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The View from 1984: What Have We Learned in Five Years?

I. Introduction

In this essay I would like to offer two perspectives on the United States-Japan trade relationship.

The first is a time perspective. I spent a year in Japan, from 1983 to 1984, during which time I tried to pay some attention to the trade issues people felt were important. I thought it might be interesting to re-view what the live trade issues were then and see whether we appear to have made much progress since. This is the reason for the "view from 1984" in my title.

The second perspective is a "disciplinary" perspective. My major area of academic interest is antitrust law. We are now approaching the centennial of antitrust law in the United States, but antitrust law is not found only in the United States. Japan has had an antitrust law for more than forty years. I would like to argue that an antitrust perspective is vital for addressing the second part of my title, "what have we learned in five years." Indeed, I believe that attention to antitrust concepts is important not only for the U.S.-Japan trade relationship, but also if we are to make progress in addressing significant issues of economic policy for our domestic economy. Specifically, I will argue that the United States should resist efforts to pursue a policy of "managed" trade, and should instead focus on market oriented strategies.

II. The View From 1984

What was happening in 1983-1984 with regard to trade issues? A convenient way to refresh recollection is to look through a report published in 1984 by a group of American and Japanese business people, the U.S.-Japan Trade Study Group.¹ Their report provides a laundry list of products about which we were worried. Examples included beef and oranges, soda ash, telecommunications equipment for NTT, communi-

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1. U.S.-JAPAN TRADE STUDY GROUP, PROGRESS REPORT: 1984 (Sept. 1984).

cations satellites, baseball bats and plywood.² The United States was concerned about the sales of foreign-made automobiles in Japan, and about Japan's heavy sales of automobiles in the United States. (Japan, after "threatening" not to renew its voluntary restraints on exports of automobiles to the United States, finally agreed in 1984 to limit exports to 1.85 million vehicles.) The U.S. was also concerned about access to service markets. It wanted to open Japan's capital markets to U.S. financial institutions and to open legal markets to U.S. lawyers.

A number of "structural issues," which went beyond problems of selling specific products or services, were also being discussed in 1984. One was Japan's arcane retail distribution system which, it was argued, protected numerous small retailers who were closely tied to large Japanese manufacturers, thereby making it more difficult for foreign firms to penetrate domestic markets. Another structural issue was Japan's legal mechanism for dealing with distressed industries, the apparent effect of which was to exclude lower priced imported goods. A third structural problem was Japan's system for protecting intellectual property which, it was argued, failed to protect adequately U.S. patented, trademarked, or copyrighted products. Finally, there was the yen-dollar exchange rate.

There were also several interesting political events occurring in that time period. Ronald Reagan visited Japan and became the first United States president to address the Diet. Prior to his visit Secretary of Commerce Baldrige had given a "harsh warning" to Japan that failure to resolve trade issues could invite a political crisis for the Reagan Administration. After Reagan departed, Secretary of State Schultz pronounced the visit "very successful." December elections then gave Prime Minister Nakasone an unexpected set-back, leading to expressions of caution about his government's ability to make major trade concessions. In January 1984, our Ambassador to Japan, Mike Mansfield, warned Ministry officials about the failure to make tangible progress on trade issues. In February, the United States and Japan agreed to solve all pending trade issues before Reagan and Nakasone met again in June 1984.

What has happened since 1984? As a general matter, the trade problems of 1983-1984 have not been solved. Not that there have been no changes. The value of the dollar has depreciated but the overall place of imports in the economy of Japan does not appear to have been significantly altered. U.S. lawyers can practice in Japan without passing the Japanese bar examination, but they are not permitted to give advice on Japanese law nor are they permitted to form partnerships with Japanese lawyers. It seems that they are free to give advice on U.S. law to their Japanese clients who wish to do business in the United States, but they could have done that from New York or Los Angeles without paying Tokyo prices. Foreign auto imports into Japan are still less than 4%; Honda (imported from the United States) is the fastest growing import, with the Ford Probe (made by Mazda in Michigan) right behind. (I don't

2. *Id.* at 30-40.

know what this says about the ability of "imports" to succeed in Japan.) On the export side, the automobile voluntary restraints are still in place, with the amount now set at 2.2 million vehicles (although Japanese car makers are not reaching the overall quota at this point). We have yet to sell a communications satellite to Japan, and Japanese government and university officials are unwilling to buy our supercomputers. And, of course, beef remains a problem, and rice has now been added to the list.

Political events still give the appearance of importance. We have a new president, a new U.S. Trade Representative, and a new U.S. trade law with the potential for increased sanctions if imports by Japan do not increase, although exactly what will happen under this "Super 301" process is as much an unknown to trade officials as it is to the Congress which wrote it. We also have a major political scandal in Japan involving possible bribery through stock distribution to favored politicians. On April 25, 1989, Prime Minister Takeshita resigned as a result of the scandal,³ throwing the ruling Liberal Democratic Party into disarray, at least temporarily.⁴ Indeed, the scandal may significantly limit Japan's ability to negotiate trade issues for months to come.⁵

Actually, the comparison between 1984 and 1989 should not surprise any student of U.S.-Japan trade relations. One could simply refer back to the experience of Townsend Harris,⁶ who went to Japan as our first Consular official in August of 1856. Harris had the task of making a treaty to "at once open Japan to our commerce." One of the areas of friction then was the yen-dollar rate (we thought the dollar was deliberately undervalued, impeding our ability to purchase Japanese goods cheaply). Another area of friction was distribution. Japan's government wanted to permit trade only through then-existing trading companies (*tonya*) and only in one location, some 18 miles from Tokyo. Harris recognized that this would greatly handicap the sale of imported goods, and the restriction was eventually dropped in the interest of "the experiment of free trade."

Harris' negotiating problems also sound distressingly familiar. He was first met with the argument that the Japanese, unlike the Americans, could not respond rapidly to every request. He finally hit upon the following technique: "I felt . . . that the more I yielded and acquiesced, the more they would impose on me, while, by taking a bold attitude and assuming a threatening tone, I should at once bring them to terms."⁷ Harris did obtain an agreement on tariffs and export duties, and an agreement to open the ports of Osaka and Tokyo to Americans within five years. But strong political opposition arose even to this modest

3. Weisman, *Takeshita Resigns as Japan's Premier over Gift Scandal*, N.Y. Times, Apr. 25, 1989, at A1, col. 7.

4. Pear, *U.S. Experts See Trade Disputes Put in Limbo as Tokyo Regroups*, N.Y. Times, Apr. 25, 1989, at A8, col. 6.

5. *Id.*

6. See generally, *THE COMPLETE JOURNAL OF TOWNSEND HARRIS* (M. Cosenza ed. 1930).

7. *Id.* at 496.

agreement, and the Japanese negotiators refused to sign it. The agreement was to be signed within two months, after obtaining the Emperor's approval. Four months later, without the Emperor's approval, the Japanese delegation finally signed the treaty.

Harris was not delighted with his two years of negotiation: "I shall esteem myself lucky if I am not removed from office, not for what I have done, but because I have not made a commercial treaty that would open Japan as freely as England is open to us."⁸

III. Two Paradigms

If little seems to have changed in five years (or, more pessimistically, 130 years), what should we learn from this? And what shouldn't we learn? To answer these questions I offer two paradigms, semiconductors and soda ash. I think that the way these two industries were handled in the past five years points the way.

Clyde Prestowitz, in an influential book titled *Trading Places*, argues for an increase in "managed trade."⁹ Managed trade recognizes that "nation states" compete (perhaps more so than individual companies), and that in this competition political and cultural norms may trump market forces. It is not enough, then, to "open" markets. Trade must be managed so that we get results, not just process. Results, in this context, means guaranteed market share ("quotas").

One example Prestowitz gives for managed trade is the semiconductor industry. After describing how Japan's government assisted the development of Japan's semiconductor industry, Prestowitz details the problems subsequently faced by the U.S. semiconductor industry.¹⁰ Beginning in 1984, Japanese producers of mass production semiconductor chips instituted large price reductions, causing major financial losses to U.S. manufacturers. Prestowitz indicates that U.S. trade policy then became a search for a *modus vivendi* with the Japanese industry so as to give U.S. firms time to regain their health.¹¹ The U.S. objectives were higher prices (which required control of Japanese output and the elimination of sales in "third markets") and an increase in U.S. market share in Japan. This led to the "supreme irony"¹² of asking Japan's government to cartelize its industry. Nevertheless, "the original Japanese intervention in the market had given rise to market distortion that could be corrected only by further intervention."¹³

But what were the effects of the semiconductor product agreements for which Prestowitz argues? For one, these agreements put the Ministry of International Trade and Industry ("MITI") in control of world-

8. *Id.* at 374.

9. See C. PRESTOWITZ, *TRADING PLACES* 322-27 (1988).

10. *Id.* at 44-45.

11. *Id.* at 61.

12. *Id.* at 62.

13. *Id.*

wide semiconductor pricing. For another, the agreements left the Japanese firms with high profits which they have proceeded to reinvest in further development. In the last six months of 1988 approximately \$3 billion in Japanese investment in new semiconductor lines was announced. The agreements also raised input prices to downstream U.S. computer manufacturers, to the dismay of our computer industry.

What didn't the agreements do? For one, they failed to attract entry by U.S. firms into the mass production DRAM market. Japanese firms continue to dominate this field. For another, the agreements have not led to an increase in the share of Japan's market held by U.S. firms.¹⁴ In fact, by January 1989, the U.S. chip industry was reported to be sliding once again.

My other paradigm is soda ash. Soda ash is a raw material used in a number of production processes, including glass. The United States has extensive deposits of natural soda ash. Japan has none, relying instead on more expensive manufactured soda ash. From 1973 to 1983, Japanese manufacturers of soda ash formed a cartel to limit the imports of the cheaper natural U.S. soda ash. The approach taken in this case by the U.S. government and the U.S. industry, however, was not to "manage" trade in soda ash. Rather, it was to open Japan's market through the use of Japan's antitrust law. In 1983, acting on complaints of the U.S. industry, forwarded by U.S. government officials, the Japan Fair Trade Commission (which enforces Japan's antitrust law) found that the Japanese companies had violated the Antimonopoly Act and ordered the cartel disbanded.¹⁵ Imports did increase in the wake of this decision, although the result has not been an unalloyed success.

The U.S. industry continues to believe that Japanese soda ash manufacturers pressure their customers to limit purchases of U.S. soda ash. In 1987, after further complaints by the U.S. industry, the Fair Trade Commission called upon the domestic soda ash manufacturers to "take care not to engage in any conduct that might obstruct fair competition through unduly restricting the purchases of soda ash consumers or hindering the sales of importers."¹⁶ The Commission did not, however, find any further violations of the antitrust laws. Sales of U.S. soda ash now appear to have flattened out at about 20% of the market, an amount which is larger than the share prior to the Commission's 1983 decision, but which the U.S. industry still views as too low given its apparent price advantage.

14. Both sides are now arguing over the meaning of a confidential side letter regarding market share for U.S. firms in Japan.

15. The soda ash decision is discussed more fully in First, *Japan's Antitrust Policy: Impact on Import Competition*, in *FRAGILE INTERDEPENDENCE* 67-69 (T. Pugel & R. Hawkins eds. 1986).

16. "Actual Situation and Other Aspects of the Soda Ash Market in Japan," Japan Fair Trade Comm'n, Nov. 25, 1987, at 3 (mimeo) (English translation).

IV. Conclusion: The Failure of Managed Trade

What do the two paradigms tell us, aside from the fact that there are no instant cures for trade problems? On the semiconductor/managed trade side, I see three lessons. First, managed trade agreements do not attack underlying problems. They carry no improvements beyond the immediate relief of a particular problem—import competition. They do not require that industry investments be made or innovations be undertaken; real structural change does not occur. Indeed, by ignoring the underlying economic phenomena which gave rise to the need (for example, experience curve economies in semiconductor manufacturing), managed trade agreements paper over problems rather than solve them. Second, once in place, managed trade agreements do not disappear. Steel and automobile restraints are still with us, for example, and I would not expect semiconductor restraints to disappear when the agreements expire in 1991. Third, managed trade agreements set up market distortions which are costly and can create new problems. Industrial development incorporates the restraints; product planning, investment, and purchasing decisions are made based on their existence. Would Japanese automobile manufacturers have moved to more “upscale” models in the absence of export restraints? Does high definition television (“HDTV”) look more attractive given the existence of the semiconductor agreements?

On the soda ash/competition side I see different lessons. Competitive solutions are market driven. They are based on the only approach that offers the possibility of long run success. Competitive solutions recognize the economic motivations of all. Japanese buyers of soda ash (or beef) will prefer a less expensive product if they can get it; we will not need quotas to force it on them. If producers are able to get cheaper and better goods to consumers (whether the consumers are Japanese or American), eventually consumers will buy. I don't mean to denigrate the formidable obstacles to making this approach work. Identifying structural impediments to competition is often difficult. Even in Japan, cartels are not always as observable as the soda ash cartel. Still, it seems to me to be preferable to make the effort to look for anticompetitive agreements and to push antitrust enforcement authorities to do their job, so that the market can do its job.

It would not surprise me if U.S. industry supports managed trade. Why shouldn't our companies prefer guaranteed market shares to the uncertainties of competitive markets? It would not surprise me if Japanese industry supports managed trade. The lessons of a guaranteed market share in automobiles cannot have been lost on Japan's managers. It would not surprise me if Japan's government supports managed trade. Guiding industries based on market shares is not an unfamiliar task to Japan's ministries (particularly MITI).

But what of the United States government? The policy drift of the last eight years has been to negotiate industry-specific fixes from competition and to stop there. It is no wonder that these issues never seem to

go away and that our own economic problems seem to be growing. In this context, managed trade is alluring. I would hope we pick a different course, though. I would, on the one hand, take a more active governmental role in directing strategic emerging and declining industries. At the same time, I would reject the drift toward quota capitalism. Instead, we should adopt policies that aim for the emergence of structurally competitive markets in the United States *and* in Japan. Competition—unpredictable, pluralistic, and unruly—remains the best policy.

