BIISS JOURNAL. VOL. 17, NO. 3, 1996

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US-JAPAN RELATIONS : A STRATEGIC TRADE POLICY ANALYSIS

I. INTRODUCTION

Although Japan's emergence as an economic superpower is unthinkable without close economic ties to its conqueror, occupier and later protector, the United States, trade relations with it had been marked by conflicts from the very beginning. These conflicts tended to be intensified as Japan's economic power increased and significant transformation took place in economic relationship between Japan and the US. Both the countries became more dependent, reciprocating their national economic prospects through trade, direct investment, joint ventures and through commercial and military links. Growing economic interdependence between the US and Japan has transformed the old relationship from that of patron-client into an uneasy partnership.

The objective of this paper is to review the political and economic relationship between these two countries since the Second World War and to analyze the strategic trade policies that they might pursue, failing to resolve the trade disputes. Section II summarizes the US-Japan political relationship and the chronological history of trade

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disputes between these two countries. Section III discusses some of the salient features underlying the trade and industrial policies of the two countries. In Section IV the major issues of the latest round of trade disputes have been presented while Section V analyzes the probable strategic trade policies that each country can pursue and its implications that may result in. A conclusion is added in Section VI.

II. US-JAPAN POLITICAL RELATIONSHIP AND CHRONOLOGICAL HISTORY OF TRADE DISPUTES

POLITICAL RELATIONSHIP

For nearly four decades, the relationship between Japan and the US stood as a great success story. In a remarkably quick time they passed from bitter conflict to close alliance. The rise of common adversary, the Soviet Union, was a key factor. But the end of Cold War has reduced Japanese dependence on American nuclear defence shield. This gave Japan enough impetus and confidence to resent the so-called 'voluntary export restraints'[1] that they had to exercise in order to help their trading partners, in particular the US.

In fact, there has been several transformations in the nature of US-Japan relationship since Japan's defeat in the Second World War. During the period 1945 to 1952 the US-Japan relationship can be termed as 'patron-client' relation. In that period Japanese security had been inextricably linked with US protection through a Mutual Security and Cooperation Treaty. As the US emerged as a superpower forcing Japan to surrender, the latter did not want to let go the opportunity to receive US's patronage. This intention was further intensified by the urge from reconstructing the war-devastated economy as quickly as possible. In this period the bilateral relationship between these two countries can largely be explained by US's initiatives alone which required a little commitment from the Japanese to their patron.

1. Voluntary Export Restraints (VERs) are 'voluntary' only in the sense that failure to keep within the export restriction would result in import restrictions being put on by the partner country.

In the 1950s, Japan was found to be a compliant follower of the US. The US led occupation force undertook sweeping reforms to construct a demilitarized and democratic society under the aegis of a capitalist system. The US provided Japan with security not only to protect Japan's integrity and independence but also to check communist expansion in the Pacific. This was also necessary from the US's point of view as the Korean War was in its height and both the US and the former Soviet Union were involved in it. In this period the nature and extent of the Japanese role in the international arena was explicitly defined by the US. Under such circumstances the Japanese could be totally occupied in mobilizing all their resources for rebuilding their domestic economy.

During the period 1960-79 the Japanese experienced a rapid growth and became a full fledged member of the US led International Capitalist System. With the growth of the Japanese economy its exports got a large access to the US markets. On the other hand, the boost in the Japanese economy also facilitated the US to increase its export to Japan. In this period Japan played a 'cooperative' role in international politics as advocated by the US, specially in assisting to contain the then Soviet military aggression world-wide. Thus Japan appeared as a junior partner of the US both in the field of politics and economics.

However, from the 1980s there has been some significant qualitative changes in Japan's attitude which has affected its relationship with the US. In the early 1980s, Japan became skeptical of US's capability to provide them with security and went on to increase their defence capabilities and intensify its security cooperation with the 'Western Alliance' with a growing impact on regional politics. For the first time Japan was found to develop foreign policy of its own will and initiative. It also became very vocal of protecting their national interest in terms of international and regional politics, security and stability. The decade of 1980s has witnessed the emergence of Japan as an economic superpower and the collapse of the former Soviet Union. These two events have had an unprecedented impact on US-Japan political relationship.

No longer so dependent on US security shield, and eager to play a larger political role in Asia, Japan has begun to define its interest and set its policies with less regard to the US. Its Coolness towards APEC (Asia Pacific Economic Cooperation) and flirtation with membership in the Malaysia sponsored East Asian Economic Caucus from which the US would be excluded, are two examples of it. Moreover, Japan has become the largest single donor to LDCs (Least Development Countries) since 1986 and it had sent peace keepers overseas to Cambodia which is first such instance since the Second World War. These pieces of evidence add a new dimension of outward orientation in the Japanese policies; and indeed, it is now a strong aspirant for a permanent seat in the United Nations Security Council.

A Chronology of Trade Disputes

Although the US-Japan trade disputes are much talked about in recent times, this is nothing new between these two countries. Its history dates back to the early 1950s when Japan, as a maritime nation, opted to ensue itself in overseas trade particularly with her chief partner the US, to support its inhabitants. This is to mean that the example of trade disputes could even be found at the very beginning of US-Japan political relationship less than 10 years time after the Second World War.

The first wave of trade conflicts emerged between mid-1950s and mid-1960s. It was caused by considerable increase in Japan's export of textiles, sewing machines and some other products to the USA. It, however, ended when Japan complied to US request to put into effect a voluntary export restraint (VER). During the first phase of the trade conflict politically Japan was recognized as a compliant fellow of the USA.

The second round of trade dispute erupted between 1968 and 1972 when mutual negotiations on Japan's textile export proved difficult and lengthy. The next dispute was triggered by the worldwide recession following the oil crisis, during which the Japanese government tried to stimulate the economy by boosting export. A fourth row of conflicts at the beginning of the 1980s was rooted in an export drive by Japanese automobiles in the US market.

The next round of dispute began when the US imposed tariff on certain Japanese imports in reaction to Japan's dumping of semiconductors in the US market. And finally, the sixth and the latest wave of trade friction arose in the first half of the 1990s when the US insisted on access to the Japanese market of US cars, auto-parts, photo films etc., in an effort to reduce its ever growing trade deficit with Japan. The chronological history of the trade disputes *vis-a-vis* US-Japan political relationship has been summarized in Table-1.

During the first round of trade disputes, Japan was highly dependent on the US for its security and acted as its compliant follower. By the time the second round of trade dispute occurred, Japan had started to enjoy economic miracle and became a junior partner of the US and tried to assist the US against communist expansionism. Since 1980, when Japan established itself as a global economic super power it began to develop foreign policies on its own which would serve their own interest. This period has thus been marred with relatively more trade disputes which has been more intensive and fiercer in nature and involved many more items than before. Japan now seems to be showing its teeth to the US, giving up its habitual behavior of submitting to the US pressure. In fact, Japan's economic progress in recent years has created intense nationalistic competition and increased politicisation of trade ties between these two countries.

Although there is no denying the fact that Japan's magnificent economic performance lies in the heart of US-Japan trade disputes, it is widely believed that Japan's miraculous progress can largely be attributed to various policies and schemes, planned and supervised by the state mechanism. Thus, to understand the nature and impact of

Table 1 : A Chronology of Major Trade Disputes and Political and Economic Relationship between US and Japan

Time	Issues in Trade Dispute	Items of Dispute	Political Relations
First Trade Dispute 1955-65	Increase in Japanese export of textile, sewing machines etc. prompted the US to ask for Voluntary Export Restraint.	Textile and Sewing Machines	Patron Client Relation
Second Trade Dispute 1968-72	Dispute brewed up when mutual agreement regarding Japanese textile export to the US became ineffective.	Textile	
Third Trade Dispute 1976-78	Dispute began when Japan went for export expansion directed towards the US to free the economy from adverse condition caused by oil crisis.	All major items	Japan as junior trade partner of the US
Fourth Trade Dispute 1980-85	Dispute arose when Japanese car manufacturers began to accelerate export of cars to the US.	Cars	Japan as a Member of Western Alliance
Fifth Trade Dispute 1987-88	Dispute arose when the US imposed tariff on few Japanese exports in reaction to Japan's dumping of semi-conductors in US market.	Semi-conductors	
Sixth Trade Dispute 1990-95	Dispute began when the US asked Japan for measured trade and to open its market for US cars, car-parts, films, etc. to reduce its huge trade deficit.	Cars, Auto-parts, Films, Aviation, Cosmetics, Medical equipments, Telecommunications, Insurance, etc.	Japan as an Economic Super power

US-Japan trade disputes it is necessary to assay the industrial and trade policy of Japan. The following section is designed to cover this subject along with a brief account of the salient features of the contemporary US trade policies.

III. TRADE AND INDUSTRIAL POLICIES OF JAPAN AND US

The Japanese Perspective

Although the Second World War had a catastrophic impact on the Japanese economy and society, Japan wasted no time in restructuring its overall socio-economic infrastructure. The Japanese had a strong, shared motivation - a national consensus to recover as quickly as possible from the humiliation of defeat in the Second World War and to achieve rapid economic growth which was regarded as the only means to regain national pride. This consensus actually led to a pro-growth policy, (i.e., explicitly favouring growth over equity) - a policy which was subject to immense debate in the history of development of many countries. But it was in fact the most important determinant to the rapid growth of the Japanese economy. The Japanese government through its functionaries tried to disseminate active policies to implement and enhance this growth objective. In this regard, two institutions, namely, Ministry of Finance (MOF) and Ministry of International Trade and Industry (MITI), played the pivotal role in promoting an investment race and adopting successively more efficient mass production technologies which led to reduction of unit cost among the large export oriented firms in the major industries that were to act as an engine of economic growth.

In promoting such an investment race, MITI and MOF completely depended on Hirschman's Unbalanced Growth-type strategy,[2] which

2. This strategy suggests that investment should be made only in some selected sectors rather than simultaneously in all sectors of the economy. Hirschman contends that investments in strategically selected industries or sectors of the economy will lead to new investment opportunities and "development has of course proceeded in this way, with growth being communicated from the leading sectors of the economy to the followers". See, Hirschman, *The Strategy of Economic Development*.

decided to provide scarce resources only to selected large firms in the export industry depriving consumers and small firms of funds. This policy was feasible because the Japanese capital market was insulated from international money markets. It is clear that the MOF's policies of preferentially directing credit to large and efficient firms in each industry intensified the tendency toward the domination of each sector of the economy by a small number of large firms. For in addition to enjoying the cost reductions of mass scales, these firms had more secure and ready lines of credit than did small competitors.[3] The MITI, on the other hand, had the power to allocate selectively foreign exchange for the purchase of imports, because nearly every Japanese industry relied heavily on imported raw materials. This gave MITI a discretionary power to prevent prodding business and enabled it to restrict selectively the importation of goods that competed (or would compete) with those produced (or which would be produced) by certain Japanese industries. The MITI also acted as a 'doorman' to vital imports of western technology which Japanese firms sought out and purchased in vast quantities during the rapid growth period. In essence, the MITI and MOF had the common objective of patronizing only a few large firms with adequate funds, and sophisticated technology. The idea was to prevent the protected home industry from becoming inefficient and promote them at the end of the day to become competent in the world market. While the ability of MOF to pressure Japanese financiers to divert funds into strategic industries was a result of structural and procedural features of the Japanese capital market, the power of MITI to influence the investment and marketing decisions of private companies was largely due to the ministry's control over essential conduits linking the Japanese economy to source of raw materials and technology.

In fact, Japanese industrial policy during the rapid growth period consisted of a widespread protection of domestic markets and of

3. See Ryaichi Mikifani, "Monetary Policy in Japan", in Karel Holbik ed., *Monetary Policy in 12 industrial countries*, Boston, 1973, pp. 246-281.

oligopolisation of major industries which together allowed large firms in major industries to price their products sold in the domestic market as would any oligopolist enjoying a protected market. The protectionist stance taken by the Japanese government during the 1950s and 1960s is evidenced by the high level of tariffs and restrictive quotas that characterized Japan's imports. Until 1960 approximately 60% of Japan's import were under quota; when international pressure forced the elimination of some of these restrictions, tariff rates increased on 233 newly liberated items[4]. Furthermore, MITI could quickly restrict any given import shipment by withholding the allocation of foreign exchange. Despite the fact that protectionism is viewed by most Americans as tantamount to industrial stagnation, some economists contend that protection from foreign competition was probably the most important incentive to domestic development that the Japanese government provided[5].

However, the nature of protection in Japan was a different one and did not take a traditional course. There, protection was meant to create an oligopolistic industry, consisting of a few firms, equipped with the state of the art technology and since competition among the domestic firms in each industry was restricted, each firm in the oligopolized industry got a large share of the market which ultimately resulted in a long run declining average cost curve due to the advantage of economies of scale and this also enabled the Japanese firms to be very competitive in the international market in the long run. In fact, what MITI did was to guide the firms to invest in such a way that each large firm in a market expanded its productive capacity roughly in proportion to its current market share - no firms was to make an investment so large that it could destabilize the market. The policy was effective in encouraging competition for market share (i.e.

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4. Edward J. Lincoln, *Japan's Industrial Policies,* Japan Economic Institute of America, *Washington,* D.C. 1984.
5. *Ibid*

preserving the essential competitiveness in the industrial markets) while reducing the risk of excessive investment. Thus it promoted the aggressive expansion of capacity necessary to increase productive efficiency and output. However, this policy may become ineffective when demand declines or fails to keep pace with the rate of increase in productive capacity triggering a profit robbing open price war. To prevent such an incidence from taking place MITI's solution was to form cartels. Thus administered prices and *de jure* and *de facto* cartels among the large firms engaged in the investment race proliferated in steel chemical and several other industries.

So it is clear how policies of MOF and MITI could limit the competition only among a few large firms in each industry. However, another remarkable and important barrier to the entry of new firms, particularly of foreign firms, has been industry-wide vertical integration into marketing - a complete marketing mechanism (a distribution *Keiretsu*) composed of wholesalers and retailers who are discouraged from selling competitors goods. This has enabled large manufacturers to close a large segment of the market to new entrants and has also capacitated them to control retail prices and to set quantities. The effects of forming *Keiretsu* were essentially those of cartelizing the domestic market, enforcing industry wide retail price maintenance, collusively setting of rebate rates and profit margins for distributors, and collectively boycotting unaffiliated wholesalers. Moreover, the *Keiretsu* helped encouraging consumers in buying the Japanese large firms' products. In this respect, the example of the underwriting of consumer installment purchase plans by the controlling manufacturer can be cited. On the one hand, MOF's control of financial markets did not allow Japanese banks to lend money for purchasing consumer's products, on the other hand, it promoted preferential access to bank loans to the large manufacturers. Under these circumstances the large firms compelled the *Keiretsu* to initiate consumer's installment purchasing system which in real sense made the consumers entitled to receiving some sort of credit which they were deprived by the national institutions. And it also encouraged consumers to buy only those firms' products that allowed the consumers to pay in installments. By the end of mid 1960s each large producer had built a chain of *Keiretsu* retailers, and by the end of 1974 more than 73 percent of the products of Japanese firms was sold through the *Keiretsu* outlets.

Although the Japanese policies of protection were different, as we have argued earlier, the typical characteristics of distributional cost that transfers benefits from the consumers to the producer in a protected market, was very much apparent in the Japanese economy. This particularly occurred in case of some goods produced by Japan which were relatively cheaper in international market than Japan's domestic market itself. For example, in 1966 while the average ex-factory domestic television price was 150,000 yen, the average f.o.b. price in the US market was only 64,800 yen. So it is evident that the Japanese consumers had to pay huge 'tax' to the producers to enable their firms to penetrate the overseas markets. And indeed the Japanese share of the monochrome TV set market rose from 0.8 percent in 1962 to 25 percent in 1977, and that of the colour set increased from 3 to 37 percent between 1967 and 1977 in the US economy. It goes without saying that the main target of Japanese products was the U.S. market. As imports from Japan increased and depressed prices causing American firms to move abroad, domestic employment in television production in the US fell 50 percent between 1967 and 1970 and another 30 percent between 1971 and 1975, and yet another 25 percent between 1977 and 1981[6]. MITI even organized an export cartel and the manufactures under its ambit agreed to observe minimum prices on all exports to the US[7]. However, every company except Sony, was engaged in widespread, long term under cutting of this minimum prices and thereby suddenly captured large part of the US markets.

6. See, Krugman (ed.) *Strategic Trade Policy and the New International Economic Order,* MIT press, Cambridge, 1993.

7. *Ibid.*

From Follower to Competitor:

So far it has been shown how Japan had been able to catch up with its leader, the US, through the policy of readily importation of technological know-how, protection from foreign competition, effective distribution system and financial support of the national institutions. Adoption of this line of policy action converted Japan to a competitor of the US in a relatively quick span of time. In this changing environment it is true that amongst competitors the one who will be able to innovate sophisticated technology earlier, will gain a large share of market. Specially, in the technology intensive industry, the share of the market is largely attributed to the technological capabilities of the firms.

In the above context, Japan cannot now rely on imported or imitated technology as it did in the earlier period. So, the Japanese firms are now competing its rivals even in the technology market. This is, in fact, a deviation from the classical trade theory which presumes that 'technology is free' or 'knowledge travels freely'. With this fact in mind MITI is still doing its utmost to assist Japan's hi-tech industries. There are some evidence which demonstrate that Japanese policy toward high technology industries, especially the semi-conductor industry substantively differ from that in the US. A salient feature of MITI policy is that the ministry takes vigorous initiative in organizing and administering joint research projects among large oligopolistic firms. The idea working behind it, is that since the firms are now quite large and established in the market and since they can realize that in the present context (where they are competitors and not followers) their survival is at stake if they cannot brew up technology ahead of their rivals, the individual Japanese firms may have the incentive to spend huge amount of resources on R & D and thereby even competing amongst themselves some may be able to assail the new technology while others may lag behind. This may lead to a two fold problem. Firstly, the unsuccessful firms may invest a huge amount of resources simply to duplicate the technology that has already been developed by one of their native firms, which may cause wastage of valuable resources. Secondly, since the foreign firms are also engaged in innovations they can supersede the firms in Japan which have not been able to come up with the latest technology, and thereby capturing the market share of the latter. That is, as an oligopolistic market system was deliberately formed and if only a few among them succeeds in terms of adopting better technology, it may result in a huge decline of Japanese share in the world market. To prevent this from happening MITI initiated the joint research venture in order to retain Japanese firms' grasp on the foreign market and to save the scarce resources from being spent simply on duplicative research.

We present in Figure 1 a flow chart to get a clear picture of the salient features of the Japanese Industrial and Trade Policies highlighting the roles of different government institutions.

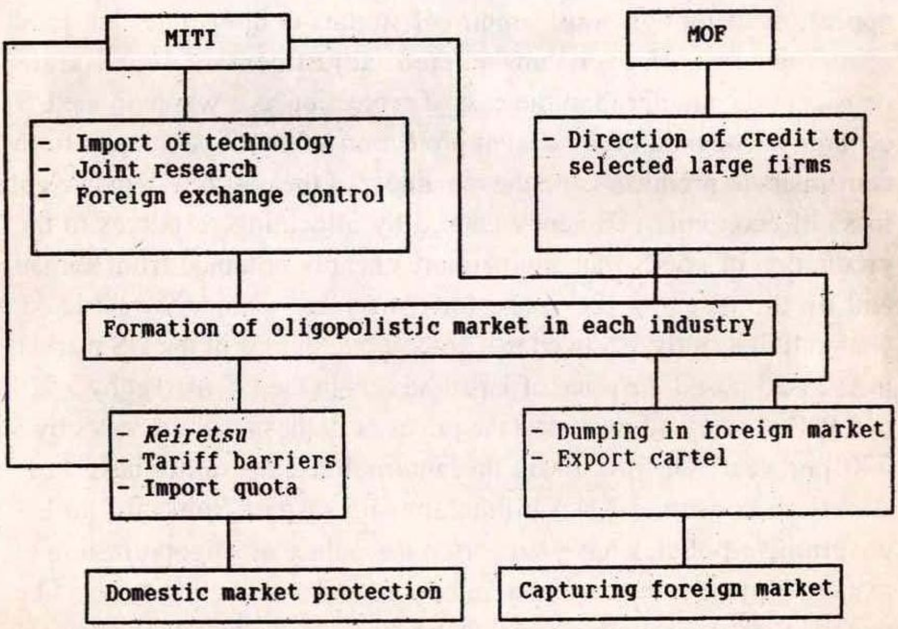


Figure 1 : Japan's Industrial and Trade Policy.

The US Perspective

In principle the US industrial and trade policy is premised on market determination and free trade. The nation has specifically rejected the idea that the government should favour specific sectors and discourage others. The only significant areas of positive stimulus to specific industries have been in Defence and Agriculture. Indeed, the US did not make any difference in granting special treatment between export and import substituting industries. The concept of protection of industries in the US has been found to be different from those of other countries including Japan. An integral part of the concept of permissible trade protection in post war trade policy in US has been that any such protection is temporary for the purpose of softening injury from imports, and that the industry in question is expected to adjust overtime rather than receive permanent protection.

This underlying concept of protection for adjustment has inherent appeal, even though most empirical studies demonstrate that total economic cost of even 'unsheltered' adjustment to imports are considerably smaller than the cost of protection as a whole in the US economy. The bulk of the cost of protection amount to a transfer from consumers to producers and the remainder of the cost is a "deadweight loss" of economic efficiency caused by allocating resources to the production of goods that can be more cheaply obtained from abroad and by the fact that the scope for consumer's choice is restricted. Crandall in a study[8] showed that automobile quotas in the US market in 1981-83 raised the price of Japanese cars in the US market by $ 920 to $ 960 per car and increased the prices of domestic automobiles by $ 370 per year. On this basis the automobiles restraints have cost American consumer $ 4.5 billion annually. Apart from this, no US government policies have supported the policy of oligopolization of market. Virtually, the cartels were banned and a marketing system like that of *Keiretsu* is unthinkable. It has always advocated the principle

8. See, Robert W. Crandall, "Import Quotas and the Automobile Industry : The Costs of Protectionism", *The Brooking Review*, Summer 1984.

of free entry and exit with large number of firms participating in the market mechanism. Although there are 'giants' in each of the industries, none of them received any form of institutional support, like those of Japan.

It is also quite evident that the innovation of new technology has played a vital role in capturing a huge share of the market, since most of the US firms individually invest in R&D. Indeed, the US approach to developing knowledge intensive industries has been quite different from Japan's. Commercial application of new technology are best left to the private sector. It is widely believed in the US that the opportunity for a good rate of return on a new investment or for higher salaries and faster advancement in a high-tech firm would be sufficient to attract capital and labour to emerge industries. Most Americans have felt that the appropriate role for government is to provide an environment that would stimulate private firms and workers to develop high-tech industries. This environment includes a well-educated labour force and a body of basic knowledge that could be used to develop specific commercial products and processes. In fact, the difference between Japan's MITI-led joint research and US's individual firms' research projects reflects the basic distinction between the Japanese and American perceptions of the appropriate role the government is to play in promoting technological progress and national economic interest. In both economic and theoretical literature and in the minds of policy makers, Americans are far from reaching a consensus as to the desirability of encouraging, as a matter of public policy, joint research ventures among firms, specially among large firms. The Americans recognize that the competitive and unconstrained market is better able to predict and "pick" future technological "winners" than the government officials who administer a public policy intended to achieve the same goal. The principal reason for this American view is that even seemingly "wasteful" duplicative research has been a source of major research breakthrough. Thus both large and small firms should pursue research goals independently, and no public policy should be adopted if its effect is to limit the innovative activity of small firms or to give preference to groups of large firms.

In contrast, most Japanese implicitly accept the view that the contributions large productive firms make to society are evident in the performance of the Japanese economy; so these contributions more than compensate for social cost the large firms might impose, e.g., as a result of their anti-competitive practice at home or even trade conflicts they create. Thus for most Japanese, the oligopolistic market structure and even various indications of collusive conduct and "export drives" are not viewed with concern, as they might be in the US. Rather, the existing market structure is seen basically as a necessary consequence of scale economies to be realized, and the indication of collusive product is accepted as an inevitable side effect of achieving rapid economic growth. The favoured status that is accorded to the large firms by the public policy are widely accepted by the Japanese as socially necessary and not regarded as an undesirable intrusion in market activities and hence so far has not been challenged on the ground of economic efficiency or public welfare, as it would be in the United States. In fact, the Japanese have few doubts about the relative advantage of "MITI-led" joint research accompanied by other forms of government involvement over the American-style "market-determined" innovative activity with the government basically standing aside.

One interesting feature that appears from the analysis of US-Japan trade policy is that the US until the recent past was reluctant to take any strong action against Japan although it was well known to them that the Japanese trade and industrial policy was harming the US economy. Threat of communist aggression, Japan's war devastated economy and its loyalty towards the US in earlier years might have prompted the US not to retaliate. But in the recent times, when Japan has emerged as a competitor and when the trade deficit with Japan is increasing rapidly, it appears that US has no other alternative but to take stern action. In the next chapter we will look into the genesis of the latest round of US-Japan trade disputes briefly.

IV. GENESIS OF THE LATEST ROUND OF TRADE DISPUTE

The recent dispute owes its origin to the changing economic situations of the two countries for the last three decades. While the US lost its status as an economic giant, Japan has come up as a big challenger both in the economic and political field. In fact, worsening economic relation stands aloft as the biggest and the most fundamental cause underlying the US-Japan trade disputes at present; and in the heart of the strained US-Japan economic relations lies the problem of US trade deficit *vis-a-vis* Japan, which has increased unproportionately since the beginning of the 1980s (see Table-2).

In Table-3 we have presented the growth of US and Japan's exports, as well as US's trade deficit with Japan over the period 1974-1994. It is found that the US export to Japan has been growing at the constant absolute amount of \$2.25 billion a year, while the corresponding figure for Japan's export to US is \$ 5.43 billion per year. That is, Japanese export growth in absolute amount was more than twice than that of US. However, considering the trend growth rates it is observed that while the US's export to Japan has been growing at a rate of 9 per cent per annum, Japan's annual export growth to US is 12 percent. The table also shows how US's trade deficit with Japan has increased over time. The deficit has increased at the constant absolute amount of about \$ 3.2 billion a year and at an annual rate of about 17 percent.

From these figures it is evident that Japanese exports have captured the US market rapidly. It is from this urge of reducing the recurring trade deficit, the US has sought to put Japan under severe pressure. Moreover, the end of the Soviet era along with the fear of communist expansionism has facilitated the US to make 'attainment of economic success' its first priority. Thus, it can be inferred that in this changing circumstances the US will eventually try to reduce its trade deficit with its once ally - Japan, specially when the latter enjoys an enormous trade surplus.

Table-2: US-Japan Bilateral Trade Balance

(in billion US$)

Year	US Export to Japan	US Import from Japan	US Trade Deficit
1960	1.4	1.1	0.3
1965	2.1	2.4	-0.3
1970	4.6	5.8	-1.2
1980	20.8	32.9	-12.1
1981	21.8	37.8	-15.8
1982	21.0	37.7	-16.7
1983	21.9	41.2	-19.3
1984	23.6	57.1	-33.6
1985	22.6	68.8	-46.2
1986	26.9	81.8	-54.9
1987	28.2	84.6	-56.4
1988	37.7	90.2	-52.6
1989	44.5	93.5	-49.0
1990	48.6	91.1	-42.5
1991	48.1	92.2	-44.1
1992	47.7	97.0	-49.3
1993	47.9	107.2	-59.3
1994	53.4	118.7	-65.3

Source: ***Direction of Trade Statistics Yearbook, IMF, 1995 and other issues.***

At present, trade deficit of USA with Japan constitutes about 37 percent of its total trade deficit with the world (See Table - 4). For other years since 1988 this deficit was always more than one third of the overall US trade deficit. In 1991, the figure was as high as 50.6 percent.

Although US's total trade deficit has experienced a wide fluctuation, as table - 4 shows, its trade deficit with Japan seems to

Table - 3 : Export Growth of US and Japan and Growth of US's Trade Deficit, 1974-1994

Indicators	Growth in absolute amount (US$ billion)	Trend growth rates (percentage)
US's Export to Japan	2.25	9.1
Japan's Export to US	5.4	12.1
US deficit *vis-a-vis* Japan	3.2	17.1

Note : *Growth figures in absolute amount have been computed from a simple trend equation while trend growth rates in the last column, have been estimated by fitting a semi-log function to data.*

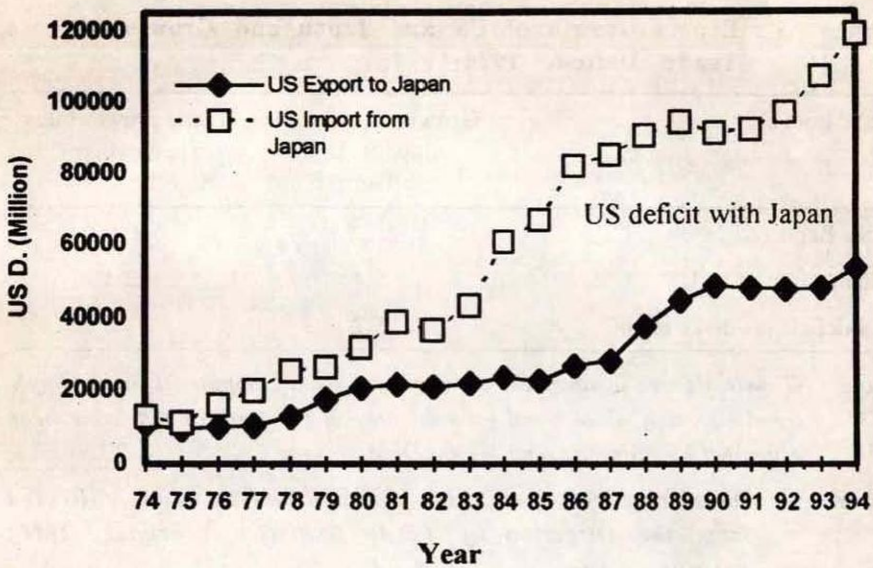
Source : *Data required for this exercise have been collected from the Direction of Trade Statistics Yearbook, IMF, various issues.*

Table - 4: US Trade Deficit With Japan as Percentage of Its Total Trade Deficit, 1989-1993

Year	**Total US Trade Deficit (US$ bill.)**	**Deficit With Japan (US$ bill.)**	**Deficit With Japan as % of Total Deficit**
1988	137.3	52.6	38.3
1989	129.1	49.0	38.0
1990	123.8	42.5	34.3
1991	87.2	44.1	50.6
1992	106.5	49.3	46.3
1993	138.1	52.3	37.8
1994	176.8	65.3	36.9

Source : *Authors' estimate from the Direction of Trade Statistics Yearbook, IMF, 1995.*

have accelerated over the period 1974 to 1994. This is evident from Figure - 2.



Source : Direction of Trade Statistics Yearbook, IMF, Various Issues.

Figure - 2 : US Trade Deficit with Japan 1974-1994

The Issues in the Conflict

A variety of subtle barriers remain in place in Japan. These are embedded in the nature of Japanese corporations, in the web of interdependencies between suppliers and manufacturers inside the '*keiretsu*', the industrial and financial conglomerates dominating large sectors of the economy. This system makes it difficult for foreign companies to enter the market. At the same time, the Japanese system of interrelated shareholding between companies, which renders firms relatively less sensitive to concerns like dividends and profits, allows companies to be fierce competitors at home and abroad - a major factor driving up the trade surplus. The major issues of conflict between US and Japan have been summarized below.

A. Cars and Auto Parts

The unresolved issue of access to the Japanese car market, remains the key source of friction. Japanese car sales in the US, dwarf

American auto sales in Japan; the imbalance accounts for 60% of the total US trade deficit with Japan. However, Toyota, Nissan, Mitsubishi Motors, Honda, and Mazda have announced that they would increase their American purchases from 25-50% during the fiscal years starting in April 1995.

B. Telecommunications

In the case of telecommunications market, the US argues that foreign firms have market shares of 22% in Germany and 28% in the US, while in Japan, the comparable figure is only 5%. The US wants Japan to raise access to a level comparable to other G-7 countries. Tokyo and Washington, however struck a deal on March 12, 1994 that calls for the Japanese government to monitor investment by a Japanese private company, IDO, in a cellular phone system promoted by US based Motorola. The Japanese also agreed to allocate more radio frequencies to the Motorola system in the key Tokyo-Nagoya urban corridor, at the expense of the now-dominant system, promoted by Nippon Telegraph and Telephone.

C. Aviation

This dispute is different from other US-Japan trade wrangles in two important respects. First, whereas Japan runs a surplus in its overall trade with the US in air services, the imbalance favours American carriers - meaning they could have most to lose if the 'beyond-rights' dispute escalates.

In Japan's interpretation of the 1952 accord, 'beyond rights' are intended to be supplementary in nature. But from the launch of *North West's* New York-Osaka-Sydney route in November 1991, the airline drew far in excess of 50% of its Sydney passengers from Japan. At one point, the figure was as high as 92%, but because the rules are applied flexibly to new services - largely to allow for initial marketing effects - the Japanese side at first took no action. However, with the service well established and the percentage still in the seventies, Tokyo leaned on Northwest to cut back.

Ominously for American carriers, Japan Airlines has held up the British - US agreement' as the one that Japan would like to emulate most. Under that deal, capacity is almost equally shared by the two sides.

D. Medical Equipment

Negotiations between Japan and the US about government purchases of medical equipments broke down over a single issue: should an agreement allow for "substantial" or "significant" increase in American sales to Japan?

The disagreement over terminology shows how little trust there is between the two sides. Failure to agree on Japanese Government procurement practice could jeopardize the entire US-Japanese "framework agreement" concluded in July, 1993. The US pointed out that in the case of medical equipment, US manufacturers account for nearly 40% of the public and private market in the European Union, but less than half of that in Japan. For their part, the Japanese argued that the foreign firms accounted for a 38.5% slice of Japanese Government purchases of medical equipments in 1991, against 1.5% in the US. In the latest negotiations, Japan refused to accept any wording that would include 'numbers' for what should be the US share of Japanese market in future.

E. Photo Film

This is the latest product that was included in the US-Japan trade disputes. Less than a week after reaching an agreement in auto trade talks with Japan, Washington decided to launch a new investigation into Eastman Kodak Co.'s claim that Japan's Fuji Photo Film Co. is engaged in unfair trade practices that is keeping Kodak products out of Japan's market. Kodak filed a petition under section 301 of US Trade Act of 1974, alleging that Fuji is blocking its entry into the Japanese and photographic paper market. Kodak's allegations includes, *inter alia*, price fixing by Japanese trade groups, cash payment to financially strapped wholesalers and retailers, and boycott of distributors that carried Kodak products. In its 250 page complaint, which cost 1 million dollars and one year to produce, Kodak contends that Japanese market is being unfairly controlled by its main rival Fuji due to active governmental cooperation.

At present Fuji enjoys a 75 percent share of the film market in Japan compared with only 7 percent for Kodak. However, Kodak claims that it can gain a 15 percent market share if Japan's market practices are changed to allow more foreign competition. It also believes that the company has lost 6 billion dollars in revenues since 1975 due to unfair business practices of Japan and Fuji Photo Film Co.

The US tried to engage the Japanese side in negotiations over the issue during a year-long period. Tokyo, however, rejects any suggestion of holding trade talks with Washington on its photographic film market.

Negotiations to Mitigate the Trade Conflicts and Its Results

The first systematic attempt to mitigate US-Japan trade conflicts was initiated by the former US President George Bush in 1992, when he was contesting for re-election and wanted desperately to reduce the trade deficit with Japan by increasing exports. Out of deference to Bush administration the Japanese agreed to set 'goals' for importing US goods. However the Japanese resisted when the Americans wanted to 'quantify' it. Later on, Clinton-Hosokawa talks (Feb 11, 1994) broke down precisely on this point, i.e., 'managed trade'.

The Americans also sought a 'framework agreement' to guide future negotiations aimed at reducing Japan's enormous and consistent trade surpluses to get Japan to buy more American imports of goods and services in areas, such as, autos, auto-parts, insurance, medical equipments and telecommunications and to set specific goals (e.g. a reduction of the trade surplus to 1.5% of Japan's GDP) against which its performance could be measured. Tokyo rejected that approach as 'managed trade' and argued that numerical targets ran counter both to free trade principles and to Hosokawa's election pledge that the government would meddle less in Japanese economy. The US then threatened to take action against Japan and it was to revive its trade weapon called 'Super 301,'[9] a law that required the US administration to single out countries for possible retaliation if they were found to be engaged in unfair trading practices. The USA then set a deadline - 28 June 1995- before which Japan should agree to terms and avoid the wrath of the US which was poised to impose 100% tariff on 13 makes of Japanese luxury cars, raising their prices enough to make them virtually unmarketable in the US and costing Japanese automakers US$ 6 billion a year in lost sales. Japan could have retaliated by limiting imports from the US, perhaps on aircraft and from products such as beef. That might have spurred another US retaliation and started badly damaging economies and shattering financial markets in both countries - the mutually assured destruction theory of trade warfare.

However, the US and Japanese negotiators in Geneva were just able to arrive in time at an agreement to head off a possible Trans-Pacific trade war. But there has been a controversy regarding the interpretation of such an agreement. As high level delegates from world's two largest economies reached an agreement, Tokyo and Washington both claimed victory in their auto trade row. Yet, economists and analysts in both the countries are skeptical about the effectiveness of the accord in resolving the dispute on a long term

9. Super 301 is to be used against partners resorting to unfair trading practices. There is also a normal section 301 which is an old provision of American Trade Law that allows the US government to retaliate against any trader abroad deemed to be unjustifiable, unreasonable or discriminatory. Super 301, on the other hand, was invented in 1988 when America lost patience with GATT's barely functioning and marathonic dispute settlement system and unlike the normal 301 it adds a rigid time table to prevent the President from being soft on foreigners by quietly dropping suits.

basis. Moreover, Japan has already claimed that the numerical targets that are cited in final text of the agreement are nothing but the USTR's own estimates.

As we have argued earlier that Japan has all along opposed US demand for accepting numerical targets, is now arguing that the figures included in the trade agreement, such as Japanese auto makers' future purchase of US made autoparts, are Washington's projections and will not necessarily become targets. After signing the agreement in Geneva, Japan declared that it had nothing to do with the figures and the government was not involved in calculating them; they were simply Washington's projections. The US estimates that Japanese automakers' purchase of North American auto parts will increase by 6.75 billion dollars by 1998 and that the number of dealers in Japan will increase to 1000 by the end of the century. Although Japan argues that the figures do not represent Japanese promises, some believe that the US will threaten sanctions in the future on auto trade with Japan if little progress is seen in opening of the Japanese market and the steps will probably be taken on the basis of calculations drawn precisely from the figures mentioned in the agreement. From this discussion three important points can be identified :

(i) The latest agreement reached at Geneva to resolve the auto dispute is very temporary in nature and may break down at any point of time. That is, the main objective of arriving at a long term solution appears to be beyond reach.

(ii) The latest agreement was confined to auto dispute only. There is no denying the fact that imbalance in auto trade sector has turned out to be a matter of great resentment for the US; but there is no scope for underestimating the importance of mitigating the disputes pertaining to other products in trade between these two countries. The dispute regarding the Photo-film is such an instance. Japan has boldly declared that they are least interested to participate in any negotiation that concerns the access of US photo film in Japanese market, implying that the tradition of "Japanese surrender" in the negotiation tables may not be repeated any more in future.

(iii) The most striking feature of this development is that the settlement of auto dispute, although temporary in nature, deprived the World Trade Organization (WTO) of an important test case that would have otherwise provided an opportunity to test the recently established system. The WTO is considered to have tougher powers to settle trade disputes than its predecessor, the General Agreement on Tariffs and Trade (GATT), and the government can not simply ignore or block the WTO rulings.

V. STRATEGIC TRADE POLICIES OF US AND JAPAN AND THEIR IMPLICATIONS

It is apparent from the discussion in the previous section that most of the issues of dispute in trade between the US and Japan still remain unresolved. The Japanese attitude of giving virtually no concession in the negotiations may make these issues complicated and very fatal in nature. And if the negotiations fail to break the ice, the US may resort to the use of its ultimate trade weapon the 'Super 301'. But in a condition where an air of change is noticeable in Japan's political role in international affairs, it is not very unlikely that Japan can retaliate. That is, there is a good possibility of an all out strategic trade war between these two rival nations.

In this section we would like to analyze the possible strategic behaviour of the two rival states in pursuit of an optimal trade policy. These strategic trade policies can be represented in a ***prisoner's dilemma*** *game theory* model[10]. The structure of this strategic environment faced by the governments of the two countries is similar to the environment faced by oligopolistic firms. The payoffs to each player

10. This type of model was first formalized by Tucker in 1950 and it is the most widely studied structure in the theory of strategic interaction or game theory. The name prisoner's dilemma stems from the fact that it was originally described using prisoners rather than countries.

depends on its own action and the action of its rival. In our model each country has two strategies, i.e. 'maintain *status quo*' and 'defection'. Here 'maintain *status quo*' means, the countries will refrain from taking policies deliberately to damage the export potential of its rival, while *defection* will mean the complete opposite behaviour.

Here the US strategy of *status quo* and *defection* are represented by A_1 and A_2 while that of its rival, Japan, are symbolized by B_1 and B_2 respectively.

Table - 5 : US-Japan Strategic Trade Policies and Their Outcomes

Country Strategy		JAPAN	
		B_1	B_2
USA	A_1	$A_1 B_1$ (200, 200)	$A_1 B_2$ (50, 300)
	A_2	$A_2 B_1$ (300, 50)	$A_2 B_2$ (100,100)

The first element in the parentheses in each small box in Table - 5, represents the payoff to US and the second element represents the payoff to Japan. Along the top Japan's strategies (i.e., B_1 and B_2) are represented and along the left US's strategies are listed. Thus, if both countries defect (i.e., the strategies of A_2 and B_2) each country gets a return of 100. If the US defects, and its rival Japan does not (A_2 and B_1), then US gets a return of 300 and Japan gets only a small net benefit of 50. If neither country defects (A_1 and B_1) each country gets a net benefit of 200. So, it is clear that unilateral predatory policy is attractive if the other country is passive but mutual cooperation would give the highest combined total returns, in this case 400 (200 + 200).

Let us now consider the decision problem faced by the US if it has to make a once and for all policy decision. If Japan chooses a strategy of *status quo* (B_1) then the US can make gains by playing the strategy of defection(A_2) because 300 is greater than 200. Furthermore, even if Japan chooses to defect (B_2), US's best strategy is still to defect (A_2) because 100 is better than 50. A similar type of decision problem will be encountered by Japan, in which case Japan will also end up in adopting the strategy of defection. Thus defection will be a dominant strategy: no matter what the other country does. If governments only make decisions once, then the outcome in which both countries defect is compelling as an equilibrium. So each country gets 100 which is clearly worse than the 200 each could get, if only the countries could agree to cooperate and maintain *status quo*.

So far the numbers we have used to represent payoffs to each country are hypothetical. However, an attempt has been made to replace these numbers with the export figures of the two countries to their rival's markets. This is explained in the following lines.

In the year 1994, Japan's export to US was $118693 which is about 30 percent of the total Japanese exports and about 18 percent of the total US imports. The average growth rate of Japan's export to US over the period 1988 to 1994 was 4.8 percent. On the other hand in 1994, US's export to Japan amounted to $53481 which is 10.4 per cent of total US exports and about 23 per cent of total Japanese imports in that year. The average growth rate of the US export to Japan had been 6.6 per cent over the period 1988-1994[11]. Thus we assume that each country's export will increase by its respective export growth rates provided that its rival maintains *status quo*. We also assume that defection by one country, while the other maintains

11. However, one should not think that the US enjoys a trade surplus over Japan since its export growth rate to Japan is higher than Japan's export growth rate to US. In fact, the real scenario, as we have described earlier, is completely the opposite and US's desperate attempts to reduce this trade imbalance through bilateral talks lies in the heart of current phase of the US-Japan trade disputes.

status quo, will reduce its rival's export by 25 per cent[12], increasing its own export by its average export growth rate. Similarly, if both the countries defect that will result in a reduction of export earning by 25 percent for both countries.

Thus in *status quo* (i.e., A_1 and B_1) the payoffs to US and Japan are \$53481 and \$118639 respectively. Now if Japan maintains *status quo* and US defects (i.e. A_2 and B_1), according to our assumption, Japan's export volume to US will experience a 25 per cent decrease whilst US's export to Japan will increase by its average export growth rate (6.6 per cent). That is US will get \$56048 million and Japan \$89019 million.

On the other hand, when US maintains *status quo* and Japan defects (A_1 and B_2) Japan's export will increase by its average growth of export, i.e, 4.8 per cent, while the US will experience a decline in its export to Japan by 25 per cent. Thus the US's and Japan's outcome will be \$40110 million and \$124390 million respectively. Finally, when both of them defect (i.e., A_2 and B_2) that will cause a 25 percent decline in each country's export volume. So the US will receive \$40110 million and Japan \$ 89010 million.

Let's now consider the decision problems. If Japan chooses the strategy of *status quo*, then US can make gains by playing the strategy of defection because 56048 is higher than 53481 and moreover this will reduce Japan's export from 118693 to 89019, which would also reduce US's trade deficit with Japan. Furthermore, even if Japan chooses to defect, US's best strategy is still to defect because it is only by defecting that the US can minimize its trade deficit with Japan. Similarly for Japan, defection will be the most attractive option. It is due to the fact that if US chooses the strategy of *status quo* and Japan

12. This figure is arbitrary, however, replacement of it by any other number, which just states that defection will lead to a handsome reduction in rival's export will give us the same result.

defects (A_1 and B_2), it will result in an increase in Japan's exports along with trade surplus of about $84280 million (124390 - 40110) from that of $65212 million (118693 - 53481) if it instead played the strategy of *status quo*. On the other hand, if the US defects, Japan's best strategy would also be to defect because it is only by playing this strategy it can increase its trade surplus to $48900 million (89010 - 40110) from $32971 (89019 - 56048), if it instead played the strategy of *status quo*.

Thus defection is again a dominant strategy and ultimately the US's exports to Japan will stand at $40110 and Japan's export to US at $89019. The total trade volume of these two countries while playing *defection*, is clearly much worse than the situation where both of them refrain from intervening. This will ultimately result in reducing welfare in both the countries. And the cost involved in terms of reduction in welfare can only be overcome through mutual cooperation, (i.e., the strategy of A_1 and B_1), where it would give the highest combined total return, i.e. the sum of US's and Japan's payoffs $172174 million (i.e. 53481 and 118693).

In this context it should be pointed out that *defection* can be a dominant strategy only with a very strong assumption that there is no scope for mutual discussion which is also the basic assumption underlying 'prisoner*'s dilemma*' model. However, with the consideration that the players have scopes to interact, probably '*defection*' will be the dominant strategy in the short run only. In the longer term, the declining trade volumes and concurrent degradation of welfare will induce the parties involved to maximize their expected payoffs, and in that case cooperation, i.e., maintain *status quo* in our model might be the dominant strategy[13]. The strategy of *cooperation* as a dominant strategy in the case of US and Japan will only be possible through a unison of the two apparently conflicting trends of expansion of trade

14. See, Kreps David M., "A Course in Microeconomic Theory", Princeton University Press, 1990, p. 505.

between these two countries and depletion of US trade deficit with Japan. This implies that US's maximization of expected payoffs is not only dependent on the expansion of its trade with Japan, but also is constrained by the urge to minimize its deficit. This US objective may prove to be the most critical factor in impeding any possible notion for 'cooperation' to be the dominant strategy.

Implications for Developing Countries

We will now take into account the impact of strategic trade policies adopted by the US and Japan when defection becomes unavoidable on the part of both of them. Since export markets in the rival countries will be squeezed, both US and Japan will desperately hunt for new market niches which may have serious implications for other economies, specially the developing countries. In this regard, it will be useful to look at Table-6 which shows Japan's and US's exports to different region as percentage of their respective export volumes. It is seen that in 1994 around 30 percent of the total Japanese exports was bound for US while the corresponding figure for US export to Japan was 10.4 percent. So it becomes clear that a trade war will seriously affect the Japanese economy. On the other hand, since the absolute US export volume is originally much larger than that of Japan the market loss due to Japan's retaliation will also have similar repercussions for the US economy. It goes without saying that under such circumstances both the US and Japan will seek for markets elsewhere.

Over the last seven years, as shown in Table-6, Japan's export share to the industrialized countries has suffered a decline twice as much as that of the US has experienced in terms of their respective shares. However, considering EU alone, the decline in the share of exports, has been almost the same for both the countries. US's export volume fell from 23.4 percent to 21.0 percent while Japan's export share fell to 14.5 percent from 17.5 percent. After the industrialized countries, Japan's second largest export market is Asia. In Asia, US export bundle has slightly increased from 16 percent in 1988 to about

Table-6 : Export of US and Japan to Different Regions As Percentage of Their Respective Total Export, 1988-1994

Country/ Region	US Export as % of its total export							Japan's Export as % of its total export						
	1988	1989	1990	1991	1992	1993	1994	1988	1989	1990	1991	1992	1993	1994
US	-	-	-	-	-	-	-	34.1	34.2	31.7	29.3	28.4	29.5	29.9
Japan	11.7	12.2	12.3	11.4	10.6	10.3	10.4	-	-	-	-	-	-	-
Industrial countries	62.6	63.2	63.9	61.3	58.5	57.6	57.3	60.4	60.4	58.6	55.7	54.0	51.4	50.5
Developing countries	37.3	36.6	35.9	38.6	41.4	42.3	42.6	39.4	39.5	41.3	44.2	46.0	48.6	49.4
Africa	1.6	1.4	1.4	1.4	1.5	1.4	1.2	1.8	1.6	1.6	1.6	1.7	1.8	1.5
Asia	16.0	15.8	15.5	16.0	16.6	17.6	17.9	29.2	30.1	31.3	33.6	34.6	37.7	40.1
Europe (except EU)	1.9	2.2	1.8	1.8	1.9	2.2	1.7	1.7	1.6	1.7	1.4	0.9	1.1	0.7
Middle East	4.1	3.8	3.4	4.3	4.5	4.2	3.7	3.4	3.0	3.3	3.8	4.3	3.6	2.7
EU	23.4	23.8	25.0	24.4	23.0	21.0	20.1	17.8	17.5	18.8	18.9	18.5	15.7	14.5
Western Hemisphere	13.6	13.5	13.7	15.0	16.9	16.9	18.1	3.2	3.2	3.4	3.9	4.4	4.4	4.4

Source: *Computed from the Direction of Trade statistics, 1995, IMF.*

18 percent in 1994. While the corresponding figure for Japan is 29.2 percent to 40.0 percent. So any export blockade in US's market will make Japan more inclined to direct its bulk of export to the Asian nations. Another notable feature that can be derived from the same table is that US's trade share in the Western Hemisphere countries is much higher than that of Japan. US now, is channeling about 17 percent of its total export volume to those countries in contrast to Japan's paltry share of only 4.4 percent. As a whole, in the developing countries, Japan is exporting about half of its exports whilst the US is channeling about 43 percent.

From these figures, it can be inferred that the markets in the developing countries will be the main target for both the US and Japan (if trade conflicts between them becomes unavoidable), leading to severe implications for their economies. Moreover such a trade war might lead to violation of trading rules and principles of free trade which could encourage developed countries to adopt various unfair policies which includes, *inter alia*, dumping and subsidization of exports. The developing countries may also fall victim to various new 'clauses' (e.g., environmental and social) well suited to serve the interest of their rich partners. There are some instances that some of the developed countries are already threatening the boycott of imports from developing countries on the ground of social and environmental issues. An initiation of trade tensions between the US and Japan will aggravate the situation further. Both the countries may go that far as to put pressure on the developing countries individually to reduce trade deficits through increasing imports from them, which may even be at the cost of boosting unnecessary luxury imports. If this so happens, the condition of the relatively backward developing countries will be the most precarious.

It is feared that trade tensions between US and Japan will severely damage the prospects of LDCs, most of whom in recent years have put maximum emphasis on trade in the light of the empirical evidence that trade has been the 'engine of growth' for many countries, particularly the newly industrialized countries, *viz*., South Korea, Hong Kong, Taiwan and Singapore. Some of the LDCs are currently having larger export markets in the US and Japan and it is expected that these will further flourish if trade discipline is maintained. For example, Bangladesh's largest export market is the US which consumes 30 percent of its total export. Bangladesh also enjoys a colossal trade surplus with the US. But if a trade war between US and Japan becomes unavoidable and as a result the bilateral trade volume shrinks, countries like Bangladesh may face serious consequences as these economic giants may put tremendous pressure to allow greater access of their products in the poor countries. Besides, such attempt might be accompanied by 'demanding export cuts' from the LDCs which will further aggravate the balance of payments situation of the poor economies. It goes without saying that as the economies of the LDCs are not diversified, any export blockade by the developed countries will leave serious repercussions which might prove to be beyond the capacity of these countries to mitigate.

Competitive Strategies of US and Japan

There is every possibility that the unresolved trade conflicts will have effect on US's and Japan's strategic stances which will not only be confined between themselves but will also extend to other countries. These two countries may make strenuous efforts through their diplomatic missions abroad to promote their exports to the developing countries. In this regard foreign aid may be used as a tool to serve the purpose. Both US and Japan might resort to 'tied aid' so that market opportunities of their products can be ensured. Similarly, foreign direct investment (FDI) may tend to be directed in line of producing those commodities for which markets already exist in the recipient countries, and thus threatening the prospect of domestic import substituting industries. Through these attempts if the US and Japan can penetrate the markets of the developing countries, the prospect of future mutual negotiations to resolve their trade disputes will badly be affected.

In fact, as the two countries will desperately hunt for new markets for their products, their strategies towards the developing countries will be very competitive. This may lead to two types of policy outcomes. One outcome may be that as one rival offers a policy with liberal terms and conditions to the developing countries, with a view to getting access to their markets, the other may follow suit with a more attractive one. If this is so, the developing countries will have a very little to worry about. However, if one of the two rival nations starts with a stringent approach which ensures a better market prospect in the short run, the other will have every incentive to make its policy at least as stringent as the other, if not more. Between these two policy approaches the latter one has relatively stronger appeal to US and Japan since it would very quickly serve their interest. So, it appears that competitive strategies played by the two countries will carry a greater probability of worsening the condition of the developing countries than otherwise.

The worst that may be encountered is the possibility of forming rival trade blocks led by US and Japan respectively. This may revive a sort of cold war under the aegis of world wide trade tensions leading to gross irregularities, malpractice and breaching of international trade norms. After the demise of the former Soviet Union, when most of the nations opted for free market oriented, outward looking policies and when it was expected that world trade volume would inflate and world welfare would increase manifolds, such trade turmoil may shatter this potential prospect.

VII. CONCLUSION

There is no doubt that the US-Japan trade relationship has entered into a critical stage, where they have come from that of a patron-client relationship to an uneasy partnership. This is true that Japan has all through adopted policies quite contradictory to market mechanism and ultimately become a competitor of the US, against which the US was reluctant to react until very recent times. A shift in the attitude of the

US policy towards Japan can largely be attributed to the changing political atmosphere of the world and also to the consistently diminishing comparative advantage of the US firms *vis-a-vis* its rivals. Any aggressive policy against Japan, can be rationalized by the US, arguing that since Japan distorted the market earlier, it is appropriate for them to adopt a second best policy by taking another distortive measure. But such actions can severely damage the principle of free and fair trade worldwide - the principle which was agreed by most of the countries through the signing of the final act of the Uruguay Round of Multilateral Trade Negotiations (MTNs). Moreover, the adoption of competitive strategies by US and Japan towards the developing countries in the form of stringent aid conditionalities and foreign direct investment (FDI), trade blocks, etc., is likely to add to their miseries. Indeed, it is a matter of great concern that if the US-Japan trade disputes initiate a tendency of circumventing and violating the free trade ideology, the efforts so far made to enhance free and fairer multilateral trade may suffer a set back, leaving serious implications for the developing countries, particularly for the LDCs, welcoming an era of neo-protectionism.

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