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## A Perspective on Japanese Trade Policy and Japan-US Trade Friction\*

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### Abstract

In spite of Japan's full participation in multilateral tariff reductions, it frequently has been embroiled in contentious trade disputes with the United States. Before 1980, most of the friction was generated by U.S. industries seeking protection from Japanese imports, including textiles, steel, televisions, and automobiles. All of the cases just mentioned, and others, were ultimately settled when the government of Japan agreed to voluntarily restrain exports of the disputed items. By the mid-1980's, a substantial fraction of Japan's exports to the United States were subject to Japanese government restraints. Nevertheless, protectionist pressures in the U.S. seemed to grow rather than dissipate. To counterbalance the protectionist pressure, American politicians and government officials attempted to shift the focus of U.S. trade policy, away from Japanese imports and towards expanded sales of U.S. products to Japan, particularly in closed or regulated markets there. In a succession of bilateral negotiations since 1985, the U.S. government has demanded and obtained, under threats of retaliation, many Japanese concessions benefitting American exporters to Japan. The beneficiaries of this policy include American exporters of semiconductors, beef, oranges, wood products, insurance, telecommunications, auto parts, and other items. Through it all, Japan has only rarely lodged official protests against the trade policies or practices of the U.S.. From the one-sidedness of the complaints, one might think that Japan-U.S. trade friction really is about Japan's "unfair" practices and "closed" markets. It is not. It is about how best to deal with, or deflect, the protectionist response in the U.S. to expanded Japanese exports.

\*Much of this essay is based on material included in: David Flath, Japanese Economy, Oxford University Press, forthcoming (Ch.8).

## A Perspective on Japanese Trade Policy and Japan-US Trade Friction

Protectionism lowers the national income and economic welfare of the nation that practices it. Theoretical exceptions may be noted --the exploitation of international market power, the protection of an infant-industry, or the counteraction of distorting effects of other policies-- but they hold little practical significance.<sup>1</sup> In spite of it, Japan has adopted numerous policies that interfere with foreign trade--tariffs, import quotas (including those implicit in foreign exchange rationing prior to 1964), export restraints (at the request of foreign governments) and, until 1980, restrictions on inward foreign direct investment. But it is not alone in this. An examination of the recent trade policy of the U.S. or the nations of the EU also reveals many examples of protectionism. And all of these nations seem to have significantly reduced their own interferences with trade, particularly tariffs, only after negotiating international treaties that required them to do so. The first question to ask about all this is why? Why have nations interfered with trade, deliberately foregoing gains, and why are international treaties needed for them to stop doing so?

### International Negotiations and Japanese Liberalization

Trade policies emerge from political conflict among competing special interests, not from consensus regarding the national interest. In a representative democracy, the outcome of a political test is often determined more by the relative magnitudes of political contributions than it is by the simple number of persons on each side of the issue in question. The side that more clearly perceives its self-interest, and is better able to overcome free-riding among its own members, is likely to amass a larger war chest and may actually prevail, even if its desired policy confers smaller collective benefits on its own members than the losses it imposes on the rest of society. And this is why countries, so often, adopt self-damaging trade policies. In a referendum on protection of a single industry, domestic producers may well prevail, for the policy, if adopted, would enrich the few of them at the expense of the many demanders. The concentration of benefits on producers and diffusion of losses among demanders, makes it easy for the producers and hard for the demanders to overcome free-riding, amass a large war chest, and mount an effective political lobby. But in a referendum on an economy-wide policy of free trade, versus economy-wide protection, matters are apt to play out quite differently. Producers benefit only from their own specific exceptions to free-trade but are harmed by the exceptions proffered to others. Economy-wide protection can garner little effective support.

A series of multilateral trade policy agreements has cumulatively reduced the developed nations' *ad valorem* tariff rates (averaged across dutiable imports) from 40 percent in 1947 to 4 percent in 1994. These international treaties were needed for each country to reduce its own tariff rates, not because they assured reciprocity, but because they framed the question of tariff reduction as a single economy-wide issue, rather than as a multiplicity of separate issues each mostly affecting only one import-competing industry. To quote the eminent trade economist Paul Krugman, "...[t]he true purpose of international negotiations is arguably not to protect us from unfair foreign

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<sup>1</sup>For a detailed discussion of the theoretical justifications for policies that interfere with foreign trade refer to the following: Neil Vousden, The Economics of Trade Protection, New York: Cambridge University Press, 1990.

competition, but to protect us from ourselves.”<sup>2</sup> It is often suggested that foreign pressure (*gaiatsu*) is an essential catalyst in the elimination of protectionist trade policies of the Japanese government. In the way just described, the same could be said of virtually every developed nation including the U.S.. International negotiations have drawn all of them towards more liberal trade policies.

The General Agreement on Tariffs and Trade (GATT), launched in October 1947, provided the essential starting point for the rounds of multilateral negotiations on tariffs alluded to in the previous paragraph. The cornerstone of the 1947 agreement was that signatories would accord one another most-favored-nation status, that is, would not apply a higher tariff rate to imports from any of them than was applied to imports from any other, nor a lower duty on exports to one signatory nation than to another. Japan was still under American occupation in 1947 and not an original signatory to the GATT. But, in August 1955, three years after Japan’s sovereignty was restored, it joined the agreement in full, having obtained the approval of the required two-thirds of incumbent signatories. Japan’s accession to the GATT did not require it to abolish its rather sweeping system of foreign exchange rationing. The 1947 agreement (article 11), prohibited the use of quantitative restrictions (quotas) except to maintain balance of payments equilibrium, promote economic development, preserve national security or to protect agriculture. Within this set of qualifications, the government of Japan discovered license to maintain its system of foreign exchange rationing, only abandoning item-specific trade quotas (except those pertaining to agricultural commodities) in February 1963, that is, converting the quotas to tariffs. Japan finally abandoned all foreign exchange restrictions on current transactions in April 1964 (and in accordance with the IMF charter, the “rule book” for the Bretton Woods monetary regime, was bound thereafter not to reintroduce them (article 8)). The government of Japan had used its foreign exchange rationing system to nurture favored sectors of the economy, such as petrochemicals, steel, and automobiles, and retard others. Abandonment of that tool permanently weakened Japanese industrial policy, and greatly liberalized Japan’s foreign trade.

Fourteen countries (Australia, Austria, Belgium, Brazil, Cuba, France, Haiti, India, Luxemburg, the Netherlands, New Zealand, Rhodesia-Nyasaland, South Africa and the U.K.) did not assent to Japan’s accession to GATT in 1955, which, under Article 35 of the 1947 agreement, meant they were not obliged to accord Japan most-favored-nation trading status. These countries withheld most-favored-nation treatment from Japan and imposed discriminatory tariffs on it, that is, higher than they imposed on imports of like goods from other nations.<sup>3</sup> In contrast, West Germany acceded to GATT nearly five years before Japan with little opposition, and was accorded most-favored-nation trade status by all of the Western European nations. Soon after its accession to GATT, Japan entered bilateral negotiations with Britain, France, Australia and the other nations invoking article 35 against it, in pursuit of most-favored-nation status. The effective opposition to the policy in each of them appeared to emanate from economic sectors likely to be harmed by expanded textile imports from Japan. Textiles had been Japan’s major export in the prewar era, and would again be in the early

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<sup>2</sup>Paul R. Krugman, “What Should Trade Negotiators Negotiate About?” Journal of Economic Literature, vol. 35, March 1997, pp.113-120, at p. 118.

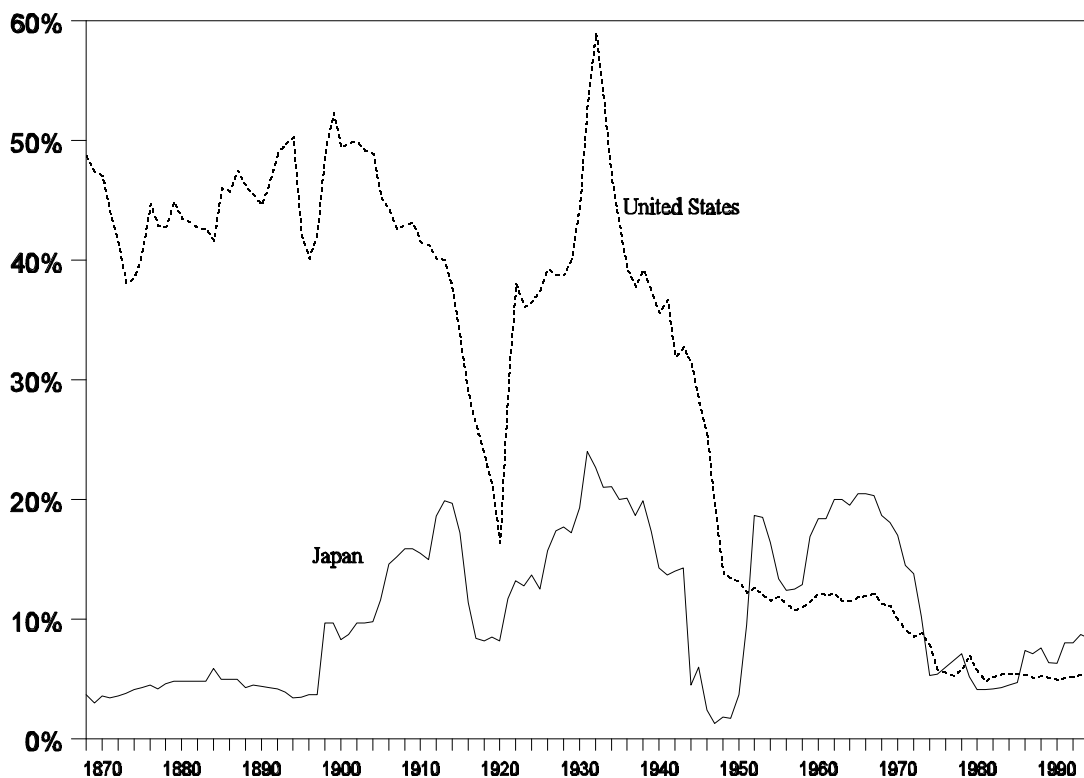
<sup>3</sup>For details pertaining to Japan’s accession to GATT and the discriminatory tariff policies of the fourteen nations voting against it refer to the following: Gardner Patterson, Discrimination in International Trade the Policy Issues, 1945-1965, Princeton University press, 1966. See especially Chapter 6: “Discrimination as a Tool for Protection”, pp. 271-322.

postwar period. Few in the 1950's perceived the dramatic advances in Japan's economy that were soon to shift its comparative advantage away from textiles and towards more capital-intensive manufacturing industries. To obtain most-favored-nation status, the government of Japan agreed to administer restraints of selected Japanese goods, mostly cotton textiles, to the respective nations. The precedent for this had been set by the U.S. which had already elicited Japanese restraint of exports to it of tuna, beginning in April 1952, and of cotton textiles, first in 1956 and then extended for a five year interval beginning in 1957, and for plywood, stainless steel kitchen utensils, and woodscrews, all from 1958.<sup>4</sup> These "voluntary export restraints", as they were euphemistically dubbed --they were not really voluntary, but adopted under some duress— muted the foreign opposition to Japan's participation in multilateral trading arrangements. Britain disinvoked GATT article 35 in its policies towards Japan in Spring 1963, and Australia, France, and the Benelux countries disinvoked it soon after, each of them, in doing so, extending most-favored-nation status to Japan. But the Japanese concessions to foreign seekers of protection set a troublesome precedent. By the early 1960's Japan had agreed to voluntary restraint of its exports of cotton textiles and a few other items to no less than 20 nations. Japan agreed to numerous additional voluntary export restraints in subsequent years. The perpetuation or enlargement of foreign protection directed against particular Japanese industries, has seemed to be an inevitable accompaniment to Japan's inclusion in multilateral agreements liberalizing tariffs.

The 1947 GATT included an ongoing commitment of signatories to meet annually in Geneva and to also meet at irregular intervals in special conferences like the original one, to seek further multilateral tariff reduction agreements. There have now been seven more special GATT conferences since the original one in 1947, each resulting in a further round of multilateral tariff reductions. The first four of these achieved only modest tariff reductions, but the fifth, known as the Kennedy round (1963-1967), sixth (Tokyo) round (1973-1979), and seventh (Uruguay) round (1986-1993), each reduced tariff rates in all the developed nations, averaged over dutiable items, by about one third. The Figures 1a and 1b depict tariff rates in Japan and the United States, averaged over dutiable imports and over all imports, respectively, show the liberalizing effect of the Kennedy round and Tokyo round agreements in historical context.

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<sup>4</sup>On the American political background surrounding the Japanese voluntary restraints of exports to the U.S. prior to 1970, refer to the following short but informative work: William McClenahan, "The Growth of Voluntary Export Restraints and American Foreign Economic Policy" Business and Economic History, second series, vol. 20, 1991, pp. 180-190. According to McClenahan (p. 189), "VERs and bilateral restraints of Japanese products allowed the United States to continue to advocate unconditional most favored nation treatment in international trade while it maintained some modicum of protection for domestic industries whose opposition to liberal trade policies could jeopardize those policies and future legislation."



**Figure 1a. Annual average tariff rates (Customs duties divided by dutiable imports) of Japan and the United States, 1868-1995.**

Sources: Japan: LTES, vol. 14, table 22, p. 252; and *zaisei kinyā tōkei geppō* (no.389 (sept. 1989) and no. 534 (Oct. 1996)).

US: US Bureau of the Census, Historical Statistics of the United States From Colonial Times to 1970; and Statistical Abstract of the United States (annual).

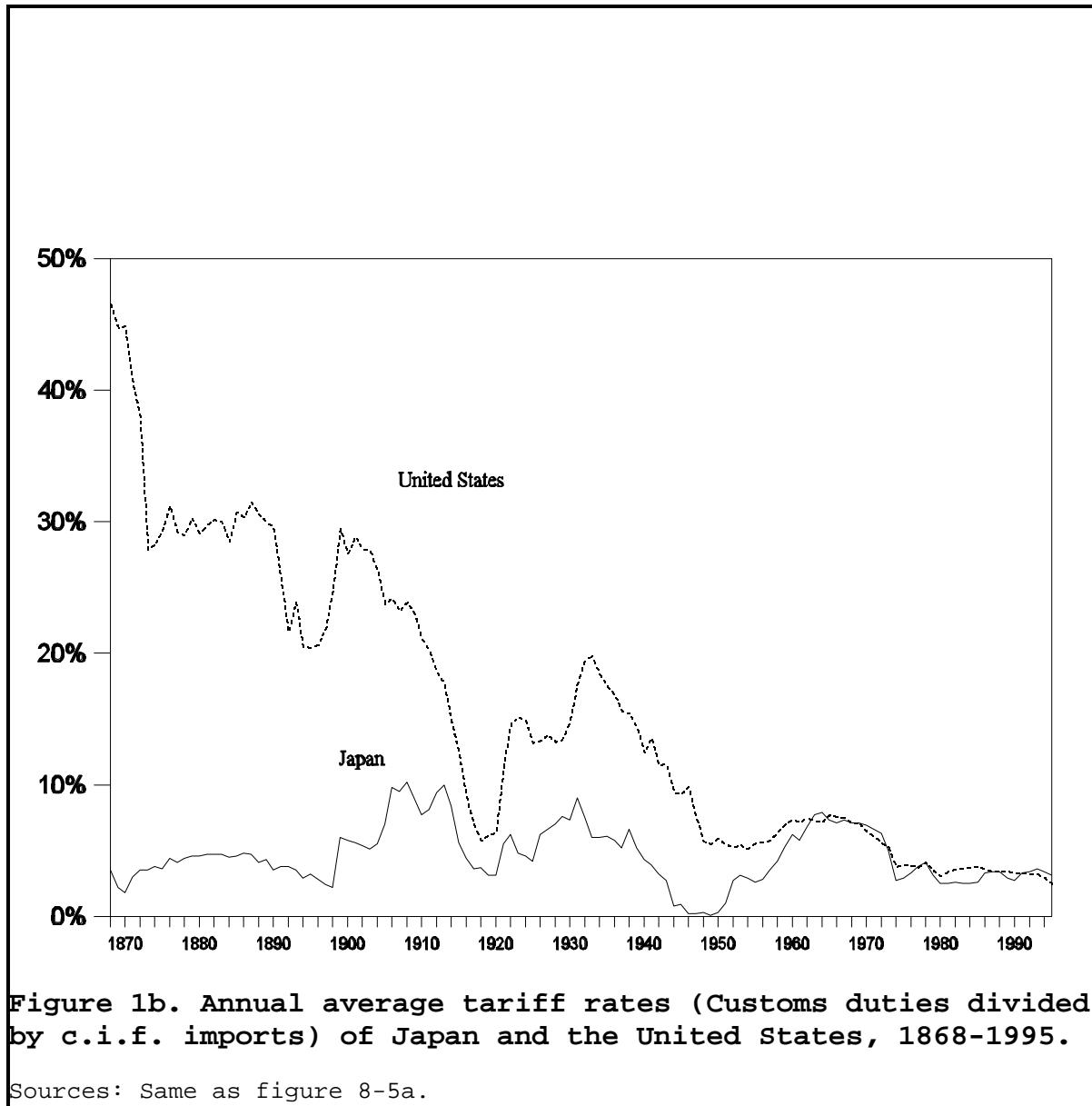


Figure 1b. Annual average tariff rates (Customs duties divided by c.i.f. imports) of Japan and the United States, 1868-1995.

Sources: Same as figure 8-5a.

The Uruguay round, besides reducing tariff rates, also abolished voluntary export restraints, initiated a phased ten-year elimination of internationally agreed textile trade quotas, and converted many agricultural import quotas to tariffs (but not Japan's quota system for rice imports, until 1995, a virtual ban on such imports). The Uruguay round also established a body known as the World Trade Organization (WTO) to adjudicate trade disputes among members (GATT signatories), and carry forward the other activities that emanated with GATT (The original 1947 GATT had included a provision that would have established a standing body to adjudicate international trade disputes, but the U.S. Congress failed to ratify it and it was never implemented). Perhaps the WTO will be the forum in which trade complaints aimed at Japan are finally defused or settled.

## Trade Friction

In spite of Japan's full participation in multilateral tariff reductions, it frequently has been embroiled in contentious trade disputes with the United States, and, to a somewhat lesser extent, with Europe. Before 1980, most of the friction was generated by U.S. industries seeking protection from Japanese imports, including textiles, steel, televisions, and automobiles. All of the cases just mentioned, and others, were ultimately settled when the government of Japan agreed to voluntarily restrain exports of the disputed items. And restraint of exports to the United States often led to requests by the EU, to which Japan acceded, that it also restrain exports to it. By the mid-1980's, a substantial fraction of Japan's exports to the United States were subject to Japanese government restraints. Nevertheless, protectionist pressures in the U.S. seemed to grow rather than dissipate. To counterbalance the protectionist pressure, American politicians and government officials attempted to shift the focus of U.S. trade policy, away from Japanese imports and towards expanded sales of U.S. products to Japan, particularly in closed or regulated markets there. In a succession of bilateral negotiations since 1985, the U.S. government has demanded and obtained, under threats of retaliation, many Japanese concessions benefitting American exporters to Japan. The beneficiaries of this policy include American exporters of semiconductors, beef, oranges, wood products, insurance, telecommunications, auto parts, and other items. Through it all, Japan has only rarely lodged official protests against the trade policies or practices of the U.S.. From the one-sidedness of the complaints, one might think that Japan-U.S. trade friction really is about Japan's "unfair" practices and "closed" markets. It isn't. It is about how best to deal with, or deflect, the protectionist response in the U.S. to expanded Japanese exports.

### *Growth in Japanese Trade and Protectionist Response in the U.S.*

In a bow to the inevitable, the GATT article 19, known as the "escape clause", explicitly recognizes the legitimacy of temporary protection against surging imports. Additionally, GATT article 6 authorizes special protection from imports sold at lower price than in the country of origin, referred to as "dumping", and also authorizes special tariffs called "countervailing duties" to offset the effect of foreign subsidies. These GATT stipulations were modeled on corresponding stipulations in U.S. trade laws. The 1897 Countervailing Duty Law authorized the U.S. Treasury to impose special tariff protection equal in size to any foreign subsidy to foreign competitors. The Anti-Dumping Law of 1921 authorized the U.S. Treasury to impose special anti-dumping penalties on foreign goods sold at lower prices in America than in the country of origin. And versions of the escape clause were appended to U.S. trade law as early as 1934, authorizing special tariffs in the event of a finding by the U.S. Tariff Commission, an official advisory panel in existence since 1916 (renamed the U.S. International Trade Commission (USITC) in 1974), of substantial injury from any import competition resulting from U.S. concessions. The political scientist I. M. Destler has argued that the U.S. Congress established these special avenues for industries seeking protection, to deflect political pressure away from itself and preserve and expand, to the extent politically feasible, a

generally liberal trade policy.<sup>5</sup> In other words the “administered protection” embodied in commission recommendations and special executive orders is the lesser of two evils, a preferred alternative to legislated tariffs and other sweeping trade restrictions. Imports from Japan strained this U.S. political equilibrium nearly to the breaking point in the 1970's and 1980's. It is important to understand why.

Industries facing new competition from imports are particularly effective at gaining protection. Nobel laureate Gary Becker has attributed this to the fact that the deadweight costs of protecting such industries are smaller relative to the wealth transferred than is true of other industries.<sup>6</sup> An industry facing an unexpected surge of competing imports will have already installed the productive capacity needed to meet the domestic demand, and incurred some non-recoverable sunk costs in doing so. In contrast, an industry that faces long-standing competition from imports will install the capacity needed to meet domestic demand only if protection is granted. In other words, the costs of installing new capacity add to the deadweight cost of protecting an industry only if the import competition it faces was expected. And this is why industries facing unexpected competition from imports are more able to exert influence and elicit political support. Protection of such industries imposes relatively small deadweight costs and thus encounters little effective resistance. Persistent growth in Japanese trade, particularly following the Kennedy round tariff reductions of the late 1960's, therefore eventually incited a protectionist response in the U.S. that produced friction between the two countries.

An early episode of Japan-U.S. trade friction was the “textile wrangle” that continued for the three years, 1969-1971.<sup>7</sup> Japan’s exports to the U.S. of cotton textiles had been subject to voluntary restraint in 1956 and the restraint was extended for an additional five years, 1957-1961. After that agreement expired, it was immediately succeeded by a series of multilateral agreements permitting the signatories, which included the U.S., to set maximum limits on imports of cotton textiles and apparel from each other nation (The Short -Term Cotton Textile Arrangement 1961-62, and the Long-Term Arrangement Regarding International Trade in Cotton Textiles 1962-74). The agreements did not encompass textiles woven of wool or synthetic fibers, and in the 1960's exports of such items from Japan to the U.S. increased significantly. The U.S. government, under President Lyndon Johnson, had requested that Japan voluntarily restrain its exports to America of synthetic fiber textiles and been rebuffed. To secure the support of southern, textile-producing states in the 1968 presidential election, Richard Nixon promised to insist upon Japanese restraint of synthetic textile exports to the U.S., and to condition the return of Okinawa to Japanese control upon it. President Nixon fulfilled this campaign pledge and after three years of somewhat clumsy negotiations

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<sup>5</sup>I. M. Destler, American Trade Politics, Institute for International Economics, third edition, April 1995. Destler argues that the “root problem” of U.S. trade policy since 1930 was the political effectiveness of special interests seeking import protection, and that the “solutions” over the years have involved various ways of “protecting Congress from trade pressures” by deferring trade policy questions either to an executive, such as the Secretary of State or the U.S. Trade Representative, or to administrative bodies such as the U.S. International Trade Commission.

<sup>6</sup>Gary Becker, “A Theory of Competition Among Pressure Groups for Political Advantage”, Quarterly Journal of Economics, vol. 98, no.3, August 1983, pp. 371-400. Becker discusses industries facing unexpected competition from imports on p. 382.

<sup>7</sup>I.M. Destler, Haruhiro Fukui, and Hideo Sato, The Textile Wrangle: Conflict in Japanese American Relations, 1969-1971, Ithaca, NY: Cornell University Press, 1979.



and heavy-handed American pressure, the government of Japan consented in 1971 to administer the export restraint and in 1972 Okinawa reverted to Japanese control. Hong Kong, Taiwan and Korea also consented in 1971 to voluntary restraints of exports to the U.S. of woolen and synthetic textiles. Ironically, very soon after the voluntary export restraint was invoked, Japan's textile industry shrunk dramatically, a manifestation of shifting comparative advantage. Japan became a net importer of textiles and the export restraints were totally redundant. Nor is this all. The export restraints would have been redundant even had Japan continued to be a net exporter of textiles, for in 1974, the year the Japanese voluntary restraint took effect, the multilateral agreement permitting GATT signatories to impose country-by-country import quotas on textiles and apparel was expanded to encompass synthetic fibers, an agreement known as the Multi-Fiber Arrangement. That arrangement has been in effect in some form ever since (Under the terms of the Uruguay round it is to be phased out over a ten year period ending in 2004).

Steel was another of the industries in which expanding Japanese exports first incited U.S. protectionist pressure. Imports from Japan rose from less than one percent of total steel consumption in the U.S. in 1960 to nearly seven percent in 1968. The steel industry responded by filing numerous petitions for the imposition of countervailing duties and anti-dumping penalties upon both Japanese and European steel exporters. Under the threat of legislated quotas on steel imports into the U.S., both Japan and the European Community agreed to voluntarily restrain steel exports to the U.S., January 1969-December 1971. A second series of voluntary export restraints were agreed upon for May 1972-December 1974. After the voluntary restraints lapsed, in a pattern that has been repeated many times since, the American steel producers again filed numerous petitions with the U.S. government for special relief. To resolve matters, the U.S. government effectively imposed a minimum price for steel imports, based on presumed Japanese production costs and costs of transport to America, the so-called "trigger price mechanism"<sup>8</sup>, in effect Jan.1978-Mar.1980 and Oct.1980-Jan.1982. In return, the steel industry agreed to refrain from filing countervailing duty, anti-dumping or escape clause petitions. The arrangement ultimately broke down when appreciation of the dollar in the early 1980's rendered the trigger price mechanism ineffective. Steel producers again began filing petitions for special protection, ultimately inducing the reinstatement of voluntary restraint of exports, not only by Japan and the EC, but also by Brazil, Mexico, South Africa, and Korea, Oct.-1984-Mar.1992. Steel firms have continued to file petitions for relief and to lobby for a system of multilateral export quotas similar to the Multi-Fiber Arrangement, so far unsuccessfully. U.S. imports of steel from Japan, in 1995 amounted to 2.2 million metric tons, half as much as the 4.4 million metric tons imported from Japan in 1966, and a mere two percent of U.S. total steel consumption and only about ten percent of U.S. imports of steel. As with textiles, shifting Japanese comparative advantage, and not U.S. protection, is largely responsible for secular decline in Japanese imports.

Other U.S. industries besides steel and textiles sought special protection from Japanese imports in the 1960's and 1970's but were less successful in obtaining it. The television case is illustrative. A 1968 petition by Zenith for imposing anti-dumping penalties on Japanese exporters was decided upon favorably by the U. S. Tariff Commission in 1971, but only in 1978 was an (\$440-million) anti-dumping penalty actually assessed by the U.S. Treasury. In 1980 a greatly reduced (\$66-million) anti-dumping penalty was finally collected. Meanwhile, in December 1970, some American television manufacturers had initiated antitrust suits against the Japanese competitors (yes, charging

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<sup>8</sup>Imports sold below the stipulated legal minimum price, would automatically trigger the imposition of special anti-dumping penalties.

them with violating U.S. law by pricing their products at too low a level), which began a long, torturous and ultimately futile progression through the U.S. courts, failing at the Supreme Court in 1987.<sup>9</sup> After the USITC ruled favorably on a petition by Sylvania for special protection based on the escape clause, the government of Japan acceded to voluntarily restrain its exports of color television sets, between July 1977 and June 1980. The voluntary restraint did not prevent television imports from entering the U.S. from countries other than Japan, such as Korea and Taiwan. Within a few years after the voluntary export restraint had expired, Zenith was the only American-owned manufacturer of televisions still in operation.

Rising imports into the United States in the 1960's and 1970's, from both Japan and Europe, brought political pressure not only to protect particularly besieged American industries such as steel and televisions, but also to make it easier, in general, for petitioners to obtain anti-dumping penalties, countervailing duties or escape clause protection. The pressure met with an affirmative response. The 1974 Trade Act (authorizing U.S. participation in the Tokyo round), section 201, relaxed the criteria for invoking the GATT escape clause, so that imports (not necessarily the result of U.S. tariff concessions, as before), must be a "substantial" cause of injury, that is not less than any one other cause, rather than, as before, the "major cause" of injury, that is, greater than all other causes combined. The 1974 Trade Act also lowered the threshold for finding that dumping had occurred, from one of sales at lower prices in the country of origin than in the U.S., to one of sales "below cost" in the U.S., with cost to be determined based on indirect evidence. Before 1974, very few U.S. petitioners for administered protection of any kind actually secured relief from import competition.<sup>10</sup> Now the number of petitions began to rise, particularly for anti-dumping penalties, and more met with an affirmative response. Further changes enacted in 1979 hastened these trends. The Trade Agreements Act of 1979, approving the Tokyo round agreements, included stipulations shifting the administration of countervailing duties and anti-dumping penalties from the U.S. Department of the Treasury to the Department of Commerce, set precise time limits on investigations, and mandated the imposition of penalties in the event of an affirmative finding (Before that, penalties were left to the discretion of the president).

Even after the new laws were enacted, administered protection remained elusive for many petitioners. This point was driven home quite forcefully by the denial in 1980 of petitions (by the United Auto Workers Union and by Ford Motor Company) before the USITC, for escape clause protection from Japanese automobile imports. Process innovations developed at Toyota in the 1950's

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<sup>9</sup>For a detailed account of this episode refer to: Kozo Yamamura and Jan Vandenberg, "Japan's Rapid Growth Policy on trial: The Television Case", in Gary R. Saxonhouse and Kozo Yamamura, eds., Law and Trade Issues of the Japanese Economy: American and Japanese Perspectives, Seattle, WA: University of Washington Press, 1986, pp.238-284.

<sup>10</sup>Of 113 Tariff Commission escape clause investigations between 1948 and 1962, it recommended relief in 41 and the president provided it in only 15. Of 30 escape clause petitioners before the Tariff Commission, 1962-1974, only 4 obtained relief.

Between 1934 and 1968, the U.S. Treasury considered 191 petitions for countervailing duties but actually imposed them in only 30. In 1969 it imposed three more countervailing duties and between 1970 and 1974 imposed eight more.

The U.S. Treasury investigated 371 allegations of dumping, from 1955 through 1968, and imposed anti-dumping penalties in only 12 cases, but 89 others resulted in price revisions or withdrawal from the U.S. market. (Destler, 1995, p.141 and *passim*).

and 1960's, and then diffused to other Japanese companies, had lowered the production costs of the Japanese auto manufacturers and boosted their exports. Then the rise in gasoline prices due to the two oil shocks, the 1973 Arab oil embargo and the 1979 Iranian revolution, switched demand away from the large American cars and towards the Japanese imports. The USITC, in declining to recommend escape clause protection, ruled that business recession, and not imports, was the greater cause of injury to the American automobile producers, the "substantial" cause. Congressional response was swift. In February 1981 Senators John Danforth (Republican-Missouri) and Lloyd Bentsen (Democrat-Texas) proposed a bill (s.396) that would have established import quotas for automobiles. Soon afterwards, May 1981, the government of Japan agreed to administer a system of voluntary export restraints for two years, April 1981-March 1983, with renewal possible thereafter. The restraints were renewed annually through March 1994, before finally being allowed to lapse, and this was in spite of the fact that the United States government ceased formal requests for their renewal in 1985. The Japanese government had also arranged restraints of automotive exports to the UK beginning in 1977 and continuing through 1992, and to the EU beginning in 1986 and still in effect (but scheduled to lapse in 1999).

One of the curious implications of the Japanese automotive export restraints to the U.S. in the first two years it was in effect, was the switch towards higher quality vehicles. Because the export restraints entailed MITI assigning each manufacturer a maximum allowable number of vehicles to export, the companies naturally tended to export vehicles on which the profit margin was as great as possible, in other words, higher quality vehicles. The trade economist Robert Feenstra estimated that as a result of the export restraint, the average inflation-adjusted retail prices of Japanese small cars sold in the U.S. rose by 8.4 percent in 1981 compared to the previous year, relative to the prices of American small cars (that also rose), but that a 5.3 percent rise in Japanese small car relative price could be attributed to increased average quality of Japanese cars sold.<sup>11</sup> In a later paper, comparing the American prices of Japanese cars (subject to VER) and trucks (not subject to VER), Feenstra found that little further quality upgrading of Japanese cars occurred in 1983-84, but that the prices of the Japanese cars rose by about another 12 percent in those years over their 1981-82 level.<sup>12</sup> This further price rise occurred in spite of expanded production by Japanese manufacturers' American plants, and establishment by them of more such plants. The export restraint, by raising the American prices of Japanese cars, increased the demand in America for both American and European cars, and induced rises in their prices.<sup>13</sup> American automobile manufacturers' profits soared in 1983 and 1984, as did the profits of Japanese automobile manufacturers on their American sales. In other words, the Japanese export restraint acted as a cartelizing restriction of output. The Reagan administration's announcement in March 1985 that, because of the harm inflicted on U.S. consumers, it would not

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<sup>11</sup>Robert C. Feenstra, "Voluntary Export Restraint in U.S. Autos, 1980-81: Quality, Employment and Welfare Effects", Ch. 2 in Robert E. Baldwin and Anne O. Krueger, eds., The Structure and Evolution of Recent U.S. Trade Policy, Chicago, IL: University of Chicago Press, 1984, pp. 35-66.

<sup>12</sup>Robert C. Feenstra, "Quality Change Under Trade Restraints: Theory and Evidence From Japanese Autos", Quarterly Journal of Economics, vol. 102, 1988, pp. 131-146.

<sup>13</sup>Dinopoulos and Kreinin found that American prices of European cars were raised by about one third in 1984, as a result of the Japanese VER. Elias Dinopoulos and Mordechai E. Kreinin, "Effects of the U.S.-Japan Auto VER on European Prices and on U.S. Welfare", The Review of Economics and Statistics, vol. 70, no. 3, August 1988, pp. 484-491.

seek renewal of the voluntary export restraint was met with a storm of protests from the American auto producers. Spurred, in part, by proposals before Congress to legislate Japanese import quotas for cars, the government of Japan announced that it would unilaterally continue to administer the export restraint, but would raise the maximum number of vehicles to be exported by 24 percent. Subsequent Japanese exports fell substantially short of the maximum limit in each year that the voluntary restraint remained in effect. In 1992 the Japanese government reduced the export limit again, but with minimal apparent effects. The restraint was finally allowed by the government of Japan to lapse altogether in March 1994.

America's machine tool industry was among the most persistent in seeking protection from Japanese imports, eventually winning voluntary export restraints. After the industry association (National Machine Tool Builders Association) failed in its 1977 petition for anti-dumping penalties, one firm, Houdaille Industries, citing a never-before invoked clause in the U.S. tax code, petitioned the president in June 1982 to deny investment tax-credits for U.S. purchasers of Japanese machine tools, on the grounds that the Japanese manufacturers had obtained Japanese government subsidies. The petition was not affirmed. Next, in March 1983, the industry association again petitioned for special protection, this time on the basis of necessity to the national defense, exploiting a stipulation in the 1962 Trade Expansion Act. This petition, too, seemed headed for oblivion until a 1986 incident in which a Japanese machine tool company, Toshiba Machine Corporation and a Norwegian one, Kongsberg Corporation, were found to have sold machine tools for milling quiet propellers for submarines to the USSR, a serious breach of alliance security policy. In the ensuing flap, the government of Japan, and that of Taiwan, agreed to voluntary restraint of machine tool exports 1987-93. West Germany and Switzerland informally agreed not to expand their U.S. exports of machine tools in response. Machine tool prices in the U.S. seem to have risen slightly in 1987 as a result of the export restraint. But in 1988, expansion of Japanese machine tool plants in the U.S. largely reversed the price rise of the previous year.<sup>14</sup> Japan had already imposed voluntary restraint of machine tool exports to the EU in 1986, and these remained in effect until 1993.

The late 1980's marked the high tide of Japan's voluntary export restraints. The Table 1 indicates the most important ones, including some not discussed here. A comprehensive listing is difficult given the non-transparent way in which such restraints often have come about. MITI estimated that in 1989, 29 percent of Japan's merchandise exports to the U.S. and 5 percent of its merchandise exports to the EEC were subject to restraints.<sup>15</sup> It might seem from the pervasiveness of voluntary export restraints, that expansion of Japan's exports to the U.S. in the 1960's and 1970's had met a substantial protectionist response. But, then again, perhaps not. One of the striking differences between voluntary export restraints and either import quotas or tariffs, is their porousness. Diversions of trade through third countries, quality upgrading, and production in foreign plants, all

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<sup>14</sup>Elias Dinopoulos and Mordechai E. Kreinin, "The U.S. VER on Machine Tools: Causes and Effects", Ch. 4 in Robert E. Baldwin, ed., Empirical Studies of Commercial Policy, Chicago, IL: University of Chicago Press, 1991, pp. 113-129.

<sup>15</sup>General Agreement on Tariffs and Trade, Trade Policy Review, Japan, 1990, Geneva: GATT, November 1990, p. 200.

afford ways around an onerous export restraint.<sup>16</sup> The previous discussion has included references to all of these. Voluntary export restraints, at the very least, preempted more severe and more permanent forms of protection. As a result of the Uruguay round agreement, existing voluntary export restraints will be allowed to lapse and new ones will not be imposed.

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Table 1. Voluntary Export Restraints of Japan

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Countries and affected products	Duration
<i>United States</i>	
Ball bearings	-July 1993
Metal flatware	1962-December 1994
Pottery and chinaware	1964-December 1994
Textiles and clothing	October 1974-1992
Passenger cars	April 1981-March 1994
Steel and steel products	January 1969-December 1971 May 1972-December 1974 October 1984-March 1992
Machine tools	December 1987-December 1993
<i>European Union</i>	
Ball bearings	-July 1993
Cotton fabrics	1978-
Steel products	1972-April 1992
Machine tools	1986-December 1993
Passenger cars	1986-December 1999
Forklift trucks	1987-December 1994
<i>United Kingdom</i>	
Pottery and chinaware	1964-
Light and heavy commercial vehicles	1975-1992
Passenger cars	1977-1992
Clothing	1978-December 1994
<i>Canada</i>	
Ball bearings	-July 1993
Pottery and chinaware	1964-
Polyester filament, fabrics, clothing	1982-December 1994
Passenger cars	1986-1988
<i>Australia</i>	
Ball bearings	-July 1993

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Source: GATT, Trade Policy Review: Japan 1994, Geneva: GATT Secretariat, 1995, table 1v.16, pp.81-2).

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By 1985, political pressure for more effective protection from Japanese imports was building

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<sup>16</sup>Jagdish Bhagwati, "VERs, Quid pro quo DFI, and VIEs: Political-Economy-Theoretic Analyses", International Economic Journal, vol. 1, no. 1, 1987, pp. 1-14.

in the U.S.. American and Japanese government leaders were able to deflect the pressure only by switching the focus away from the U.S. market and towards expanded sale of American products in Japan.

### *Expanded Access to the Japanese Market*

In 1985, anti-Japan, protectionist sentiment in Washington reached its high-water mark. Not coincidentally, that was also the year of peak real appreciation of the dollar relative to the yen, caused by the Reagan administration's ongoing expansionary fiscal policy coupled with the anti-inflationary monetary policy of the Federal Reserve Bank under the chairmanship of Paul Volker (1979-1987). The strong dollar, and not the "closed" Japanese market or "unfair" Japanese trading practices, had promoted sales of Japanese goods in America and inhibited the sale of American products in Japan. Nevertheless, in March 1985, the U.S. Senate unanimously passed a non-binding resolution proposed by Senator John Danforth (Republican-Missouri) condemning Japan as an unfair trader, and imploring the president to retaliate. Senator Lloyd Bentsen (Democrat-Texas), in supporting the measure, famously remarked, "We are in a trade war, and we are losing it." Legislated protection directed specifically at Japan now seemed dangerously possible, and Congressman Richard Gephardt (Democrat-Missouri), in concert with Senator Lloyd Bentsen and Congressman Dan Rostenkowski (Democratic-Illinois), the chairman of the House Ways and Means Committee, provided the instrument, in the form of proposed legislation that, in blatant contravention of the GATT, would have imposed a 25 percent surtax on imports from any nation with a large bilateral surplus in its trade with U.S.. Japan, clearly the intended target, was one of only four nations to meet the proposed criterion (the other nations were Brazil, Korea and Taiwan). This was the background in which the G-5 financial ministers, meeting at the Plaza Hotel in New York, September 22, 1985, agreed to coordinate their nations' respective monetary policies to effect depreciation of the U.S. dollar. The ensuing real depreciation of the dollar relative to the yen, at first, seemed to have little inhibiting effect on Japanese exports to the U.S.. This, in a delicious irony, was probably a reflection of the large portion of those exports subject to voluntary restraints.<sup>17</sup>

The governments of both Japan and the United States now stepped up their ongoing attempts to deflect the growing protectionist sentiment in the U.S., by shifting the focus towards expanded sales of American products in Japan. The government of Japan had already entered a series of negotiations with the U.S., to remove offending regulations claimed to impede the sale of American products in four specific sectors: telecommunications, medical equipment/pharmaceuticals, microelectronics, and forest products. These negotiations, initiated at the January 1985 summit meeting between Prime Minister Nakasone Yasuhiro and President Ronald Reagan, became known as the Market-Oriented, Sector-Specific (MOSS) talks. In 1986, transportation machinery and automotive parts, were also added to the agenda. In these last two sectors, the Americans argued that exclusionary business practices were impeding American export sales in Japan. The MOSS talks concluded in August 1987, having achieved only modest Japanese concessions, mostly in the form of tariff reductions and some relaxation of regulations.

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<sup>17</sup>This point is argued quite persuasively by: Jagdish Bhagwati, "The Pass-Through Puzzle: The Missing Prince from Hamlet" ch. 5 in Jagdish Bhagwati, Political Economy and International Economics, Cambridge, MA: MIT Press, 1991, pp.116-125.

In October 1985, Prime Minister Nakasone empaneled a special advisory commission chaired by Maekawa Haruo, former governor of the Bank of Japan, (dubbed the Advisory Group on Economic Structural Adjustment for International Harmony, but widely known as the Maekawa commission), to recommend measures that would expand foreign access to the Japanese market. The commission issued reports in April 1986 and May 1987, recommending, among other things, expansionary fiscal policy to stimulate Japanese aggregate demand, relaxation of government restrictions inhibiting the opening of large stores, and relaxation of agricultural land-use controls. The Maekawa reports, like the MOSS talks, had almost no noticeable effect on the sentiment in Congress supporting a more aggressive U.S. government posture towards Japan-U.S. trade. The Reagan administration, belatedly, was seeking to effect such a posture, all the while avoiding, to the extent possible, seriously damaging relations with Japan. This required a delicate balancing act.

The 1974 U.S. Trade Act included stipulations (section 301) authorizing the president to retaliate against a foreign country that maintains “unjustifiable or unreasonable” tariff or other import restrictions or export subsidies, “substantially reducing sales of the competitive United States product.” This afforded American exporters an avenue for enlisting U.S. government leverage in their pursuit of expanded access to foreign markets, but, before 1985, very few had availed themselves of it, and fewer still attained positive results. Now this would change. In September 1985, the Reagan administration, amidst much fanfare, opened some new section 301 investigations, including one involving cigarette sales in Japan, and threatened retaliation in another long-standing but unresolved 301 case involving Japanese import quotas on leather hides and leather shoes. Japan responded to the cigarette complaint by agreeing to eliminate its tariffs on cigarettes. Sales of American cigarettes in Japan subsequently rose from less than \$100-million in 1985 to more than \$1-billion in 1990.<sup>18</sup> Also about this time, acting on its own initiatives and on earlier section 301 petitions and dumping complaints by the Semiconductor Industry Association, the U.S. entered negotiations with the government of Japan that led to the August 1986 Semiconductor agreement, stipulating minimum selling prices for certain types of Japanese semiconductor chips in American, Japan and third countries.<sup>19</sup> The agreement also included a side letter stating an expectation that foreign sales of such chips in Japan would at least double over five years, from 10 percent in 1986 to 20 percent in 1991. The U.S., in March 1987, claimed that Japan had violated the agreement, both by underpricing in third countries and by failing to make ample progress towards the goal of expanded foreign market share in Japan, and imposed sanctions in the form of retaliatory 100 percent tariffs (on laptop and desktop computers, color televisions and power hand tools). In 1991 the semiconductor agreement was renegotiated and extended for five years, and ultimately allowed to lapse in 1996. The semiconductor arrangement was nothing less than a Japanese international price-setting cartel, instigated by the U.S. government, a clear example that export-promoting trade policies do not always promote economic efficiency. Meanwhile, the U.S. government continued to wrest substantive concessions on specific sectoral issues as outcomes of section 301 investigations (abolition of Japan’s import quotas of beef and citrus (July 1988)), or under the threat of such

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<sup>18</sup>Thomas O. Bayard and Kimberly Ann Elliot, Reciprocity and Retaliation in U.S. Trade Policy, Washington, D.C.: Institute for International Economics, September 1994, p. 414-415.

<sup>19</sup>For details on the semiconductor agreement, the following is excellent: Kenneth Flamm, Mismanaged Trade? Strategic Policy and the Semiconductor Industry, Washington, D.C.: Brookings Institution Press, 1996. See especially Ch. 4, “The Semiconductor Trade Arrangement and its Aftermath”, pp. 159-226.

investigations (relaxation of restrictions on activities of foreign lawyers in Japan (February 1987), relaxation of import quotas on fish products (March 1987), opening to foreign firms of Japanese procurement of construction services (May 1988), relaxation of restrictions on foreign entry into Japan's cellular telephone business (June 1989)). Cases such as these are still a prominent aspect of American trade policy towards Japan, even now.

Through 1986 and 1987, the U.S. Congress continued to debate measures for an even more aggressive policy towards Japan. This eventually culminated in its attaching the so-called "Super 301" provision to the 1988 Omnibus Trade and Competitiveness Act (the law authorizing U.S. participation in the Uruguay round). The Super 301 provision was intended to mandate the threat of trade sanctions against recalcitrant foreign nations, Japan in particular. Specifically, it required that the U.S. Trade Representative,<sup>20</sup> by May 31 of each of the two succeeding years (1989 and 1990), publicly name "priority foreign countries" exhibiting numerous and pervasive "acts, policies, or practices" impeding U.S. exports, and impose retaliatory sanctions if in the ensuing year the offending measures were not redressed. To the surprise of no one, on May 25, 1989, Japan was named (along with Brazil and India) as a priority foreign country of threatened U.S. retaliation. On the same day, the U.S. Trade Representative, Carla Hills, announced the beginning of special negotiations between the governments of Japan and the U.S. on wide-ranging economic issues, to be known as the Structural Impediments Initiative (SII).

The Super 301 agenda for 1989 included (besides Brazil's import quotas, and India's closed insurance market and restrictions on inward foreign direct investment), Japan's exclusionary government procurement of super-computers and satellites, and its barriers to trade in forest products. Japanese government purchase of supercomputers had also been on the agenda of the MOSS talks, which had resulted only in token purchases of U.S. supercomputers. The 1988 law enacting the Super 301 provision had included a "sense of Congress" section deploring Japan's unresponsiveness in the matter and urging the U.S. Trade Representative to attach a high priority to it, so its designation by the USTR Hills was, in a sense, pre-ordained. In June 1990, the two countries announced an agreement abolishing discriminatory features of Japan's government procurement of supercomputers and settling the dispute.<sup>21</sup> Tariffs on products fabricated of wood had been a subject of U.S. complaints at least since 1977, and had also been a topic in the MOSS talks. In the MOSS agreement, Japan had agreed to accelerate scheduled tariff reductions, and to alter building codes and product standards and testing in ways intended to benefit American exporters, but this did not go far enough to satisfy the U.S. congressmen representing lumber exporting states. In April 1990 the government of Japan agreed to further revisions in tariffs and building standards. Inclusion of satellites in the super 301 designation was an oddity because the American producers of satellites had not lobbied for it. Rather, officials of the Bush administration, acting on their own counsel, had apparently concluded that it was in the U.S. national interest to preempt Japanese development of commercial satellite technology. In June 1990, Japan agreed to

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<sup>20</sup>The U.S. Trade Representative is America's chief negotiator of international trade policy agreements. The position, originally titled Special Trade Representative, was created in 1962 to facilitate negotiation of the Kennedy Round. In 1974 the office was renamed and elevated from ambassadorial status to cabinet level status.

<sup>21</sup>On the supercomputer agreement and other Super 301 cases involving Japan, refer to Bayard and Elliot, 1994 *opus cited*, ch. 5, pp. 101-148; and Michael Mastunduno, "Setting Market Access Priorities: The Use of Super 301 in US Trade with Japan", *The World Economy*, vol. 15, no. 6, November 1992, pp. 729-753.



enforce non-discriminatory and transparent procurement of commercial satellites. U.S. Trade Representative Carla Hills announced no new priority countries in June 1990, asserting completion of the Uruguay round to be the top priority. She again designated India, having achieved no results, but suspended the investigation and imposed no retaliatory sanctions. Having satisfactorily resolved each of the Japanese issues raised under super 301, and the Brazilian issue, she designated neither country as a continuing priority.

The joint report concluding the SII talks was also issued in June 1990. The broad-ranging SII agenda--structural impediments to trade, factors affecting the bilateral trade balance, anti-competitive practices--more or less precluded tangible results. Japan agreed to enlarged government infrastructure investment over the ensuing decade (it probably would do this anyway). It agreed to enhance antimonopoly enforcement and increase penalties for violating antimonopoly laws (the laws remain toothless and inconsequential, which in all likelihood means only that large firms in Japan including foreign ones are less impeded by inefficient prohibitions). It agreed to reform the Large Store Law, expediting the process of reviewing applications to open large stores (but that law is probably not a major source of inefficiency anyway). Corresponding features of the U.S. economy and economic policy had also been on the SII agenda. The U.S. agreed to reduce its federal budget deficit, increase support for research and development, and improve workforce training. SII was, at best, an earnest attempt, by both sides, to hold U.S. protectionist pressures in check.

The Clinton administration took a somewhat different tack than had been embodied in SII, focusing its demands on precisely quantified expansions of U.S. sales to Japan, similar to the side letter in the 1986 semiconductor agreement. The Clinton administration's Japan policy was unveiled at the July 1993, Tokyo summit meeting of the G7 nations, in the form of an announcement that Japan and the U.S. would enter yet another round of bilateral negotiations on trade issues, this time under the rubric: U.S.-Japan Framework for a New Economic Partnership (known as the "Framework" talks). The talks were to focus upon access to the Japanese markets for insurance, vehicles and automotive parts, telecommunications (NTT purchases), flat glass, financial services, intellectual property rights, and foreign direct investment in Japan. The Framework talks began during a difficult period in Japanese politics. In August 1993, the month after initiation of the talks, the scandal-plagued Liberal Democratic Party fell from power after 38 years of continual rule. The new prime minister, Hosokawa Morihiro, leader of the Japan New political party (*nihon shin tō*, newly formed from a splinter faction of the LDP), assumed office as the leader of an eight party coalition. Meanwhile, the Framework talks were at an impasse, with Japan opposed, on principal, to the setting of quantitative targets for increased Japanese purchases of American goods in designated sectors. At the, rather tense, February 1994, Clinton-Hosokawa Washington summit, the two leaders announced that the Framework talks were deadlocked and would be suspended indefinitely. The following month, March 1994, President Clinton, in what was widely viewed as a slap at Japan, issued an executive order reinstating the super 301 provisions for an additional year (The original super 301 amendment had remained in effect for the two years 1989-1990 only, and attempts in Congress to renew it had met with failure). The new, Clinton-super 301, which has been extended thrice and remains in effect as of this writing (1997), manifests slight differences over the previous super 301 statute, intended to soften foreign distaste. The USTR is to designate unfair practices, not countries, and is explicitly granted wider discretion than in the earlier statute, both in announcing such priorities and in the decision of whether to initiate investigations or to invoke retaliatory sanctions.

Prime Minister Hosokawa was forced to resign April 8, 1994, over questions about the

financing of his 12 year previous prefectural governor campaign, and was succeeded by Hata Tsutomo of the Renaissance Party (*shinsei tō*, another splinter off of the LDP), leader of the same eight party coalition that had assumed power the previous year. The next month, May 23, 1994, the governments of America and Japan reached an understanding that enabled a resumption of the Framework talks. The very next month, June 1994, Hata was forced to resign after his overly tepid response to controversial statements by the Minister of Justice about the 1937 Nanking massacre, and Murayama Tomiichi, president of the Japan Socialist Party, and the leader of a three party coalition, became the fourth Japanese prime minister within the previous twelve month interval. The Framework talks, which were extended for a second year in June 1995, ended in a number of sectoral accords, including an agreement in June 1995 to increase Japanese purchases of American automobiles and auto parts, concluded only after the U.S. threatened a retaliatory tariff on Japanese luxury cars if its demands were not met.

The era of wide-ranging demands for expanded U.S. access to the Japanese market is, for the time being, over.<sup>22</sup> But it could be revived if Japan's exports again provoke a protectionist response in the U.S..

### Conclusion

Japan's integration into the world economy has contributed to the international division of labor and thereby expanded the consumption possibilities of both Japan and other countries. To preserve and enlarge such gains, the nations of the world have expended much diplomatic effort in erecting and maintaining a liberal international trading regime. The protectionist response in America to the postwar growth of Japanese exports threatened that process but did not derail it. The political rhetoric attending these events can easily confuse us, and is often meant to do so. We should resist the confusion.

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<sup>22</sup>For many thoughtful essays and comments on the American government's adoption, in the 1980's, of a more aggressive posture in its trade disputes with Japan refer to: Jagdish Bhagwati and Hught T. Patrick, eds., Aggressive Unilateralism, America's 301 Trade Policy and the World Trading System, Ann Arbor: The University of Michigan Press, 1990. On the apparent recent demise, of U.S. aggressiveness towards Japan, refer to: Douglas Ostrom, "U.S.-Japan Trade Relations: Bilateral Versus Multilateral Options", Japan Economic Institute Report, no. 43A, November 14, 1997.

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