S. Department of Agriculture data.

States—projects such as Nissan's truck plant at Smyrna, Tennessee—has been concentrated there, with most of the rest in other Sunbelt states such as California. Well over half of Japanese manufacturing investment in the United States during the mid-1980s was concentrated in sixteen Sunbelt states; the top three were California, Texas, and Georgia. Yet enough investment is distributed elsewhere to undercut protectionist activity even in the Rustbelt states most adversely affected by economic competition with Japan, such as Michigan and Ohio. Japanese direct investment in the United States, totalling more than $50 billion in 1988, already provides over 250,000 jobs, with this number expected to quadruple to over one million jobs by the year 2000.[8]

Like the economically healthy regions, the sectors of the U.S. economy that have grown vigorously over the past decade have been in a broadly symbiotic relationship with Japan and other major East Asian industrial exporters. For the construction industry, Japan and South Korea have often offered cheaper steel or better delivery times, and, hence, increased profits on bids. In finance, Japan has provided increased market opportunities; a wide range of American banks with fund surpluses, many of them regional and local, have benefited by financing much of Japan's rapidly growing dollar-based trade and investment. Since the mid-1980s, a growing number of U.S. state and local governments have also been raising funds in Japan for a broad range of public purposes, and their activities may be widened to include other nations of the Pacific with major capital surpluses.

Reinforcing these regional and sectoral complementarities with Japan and its neighbors are the growing stakes that many U.S. multinational firms have in maintaining smooth trans-Pacific relations. These stakes are especially high in the electronics, banking, energy, and automotive sectors that are so central to the U.S. political economy. By the end of 1986, direct U.S. investment in Japan was $11.3 billion and rising, particularly in high-technology sectors. For example, Texas Instruments produced all the 64K RAM computer chips for its global operations in Japan, IBM sourced over half of its IBM PC components there, and General Motors, Ford, and Chrysler all made heavy captive exports to the United States from Japan of both components and finished automobiles.

To a much greater extent than most Americans realize, Japan's trans-Pacific trade surplus stems from the sourcing decisions of such multinationals as IBM, together with those of major U.S. distributors, rather than from autonomous export drives by Japanese firms. Over 10% of Japan's exports to the United States in the mid-1980s consisted of parts exports—largely to U.S. firms. The Big Three sourcing in Japan of auto parts alone came to over $1 billion in 1986. Roughly 7% of

8. The estimate of one million jobs by the year 2000 is from MITI. *See* Holstein, *Japan, U.S.A.*, Bus. Week, July 14, 1986, at 46. On direct investment, see Keizai Koho Center, *supra* note 7, at 56. Figures are for the accumulated value of approvals and notifications.

Japan's U.S.-bound exports are items like video tape recorders and 35-millimeter cameras that are virtually not produced in the United States, yet are marketed by U.S. retailers under Japanese brand names.[9] A further 2 to 3% of Japan's exports to the United States are sold under the private brand names of U.S. distributors—Japanese-made Sears home appliances, for example. Finally, around 5% of Japan's exports to the United States represent exports of finished products from Japan to the United States by foreign firms—largely American—that manufacture in Japan. In short, over a quarter of Japan's current exports to the United States appears to be structurally linked to the production and marketing activities of U.S. firms in their home territory. Thus, U.S. firms have a massive economic interest in imports from Japan; in practice this inevitably limits the options of U.S. policymakers. A predictably strong exchange value for the yen, continuing over a period of some years, may be required to change this. Even then, change will probably occur only slowly.

The explosive growth of Japanese capital markets during the mid-1980s has inspired additional interest among multinationals in assuring smooth dealings with Japan, for they see potentially enormous opportunities in funding, underwriting, and brokerage activities. The Tokyo bond market, well over five times the scale of 1980, passed London to become the second largest in the world during 1984. In mid-1987 the Tokyo Stock Exchange passed even New York's to become the largest in the world, in terms of market capitalization. Between 1984 and 1987, virtually all the major American multinational financial firms sharply increased their securities and merchant banking staffs in Tokyo, sensing an expanded global role for the yen as well as rapidly growing offshore dealings there in Western currencies. By 1988, U.S. banks were handling the bulk of the 45% foreign share of foreign-exchange trading in Tokyo, a highly lucrative business.[10]

Traditionally, much of Japan's attractiveness for U.S. multinationals has been rooted in profitability. Although U.S. companies employed only 1% of the Japanese work force during 1982, they registered 3.3% of the corporate profits in Japan.[11] Over the past 15 years, the return on investment of U.S. manufacturing firms in Japan has averaged roughly twice the return realized by U.S. affiliates in Canada, the United Kingdom, or France.[12]

In addition to Japan's profitable domestic markets, made ever more lucrative by a strengthening yen, U.S. multinationals often find in Japan an excellent production base for sourcing operations worldwide. Both

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9. *See* TSUSHO SANGYO SHO, *supra* note 1 (1987 ed.).

10. Holden, *Look Who's Winning Tokyo's Currency Sweepstakes*, BUS. WK., Apr. 11, 1988, at 71. For a detailed review of changes in the Japanese financial markets, *see* Semkow, *Emergence of Derivative Financial Products Markets in Japan*, 22 CORNELL INT'L L.J. 39 (1989).

11. American Chamber of Commerce in Japan (unpublished data).

12. *Id.*

the quality of the work force and the favorable regulatory climate seem to have encouraged this development, which has persisted despite the yen's post-Plaza strength. Since 1982, U.S. firms in Japan have been eligible for Japan Development Bank loans on a case-by-case basis and have received low-interest government small-business financing as well.[13] Favorable regional development incentives are being given to U.S. high-technology firms willing to start up operations in Japan, and export financing is reportedly available for global sales from Japanese production bases. Opportunities for American financiers are also expanding in such areas as trust and investment banking.

American multinationals have grown increasingly active in U.S. trade policy formation since 1970, as they have come to perceive their interests threatened by protectionist sentiment both in Congress and abroad. Generally this rising activism on the part of multinationals, through such groups as the Emergency Committee for American Trade (ECAT), has helped keep U.S. markets open to Japanese imports—a substantial and rising share of which, as noted above, has been captive imports by U.S. multinationals from Japan to the United States. Since 1981, the AT&T consent decree, the end to the Justice Department suit against IBM, and the Reagan and Bush administrations' generally supportive attitude toward multinationals have significantly increased the leverage such firms can exert on behalf of free-trade policies.

A parallel development has been the rising activism and influence on Congress of major distributors—a result of their growing stakes in an open trade regime. Companies like Sears Roebuck and K-Mart, together with the smaller-scale automobile and appliance distributors, have massively increased their foreign sourcing over the past decade to their considerable profit. The strength of the dollar between 1981 and 1985 increased this profitability, insofar as an oligopolistic market structure prevented exchange-rate windfalls from being passed on to the consumer. Even the sharp revaluation of the yen during 1985-1987 did not extinguish foreign sourcing, both because Japanese exporters absorbed much of the exchange rate shift and because many of the imported goods handled by distributors came from newly industrializing countries (NICs) like South Korea and Taiwan, whose currencies did not rapidly appreciate. The business contacts of U.S. distributors simply broadened to new areas of the Pacific Basin. The distributors are said to be highly active on Capitol Hill; the fact that their outlets are scattered across a broad geographic area and that local distributors are often intimately involved in grass-roots politics, serve to enhance these firms' political influence.[14] Because distributors can benefit from any sort of merchan-

13. As of March 31, 1986, the Japan Development Bank had $78.9 million in loans outstanding to foreign-owned subsidiaries operating in Japan and a further $292.0 million out to 50-50 joint ventures, with most loans being made to U.S.-affiliated companies. *See* JAPAN DEVELOPMENT BANK, 1986 ANNUAL REPORT 15.

14. For example, distributors were influential in the defeat of domestic content legistation for automobiles in 1982 and tightened quotas for textile imports in 1985.

dise transaction, and because Japanese manufacturers have placed a high priority on establishing and rewarding a distribution network, these distribution firms have become powerful open-trade advocates.

A little noticed but increasingly active and potent political ally in the United States of an open trade and financial regime is state and local government. With the gradual retrenchment in non-defense, federal government spending over the past fifteen years and the active devolution of governmental functions to the states encouraged by the Nixon, Ford, and Reagan Administrations, local government's role in the overall federal system has expanded.[15] Although promotion of new investment was a traditional function of local governments long before the recent expansion of their responsibilities, local governments have now fervently seized the expansion of foreign investment as a major new opportunity to address the policy demands and long-run revenue concerns which recent federal budget cutbacks have placed on them.

State and local governments have taken generally moderate policy stands on international trade and financial policy questions which they have addressed. Indiana Governor Robert Orr's 1987 opposition to congressional sanctions against Toshiba, in the wake of the Toshiba Machine Tools technology-diffusion scandal, with a major Toshiba plant-investment decision in the U.S. pending is a typical case in point. Thirty American states had representatives in Tokyo at the end of 1987, with most of them oriented toward investment and export promotion.[16] With Japanese investment alone in the United States expected to rise tenfold over the next fifteen years, creating a fourfold increase in jobs and possibly an even greater rise in local tax revenues,[17] the non-federal element of government in the United States may well be a force for moderation and for deepening trans-Pacific integration, possible tensions due to cultural differences notwithstanding.

In addition to this support from multinationals, distributors, and local governments, foreign firms striving to preserve an open trade regime have potent help from Washington's largest corps of professional lobbyists. In the mid-1980s, lobbyists for the Japanese government and private sector, working both to catalyze the diverse supporters of an open trade system in the U.S. and to explain U.S. realities in Japan, reported fees double those received by representatives of any other nation. Knowledgeable Washington analysts estimate total Japanese lobbying expenditures at over $60 million annually, including outlays for which formal reports are not required.[18] One out of every five registered Washington lobbyists in 1987 worked for Japanese firms, Japanese

See I. DESTLER & J. ODELL, ANTI-PROTECTION: CHANGING FORCES IN UNITED STATES TRADE POLITICS 49-56 (1987 Institute for International Economics 21).

15. *See* R. NATHAN & F. DOLITTLE, REAGAN AND THE STATES (1987).

16. *State Offices in Tokyo: "Selling Out" the U.S.?*, TOKYO J., Dec. 1987, at 15.

17. *See* Laderman, *What the Rally Really Means*, BUS. WK., FEB. 2, 1987, AT 58. *See also* Holstein, *Japan is Winning Friends in the Rust Belt*, BUS. WK., Oct. 19, 1987, at 54.

18. *See* Farnsworth, *Americans Who Lobby for Japan*, N.Y. Times, May 3, 1987, sec. 3, p. 4, col. 3.

industry associations, or the Japanese government, with these lobbyists garnering 30% of the fees paid to all registered lobbyists combined.[19] Since congressional decision-making processes have become much more complicated over the past fifteen years, as the subcommittee system has expanded, there are now many more access points at which outside groups can exert their influence. Japan's representatives, and those of other foreign economic partners of the United States, clearly benefit from this situation.

Just as the political and economic strength of U.S. groups with interests complementary to those of other Pacific economies has risen since 1970, the position of antagonistic groups has declined. Most notably, the political clout of organized labor has fallen sharply, as a result of high manufacturing-sector unemployment, declining union membership, and the anti-labor sentiment of much of the conservative Sunbelt coalition. According to AFL-CIO estimates, union membership declined from 35% of the work force in 1955 to less than 19% in 1985.[20] This drop has been especially steep since the 1979 oil shock. Between 1981 and 1983, for example, union membership declined by 800,000. The membership of the United Steelworkers Union has fallen by half—from 1.062 million to 572,000— between 1975 and 1985, with most of the decline since 1980.[21] Other indications of the erosion of labor's position include the union concessions and give-backs that have been common in recent labor agreements, the 1982 failure of domestic content legislation and other protectionist efforts, and the misfortunes in 1984 of the AFL-CIO's endorsed candidate Walter Mondale—his difficulties against Gary Hart in the primaries and his subsequent sweeping defeat by Ronald Reagan. The difficulties of Richard Gephardt in the 1988 presidential campaign point in the same direction.

Structural transformation within the American political economy will never be complete because the process of change is a continuing one. The effects of that transformation are mediated through two major political parties, which in the American context stand, to some degree, on contrasting social bases. The Democratic Party has had more sympathy for and stronger ties to Snowbelt and organized labor groups adversely affected by the emergence of the trans-Pacific economy than has the Republican Party and tends to be more solicitous of these disadvantaged groups.

But as noted above, the role of organized labor in the American work force is in a process of long-term decline. The locus of influence in both the Democratic Party and the nation as a whole has shifted elsewhere, as the travails of Walter Mondale and Richard Gephardt in the 1984 and 1988 campaigns would seem to indicate. Suburban and minority inner-city electorates appear to have gained relative salience

19. *Id.*
20. Serrin, *Unionism Struggles Through Middle Age*, N.Y. Times, Sec. 4, p. 4, col. 3.
21. *Id.*

for Democrats. More generally, the decline of organization in American politics, a continuing phenomenon since at least the 1950s, has made it more difficult for groups affected adversely by economic change to express their opposition effectively through the political process.

II. Confronting the Consequences (1985-1989)

Transformation in the structure of the American domestic political economy during the 1970s and early 1980s helped sustain a remarkably open orientation in U.S. trade and investment policy, through a period of depression in American industry and agriculture in the Midwest and Northeast during the early 1980s. This openness toward imports and foreign investment accompanied the strong dollar and the huge current-account deficits generated by the Reagan Administration's simultaneous defense buildup and tax cut. But the obverse side of this openness, and the resulting economic efficiencies, has been an erosion of the American industrial base, a structural dependence on imports, and a political obliviousness to the rapid escalation of U.S. foreign debt at a pace which, in the long run, is not sustainable. At the end of 1988, net U.S. external liabilities were well over $400 billion and were increasing at a rate of $150 billion annually. By the early 1990s, if recent trends continue, the annual U.S. foreign debt service burden will be as large as the current yearly U.S.-Japan trade deficit.

The emergence of the trans-Pacific economy, in short, has meant a surge of imports, stimulating competition, and an escalation of debt. These are mere abstractions until they must be paid back through a real decline in living standards vis-à-vis more productive parts of the Pacific Basin. But that reckoning day must inevitably come.

Throughout the early 1980s, the United States was insulated from the long-run consequences of its declining productivity and rising debt by the anomalous strength of the dollar and the consequent eagerness of foreigners to invest in the United States. But following the Plaza International Monetary Accords of September, 1985, and the steady subsequent revaluation of the yen and the Deutschmark, those inevitable long-run consequences have become increasing clear. Within little more than two years, the purchasing power of the yen in the United States doubled while the value of dollars in Tokyo conversely fell to half of pre-Plaza levels. Although American exports to Japan were frustratingly slow to rise, in part due to the complexity of the Japanese distribution system and the large share of the exchange-rate profits to the Japanese nation as a whole which it absorbed, Japanese investment in the United States rapidly surged. In 1988, Japanese direct foreign investments in the United States rose to over $50 billion, nearly 50% higher than the previous year.[22] This new surge of Japanese direct investment in the U.S. generated a range of new trans-Pacific economic policy issues, such as the propriety of government restrictions on joint

22. KEIZAI KOHO CENTER, *supra* note 7, at 56.

ventures and acquisitions like the abortive Fujitsu effort to acquire Fairchild Semiconductors in 1987.

Among the perverse long-run consequences of the overvalued dollar of the early 1980s, in the context of an emerging trans-Pacific economy, was the heavy and rapid erosion of the U.S. industrial base in semiconductors, particularly in advanced memory components. To offset some of the losses it suffered, the semiconductor industry went to the government. What followed, during 1986-1987, was a clumsy intrusion of government into U.S.-Japan high-technology trade which from the beginning had dubious objectives, limited prospects of success, and which ultimately aggravated U.S.-Japan relations without achieving substantial new market opportunities for American firms in Japan. MITI and the U.S. Department of Commerce negotiated an agreement to set guidelines for semiconductor prices and U.S. market shares in Japan. That agreement rapidly proved unenforceable, leading in the spring of 1987 to recriminations and the first U.S. retaliatory tariffs on Japanese exports to the United States since World War II.

At a bilateral level, the emergence of the trans-Pacific economy during the 1970s and the early 1980s stimulated deepening economic and political interdependence between the United States and Japan, and frictions inevitably arose. Increasing American and Japanese intimacy had even more important implications for both nations in the global political economy as a whole. As the world's largest creditor and debtor, with credits and debits of well over $200 billion and $400 billion respectively at the end of 1988, Japan and the United States find themselves the central actors in the international financial system. They are jointly responsible, to an unprecedented degree for two nations, for the stability of global exchange rates and capital markets.[23] In addition, by consuming nearly 40% of world oil imports, the two nations also have a fundamental stake in the stability of world energy markets and powerful incentives to cooperate to ensure that stability.[24]

Perhaps the most important consequences of the emerging trans-Pacific economy are its profound implications for the national security of the United States and its allies, including Japan. As Robert Gilpin has pointed out, Japan since the late 1970s has become the most powerful and strategic supporter of American global hegemony, assuming a role played in the early postwar period by Great Britain and subsequently by West Germany.[25] The principal mechanism of Japanese financial support until mid-1987 was Japanese private-sector portfolio investment in

23. Analysts on both sides of the Pacific are thus speaking of a "G-2" condominium dominating the international monetary system. *See* Bergsten, *Economic Imbalances and World Politics*, 65 FOREIGN AFF. 770, 789-793 (1987); Y. YOICHI, NIHIBEI KEIZAI MASATSU [Japan-U.S. Economic Friction] 194-230 (1987).

24. On the U.S. and Japanese roles in global energy markets, *see* R. VERNON, TWO HUNGRY GIANTS: THE UNITED STATES AND JAPAN IN THE QUEST FOR OIL AND ORES (1983).

25. R. GILPIN, THE POLITICAL ECONOMY OF INTERNATIONAL RELATIONS 134-51 (1987).

the United States, which reached roughly $100 billion in 1986. During 1987-1988, capital flows from Japan continued, although increasingly in the form of official flows. Bank of Japan holdings of dollar assets, for example, increased more than $30 billion for the second half of 1987. Due to these huge capital inflows from Japan, which began just as the Reagan Administration began its major defense buildup, the United States was able to sustain both its huge defense buildup of the early 1980s and one of the most rapid rates of overall growth and employment creation among the major industrialized nations without suffering a debilitating and politically disastrous credit crunch.

For the 1990s, American global defense commitments continue to loom large. But the intractable U.S. fiscal deficit and the increasing reluctance of foreign investors to fund it has cast into increasing doubt the United States' economic ability to sustain existing global commitments. Exchange-rate realignments set in motion by the Plaza accords give Japan, together with West Germany, increasing economic capacity to share the American security burden. This ability has been enhanced still further in the Japanese case by the administrative reforms and domestic subsidy cutbacks of the early 1980s, coupled with important changes in the tax structure introduced during 1988 by the Takeshita administration. Japan is increasingly capable of shouldering the cost of U.S. defense burdens, if it can be persuaded politically to do so.

During the early 1980s Japan steadily increased its so-called "strategic foreign aid" to nations like Pakistan, Thailand, and the Sudan, which were of demonstrable military-political importance to the United States. Since 1979 Japan has also been the largest source of foreign aid to the Philippines, increasing its support sharply following the downfall of the Marcos regime. For fiscal 1989 Japanese low-interest credits to the Philippines reached 88.6 billion yen ($728 million).[26] By comparison, American assistance to nations hosting American bases was $1.47 billion in fiscal 1988, up from $941 million in 1980, although still $700 million less than the Reagan Administration requested in 1988 from Congress.[27] Japan, whose overseas foreign assistance became the largest in the world in 1989, could expect to pick up an increasing share of such costs in the future while also assuming under an indirect offset arrangement some share of the $6 billion expended annually by the United States for actual operation of its foreign military bases.

As the United States and Japan look to the future of a relationship that has come to have fundamental importance on the global scene, the underlying structure of their bilateral ties remains remarkably similar to the pattern with which they began their independent relationship at the end of Allied Occupation nearly forty years ago. The United States sup-

26. Japan Econ. J., Dec. 10, 1988. These loans carried an annual interest rate of 2.7%, over 25 to 30 years.

27. The nations in question were Turkey, Greece, Spain, Portugal, and the Philippines. 1988 figures represented subcommittee recommendations with supplemental funding expected for the Philippines.

plies the military security while serving also as defender of open global markets for trade and finance which strongly benefit Japan and other U.S. allies. The rapid accumulation of American foreign debt, and the increasing reluctance of foreign investors to fund it, suggest with increasing urgency that the status quo is not indefinitely viable. The pressing challenge to both the United States and Japan is to find a means of smoothly sharing the economic burdens of global leadership so as to preserve the economic and security regime which has brought unprecedented prosperity to both of them, and to the world as a whole, since its inception four decades ago.