The US / Japan Trade Dispute
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The US/ Japan Trade Dispute

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Major Issues

The US has threatened to impose 100 percent tariffs on the importation of thirteen Japanese luxury cars. Their public justification for this action is based on alleged structural barriers in the Japanese market and related protectionist policies. In response Japan has initiated a dispute settlement procedure with the recently inaugurated World Trade Organization on the grounds that the US action is contrary to the WTO principle of most-favoured nation. The legal basis of threatened US sanctions is found in Section 301 of the US Trade and Tariff Act of 1974 (amended in 1988) which allows the use of unilateral action against any country found to be employing "unreasonable" trade practices to the detriment of US trade.

While the US' trade deficit with Japan is cited as proof of Japanese structural barriers, commentators have highlighted US domestic politics as a central motivation for the initiation of the "301" proceeding.

Japan's referral of the dispute to the WTO is reflective of its dissatisfaction with past US measures which have imposed restrictions on Japanese imports. The trade dispute and how Japan handles it is also integral to Japan's domestic political situation and issues related to its regional and international leadership.

The Uruguay Round of GATT negotiations instituted the WTO and established dispute settlement procedures to facilitate resolution of just such a dispute. The future credibility of the Organization rests heavily on the outcome of this dispute and with it the viability of the multilateral system. Six potential outcomes are identified in this paper.

Finally Australia's reliance on the multilateral system and vulnerability in this dispute is examined; the paper concludes that Australia's trade interests would be best furthered through promotion and support of the multilateral system as embodied in the WTO.
Introduction

On 16 May the US government announced it would impose 100 percent tariffs on thirteen Japanese luxury cars¹ on 28 June, to apply retrospectively from 20 May. The sanctions are based on US "301" trade policy which allows the use of unilateral action to redress perceived "unfair" trade practices. While history would suggest a bilateral solution will be found before the dispute is dealt with by the World Trade Organization (WTO), subtle changes have occurred in the international trading environment as a result of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) negotiations. This changed trading environment means the potential repercussions of US unilateral sanctions, irrespective of whether this dispute is or is not settled through the WTO, could seriously undermine the multilateral trading system.

This paper examines the legal basis of US unilateral action and the public and political motivations behind the threatened sanctions. It outlines Japan's current position, the role of the WTO in this dispute and six of the most likely potential outcomes. Finally the paper examines Australia's position and the centrality of the multilateral system to our trade situation.

The Legal Basis of US Sanctions.

The threat of US sanctions on Japanese car imports comes under a piece of legislation known as Super 301. The term derives from Section 301 of the US Trade and Tariff Act of 1974 which was established to facilitate unilateral action in order to enforce trade rights previously agreed upon under GATT and other bilateral trade treaties. The 1974 legislation was consistent with international trade agreements and in fact required a GATT dispute settlement mechanism to be initiated prior to any sanctions being imposed. Super 301 was added in 1988 and represented a move away from internationally accepted practices by enabling the US administration to launch "retaliatory" action on what they define as "unreasonable" trade practices. While the issue of "unreasonable" practices was addressed in Section 301, Super 301 increased the number of practices which could be interpreted as "unreasonable", outlined methods for their removal and established strict time limits for the implementation of a 301 procedure.

The current dispute, which was launched by the US Trade Representative (USTR) Mickey Kantor, was preceded by an extensive period of negotiation begun twenty-eight months earlier. The 301 process requires the USTR to prepare an inventory of foreign barriers, the main perpetrators of these barriers and their "unreasonable" practices. Deadlines are then set for both the termination of the offending practices and the imposition of US retaliatory action should they not be removed. This particular dispute is a little different in that rather than demanding the removal of restrictive practices, the US is actually specifying that Japan increase its imports of US car parts.

¹ These cars are the Honda Acura Legend and Acura 3.2 TL, the Toyota Lexus LS 400, Lexus SC 400, Lexus SC 300, Lexus GS 300, Lexus ES 300, the Nissan Infiniti Q 45, Infiniti J 30, Infiniti I 30, the Mazda 929 and Millenia and the Mitsubishi Diamante.
The dispute is not a new development in US / Japan trade relations. The history of US restrictions on imports from Japan goes as far back as 1937 when the Japanese agreed to limit exports of cotton textiles and selected cotton products to the US. Similar voluntary export restraints were negotiated over textiles (1957-61), steel (1968 and 1984), soybeans (1973), automobiles (1981) and machine tools (1986), and for the fixing of floor prices for exports of Japanese steel, machine tools (late 1970s) and semiconductors (1986).^2

**US Justification for Sanctions.**

US justification for its 16 May action is based primarily on economic factors, though commentators have identified political issues as decisive.

The US annual trade deficit with Japan is currently $US65.7 billion ($A90 billion) of which sixty percent is accounted for by car and car part imports^3. Forcing Japan to increase its imports of US car parts is intended to redress this imbalance. This would involve the Japanese bureaucracy ensuring car manufacturers agree to import specified volumes of US car parts - a step which could be considered to be an abuse of the GATT principle of most-favoured nation prohibiting discrimination between Members.

The US Administration views the trade imbalance as representative of hidden structural barriers in the Japanese market^4, barriers some of which they see the WTO as incapable of dismantling. It is these structural barriers that the 301 action is attempting to counter. If the US government does end up taking a complaint to the WTO, it will be the relatively closed nature of the Japanese market upon which it will fight.

The kinds of practices identified by the US and other observers as structural barriers include the *keiretsu* system, where special relations exist between a very small number of large Japanese corporations which guarantees minimal competition for imports and exports. This special relationship is evident among Japan's nine major trading companies (who handled 77 percent of Japan's imports in 1987) where they tend not to import products which compete against domestic affiliates^5. In addition factors such as the Japanese distribution system (where sales outlets tend only to deal with specific manufacturers), regulations limiting share market takeovers, 'administrative guidance' from the government, inadequate protection of intellectual property rights and delays in granting patents to foreign products and ideas (enabling the reproduction of these products and ideas in Japan), and restrictive customs and certification procedures for imports are identified as structural barriers to trade^6. However, Japan is not alone in maintaining restrictive trade practices. Most countries use these tools to varying extents in order to protect their domestic economy.

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^4 The *Australian*, p. 9.


^6 ibid., p. 118.

ibid., p. 114-5.
Many observers argue that the economic factors used to justify US sanctions are merely a cover for political motives and that the essence of the Japan / US trade imbalance has more to do with low levels of US savings and poor macroeconomic policy. 1996 is a US presidential election year and, in the light of recent Republican wins in the US mid-term Congressional elections, the incumbent Democratic President's position is not strong. There is a view that the stand taken by President Clinton will gain political kudos irrespective of the outcome. If Japan does succumb to US sanctions, then the President will be seen to have "won". Yet even if Japan stands firm and the US fail to get their way, the President will still be seen as having 'stood up to the Japanese'.

**Japan's Position in the Dispute.**

The imposition of 100 percent tariffs on selected Japanese car imports has been depicted by some commentators as a relatively ineffective measure, one not particularly detrimental to either the Japanese economy or even its car industry.

Recent increases in the value of the yen have had far greater effect on the US / Japan trade imbalance than that envisioned by the proposed US sanctions. The value of the yen compared to the US dollar has almost doubled in the last five years, from a rate of 152.2 yen in June 1990 to 83.1 yen in May 1995. The changing exchange rates have seen the cost of Japanese exports increase dramatically, while US exports have become far more affordable. Though the Japanese car industry has suffered losses due to increases in the value of the yen, they so far have been willing to absorb the costs of these increases. However, the effects of changes in the exchange rate have had repercussions which go far beyond the car industry. This year alone the Japanese economy has suffered a loss of potential earnings of $US54 billion.

Having weathered these far more substantial burdens, Japan, it is argued, is less likely to give into sanctions threatening the loss of car sales worth only $US5.9 billion. In addition, the extensive size and competitiveness of the Japanese car industry would enable losses incurred in the luxury car market to be offset by increased sales in other categories. Both the Japanese automotive industry and the Japanese Ministry of International Trade and Industry have been quoted as wanting to resist the sanctions.

The trade dispute raises an array of issues for Japan that go far beyond economic ones. Questions relating to domestic politics, and Japanese international and regional leadership and security are integral to their stand on US sanctions.

Japanese domestic politics is experiencing a period of change unprecedented in the post-World War Two period. With Japan traditionally run to a high degree by an extremely strong and extensive bureaucracy, the government has tended to play a secondary role in the administration of the economy. Signs of public discontent with this system could be said to have been in evidence when the Liberal Democratic Party, in government for 38 years, was

7 ibid., p. 129.
8 *Sydney Morning Herald*, 20/5/95, p. 28.
10 ibid, 23/5/95, p. 18.
11 ibid, 8/5/95, p. 15.
defeated by a reform coalition in 1994. In April this year, elections for prefectural governors across Japan had equally unexpected results when the majority of officially sanctioned major-party candidates were beaten by hundreds of new independent and minority-party candidates. The perceived instability of this political environment would not be assisted by a Japanese government which succumbed to US demands.

In addition, the Japanese Minister for Trade, Ryutaro Hashimoto, has political aspirations for the Prime Ministership which would seemingly be furthered by resisting US pressure.

Over the last decade, calls for Japan to take on an international role more commensurate with its economic strength have increased from both within and outside the country. They have called for Japan to take a more positive stand on global issues, be an active force for international trade liberalisation and international security and accept greater financial responsibility for Third World and Eastern European development. Should the Japanese give in to US unilateral pressure once again, they open themselves to criticisms of negating their international responsibility to enforce liberal trade practices. Domestically it is a question of "losing face" to a country some Japanese see as no longer qualified to exercise leadership.

The issue of Japan / US security ties is also a significant factor in Japan's calculations as to how it will deal with US sanctions. The end of the Cold War has seen the US push disputes beyond previously accepted boundaries in a way which has brought into question the continued viability of the US / Japan security alliance. While US Assistant Secretary for Defence for International Security Joseph Nye has argued against linking trade and security issues, rhetoric surrounding the dispute has seen other US trade and defence officials comment to the contrary. The US has considerable forces stationed in Japan as part of its commitment to the US / Japan alliance. It is an alliance that is said to provide a significant deterrent to potentially hostile action, thus contributing to stability in the East Asian region. Should the US decrease its commitment, Japan would need to increase its defence spending in order to provide a similar level of deterrence. This scenario, however, is unlikely in light of the possibility of increased regional instability and US / Japanese economic interdependence.

The Role of the World Trade Organization.

Both Japan and the US have chosen to initiate dispute settlements with the WTO in relation to the 16 May US announcement, though as yet only Japan has laid a formal complaint. The US has submitted a pre-filing notification indicating its intent to initiate a dispute settlement at around the time sanctions come into effect. This indication of intent is not actually required by the WTO and does not constitute an official complaint. The nullification or
impairment of benefits due to a Member, as derived from GATT / WTO agreements, establishes the right of a WTO Member to initiate a dispute settlement. The breach of an agreement equally authorises a Member to complain to the WTO on the understanding that such a breach would prima facie result in nullification or impairment of benefit.

In Japan's case, their complaint is based on the proposed imposition of US unilateral sanctions which would constitute an abuse of Article I of the General Agreement on Tariffs and Trade as first formulated in 1947 and subsequently incorporated into the Agreement Establishing the World Trade Organization. This Article states that "any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." By imposing additional tariffs on Japanese car imports and not on the imports of any other Member, the US is in breach of this article. Under WTO dispute settlement procedures, the Japanese will have to show nullification or impairment of benefit that they would otherwise have gained had no additional tariffs been imposed. This should not prove difficult.

The nature of America's complaint derives from alleged structural impediments in the Japanese economy which, it is argued, have stopped the US from receiving benefits that would otherwise have accrued to it. While this will constitute the central pillar of the US dispute action, the exact WTO agreements which Japanese structural impediments are alleged to violate have not yet been specified.

The WTO's dispute settlement process has been designed to cut down on the duration of settlement procedures and enforce adherence to panel findings. Annex 2 of the Uruguay Round Agreement includes a detailed exposition of dispute resolution procedures and strict time scales for their implementation. Unlike the system under GATT, WTO dispute procedures operate automatically, requiring a consensus decision by Members to interrupt them. It allows for the appointment of persons qualified in international law to hold dispute panel positions and establishes an appellate tribunal.

The WTO's Dispute Settlement Body (DSB), currently chaired by the Australian Ambassador Donald Kenyon, follows a defined procedure for the settlement of disputes. This procedure is initiated when a Member requests a consultation session with the offending Member based on nullification or impairment of benefit, as derived from a GATT/WTO agreement. The Member to whom the request for consultation has been made, must reply to the request within ten days and shall enter into consultation within a period of no more than thirty days. If the offending Member does not reply to the request then the Member lodging the complaint may directly request the establishment of a panel.

A WTO panel in a dispute settlement exists to assist the DSB in making recommendations or rulings. It is composed of three to five people, expert in the field of international trade negotiation and / or law. A panel's terms of reference are to examine a dispute between two or more parties based on their adherence to or deviation from WTO agreements as specified and agreed to by those parties. The panel then determines a timetable by which parties to the dispute should present submissions supporting their complaint. Should the parties fail to develop a mutually satisfactory solution in this time, the panel shall submit its findings in the form of a written report to the DSB no later than six months after the terms of reference have
been agreed upon, and three months in cases of urgency. The panel report is then issued to
the parties who have to submit any objections to the report within ten days of the report being
presented to WTO Members. If no further objection is made by either the parties to the
dispute or other Members, the panel report is adopted automatically by a DSB meeting unless
the DSB decides by consensus not to adopt the report. Under GATT, parties to a dispute
were able to block the adoption of a panel decision.

As yet, the Japan / US dispute has only reached the stage of a request for consultation. Tokyo
rejected an offer by the US to hold talks in Washington, a week before sanctions are due to
take effect, instead of in Geneva under WTO auspices. Following Japan's refusal, Washington subsequently agreed to a meeting on 16 June to take place in Geneva. This is
significant, as is the US delay in submitting a WTO request for consultation with Japan
regarding its own complaint, because it suggests the US is not confident of a favourable result
in a WTO dispute settlement.

In addition, US reticence at launching their own dispute settlement procedure in relation to
Japanese barriers to automotive trade can be traced to the existence of what it can be argued
are equally disruptive barriers in the US' own economy. While the US is one of the main
proponents of trade liberalisation, its own record on lowering trade barriers is not
unblemished. The US increasingly has implemented trade barriers that either result from
inappropriate use of WTO provisions (such as countervailing duties, anti-dumping actions or
rules of origin provisions) or are WTO-inconsistent (such as, orderly marketing arrangements
including import quotas, non-automatic licensing and variable levies)\(^ {16}\). Since the WTO
works on the principle of Most-Favoured Nation whereby concessions should be as equally
available to the Member offering the concession as receiving it (at least in theory)\(^ {17}\), opening
of the Japanese market would focus attention on US barriers and, by implication, require it to
reduce its own similar barriers, something it has been extremely unwilling to do


Several outcomes could result from this dispute. While this paper acknowledges the inherent
dangers in predicting likely outcomes, it is a necessary exercise if we wish to identify issues
pertinent to Australia's trade situation.

The potential repercussions of the US 301 action should cause concern, not so much for the
potentially debilitating effects of this action on US / Japan relations (though this is naturally
disturbing) but rather for the potential danger it poses to the multilateral trading system as
embodied in the WTO. While dispute settlement procedures have been invoked before, this
is the first dispute between two major trading Members of the WTO to come before its
tribunal. Whereas previously, contracting parties to the GATT (the predecessor of the WTO)
were less bound by the finding of a dispute settlement panel, the Uruguay Round has
instituted changes which make this more difficult and therefore far more an issue of the
WTO's credibility.

\(^{16}\) J. Bhagwati, Protectionism, Cambridge, Massachusetts: Massachusetts Institute of Technology, 1988, pp.
45-53.

\(^{17}\) J. A. Findlayson and M. W. Zacher, "The GATT and the Regulation of Trade Barriers: Regime
Of the several possible outcomes of the dispute, six of the most likely are outlined here. This paper does not single out any one outcome as being more likely to eventuate over any other, but rather highlights the potential dangers in each and suggests the outcome which would be the most favourable for the maintenance of the multilateral system.

I. A Bilateral Solution to the Dispute.

Should Japan and the US reach a bilateral solution to the dispute it would involve either the US withdrawing their threat of 301 sanctions without receiving anything in return, or Japan agreeing to set quotas for increased imports of US car parts, or an agreement that does not achieve either of these outcomes but provides a solution that would allow both parties to "save face". In some respects a bilateral solution could protect the WTO from having to find against either of the parties and thus avoid a situation which might cause one of them to break from the Organization as a result of an adverse verdict.

- **The US Concedes.** The likelihood of the US withdrawing its sanctions is based on recent domestic criticism of the action from both trade officials (particularly Carla Hills the USTR under the Bush Administration) and some sections of the US car industry (who fear job losses in the luxury car parts sector which exports to Japan already, and American dealerships of Japanese luxury cars). International criticism was voiced at the most recent OECD meeting where not one Member came out in support of US sanctions. Despite these criticisms the political cost of withdrawing sanctions would probably be too high for President Clinton to seriously contemplate.

- **Japan Concedes.** Should the Japanese succumb to US pressure and accept import quotas on car part imports they would directly undermine the WTO by demonstrating a lack of confidence in its dispute procedures and enforcement abilities. If Japan is not willing to pursue a dispute in which it is in the right, **based on WTO agreements**, then the confidence of lesser trading states to take complaints to the WTO, especially complaints leveled against major trading Members, would be undermined. American success would demonstrate that power-based relations continue to dominate trade relations between WTO Members, a system the Uruguay Round attempted to replace with one favouring rules-based relations. The American reversion to unilateralism would increase uncertainty in the trading system, the basic ingredient for international trade liberalisation.

- **Compromise.** Perhaps the most favourable bilateral outcome would be a compromise whereby nothing is essentially changed yet both parties are diplomatically portrayed as having "won". The kind of change the US requires of Japan should be negotiated within the WTO framework, not through unilateral action. This outcome would reinforce the multilateral system as the WTO emphasises consultation and negotiation as acceptable and necessary processes in dispute settlement. This line of action was originally supported by Mr Renato Ruggiero, the WTO Director-General, to avoid the possible repercussions of a DSB finding against either of the parties.

II. A WTO Settlement.

- **The WTO Rules Against the US.** As yet only Japan has launched a dispute settlement under the WTO. If a WTO panel is established and finds against the US, the US would be
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asked to remove the sanctions (if implemented) within a specified period of time. Should the US refuse to do this, Japan would be allowed to either request compensation or withhold concessions previously granted (such as reduced tariff rates for some goods or services) to the value of the damage inflicted by the imposition of US sanctions. The withdrawal of concessions is allowable for a limited time only. Though the US has publicly stated that they will abide by WTO decisions, if they feel that the finding against them directly threatens their national interest, however defined, it is not unthinkable that the US would withdraw from membership of the WTO. While the repercussions of this might not be fatal for the Organization (though in this situation the demise of the WTO is highly likely), this outcome would undoubtedly undermine the WTO's credibility.

- The WTO Rules Against Japan. Should the US bring a complaint to the WTO on the grounds of structural barriers in the Japanese economy, its case will be harder to prove. If the US are able to prove their case the repercussions of a finding against the Japanese would be far more substantial than a finding against the US. In Japan's case a major overhaul of its commercial practices, which a reduction in structural barriers would suggest, could have huge ramifications not only for its economy but also for social, political and security concerns.

- The WTO Rules Against Both. The most favourable multilateral outcome of this dispute would have the WTO DSB find against both the US and Japan and both countries adhere to the findings. This would require the US to cease unilateral action and discourage it from employing such measures in the future, and force the Japanese to identify and decrease practices which act as structural barriers to international trade. Yet these changes would be done within the multilateral framework allowing consideration for domestic adjustment problems and within a time frame decided by all Members, not only by the US. In the process of achieving these two ends the multilateral system would have been strengthened. Should this eventuate the essential factor here, and the one most likely to undermine the Organization's effectiveness, is the WTO's (in)ability to enforce adherence. The only way to test this is through practice.

Australia's Position.

Australia currently exports $180 million worth of car parts to Japan. Both Mickey Kantor and Ryutaro Hashimoto have assured Australia's Trade Minister McMullan that this trade would not be damaged by the dispute. The strength of these assurances can only be proven with time, yet history would suggest US assurances at least, are not particularly reliable. Should our car part exports decline as a result of this dispute Australia would be able to lodge a complaint with the WTO, although the effectiveness of this would depend very much on the outcome of the US / Japan resolution. Should the WTO's dispute settlement procedure in this dispute be found to be ineffective in enforcing agreements, there would be little point in Australia taking a complaint to the DSB.

Some commentators have examined the implications of the dispute for APEC. This regional grouping has a significant distance to travel before it is capable of overseeing disputes between members. Most APEC countries have encouraged the US and Japan to seek settlement through WTO channels. Should the parties to the dispute fail to reach a satisfactory resolution, the fact that the two most significant members of APEC were unable
to reach agreement on trade liberalisation would severely undermine future attempts by APEC to open regional trade, let alone "create a noun out of the adjectives" by establishing the group on a more formal institutional basis.

Both Australia and the European Union have notified the DSB that they consider that they have substantial interests in the Japan / US dispute and have been subsequently granted third party status in the impending WTO settlement procedure. This allows Australia access to the respective parties' DSB submissions and enables Australia to make submissions on its own behalf. This option only becomes available to third parties if the US and Japan carry through with their decision to take the dispute to a DSB panel. As yet the US have disallowed Australia and other third party requests to observe preliminary negotiations despite Japan's invitation. Australia's role as an interested third party allows it to focus attention on the dispute and try to guarantee a maximum degree of transparency in negotiations. An open negotiation should dissuade the US and Japan from making agreements which essentially block out other WTO Members from accessing possible negotiated concessions.

As a middle-ranked trading power Australia relies on the agreements established by the WTO and the forum it offers for negotiating change of those agreements. Our range (predominantly primary products) and volume (we have a 1.1 percent share of world merchandise exports and 1.2 percent share of world merchandise imports\(^{18}\)) of traded goods places us in a relatively vulnerable position when it comes to negotiating with major trading countries (our combined trade with Japan, the US and the European Union in 1992-3 constituted sixty percent of our imports and 45 percent of our exports of total trade\(^{19}\)). If Australia wishes to protect and increase its volume of trade, then it may be argued that the multilateral system currently provides the most effective channel for achieving this.

It is strongly in Australia's interests for it to do all in its power to promote the WTO as the forum for resolution of the US / Japan trade dispute. The potential damage this dispute could do to the WTO must be emphasised by either formal or informal means, in order to bring home to the Japanese and the US that there is much more at stake in this dispute than domestic concerns.


\(^{19}\) I. Castles, *Year Book Australia 1995*, No. 77, Canberra: Australian Bureau Of Statistics, p. 764-68