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**Explaining Patterns of Trade War and Threat Effectiveness:
The Importance of Competitive Versus Complementary Trade Structure**

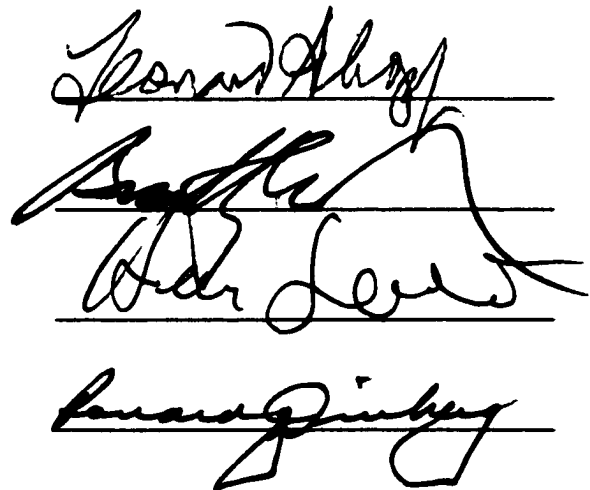
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Four handwritten signatures are arranged vertically, each on a horizontal line. The signatures are written in black ink and are highly stylized and cursive. From top to bottom, they appear to be: 1. A signature that looks like 'Edward A. ...'. 2. A signature that looks like 'Robert ...'. 3. A signature that looks like 'John ...'. 4. A signature that looks like 'Edward ...'.

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Abstract

I explain the cross-national variation in the effectiveness of U.S. aggressive trade bargaining strategies and examine the relationship between regime type and the probability of trade war for trade disputes involving the United States. Drawing on “two-level game” theory, I develop a model to elucidate the conditions under which domestic politics supports the use of aggressive negotiation tactics. I argue that a system-level variable, the structure of trade among nations, systematically affects threat effectiveness and the probability of trade war by influencing both the level of unity among domestic interest groups and the degree of divided government in the sender of threats (the U.S.). America’s sanction threats will enjoy more unified domestic support and hence be more credible when the dispute involves a country having a competitive, rather than complementary, trade relationship with the United States. Domestic unity in trade disputes with nations having competitive trade relations with the United States leads to stronger pressure for brinkmanship and the greater likelihood of trade wars with these states. Since many of these nations happen to be democracies, this results in the anomaly of democratic trade war.

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Acknowledgements

I owe my greatest debt to my dissertation adviser, Leonard Schoppa. This work would not have been possible without his guidance, encouragement, and support. His inspiration and advice made the dissertation-writing stage of my Ph.D. study a truly rewarding experience. I hope to live up to his scholarship and standards.

I also would like to thank the other members of my dissertation committee, Herman Schwartz, Brantly Womack, and Ron Dimberg, for their insights and recommendations.

I owe my special thanks to Wimonkan Kosumus, Vanicha Vichai, Mina Wang, and Bryson Clevenger at the University of Virginia who provided me with invaluable friendship and suggestions. They were always there when I needed them the most. Karen Cox at the Government Department and Carol Hunter at Alderman library offered me much-needed assistance with statistics, an area in which I had the least expertise.

I am grateful to the institutions that provided funding for my research, including the Department of Government and Foreign Affairs at the University of Virginia, Dr. Lee Yuh-jie Foundation, the Albert Gallatin Foundation, and the Weedon Fund.

Finally, my gratitude goes to my family for their understanding and support. I hope the time I took away from them has been spent as productively as they could have wished. This work is lovingly dedicated to them.

~ 1 ~

Introduction

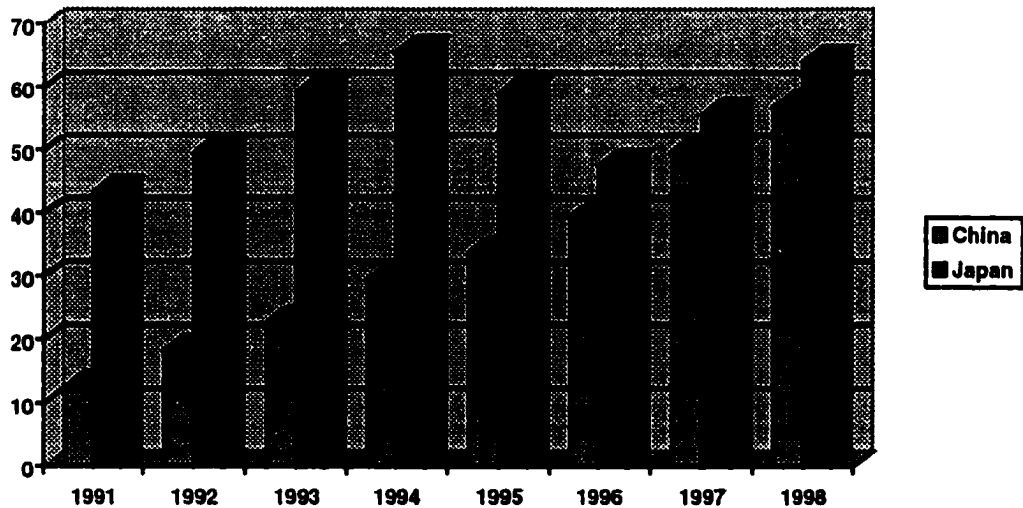
Increasing international interdependence has been accompanied by heightened commercial rivalry among nations. In the past two decades, trade conflicts between advanced industrial countries have intensified as these states competed to maintain a vibrant domestic production base. Confronted with the possibility of eroding economic competitiveness and challenged by other developed nations, the United States has engaged in a never-ending series of trade conflicts with its European and Japanese competitors, particularly in those high-technology industries such as semiconductors and aircraft that directly affect the national economic and security interests. Some of these conflicts even led to trade wars.

As the United States was forced to adopt an increasingly aggressive trade strategy in dealing with other industrial nations, it also had to cope with growing trade challenges from developing countries whose pursuit of mercantilist and protectionist policies for rapid economic catch-up put them on a collision course with the Americans. In the late 1970s and early 1980s, the United States increasingly began threatening trade sanctions to liberalize markets in newly industrializing countries such as Taiwan, South Korea, and Brazil.

More recently, China's remarkable economic growth has begun to pose another major challenge to American trade policy. Although total trade between the two nations

grew from \$4.8 billion in 1980 to \$85.4 billion in 1998, making China the sixth largest U.S. trading partner, the U.S. trade deficit with the Chinese is also on the rise, reaching \$56.8 billion in 1998.¹ (see Figure 1) Today China trails only Japan as the country with the largest trade surplus with the United States. For one month in June 1996, its monthly trade surplus with the United States even surpassed that of Japan.

Figure 1.1: U.S. Trade Deficits with Japan and China: 1991-1998 (in \$ billion)



Source: U.S. Department of Commerce Data.

Not surprisingly, the two sides have found themselves embroiled in a wide range of trade conflicts over the past few years in such areas as intellectual property rights, textiles, market access, and China's Most-Favored-Nation (MFN) status. What is most surprising, in view of the disparity in bargaining power and resources between the two countries, is that America's threatened trade sanctions against China has succeeded in winning

¹ International Trade Administration, *U.S. Foreign Trade Highlights*, various years.

unilateral concessions in few of these conflicts. Prior to the 1999 U.S.-China agreement on China's entry into the World Trade Organization (WTO), the Clinton administration faced considerable difficulties in its efforts to open up the Chinese market because the Chinese government, preoccupied with problems associated with its efforts to further reform the economy, demonstrated little willingness to dismantle trade barriers. Although recent moves by the United States to integrate China into the world trade body appear to have produced some genuine market-opening outcomes, Washington's attempts during most of the last decade to threaten China with trade sanctions for unilateral trade gains has by and large failed to induce Chinese concessions. It could be said that for American trade dispute diplomacy, China has become the most challenging state, on a par with Japan in the 1990s.

The record of these commercial rivalries presents us with two puzzles. First, even though the United States has always been the country with greater aggregate power and bargaining resources in bilateral trade disputes, it has had uneven success in extracting concessions from its trading partners through the use of coercive strategies. For instance, although Japan is less dependent on the American market for exports than many U.S. trading partners, it has given in most frequently to U.S. pressure.² Interestingly enough, countries that are more heavily dependent on the U.S. export market (such as

² Figure 3.1 depicts the level of asymmetrical export dependence of several major U.S. trading partners. Level of asymmetrical export dependence is measured by comparing a given target country's exports to the United States as a percentage of its GNP to U.S. exports to that target state as a percentage of U.S. GNP.

China, Brazil, and India) have turned out to be more resistant to American demands.³

Despite having fewer power resources, they have frequently been able to negotiate better dispute settlements than gross measures of power would predict. Clearly, realism, with its emphasis on nations' underlying raw power balances, cannot explain why, on average, American coercive diplomacy works less well with countries whose raw material power should have put them in a more disadvantaged position vis-à-vis the United States. It seems necessary for us to look at factors other than "raw power" in order to understand the variations in U.S. negotiating outcomes.

The second puzzle motivating this study is that the pattern of "democratic peace" that has been found to be a distinctive characteristic of international security conflicts does not seem to apply to trade conflicts. The empirical evidence presented in Chapter 3 on the pattern of states' involvement in the aggressive escalation of trade disputes leading to either unilateral or mutual retaliation suggests that trade conflicts between democracies have not more frequently escalated into trade wars than between dyads that match democratic and authoritarian states.

In a nutshell, the theory of "democratic peace" posits that democracies are significantly less likely to go to war with one another.⁴ With a few exceptions, most of the recent "democratic peace" literature has focused on the effects of regime type on the

³ Thomas O. Bayard and Kimberly Ann Elliott's study on the effectiveness of section 301 in opening markets overseas provides data illustrating the variations in the effectiveness of American pressure across countries. See Bayard and Elliot, *Reciprocity and Retaliation in U.S. Trade Policy*, Washington, D.C.: Institute for International Economics, 1994, pp. 355-367. See also Figure 3.1.

probability of military wars. Relatively little effort has been made to assess the relationship between regime type and the likelihood of trade wars.⁵ Nevertheless, as this chapter will later explain, the insights of the “democratic peace” theory should be applicable not only to analyses of military wars, but also to analyses of trade wars. In particular, one version of the “democratic peace” theory, the theory of “democratic signaling” put forward by James Fearon, provides a logic that suggests that democracies should be less likely to engage in trade wars with one another.⁶

However, as the empirical evidence presented in this study will show, democracies are *not* less inclined to be involved in trade wars with one another than with authoritarian states. The record of America’s involvement in trade conflicts shows that the United States has actually been involved in a large number of trade wars with its democratic trading partners, such as Japan and Europe, a pattern that clearly does not accord with the theory of “democratic peace.” These empirical irregularities raise an important research question: is democracy indeed associated with an enhanced propensity to be involved in high-intensity conflict in trade, or is trade war driven by some more fundamental causal mechanisms than regime type?

In approaching the two puzzles described above, I draw on the notion of “two-level games” to show how domestic and international politics interact to affect negotiating

⁴ Chan 1984; Maos and Russett 1993; Russett 1993; Ray 1995; and Oneal and Russett 1997.

⁵ Among the studies that examined the relationship between regime type and trade policy are Milner and Rosendorff 1997; Mansfield et al. 1998; Reinhardt 1999; Sherman 1999; Busch 1999a.

outcomes. The two-level game approach, which has gained prominence in recent years, argues that political leaders must play their hands in the domestic and international arenas simultaneously. Their behavior cannot be understood without taking into consideration the constraints and pressure they face in both arenas. The metaphor, by adding a new “level of analysis” to international relations, allows us to go beyond the unitary actor assumption to view central decision makers, legislatures, and domestic groups as independent actors in international politics.

However, although the two-level game concept provides a good starting point for organizing empirical studies, most of the literature inspired by it has failed to generate explicit hypotheses about the interaction between domestic and international politics. Moreover, the two-level game approach remains underdeveloped theoretically. Although a number of recent works have tried to remedy the situation by developing more rigorous treatment of the domestic game⁷, few of them have explicitly utilized the two-level game concept to understand variations in threat effectiveness and the outbreak of trade wars. This study fills this gap in the literature by developing a systematic analysis of domestic

⁶ James D. Fearon, “Domestic Political Audiences and the Escalation of International Disputes,” *American Political Science Review* 88: 3 (September 1994), 577-587.

⁷ Studies that improve on the two-level game framework to explain the prospect for democracies to cooperate in trade include the following: Helen V. Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations*, Princeton, NJ: Princeton University Press, 1997; Helen V. Milner, and Peter B. Rosendorff, “Domestic Politics and International Trade Negotiations: Elections and Divided Government as Constraints on Trade Liberalization.” *Journal of Conflict Resolution* 41 (February 1997), 117-46; and Edward Mansfield, Helen V. Milner and Peter B. Rosendorff. “Free to Trade: Democracies and International Trade Negotiations.” Paper presented at the annual meeting of the American Political Science Association, 1997.

interests and institutions and of their impact on international negotiations. It argues that a system-level variable, the *structure of trade* among nations (specifically, whether the bilateral trade relationship is complementary or competitive), affects threat effectiveness by influencing both the level of unity among domestic interest groups and the degree of divided government. The same factor also affects the propensity of trade conflicts to escalate into trade wars.

The structure of trade, as will be explained in more detail in the next chapter, refers to the degree to which two countries engage in the export of a similar range of products. If two countries produce a similar set of commodities and can easily replace imported commodities with similar products produced at home, then they have a primarily *competitive* trade structure. But if each of them specializes in a different set of products in which it has a comparative advantage, and trades them for commodities that it is incapable of producing at a reasonable cost, then they have a *complementary* trade relationship. To put it in another way, trade complementarity involves the mutually beneficial exchange of goods in areas where each is deficient. By looking into the structure of trade among nations and its impact on domestic politics and international negotiating outcomes, this dissertation offers a plausible explanation for the two empirical puzzles summarized above, and, in doing so, it aims to provide a better understanding of the dynamics of international trade negotiations.

Variations in Threat Effectiveness

The first, and primary, puzzle of this dissertation concerns variations in the degree to which U.S. economic coercion succeeds in achieving its intended objectives. Following the realist insights that bargaining outcomes reflect states' underlying power balance, one would expect the United States, which holds greater aggregate power vis-à-vis all of its trading partners, to be most successful in extracting concessions from its least powerful trading partners. However, this theoretical expectation fails to be borne out by available empirical evidence. For instance, although the European Community (EC) has the lowest ratio of export dependence on the United States (EC's export dependence on the United States, measured by EC's exports to the United States as a percentage of EC's GNP, is only 0.98 percent of U.S. export dependence on the EC), it is among the U.S. trading partners that are more responsive to American pressure. Similarly, although Japan's export dependence on the United States is only 2.46 times higher than U.S.' export dependence on Japan, it has yielded more often to American demands than nations that are much more dependent on U.S. export markets such as China. In U.S. negotiations with Japan under Section 301 of the U.S. trade law, American pressure proved to be largely successful in achieving market-opening results in four out of a total of twelve cases, produced partial success four times, and resulted in nominal success in the remaining four cases.⁸

⁸ Bayard and Elliott, *Reciprocity and Retaliation in U.S. Trade Policy*, 1994, 355-368; Kimberly Ann Elliott and J. David Richardson, "Determinants and Effectiveness of 'Aggressively Unilateral' U.S. Trade

In contrast, the United States has had greater difficulty imposing its demands on nations whose raw material power should have put them in a relatively weak position vis-à-vis U.S. demands.⁹ For example, China, which is 35.5 times more dependent on the American export market than the U.S. is on the Chinese market, has yielded far less frequently than America's other trading partners. In recent trade negotiations with China, the United States has had considerable difficulty convincing the Chinese to conform to its demands. For example, in the two Section 301 cases involving China in the early 1990s (intellectual property rights protection and market access), the United States was able to achieve only nominal success.¹⁰ In these cases, although the United States managed to secure China's written consent, it rarely received substantial compliance with the terms of the agreement. When the Chinese government did agree to change its policies, it did not implement and enforce these policies completely either because of the lack of political will or because of domestic intransigence. If we apply the same criteria Bayard and Elliott

Actions," in Robert C. Freenstra, ed., *The Effects of U.S. Trade Protection and Promotion Policies*, Chicago: University of Chicago Press, 1997, 221-225. Successful cases are defined in a way that includes both the conclusion of an agreement and the actual achievement of American negotiating objectives when the agreement was implemented.

⁹ Various studies have shown how the effectiveness of U.S. economic coercion varies in ways that do not correspond with the underlying power balances. In his study of the Brazilian informatics and EC enlargement cases, for example, John Odell finds that the U.S. was more successful in winning concessions from Europe than from Brazil, although in theory Brazil should be less able to resist U.S. demands -- John Odell, "International Threats and Internal Politics: Brazil, the European Community, and the United States, 1985-1987," in Peter Evans, Harold Jacobson, and Robert Putnam, eds., *Double-Edged Diplomacy: International Bargaining and Domestic Politics*, Berkeley: University of California Press, 1993, 233-264. Similarly, the study by Bayard and Elliott on the effectiveness of the Section 301 of the U.S. trade law in opening markets in Japan, Brazil, and India during the period of 1989-90 has shown that while the Japanese gave in to most American demands, India completely refused to yield to U.S. pressure. The relative power positions of these two countries obviously cannot explain this outcome -- Bayard and Elliot, 1994, 101-170.

used to evaluate the degree of negotiating success in two other major U.S.-China trade disputes (textiles and MFN) conducted outside of the framework of Section 301 of U.S. trade law, we can see that American pressure has been similarly ineffective. The textile case represented only nominal success for the United States since the bilateral textile agreements were not implemented to U.S. satisfaction: Chinese sales of textiles to the U.S. market skyrocketed despite the quota restrictions mandated by the agreement; Chinese textile and garment producers also found ways to circumvent the quota restrictions by transshipping Chinese textiles to the United States via third countries.

The United States fared even worse in efforts to change China's trade and other domestic practices through threats to revoke China's Most-Favored-Nation status. The Chinese side completely rejected most American demands and made few, if any, changes in its domestic policies. The MFN case thus represents almost a complete failure for American negotiating objectives. On the whole, it seems fair to say that U.S. coercive strategy has produced rather limited results in China: the Chinese did not offer even minimal concessions to the U.S. in some cases. In those cases where Beijing did commit itself to written agreements, it was either unwilling or unable to implement the promised policies.

China's ability to resist American pressure is particularly puzzling in view of the fact that other similarly trade-dependent countries in Asia such as Japan, South Korea, and

¹⁰ Bayard and Elliot, *Reciprocity and Retaliation in U.S. Trade Policy*, 368.

Taiwan have tended to be much quicker to offer concessions. This contrast suggests that raw power per se is inadequate to explain the variations in the outcomes of international trade negotiations. Factors other than raw material power need to be taken into consideration for us to better understand the dynamics of international bargaining.

Democracy and Trade War

There is another puzzling aspect of international trade conflicts: inconsistent with the predictions of “democratic peace,” it cannot be established that, in trade, democracies are less war prone with one another than with authoritarian states. Simply stated, the “democratic peace” thesis contends that while democratic states are as war prone as other regimes, pairs of democracies are less likely to fight wars against each other.¹¹ Three strands of arguments have been offered to explain why democracies are less war-prone in their relations with fellow democracies. Two of these explanations, focusing on the effects of democratic norms and political structures on democracies’ external behavior,¹² are based on a logic that seems to be limited to cases of international security conflict -- the only area in which empirical evidence has been marshalled to support the contention that there *is* a “democratic peace.” However, the third strand of the argument, which emphasizes the role of domestic audience costs in constraining democracies’ propensity to

¹¹ Maos and Russett 1992, 1993; Russett 1993; Ray 1995.

¹² See, for example, Maoz and Russett 1993; Owen 1994; Weart 1994.

escalate their conflicts to the level of a “war,” emphasizes a causal mechanism that should logically yield solutions to both security *and* trade conflicts among democracies.

Norms-based explanations of democratic security peace regard the norms of self-determination, regulated political competition, compromise solutions to political conflicts, and peaceful transfer of power as powerful restraints on violence between democratic systems. “If people in a democracy perceive themselves as autonomous, self-governing people who share norms of live-and-let-live,” they are likely to extend these norms to other national actors who are “also perceived as self-governing and therefore not easily led into aggressive external behavior by a self-serving elite.”¹³ In other words, democracies are constrained and perceive other democracies as constrained by the same set of structures and behaviors that limit aggression. The externalization of democratic rights and principles, it is argued, mitigates democracies’ fears of being dominated by one another, thus preventing conflicts between democracies from escalating to the use of military force. But when a democracy comes into conflict with a nondemocracy, it will not expect the nondemocratic state, which does not abide by the norms of peaceful resolution of conflicts in its internal politics, to refrain from the use of force in its foreign relations. Out of fear that its moderation may be taken advantage of by the nondemocratic state, a democracy may resort to more forceful conduct in order to obtain a decisive outcome. In short, democratic principles and practices that denounce the threat or use of

¹³ Bruce Russett, *Grasping the Democratic Peace: Principles for a Post-Cold War World*, Princeton, N.J.: Princeton University Press, 1993, 31.

violence allow democracies to be more “dovish” in their foreign relations, fostering a “zone of peace” among democratic states.¹⁴

The second explanation of the democratic security peace focuses on the role of structural and institutional constraints on the use of violence. From this perspective, democracies are inhibited from going to war by the need to ensure broad popular support. The complexity and lengthiness of the mobilization process means that leaders will be reluctant to take the country to war unless they can convince the public that victory can be achieved at a reasonable cost. Structural delays in the process of mobilization for war on both sides of the conflict should also provide greater scope for negotiation and other means of peaceful conflict resolution. By contrast, since leaders of nondemocracies are not as constrained as leaders of democracies are, they can more easily and rapidly initiate the use of force. In short, “the constraints of checks and balances, division of power, and need for public debate to enlist widespread support” in democracies will slow decisions to use force and reduce the likelihood of war among democracies.¹⁵

These two arguments, obviously, are particularly applicable to the analysis of security issues. The third theory developed to explain “democratic peace,” emphasizing how democratic states are better able to learn about an adversary’s resolve in a crisis

¹⁴ Ibid., 1993, 30-38; Michael W. Doyle, “Liberalism and World Politics”, in *American Political Science Review*, 80: 4 (December 1986).

¹⁵ Russett, *Grasping the Democratic Peace*, 1993, 38-40. Some other scholars made similar structural arguments. See, for example, David Lake, “Powerful Pacifists: Democratic States and War,” *American Political Science Review*, 86: 1 (1992); Randall L. Schweller, “Domestic Structure and Preventive War: Are Democracies More Pacific?” *World Politics* 44: 2 (1992).

situation, in contrast, is based on a logic that seems more likely to apply to economic as well as security conflicts. For example, Bueno de Mesquita and Lalman's work dealing with the informational properties of political institutions argues that due to the presence of active domestic opposition, democratic leaders face generally higher costs in the event that they fight a losing or costly war. In other words, democratic institutions help to signal a state's true preferences by revealing that the government faces relatively high costs for using force, regardless of whether that government is making a conscious effort to signal its intentions.¹⁶

James Fearon builds on Bueno de Mesquita and Lalman's model and contends that democracies should be able to cope better with the security dilemma because they can signal their resolve to other states more credibly and clearly than can authoritarian states. According to his formal model, domestic audience costs, which refer to the reaction of domestic political audiences interested in the leadership's handling of foreign policy issues, allow states to learn about an opponent's willingness to use force in a dispute. Since democratically elected leaders face higher domestic audience costs for escalating and then backing down, they are less inclined to bluff than nondemocracies. To the extent that a democratic leader does threaten war, the threat is rendered credible because the leader is able to generate *costly signals* by incurring audience costs that would be suffered if he/she backed away from the threat. These believable signals between democracies allow them

¹⁶ Bueno de Mesquita and Lalman 1992, Chapter 5.

to learn exactly where their bottom lines are in their dispute. Given the high costs entailed if war actually breaks out, two democracies then have the incentive to use this information to reach a mutually acceptable settlement. The signaling and committing value of a stronger domestic audience makes democratic pairs less likely to begin or escalate conflicts, thus ameliorating the security dilemma between such states.¹⁷

Kenneth Schultz takes Fearon's argument and develops a more elaborate framework showing how domestic political competition can help democratic states overcome the problems associated with asymmetric information. In this view, a strategic opposition party enables democracies to send more informative signals about their true preferences by creating a second source of information. An opposition party can enhance the ability of the government to make threats by publicly supporting those threats in a crisis, or it can undermine the credibility of threats by publicly opposing them. In the latter case, the presence of a domestic competitor with political incentives to reveal its aversion to war makes it more likely that the rival state will resist the threat, leaving the home government with less opportunity to bluff or to misrepresent its preferences. Hence, institutions associated with democracy, by providing more credible information about a

¹⁷ James D. Fearon, "Domestic Political Audiences and the Escalation of International Disputes," in *American Political Science Review* 88: 3 (September 1994), 577-587. The argument is explained in more detail in Chapter 2.

state's resolve, give democracies an enhanced capacity to resolve their disputes peacefully relative to states that do not permit open competition.¹⁸

The "democratic signaling" argument, although applied thus far only to the absence of security conflicts between democracies, is based on a logic that ought to extend to trade conflicts as well. In trade conflicts, as in security conflicts, democratic leaders face high domestic audience costs that enable them to reveal their true willingness to fight over the interests involved in the dispute. Thus, threats to impose economic sanctions should strengthen the target's belief that the threats actually will be carried out and provide the opponents with greater incentives to avoid trade wars and to arrive at negotiated settlements. Trade wars, like security conflicts, also impose high costs on nations that fail to come to negotiated settlements and allow disputes to escalate. For example, it is estimated that the trade war over agricultural subsidies in third markets between the United States and European Economic Community (EEC) cost the two sides approximately \$2.5 billion over three years. Therefore, democratic dyads should have as strong an incentive to use the information generated by their enhanced signaling capacity to avoid trade wars as to avoid military wars.

The argument that this "democratic peace" theory should apply to trade wars as well as security conflicts is strengthened by Fearon's own claims that the two issue areas share a common "strategic structure." Fearon argues that "diverse international issue

¹⁸ Kenneth A. Schultz, "Domestic Opposition and Signaling in International Crises," *American Political Science Review* 92: 4 (December 1998), 829-44.

domains can be productively viewed as having a common strategic structure.”¹⁹ He contends that earlier cooperation theories that treat states as facing different strategic structures in different international issue domains are misleading. He believes that characterizing the strategic structures facing states as either coordination or collaboration games not only created difficulties in assigning state preferences, but also led to the neglect of bargaining problems that are not captured by these simple game structures. Regardless of whether the issue involves arms control, trade talks, exchange-rate coordination, or environmental regulation, he argues, states are invariably confronted with problems of dividing up new or potential benefits of agreements and of monitoring and enforcing cooperative agreements. In this sense, he writes, trade bargaining has essentially the same strategic structure as “international crisis bargaining in which one state threatens military action and war.”²⁰ If different international issue domains share a common strategic structure, then the same theoretical mechanism that helps explain the observation that crises between democracies are less likely to escalate into wars in the security realm should apply to trade disputes as well.

Indeed, some recent studies have started to devote greater attention to the relationship between states’ regime type and their propensity to cooperate on trade issues. Based on a variety of theoretical premises, most of these studies conclude that democracies, whether alone or in pairs, should be less confrontational over trade issues.

¹⁹ James D. Fearon, “Bargaining, Enforcement, and International Cooperation,” *International Organization* 52: 2, (Spring 1998), 276.

For example, Daniel Verdier concludes that democracies are more likely to pursue free trade policies because democratic elections enhance the power of voters with free trade inclinations vis-à-vis particularistic business interests with a protectionist slant.²¹ Dixon and Moon focus on the effects of regime similarity on the likelihood of international cooperation. They assert that since states with similar regime types ought to be more familiar with each other's business practices, they should experience less political conflict in bilateral economic exchanges and consequently have freer trade than mixed dyads.²²

Mansfield, Milner, and Rosendorff contend that democratic pairs are more likely to conclude free trade agreements either because of the executive's need to obtain ratification from the legislature or because of the need to retain the political support of both voters and interest groups.²³ Leeds offers a similar hypothesis, arguing that democratic dyads should cooperate more on trade with each other than should two states with dissimilar regimes because democracies face higher domestic audience costs for breaching international commitments.²⁴ Still another explanation for democracies' superior ability to settle trade conflicts cooperatively is offered by Dixon and Raymond, who emphasize the

²⁰ Ibid.

²¹ Daniel Verdier, *Democracy and International Trade: Britain, France, and the United States, 1860-1990*. Princeton: Princeton University Press, 1994, 293-94.

²² William J. Dixon and Bruce Moon, "Political Similarity and American Foreign Trade Patterns," *Political Research Quarterly*, 46 (1993), 10-11.

²³ Edward Mansfield, Helen Milner and B. Peter Rosendorff, "Free to Trade: Democracies and International Trade Negotiations," paper presented at the 1997 annual APSA meeting; Edward Mansfield, Helen Milner and B. Peter Rosendorff, "Why Democracies Cooperate More: Electoral Control and International Trade Agreements," paper presented at the 1998 annual meeting of the APSA.

²⁴ Ashley Leeds, "Domestic Political Institutions, Credible Commitments, and International Cooperation," *American Journal of Political Science* 43, 4 (October 1999), 979-1002.

importance of democratic norms and principles in constraining democracies' tendency to conflict over trade. From this perspective, democratic principles such as "bounded competition" and the rule of law extend to both security and trade relations between democratic pairs. Despite the diversity of interests that characterize democratic regimes, democracies should more frequently invoke these principles in their trade relations and bring their disputes to adjudication under international institutions governing trade such as the World Trade Organization (WTO), formerly the General Agreement on Tariffs and Trade (GATT). As a result, democracies are more likely to resolve their disputes more cooperatively.²⁵

Of course, not all of this literature emphasizes properties of democracies that diminish the chances of trade conflicts. Some scholars also highlight those aspects of democratic regimes that enhance their risks to trade confrontation. For example, Verdier contends that trade type (i.e., whether trade is intra-industry or propelled by scale economies), rather than regime type, is a necessary condition for trade conflicts. According to him, even if a democracy alone were more likely to be engaged in free trade than an autocracy, democratic pairs are more likely to experience an increase in protection because similar regimes tend to enhance the political power of the same class of

²⁵ William J. Dixon, "Democracy and the Management of International Conflict," *Journal of Conflict Resolution* 37 (March 1993), 42-68; Dixon, "Democracy and the Peaceful Settlement of International Conflict," *American Political Science Review* 88 (March 1994), 14-32; Gregory A. Raymond, "Democracies, Disputes, and Third-Party Intermediaries," *Journal of Conflict Resolution* 38 (March 1994), 24-42.

producers.²⁶ Reinhardt, based on an empirical study of the determinants of GATT/WTO trade dispute initiation, asserts that democracies are involved in a greater number of trade disputes. He reasons that since democracies empower producers over consumers, democratic regimes are particularly susceptible to the demands of both import-competing and export-dependent producers to initiate trade disputes against foreign protectionist measures in order to obtain a “fair” trade outcome. Democracies’ vulnerability to producer interests also lessens their ability to compromise and to settle disputes cooperatively.²⁷ For similar reasons, Sherman finds that democracies are both more likely to participate in GATT disputes and to be targeted under Section 301 of U.S. trade law.²⁸

On the whole, these existing empirical studies have not yielded definitive conclusions about the effect of regime type on the likelihood of cooperation over trade issues. While some research find that democratic regimes cooperate more on economic issues, others have contradicted this view with contrary evidence.²⁹ The current literature

²⁶ Daniel, V. Verdier, “Democratic Convergence and Free Trade,” *International Studies Quarterly* 42: 1 (March 1998), 1-24.

²⁷ Eric Reinhardt, “Aggressive Multilateralism: The Determinants of GATT/WTO Dispute Initiation, 1948-1998,” paper presented at the Annual Meeting of the International Studies Association, Washington, D.C., 1999.

²⁸ Richard Sherman, “Democracy and Trade Conflict,” paper presented at the annual meeting of the American Political Science Association, Atlanta, 1999; Richard Sherman, “Targeting Democracies: Regime Type and America’s ‘Aggressively Unilateral’ Trade Policy,” manuscript, 2000.

²⁹ Karen L. Remmer, “Does Democracy Promote Interstate Cooperation? Lessons from the Mercosur Region,” *International Studies Quarterly*, 42: 1 (March 1998), 25-51; Harry Bliss and Bruce Russett, “Democratic Trading Partners: The Liberal Connection, 1962-1989,” *Journal of Politics* 60: 4 (November 1998), 1126-47; James D. Morrow, Randolph M. Siverson, and Tressa E. Tabares, “The Political Determinants of International Trade: The Major Powers, 1907-1990,” *American Political Science Review* 92:3 (1998), 649-61; Edward D. Mansfield and Rachel Bronson, “The Political Economy of Major-Power Trade Flows,” in Mansfield and Helen V. Milner, eds., *The Political Economy of Regionalism*, New York:

on democracies' behavior in trade conflicts thus begs the question of whether the relationship between democracy and trade conflict is real. If the answer to this question is negative, then what might be the more fundamental causal process that drives state involvement in trade conflicts?

This dissertation provides a plausible answer to this question by assessing the influence of regime type, among many other factors, on the probability that states will escalate their trade disputes to "trade wars." In particular, it will challenge the audience cost argument proposed by Fearon, which predicts that trade wars are less likely to occur between democratic dyads than between mixed pairs due to democracies' superior signalling capacity. If the Fearon version of the democratic peace argument is valid, then we would expect to see fewer trade wars between democracies than between mixed pairs. But if empirical evidence does not support this hypothesis, then we may need to explore alternative explanations for the pattern of aggressive escalation in trade conflicts.

Before proceeding, it is necessary to define one of my key dependent variables: trade war. For purposes of clarity, I will follow Conybeare's definition and consider *trade wars* as sustained, protracted, and high-intensity international conflicts "where states interact, bargain, and retaliate primarily over economic objectives directly related to the

Columbia University Press, 1997; Marc L. Busch, "Democracy, Consultation, and the Paneling of Disputes Under GATT," manuscript, Harvard University, 1999.

traded goods or service sectors of their economies, and where the means used are restrictions on the free flow of goods and services.”³⁰

This definition allows us to distinguish trade wars from two other kinds of commercial conflicts: politically motivated trade sanctions and low-intensity trade conflicts with minor consequences. First, since trade wars mainly involve the use of economic means in the pursuit of economic objectives, they are distinct from other types of conflicts (such as trade embargoes imposed by countries involved in a military war) where economic means are used for political purposes. The following analysis will thus consider trade restrictions that have predominantly economic objectives. But it should also be noted empirically that “very few trade wars are sufficiently pure to be devoid of any political goals.”³¹ Many trade conflicts involve the pursuit of both political and economic goals. In the dispute over China’s Most-Favored-Nation (MFN) status, for example, the United States sought to use the threat of MFN withdrawal to induce the Chinese to concede on human rights issues, in addition to the economic objective of forcing changes in China’s trade policies. In such cases, political factors are treated as a form of the “linkage” policy, and will be introduced into the analysis where necessary.

Second, a trade conflict needs to reach a sufficiently high level of intensity in order to be called a trade war. According to authors such as Conybeare, routine customs decisions on tariffs involve fairly low-intensity conflicts. But if a conflict moves out of the

³⁰ John A. C. Conybeare, *Trade Wars: The Theory and Practice of International Commercial Rivalry*, New York: Columbia University, 1987.

bureaucracy and reaches the executive level of government, it can lead to high-intensity conflict. An “escape clause” petition in the United States would be an example of such high-intensity conflict. Furthermore, trade wars should involve the active participation of both sides. This means that the actor targeted for economic sanctions will engage in at least one round of retaliation for a trade war to exist. Thus, the imposition of antidumping duties or other forms of trade sanctions constitute a trade war only if the target country retaliates. An element of tit-for-tat is essential to this definition of trade war.³²

Judging from these criteria, trade wars, as far as those involving the United States are concerned, have taken place primarily between democratic trading partners. As the case summary in Chapter 3 and the case studies in Chapters 6 and 7 illustrate, the United States has been engaged in a series of trade battles with the European Economic Community (EEC) over agricultural products, including the Chicken War in the 1960s, the Turkey War in the 1970s, the war in the early 1980s over agricultural export subsidies in third markets, the U.S. imposition of penalty duties on EEC pasta in 1985 in retaliation for EEC tariff preferences in favor of Mediterranean citrus fruits, and the EC enlargement case in the mid-1980s. In 1983, the U.S. imposed tariffs and quotas on specialty steel from the EEC, prompting EEC counterretaliation against imports from the United States. In 1989, when the European Community (EC) implemented its ban on beef from cattle treated with growth hormones, the U.S. responded with retaliatory tariffs on \$100 million

³¹ *Ibid.*, 5.

³² *Ibid.*, 1-6.

of EC products. Trade wars also took place between the United States and Canada regarding lumber products and over Canadian provincial restrictions on imports of U.S. beer.

In comparison with this long list of democratic trade wars, trade conflicts between democracies and non-democratic regimes have less often escalated into trade wars. For example, the United States has threatened to impose economic sanctions against China numerous times, but rarely has carried out its promised threat, instead reaching agreement with the Chinese on most issues. The only exception occurred in 1983 when the U.S. imposed a unilateral agreement on China restricting Chinese textile exports to the American market in response to pressure from the textile industry, after which China retaliated by suspending imports of American agricultural products. The United States also imposed sanctions on China in the aftermath of Tiananmen, but these sanctions were a unilateral reaction to a crisis situation whereby the U.S. government suspended investment and development programs in China. Since the United States was not trying to use sanction threats in negotiations to compel or deter Chinese actions, the Tiananmen sanctions were clearly quite different from normal bilateral trade disputes whereby the U.S. threatened to close its markets to Chinese exports should the latter fail to comply with its demands. All other Sino-American trade conflicts in the 1990s ended up with both sides making concessions and backing down from escalation. A near absence of “trade wars” has come to characterize U.S.-China trade relations. Since the literature on crisis

bargaining predicts that misunderstandings leading to escalation are especially likely when the disputes involve at least one party that is non-democratic, the contrasting pattern described above is particularly puzzling and will be a major focus of the following empirical analysis.

To reiterate, this study is interested in addressing two empirical puzzles associated with international trade conflicts. First, why has U.S. economic coercion been more successful in extracting concessions from some countries than others? What explains the variations in American threat effectiveness? Second, why has the United States been involved in more trade wars with its democratic trading partners than with authoritarian regimes? Through an exploration of these questions illustrated by specific cases of U.S. negotiations with its trading partners, this study offers a better understanding of the conditions that limit or enhance the effectiveness of coercive diplomacy as well as those that facilitate or hinder the prospect for the peaceful settlement of international trade disputes.

The Argument

As mentioned earlier, the dissertation will draw on the concept of two-level games as the starting point of its analysis. But, in doing so, it also improves on the two-level game approach by laying out more clearly and systematically the linkages between the structure of domestic interests and preferences and international negotiating outcomes. In

the first place, it develops a specific model for understanding when threats are likely to be supported by domestic interest groups. Second, it advances explicit propositions explaining how domestic institutions can affect the ability of coercive strategies to extract the desired concessions. It will be argued that the structure of trade among nations (i.e., whether bilateral trade relations are competitive or complementary)³³ affects threat effectiveness by influencing both the level of unity among domestic interest groups and the level of divided government. The United States will find it more difficult to extract concessions from countries with whom it has complementary trade relations than from those with whom it has competitive ones due to the greater degree of domestic division in the former.

When trade relations are competitive, the nation threatening trade sanctions is likely to have large export-seeking and import-competing sectors that produce the same commodities that are made in the target country. In such cases, domestic interests in the sender of threats are more likely to be united in support of trade sanctions, since both exporting and import-competing interests gain from aggressive tactics that promise benefits whether the threat succeeds or fails. For instance, in U.S.-Japan conflict over semiconductors in the mid-1980s, American threats to impose sanctions on Japanese computers, television sets, and other electronics products unless Japan opened up its market to American semiconductor products enjoyed support not only from

³³ The structure of trade will be defined in more detail in Chapter 2.

semiconductor manufacturers who were seeking to expand exports in the Japanese market, but also from industries targeted for trade sanctions (such as the computer and electronics manufacturers). These latter industries faced stiff competition from Japanese imports. Consequently, they would not have minded if threats failed and sanctions had to be carried out because they would benefit from limiting Japanese exports to the American market. Meanwhile, because trade conflicts between countries with competitive trade relations are most likely to occur in sectors in which U.S. firms enjoy comparative advantages, the executive branch, which is typically the more dovish actor, will be more likely to deviate from the free trade ideology to accommodate domestic pressure for protectionism or strategic trade policy, thus narrowing the policy space between the two government branches. Domestic unity makes threats of sanctions more credible to foreign governments.

In contrast, when trade relations are complementary, domestic interests in the country issuing the threat will be divided in their policy preferences because of the division between export-seeking and import-using industries. Sanction threats in these cases will enjoy backing only from the export-seeking sectors, who only gain if the sanction threat succeeds. They will not enjoy support from the import-competing sector since such a sector will not exist in cases involving complementary trade relations. Instead, threats will encounter opposition from a large domestic constituency that make use of imports from the target country. For instance, in trade relations between the United States and China,

two countries having a highly complementary trade relationship, China exports to the U.S. mostly commodities no longer produced efficiently in America (such as toys, shoes, and apparel). Consequently, there are very few import-competing interests in the U.S. Instead, there is a large import-using sector in the U.S. that has benefited from, and has in some ways become dependent on, the labor-intensive products made in China. Thus, when the United States threatens to cut off Chinese imports unless the nation enforces rules protecting U.S. firms who seek to export music, video, and software, sanction threats are likely to enjoy backing only from the export-seeking firms (i.e., the intellectual property industry), who win only if the sanction threats succeed. Unlike trade disputes between the United States and Japan, there is no import-competing sector eager for the sanction threats to fail. Rather, the import-using constituencies tend to campaign to make sure that the sanctions are not carried out (even if no concessions are won). These divisions in domestic interests in the United States substantially reduced threat credibility.

American threat credibility is further undermined by the greater degree of divided government in such cases. Since trade conflicts between countries with complementary trade relations are most likely to involve non-competitive, declining industries, the U.S. executive will be less inclined to respond to domestic protectionist pressure and to go along with the tougher approach advocated by the more hawkish legislature. Divisions in domestic interests and the wider gap between executive and legislative preferences should make U.S. threats of sanctions far less credible to the target.

It will be further argued that the same set of factors that account for the variable degrees of threat credibility can also help us understand the lack of “democratic peace” in trade. Since the majority of democracies also happen to be advanced industrial countries with highly competitive trade relations, unity among domestic interest groups produces stronger domestic pressure for brinksmanship in bilateral trade disputes among these democracies. At the same time, the executive should be more likely to approve of the need to impose sanctions in these cases if he or she perceives that domestic pressure for compensation is strong enough or that an industry vital to the future economic well-being of the nation is genuinely threatened by foreign competition. These factors tend to push democracies towards more aggressive tactics with a heightened risk of escalation to trade war not because they are democracies but because they happen to have competitive trade relations.

Method

Two methodological approaches will be adopted to carry out the research. First, I will draw on the data base on Section 301 cases and other data on international trade conflicts (primarily those taking place after 1980) to see whether the structure of trade is associated, as predicted, with threat effectiveness and the instances of trade wars. If it can be shown that a correlation exists between trade structure and the two dependent

variables, we will then have increased confidence in the predictive value of the explanatory variable.

A “process-tracing” procedure will be used to supplement the above method. This approach examines and traces “the decision process by which various initial conditions are translated into outcomes.”³⁴ It places the process leading to the final outcomes at the center of the investigation and seeks to identify the factors that shape the actors’ behavior and responses, including the effect of systemic, institutional and societal factors on processes and outcomes. This strategy, by focusing on a few detailed case studies, allows the research to account for the complicated bargaining process and to see whether the explanatory variable affects bargaining outcomes in the way predicted by the theory. Specifically, it enables us to see whether the structure of trade affects threat effectiveness and the instances of trade wars through the hypothesized mechanism, i.e., by influencing the alignment of domestic interests and the level of divided government in the sender of threats.

Using the Sino-American trade relationship as an example of complementary trade, the empirical study will compare recent U.S.-China trade negotiations with American trade bargaining with Japan and the European Union (EU) -- two actors having highly competitive trade relations with the United States -- to see how well its main arguments

³⁴ Alexander L. George and Timothy J. McKeown, “Case Studies and Theories of Organizational Decision making,” *Advances in Information Processing in Organizations* 2 (1985), 35. See also the discussion by Gary King, Robert O. Keohane and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research*. Princeton, N. J: Princeton University Press, 1994, 225-228.

and hypotheses describe reality. In the first place, several episodes in U.S. trade negotiations with China and Japan will be detailed in order to explain the variations in U.S. threat effectiveness. These two trade relationships provide a good point for comparison not only because both are major Asian-Pacific trading states that have become the focus of American trade policy, but also because the structure of trade between the United States and China differs significantly from that between the U.S. and Japan. The United States has a far more competitive trade relationship with Japan than with China. This difference permits considerable variations in the explanatory variable and allows us to see whether trade structure does have the hypothesized effect on threat credibility. Such a comparison should produce interesting insights into the nature of the negotiation process.

Trade disputes between the United States and China over Most-Favored-Nation status will be compared with U.S.-Japan trade conflicts over semiconductors and the super 301 investigations over satellites and supercomputers. These cases are among the most high-profile ones in the two bilateral trade relationships. Because of their high intensity, the forces pushing for or against trade sanctions in the United States are fairly transparent, better enabling the “process-tracing” procedure to identify the factors that shape negotiation outcomes. If the structure of trade does shape the domestic landscape in the United States in different ways, and these differences in turn influence the degree of threat credibility, then we would have uncovered a crucial mechanism linking international and domestic politics.

In the MFN case, U.S. efforts to make the annual renewal of China's MFN status contingent on China's performance in the areas of trade, human rights, and non-proliferation have repeatedly been resisted by the Chinese. Any concessions by Beijing to the United States were merely token or symbolic. After three years of threatening to withdraw China's MFN status, most policymakers came to realize that the process had produced no tangible results for the United States. Recognizing the futility of using MFN as a weapon to influence Chinese behavior, President Clinton gave up the attempt in 1994. It is not an exaggeration to say that the MFN dispute represented a complete failure of U.S. negotiating objectives. Since the United States sought to achieve both political and economic objectives in this case, the detailed case study will focus primarily on America's attempt to link MFN renewal to China's trade practices.

The ineffectiveness of U.S. pressure in changing Chinese policies contrasts sharply with the greater degree of success the United States had in its trade negotiations with Japan, a country with a highly competitive trade relationship with the U.S. While variations certainly existed in the degree to which the United States was successful in imposing its demands on Japan, it can be argued that, on the whole, American pressure has led to more significant market opening outcomes with Japan than with China. This study will look at the U.S.-Japan semiconductor trade conflict in the mid-1980s as well as U.S. super 301 investigations over supercomputers and satellites, all of which occurred as a result of America's response to Japan's strategic targeting of high-technology industries,

in order to identify the factors that contributed to the higher level of American success with Japan. In all three of these cases, American negotiators were generally successful in achieving their negotiation objectives of gaining increased access to the Japanese market, but the degree to which they were able to do so varied.³⁵ Focusing on these cases allows us to see why, on average, American negotiators had greater success extracting concessions from the Japanese, even though Japan yielded more in some cases than others.

Through an exploration of these cases involving U.S. trade bargaining with Japan and China, this study hopes to shed light on the factors conditioning the effectiveness of U.S. coercive diplomacy. It will then proceed to compare trade conflicts between the United States and China, a democracy and an authoritarian state, with those between the United States and Europe, both of which are democracies. I will show that in contrast to what the “democratic peace” theorists would predict, there have been many trade wars between democracies. I will further argue that this pattern can best be accounted for by the competitive trade structure between many democratic regimes which generates potent pro-sanction forces at home that constrained the “pacifying” effects of democratic institutions and processes.

As mentioned earlier, trade relations between the United States and China since the early 1980s are largely characterized by the absence of trade wars. In almost all issue areas, the United States threatened to impose economic sanctions against China, only to

refrain from doing so in the end. In the negotiations over intellectual property rights (IPR) that will be discussed in detail, Washington several times threatened to slap punitive tariffs on Chinese products unless China took concrete measures to police property rights infringements. In the end, however, the two sides have always managed to reach an eleventh-hour agreement, thereby avoiding a costly trade battle. In addition to looking at the intellectual property issue, the dissertation will look at trade in textiles to further substantiate its argument. Although the record of the textile dispute conforms to the overall pattern of trade peace, the United States did impose quota restrictions on Chinese textile exports to the U.S. in the early 1980s, prompting Chinese retaliation in the form of a suspension of grain imports. The detailed case study will explain the general pattern of trade peace between the United States and China as well as the anomaly involving textiles in the early 1980s.

While trade disputes between the United States and China were generally resolved peacefully, those between the U.S. and Europe have more often escalated into trade wars. The trade conflict between the United States and the European Community over enlargement in the mid-1980s and the U.S.-Canada trade conflict over timber products will be examined closely to show why democracies have a greater tendency to engage in trade wars. Of course, not every trade conflicts between democracies ended in a trade war. I did not choose to examine these low-intensity trade conflicts because it was only

³⁵ According to Bayard and Elliott, American negotiators were largely successful in achieving their negotiation objectives in the satellite case, partially successful in the supercomputer case, and nominally

through an examination of cases where the dog did bark that one could possibly find out the mechanisms or stimuli that triggered the outbreak of trade wars. The factors I emphasize ought to be necessary, though not necessarily sufficient, conditions for trade wars to take place.

The Plan for the Dissertation

Since the dissertation grounds its analysis of the two empirical puzzles in broader theories of international relations, it will begin by reviewing the literature on international bargaining to show how its approach relates to the existing body of literature. Chapter 2 emphasizes the inadequacy of traditional realist models and bargaining theories and draws on the two-level game concept as an alternative basis for analysis. At the same time, it points out an important weakness of recent studies inspired by the two-level game concept: the lack of systematic analysis of the ways in which domestic politics affects international bargaining outcomes. To address this shortcoming, I propose a specific model designed to elucidate the conditions under which domestic politics likely will support the use of coercive strategies. The effects of domestic interests and institutions on bargaining outcomes will be emphasized.

Chapter 3 examines the overall record of American trade bargaining with its major trading partners. Using available data, this chapter provides substantial empirical evidence

successful in the semiconductor trade conflict.

in support of the argument that the effectiveness of U.S. pressure varies in ways that cannot be explained by realists' emphasis on relative power balances and that trade structure better accounts for these variations. It also shows that after taking into account other potentially confounding factors, states' regime type has no statistically significant effect on the probability of trade war. Instead, my key independent variable, the structure of trade, shows up as a consistent predictor of both the probability of trade war and the probability of unilateral retaliation in trade disputes. These findings lend substantial support to the arguments developed in Chapter 2 and establish a basis for the case studies that follow.

The next two chapters apply the modified two-level game approach to understand the variations in U.S. threat effectiveness in cases involving China and Japan. U.S.-China trade bargaining over MFN and intellectual property rights (chapter 4) will be compared with U.S.-Japan trade bargaining over semiconductors and the two Super 301 cases involving satellites and supercomputers between 1989 and 1990 (chapter 5). The applicability of the model to explaining variations in threat effectiveness will be discussed in detail.

The two chapters that follow utilize the same theoretical framework to explain why the United States fought more trade wars with trading partners with whom it has competitive trade relations, many of which are also democratic regimes. Using the record of U.S.-China trade negotiations over intellectual property rights and textiles as well as

U.S. trade conflicts with Europe and Canada over enlargement and timber products as examples, these two chapters (chapters 6 and 7) aim to provide a plausible explanation for the contrasting patterns of U.S.-China trade peace and democratic trade wars. The final chapter (chapter 8) summarizes the findings of the research and discusses their implications for the conduct of American foreign trade policy.

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Trade Structure, Threat Effectiveness and “Democratic Trade Peace”

The previous chapter summarizes the two empirical puzzles driving this research: why has the United States been more successful in enforcing its demands on some of its trading partners (such as Japan, Canada, and Europe) than on others (such as China, Brazil, and India), and why are there more trade wars between democracies. In addressing these puzzles, I draw on the two-level game approach to develop a specific model for understanding the conditions under which domestic politics supports the use of threat tactics. Before doing so, I provide a literature review describing existing approaches to international negotiations and their limitations, focusing in particular on the contribution of the two-level game approach. This brief review suggests possible avenues for developing a more systematic theory of the domestic determinants of international behavior and provides a basis for my modified two-level game model.

Literature Review

While this dissertation is comparative in orientation, it will use the U.S.-China trade bargaining cases as the core of its comparative analysis. In this sense, it intends to fill an important gap in the study of U.S.-China relations by grounding the analysis of this important bilateral relationship in theories of international relations. Although there is a

bountiful literature on U.S.-China relations, few theoretically based studies have focused explicitly on U.S.-China trade relations. Some of the existing literature on U.S.-China relations, such as Harry Harding's *A Fragile Relationship*, tends to be descriptive, aimed at providing broad historical and cultural understanding.¹ Since Sino-American relations and China policy have strong political, economic, and diplomatic implications, other studies (such as Robert Sutter's *Shaping China's Future in World Affairs: The Role of the United States* or *Living with China* edited by Ezra Vogel) have concentrated on studying policy feasibility and on recommending policy options.² Tan Qingshan's *The Making of U.S. China Policy*, which employs three decision-making models to analyze U.S. China policy from normalization to the post-Cold War era, can be said to be a notable exception to this general tendency toward description or a narrow policy focus, but his work focuses on the making of U.S. foreign policy towards China in general, rather than trade policy in particular.³ Robert Ross' more recent work *Negotiating Cooperation* offers a historical analysis of both the domestic and international conditions that have facilitated Sino-American cooperation in the security realm. While valuable for understanding the specific historical context for Sino-American security cooperation, the

¹ Harry Harding, *A Fragile Relationship: The United States and China since 1972*, Washington, D.C.: Brookings Institution, 1992.

² Robert Sutter, *Shaping China's Future in World Affairs: The Role of the United States*, Boulder: Westview Press, 1996; Ezra Vogel, *Living with China*, New York: W.W. Norton & Company, 1997.

³ Qingshan Tan, *The Making of U.S. China Policy: From Normalization to the Post-Cold War Era*, Boulder: Lynne Rienner Publishers, 1992.

work does not offer generalizations that apply to trade relations nor engage broader theories of international cooperation.⁴

In general, studies of U.S.-China relations seem full of descriptive details, but do not root their analyses in international relations or bargaining theories and so are not well designed to advance our understanding of the dynamics of that relationship. A more theoretically based study ought to help us ask more fundamental questions, better understand the central tendency of the relationship, and explain the logic of how things develop. In other words, it should allow us to describe how things happened, explain why they happened the way they did, and possibly predict the reoccurrence of similar events in a given situation. This directs our attention to current theories of international relations in the search for answers to the research questions that inform this study.

The Realist Paradigm

Existing international relations theories provide a good starting point for the analysis. As the dominant paradigm in the field of international relations, realism argues that since anarchy is the defining character of the international system, states tend to view one another as potential threats, aim to maximize their security through the pursuit of power, and are predisposed toward conflict and competition. In international trade bargaining, realists predict, states' bargaining positions will be shaped by their interests in

⁴ Robert Ross, *Negotiating Cooperation: the United States and China 1969-1989*, Stanford: Stanford University Press, 1995.

improving their relative power position. International negotiating outcomes will reflect the relative power resources of the parties involved in a dispute.

Most realist analysts emphasize the primacy of military power in determining a nation's power resources, but some analysts in the realist tradition argue that economic power can be converted into bargaining resources in international negotiations as well. In particular, in situations of asymmetrical interdependence, where state A's degree of reliance on state B as an export market is much higher than B's degree of reliance on A, the less dependent one should be able to use its market power to win concessions from the more dependent.⁵ In other words, economic coercion is more likely to produce the desired effects when the power resources of the sender of threats are greater than those of the target nation. Some realists go further and argue that power resources are not fungible across all issue areas. Power resources which matter in certain issue areas may not be applied equally effectively in others. Thus only if the sender of threats possesses the kind of power resources that can exert the maximum influence in the targeted issue area can threats produce the desired effects.⁶ In short, while classical realism does not speak directly to trade dispute settlement, more recent realist theories have developed a set of critical assumptions about the international political economy. They propose that: (a) states are the major actors in the world political economy; (b) states are primarily

⁵ Albert O. Hirschman, *National Power and the Structure of Foreign Trade*, Berkeley: University of California Press, 1945; David Baldwin, "Interdependence and Power: A Conceptual Analysis," *International Organization* 34: 4 (Autumn 1980).

⁶ Robert O. Keohane and Joseph S. Nye, *Power and Interdependence*, Glenview, IL: Scott, Foresman, 2nd ed., 1989.

concerned about relative gains in power resources; (c) economic sanctions can serve as an important policy instrument; and (d) state policy choices are fundamentally shaped by the international economic structure and that states are predisposed to conflict rather than cooperation in international economic relations.⁷

One of the weaknesses of the realist explanation, as scholars in the liberal tradition have often pointed out, is that increasing international interdependence has made the exercise of power more difficult. Weak states are often able to stand up to the strong because of the numerous points of leverage and influence among nations created by conditions such as: (a) economic interdependence; (b) the existence of sub-state actors; (c) the issue-specific nature of power resources; (d) the multiple foreign policy goals that states possess; and (e) the utilization of different bargaining tactics.⁸ Various studies have looked at cases of asymmetrical negotiation to explain how factors not related to aggregate raw material power can influence weak states' ability to get what they wanted some of the times.

William Zartman, in a study of trade negotiations between African states and the European Economic Community (EEC), challenges the traditional conception of power in asymmetrical negotiation. He argues that power is situational and relative, rather than

⁷ Robert Gilpin, *The Political Economy of International Relations*, Princeton: Princeton University Press, 1987; David A. Lake, *Power, Protection, and Free Trade: International Sources of U.S. commercial Strategy, 1887-1939*, Ithaca: Cornell University Press, 1988; Joseph M. Grieco, *Cooperation Among Nations: Europe, America, and Non-Tariff Barriers to Trade*, Ithaca: Cornell University Press, 1990; Stephen D. Krasner, *Structural Conflict: The Third World against Global Liberalism*, Berkeley: University of California Press, 1985.

⁸ *Ibid.*

aggregate and absolute. Powerful states may fail to impose their demands on weaker ones if they cannot effectively apply their aggregate power to the specific bilateral situation. He further suggests several conditions under which weak states may be able to overcome their power inferiority.⁹

In *Power and Tactics in International Negotiation*, Mark William Habeeb analyzes several cases of asymmetrical negotiation and reaches similar conclusions. He illustrates that between 1958 and 1976, Iceland successfully negotiated with Britain to extend its fisheries limit from 4 to 200 miles. In each stage of the negotiation, Britain backed off from its demands and acceded to virtually all of Iceland's positions. Similarly, in U.S.-Panama negotiations over the status of the Panama Canal, Panama achieved considerable success not only in obtaining financial compensation from the United States, but also in resuming sovereignty over the Panama Canal. In another case involving U.S. attempts to secure additional overseas bases from Spain, Spain tried, with moderate success, to create a formula that traded bases for close military and political ties with the United States. Habeeb takes these cases as evidence that weak states are able to resist pressure from more powerful nations in a given confrontation. He examines the dynamics of the negotiation process in detail to explain why powerful states may sometimes fail to translate their aggregate power advantages into effective bargaining chips.¹⁰

⁹ William Zartman, *The Politics of Trade Negotiations between Africa and the European Economic Community*, Princeton: Princeton University Press, 1971.

¹⁰ William Mark Habeeb, *Power and Tactics in International Negotiations: How Weak Nations Bargain with Strong Nations*, Baltimore: Johns Hopkins University Press, 1988.

John Odell presents case studies of U.S.-Korean trade negotiations as well as bilateral trade bargaining between the United States and Latin American states. He finds that both South Korea and the Latin American states were able to win some of the negotiations, attributing the weak states' victories in these cases to their superior negotiation strategies.¹¹ In another study of U.S.-Brazilian negotiations over informatics, Odell suggests that one reason that powerful nations frequently fail to achieve their negotiation objectives despite their overall power advantage is the web of interests spawned by international interdependence. He argues that Brazil, which is inferior to the United States in terms of power resources, was able to resist American demands to change its program designed to promote a national computer industry because it knew that American firms, who had extensive investments inside Brazil, were opposed to the government's pressure tactics.¹²

The above examples all point to the inability of traditional realist explanations to account for the outcomes of asymmetrical negotiations. More importantly, even though realism may explain why weak states sometimes comply with the demands of stronger ones, it has a difficult time explaining why U.S. pressure worked and did not work in degrees not predicted by raw "power." As has been described in the previous section, in

¹¹ John Odell, "Latin American Trade Negotiations with the United States," *International Organization* 34 (Spring 1980), 207-28; John Odell, "The Outcome of International Trade Conflicts: The U.S. and South Korea, 1960-1981," *International Studies Quarterly* 29 (September 1985), 263-286.

¹² John Odell, "International Threats and Internal Politics: Brazil, the European Community, and the United States, 1985-1987," in Peter B. Evans, Harold K. Jacobson, and Robert D. Putnam, eds., *Double-edged Diplomacy: International Bargaining and Domestic Politics*, Berkeley: University of California Press, 1993, 238-241.

U.S. trade negotiations with its Asian trading partners, Asian countries differed in the extent to which they conceded to U.S. demands, even though they were similarly dependent on the U.S. market for exports. Japan, Taiwan, and South Korea, for example, were among the U.S. trading partners that were most responsive to U.S. pressure. However, China, while it already depended on U.S. market for more than 30 percent of its exports in 1994,¹³ has not offered concessions to the U.S. as readily as these other Asian states. Realist power theories clearly cannot explain the U.S. inability to influence China. Explanations for these variations have to be found in factors other than states' relative power balances.

Critics may be quick to point out that an obvious reason that the United States found it less difficult to extract concessions from countries such as Japan, Taiwan, and South Korea than from countries such as China is the first group of countries' greater degree of security reliance on the United States. Since these smaller states are America's allies highly dependent on U.S. security guarantees whereas China is capable of providing for its own security, the argument goes, it is not surprising that the greater leverage the United States wields in security issues would have translated into greater bargaining power in bilateral trade disputes.

Another potential criticism, similar to the above, emphasizes the greater expectations of future conflict as well as the opportunity costs of coercion between adversaries than between allies. In a study on the use of economic coercion, Daniel

Drezner contends that because of greater concerns for relative gains and bilateral reputation, the sender of threats should be more willing to initiate economic sanctions against its adversaries. He further argues that, paradoxically, these same relative gains concerns reduce the sender's ability to obtain positive results in disputes with its adversaries as the target will be worried about the long-run implications of caving in and hence be reluctant to concede to the sender's demands.¹⁴

However, arguments along the above line of reasoning are ambiguous for a number of reasons. In the first place, it is not clear to what extent security considerations weigh in international bargaining over purely economic issues. America's objective in most trade negotiations is above all about expanding American exports in overseas markets or preventing unfair foreign competition in the American market. Concerns about the political-military relationship with the target country, while not totally absent, seem marginal at best.¹⁵

Second, granted that U.S. allies such as Japan can be more amenable to U.S. demands because of their greater dependence on U.S. security guarantees, alliance maintenance nevertheless entails considerable costs for the United States. At various points in U.S.-Japan trade negotiations, the United States was forced to soften its demands for fear of antagonizing Japan and thereby endangering the alliance relationship.

¹³ "Trade Peace: Deja Vu Again," *Economist*, 334, no. 7904 (March 4, 1995), 86.

¹⁴ Daniel W. Drezner, *The Sanctions Paradox: Economic Statecraft and International Relations*, New York: Cambridge University Press, 1999.

¹⁵ Interview with USTR officials involved in U.S. negotiations with East Asian countries confirmed this view.

In U.S.-Japanese negotiations over semiconductors in the mid-1980s, for example, considerations on the part of the State Department and the National Security Council for Japan's role as an American friend and ally complicated the decision-making process to name Japan an unfair trader, lessening the effectiveness of American pressure in the early stages of the disputes. Japan could count on those agencies within the U.S. government most concerned with security issues and refuse to negotiate seriously on semiconductors.¹⁶ As this example suggests, the incentives provided by the security relationship is often indeterminate: the leverage the United States derives from Japan's security dependence may well be offset by its need to maintain a close alliance relationship and therefore to be more attentive to Japan's perspectives.

It could be further argued that the United States, not for purely altruistic reasons, has actively worked to extend its security umbrella to Japan in order to prevent Japanese rearmament and the resurgence of Japanese military power in East Asia. Cognizant of the U.S. motive, the Japanese has during most of the post-war period enjoyed the benefits of free-riding in the security domain and refused to take up its fair share of the security obligation in the Asian-Pacific region. America's self-interest in providing a security guarantee to Japan may thus have lessened the imperative for Tokyo to cave in to American pressure on either security or trade issues.

¹⁶ Clyde V. Prestowitz, Jr., *Trading Places: How We Allowed Japan to Take the Lead*, New York: Basic Books, Inc., Publishers, 1988.

Thirdly, even though China is not dependent on America for security, as are Japan, South Korea, and Taiwan, the argument has frequently been made that security relations between great powers similarly involve mutual dependency. During the Cold War, the United States and the Soviet Union were dependent on each other for not launching a nuclear attack; the United States also sought to play the “China card” in efforts to counter Soviet expansionism in Asia. At present the United States needs to take into consideration China’s role in maintaining peace and stability in the Asian-Pacific region (especially on issues such as North Korea and Taiwan) when dealing with economic issues; and China in turn depends on the United States for maintaining the strategic balance in East Asia. In this sense, security considerations influence America’s economic relationship with China in a way similar to the way in which they shape U.S.-Japan economic bargaining outcomes. One cannot simply attribute America’s greater negotiation success with Japan on trade issues to the latter’s greater degree of security reliance on the U.S.

Bargaining Theories

In light of realism’s inability to explain the variations in the effectiveness of U.S. coercive diplomacy, other analysts have sought to identify the conditions under which threats are more or less likely to work. In an effort to modify the realist emphasis on power asymmetries, a number of scholars suggest that the *interests* of the parties involved in a dispute play an important role in determining bargaining outcomes. It is argued that a

party can strengthen its credibility and enhance its chances of obtaining a favorable outcome if it has important stakes in the issue. For example, if the sender of threat only has peripheral interests in the issue, then the target, knowing that the sender is unwilling to risk war (or trade war) for a relatively small gain, will most likely reject the sender's demands. Conversely, if the target country places a high priority on the issue and is dedicated to achieving its preferred outcomes, then the sender should be more likely to give up its demands.¹⁷ By emphasizing how factors other than power resources (such as the interests of the parties involved) may lead to variations in bargaining results across issue areas, this strand of the bargaining theory provides one plausible explanation for why weak states can sometimes stand up to the strong. However, it still does not help us understand why bargaining outcomes often vary in the same issue area where a state's interests remain more or less constant.

Another strand of the bargaining theory emphasizes the importance of bargaining tactics. Some analysts focus on negotiating tactics on the part of the sender of threats that might enhance or undermine the credibility of a threat to retaliate. Following Thomas Schelling who emphasizes the role of commitment in making a threat credible, these analyses suggest that threats to impose sanctions will be more credible if negotiators can tie their own hands with respect to retaliating, link agreement on one issue to another

¹⁷ John Odell, "Latin American Trade Negotiations with the United States," *International Organization* 34, 1980, 207-228; John Odell, "The Outcomes of International Trade Conflicts: The United States and South Korea, 1960-1981," *International Studies Quarterly* 29, (September 1985), 263-286; William Mark Habib, *Power and Tactics in International Negotiation: How Weak Nations Bargain with Strong Nations*, Baltimore: Johns Hopkins University Press, 1988, 21-22.

issue area where one has leverage over the partner, offer side payments to foreign governments in order to obtain the acquiescence of those domestic groups opposed to change, and add parties who support one's position to the negotiations.¹⁸ International negotiators would be able to improve the terms of the deal if they could expand the other side's "perceived zone of possible agreement" by using one or a number of these strategies. This approach helps to illustrate both analytically and empirically how bargaining strategies can work to improve the credibility of threats.¹⁹ However, it says nothing about the conditions under which these strategies are most likely to work. Many of the factors that may influence whether and when threats will be most effective have simply been assumed away. For example, the target's preferences, which play an important role in determining whether tactics such as threats and persuasion could work to expand the "perceived zone of possible agreement," have generally been left out of the analysis.²⁰

How weak states can use bargaining tactics to overcome asymmetric power balances has also been examined. In his study of East Asian state strategies for dealing with the Americans, David Yoffie emphasizes that weak bargainers can resist demands from more powerful actors if they can make a commitment to realize long-term gains.

¹⁸ Thomas Schelling, *The Strategy of Conflict*, Cambridge: Harvard University Press, 1960; Evans, Jacobson, and Putnam, eds., *Double-Edged Diplomacy*, 1993.

¹⁹ Scholars such as Howard Raiffa, James Sebenius, and David Lax provide detailed case studies to show how these tactics can help to enhance threat credibility by expanding the perceived zone of possible agreement of the parties involved. See, for example, James K. Sebenius, *Negotiating the Law of the Sea: Lessons in the Art and Science of Reaching Agreement*, Cambridge: Harvard University Press, 1984.

According to him, weak states can better achieve their objectives when they can negotiate for ambiguity, demand compensation for restrictions, exploit bureaucratic cleavages within the opponent, and cheat on regulations and agreements.²¹ William Mark Habeeb offers a more general logic behind weak state capabilities. He argues that conclusions about state interactions drawn from a modeled structure of a static, aggregated power relationship ignore the dynamic of process. Power, he explains, is deployed through interaction. “Outcome is explained by issue-specific power deployed through savvy exploitation of alternatives, commitment, and control. Big states may have awesome power, but they also have overwhelming ranges of commitments and unwieldy bureaucracies. The committed and nimble can outmaneuver the distracted and ponderous.”²² While this emphasis on weak state bargaining tactics has considerable validity, once again it is not clear under what conditions these tactics will be more or less effective. Given the general availability of these bargaining tactics to weak states, the question remains as to why some weak states were able to resist U.S. demands more than others.

In a 1994 study directed by Thomas O. Bayard and Kimberly Ann Elliott on the effectiveness of section 301 provisions of U.S. trade law in opening overseas markets, the authors similarly attempt to identify the factors affecting the efficacy of threats in trade negotiations. They found that U.S. negotiators are more likely to obtain market-opening

²⁰ See Leonard J. Schoppa, *Bargaining with Japan: What American Pressure Can and Cannot Do*, New York: Columbia University Press, 1997, 27.

²¹ David B. Yoffie, *Power and Protectionism: Strategies of the Newly Industrialized Countries*, New York: Columbia University Press, 1983.

outcomes the “more dependent the target country is on the U.S. market, the larger the U.S. bilateral trade deficit with the target is, and the more transparent the targeted trade barrier is.”²³ Another important conclusion drawn from the collaborative project is that the success of bilateral negotiations depends critically on the value that the target country places on maintaining access to the U.S. market: “Threats typically ‘succeed’ when the perceived economic and political costs to the target of complying with a demand are lower than the perceived costs of defiance.”²⁴ Specifically, the United States can obtain a more favorable deal under the following conditions:

(a) the greater the harm to the targeted country from having its access to the U.S. market limited; (b) the smaller the targeted country’s ability to harm the U.S. in retaliation; (c) the smaller the costs within the targeted country of complying with the U.S. demands; and (d) the greater the benefit to the United States -- in the U.S. negotiators’ perception -- from the demanded liberalization.²⁵

While the project makes an important contribution to understanding the conditions under which the use of aggressive tactics would be more effective, it is interested more in testing existing hypotheses than in advancing new ones. Many of the factors the authors identified as having credibility-enhancing effects (such as the benefits to the sender of carrying out a threat as well as the risks of retaliation and counterretaliation by the target) have been emphasized in earlier writings on international bargaining.²⁶ Most of these

²² William Mark Habeeb, *Power and Tactics in International Negotiations: How Weak Nations Bargain with Strong Nations*, Baltimore: Johns Hopkins University Press, 1988.

²³ Bayard and Elliott, *Reciprocity and Retaliation in U.S. Trade Policy*, 1994, 86.

²⁴ *Ibid.*, 80.

²⁵ *Ibid.*, 81.

²⁶ Schelling, *The Strategy of Conflict*, 1960; Thomas Schelling, *Arms and Influence*, New Haven: Yale University Press, 1966; Glenn H. Snyder and Paul Diesing, *Conflict Among Nations: Bargaining*,

conditions are also linked to the bilateral economic interdependence ratio.²⁷ Moreover, other conditions the authors hypothesized to influence threat credibility, including U.S. concerns about possible counterretaliation, public or explicit threat, and GATT procedures, turn out to be relatively insignificant in determining outcomes.

On the whole, existing bargaining theories help to advance our understanding of the dynamics of international bargaining by highlighting how certain factors not related to raw material power can impinge on negotiation outcomes. But they also suffer from important shortcomings and are not able to fully explain the puzzles described earlier. This directs our attention to a third approach in the search for answers to the research questions: the two-level game theory.

The Two-level Game Approach

Most of the theories described above assume that states are rational, unitary actors, an assumption that is increasingly difficult to sustain considering the diversity of interests, institutions, and opinions within most democratic countries. Since trade conflicts have a substantial domestic component that cannot simply be assumed away, there has been a burgeoning literature on how politics and divisions within countries can affect international bargaining behavior. These works challenge the view that states' behavior can be explained primarily by international structural factors, arguing that failure

Decision Making, and System Structure in International Crises, Princeton: Princeton University Press, 1977.

to examine domestic conditions may result in the neglect of a crucial source of international relations.²⁸

Most of this literature on how domestic politics affects international behavior has utilized the concept of the two-level game developed by Robert Putnam. The two-level game approach, in Putnam's original formulation, views national leaders as engaging in two sets of negotiations simultaneously: one with their international counterparts and the other with their respective domestic constituents. Chief negotiators not only need to "win" at the international table, but also have to make sure that any deal that is cut internationally will also be accepted by those who could veto or block implementation of the deal at home. An international agreement will be possible only if the two parties' "win-sets" -- the set of possible policies that can obtain the necessary domestic support -- overlap. Putnam and other scholars working with this approach further identify three factors that affect the size of the win-set: the combination of the power and preferences of possible domestic coalitions, domestic political institutions, and the strategies adopted by the negotiators.²⁹

²⁷ See Chapter 3 for a more detailed discussion of the relationship between bilateral economic interdependence and threat effectiveness.

²⁸ Examples of works that focus on the international systemic sources of state behavior include the following: Kenneth Waltz, *Theory of International Politics*, Reading, Mass: Addison-Wesley, 1979; Robert Keohane, *After Hegemony* Princeton: Princeton University Press, 1984; Joanne Gowa, *Allies, Adversaries, and International Trade*, Princeton, N.J.: Princeton University Press, 1993; Joseph Grieco, *Cooperation Among Nations*, Ithaca, N.Y.: Cornell University Press, 1990.

²⁹ Robert D. Putnam, "Diplomacy and Domestic Politics: The Logic of Two-level Games," *International Organization* 42 (Summer 1988), 437-449; Andrew Moravcsik, "Introduction: Integrating International and Domestic Explanations of World Politics," in Evans, Jacobson, and Putnam, eds., *Double-edged Diplomacy: International Bargaining and Domestic Politics*, 1993.

By emphasizing the interaction between domestic- and international-level variables and by integrating a number of previously disparate observations into a single theoretical framework, the two-level game approach has made a positive contribution to international relations.³⁰ It not only helps to remedy the neglect of domestic variables resulting from the dominance of structural realism in international relations theory, but also provides a basis for organizing further empirical study.

However, it should be noted that research inspired by the two-level game approach suffers from several shortcomings: first, analyses that use the two-level game concept to explain threat effectiveness focus somewhat heavily on conditions within the target country that influence threat credibility; second, the large body of literature on two-level games has so far generated only a few testable hypotheses about how domestic politics operates to affect international negotiating outcomes; and third, where recent scholarship has tried to develop more parsimonious models of the linkage between domestic and international politics, the emphasis is primarily on how domestic conditions facilitate or impede the prospect for cooperation among nations, rather than how they affect the ability of threats to extract concessions from the target country or the likelihood of trade wars.

³⁰ See the cases in Evans, Jacobson, and Putnam, eds., *Double-Edged Diplomacy*, 1993, especially the one by Odell and Ellis S. Krauss, "U.S.-Japan Negotiations on Construction and Semiconductors, 1985-87: Building Friction and Relation-Chips"; Howard P. Lehman and Jennifer L. McCoy, "The Dynamics of the Two-level Bargaining Game," *World Politics*, 44: 4 (July 1992), 600-644; Jeffery W. Knopf, "Beyond Two-Level Games: Domestic-International Interaction in the Intermediate-Range Nuclear Forces Negotiations," *International Organization* 47:4 (Autumn 1993), 599-628; Frederick W. Mayer, "Managing Domestic Differences in International Negotiations: The Strategic Use of International Side-Payments," *International Organization* 46:4 (Autumn 1992), 793-818; Leonard J. Schoppa, "Two Level Games and Bargaining Outcomes: Why Gaiatsu Succeeds in Japan in Some Cases but Not in Others," *International Organization* 47: 3 (Summer 1993), 353-386.

This makes efforts to develop a more systematic approach to understanding threat effectiveness and the probability of trade war a worthwhile endeavor.

In the first place, recent analyses using the two-level game concept to explain the variations in threat credibility have mostly examined target country politics. In his study of U.S. trade bargaining with Japan, for example, Leonard Schoppa develops a framework for analyzing when and how U.S. synergistic strategies can work to extract the desired concessions. U.S. pressure is most effective in influencing Japanese policy outcomes when the U.S. is able to employ strategies such as “synergistic linkage,” “reverberation,” “participation expansion,” and “alternative specification” to take advantage of divisions of interests and opinions on the Japanese side.³¹ Although Schoppa looks at how the effectiveness of U.S. synergistic strategies could be conditioned by domestic politics in the U.S., the focus of his study is primarily on the interaction of these strategies with domestic politics in the target nation. This selective focus leaves ample room for future studies to develop explicit hypotheses about the domestic factors in the sender of threats that may have an important bearing on negotiating outcomes.

Second, earlier studies have not been able to develop a more systematic theory of the ways in which domestic politics can intervene in the international level of play to affect bargaining outcomes. None of these studies has taken the next step in two-level theory development: the incorporation of a model of domestic politics that accounts for the pattern of *domestic preferences* that shape international bargaining behavior. In the area

of international security, one of the most systematic investigations of international and domestic theories of conflict, a study by Bueno de Mesquita and Lalman, makes a strong case that domestic politics affects international conflict. But this investigation treats domestic politics as a blackbox, characterizing it as the vector sum of the power and interests of whatever domestic actors may be relevant in a given polity.³²

The influence of domestic politics also has been studied in the area of trade policy. Numerous studies investigate the role of political parties on trade; the most recent writings also emphasize how divided government could affect trade policy. Lohmann and O'Halloran, for example, argue that, in the United States, different party control of Congress and the White House can lead to a more protectionist trade policy. They observe that when the congressional majority party is confronted by a president of the opposing party, the former has an incentive to delegate to and to constrain the latter by requiring congressional approval of trade proposals, forcing the president to adopt more protectionist policies in order to bring together a congressional majority.³³ Studies such as Lohmann and O'Halloran's emphasize the importance of domestic politics, but have not devoted sufficient attention to the *interaction* between domestic and international politics. Since trade politics operates at both the national and international levels, both should be included in analyses of the policymaking process.

³¹ Schoppa, *Bargaining with Japan*, 1997, 28-32.

³² Bruce Bueno de Mesquita and David Lalman, *War and Reason*, New Haven: Yale University Press, 1992.

John Odell's comparison of U.S.-Brazilian and U.S.-EC bargaining makes a major contribution towards understanding how domestic divisions affect international bargaining outcomes. Odell finds that successful negotiating by the sender of threats hinges on the degree to which domestic actors are united on the issue in both the sender and the target. Specifically, the more united interests are within the country issuing the threat, and the more divided interests are in the target country, the more likely that the party threatening sanctions will be able to get a favorable agreement.³⁴ For example, U.S. negotiators were able to achieve greater success in negotiations with the EC over feedgrains than with Brazil over computers primarily because domestic interest groups in the United States were unified. In the case of Brazil, the credibility of American threats was undermined because virtually no constituents supported a shift to open coercion. Even those actors that would benefit from pressure tactics were divided in their policy preferences. In the feedgrains case, most directly affected groups strongly supported government policies, and there was little domestic opposition to implementing the threat. Therefore, even though the United States had a far greater capacity to hurt Brazil, divisions among U.S. interest groups reduced the likelihood that this capacity would be effectively used, thus undermining compliance.

³³ Susanne Lohmann and Sharyn O'Halloran, "Divided Government and U.S. Trade Policy," *International Organization* 48 (Autumn 1994), 595-632; Sharyn O'Halloran, *S. Politics, Process and American Trade Policy*, Ann Arbor: University of Michigan Press, 1994.

³⁴ Odell, "International Threats and Internal Politics: Brazil, the European Community, and the United States, 1985-87," 234.

Odell's findings capture an important aspect of the negotiation dynamics by emphasizing how the degree of unity among domestic interests influences negotiating outcomes. Nevertheless, he does not go one step further to develop a more general theory for understanding *when* domestic support for sanctions is more or less likely to be present, a point to which I will return later in this chapter. His analysis thus remains rather *ad hoc* on domestic interests, unable to tell us when trade sanctions are more likely to obtain the necessary domestic consensus.

In general, Putnam and his associates have used the two-level game concept primarily as a metaphor and have not attempted to generate hypotheses through formalization. As Andrew Moravcsik acknowledged in the introduction to the collaborative project, the case studies in the volume are intended to be "plausibility probes" regarding existing hypotheses about two-level games and an "indispensable first step" in the transition from metaphor to social scientific theory.³⁵ Although subsequent studies have attempted to develop more explicit hypotheses, the concept of two-level games remains underdeveloped theoretically. In particular, the structure of domestic interests and preferences that affects the international game needs to be designated more explicitly, and the mechanisms linking domestic and international politics need to be spelled out more clearly as well.

³⁵ Moravcsik, 1993, 33.

A number of recent works have attempted to develop a more rigorous and systematic treatment of the domestic game along these lines.³⁶ The most prominent of these studies is Helen Milner's *Interests, Institutions, and Information*. Starting from the assumption that domestic politics is polyarchic, i.e., composed of at least two groups with different policy preferences that share power and decisionmaking, Milner contends that the possibility and extent of cooperation among states is vitally affected by these factors: the structure of domestic preferences (i.e., the degree of divided government and the preferences of the executive), the nature of domestic political institutions (specifically the institutional process of ratification), and the distribution of information internally.

Milner argues that the level of divided government is an important variable affecting prospects for international cooperation. Divided government, she explains, emerges when the policy preferences of the executive and the median legislator differ. Although executives and legislators are rational actors who share a common interest in retaining office, they often hold different policy preferences due to their different constituency concerns. Typically, executives are more concerned with the general

³⁶ Some authors have proposed more rigorous and formal treatment of the domestic game. See, for example, Keisuke Iida, "Analytic Uncertainty and International Cooperation: Theory and Application to International Economic Coordination," *International Studies Quarterly* 37 (December 1993): 431-57, 1993; Keisuke Iida, "When and How Do Domestic Constraints Matter?" *Journal of Conflict Resolution*, 37: 3 (September 1993), 403-26; George Tsebelis, *Nested Games: Rational Choice in Comparative Politics*, Berkeley: University of California Press, 1990; Lohmann, 1993; Jongryn Mo, "The Logic of Two-level Games with Endogenous Domestic Coalitions," *Journal of Conflict Resolution* 38 (September 1994), 402-22; Jongryn Mo, "Domestic Institutions and International Bargaining: The Role of Agent Veto in Two-Level Games," *American Political Science Review* 89 (1995), 914-924; Fredrick Mayer, "Managing Domestic Differences in International Negotiations: The Strategic Use of Internal Side-Payments," *International Organization* 46:4 (Autumn 1992), 793-818; Robert Pahre, "Endogenous

performance of the economy, whereas legislators prefer policies that would both enhance the economy and cater to their interest group supporters. In other words, executives focus more on the national constituency, while legislators have more local concerns. These differences between the policy preferences of the executive and the median legislator lead to divided government. The greater the divergences in executive-legislative preferences, the more is government divided. Divided government can be seen not only in presidential systems; it can, Milner argues, emerge in semi-presidential and parliamentary systems as well. Minority governments in parliamentary systems as well as majority coalition governments can experience divided government. Even when the same party controls both branches, divided government may occur because of the lack of party discipline or divergent policy preferences that derive from different constituency interests.³⁷

Divided government, according to Milner, makes international cooperation less likely. Since there is more than one player that can veto a deal, the need for ratification by the hawkish player within a state (i.e., the one whose preferences are further apart from those of the foreign country) places important constraints on the dovish player who is inclined to enter into cooperative arrangements with the foreign country, thus diminishing the prospects for international cooperation. The possibility for cooperation further declines and the likelihood of ratification failure increases as the policy differences

Domestic Institutions in Two-level Games and Parliamentary Oversight of the European Union," *Journal of Conflict Resolution*, 41 (February 1997), 147-174.

between the two actors increase, because the dove is now increasingly forced to accede to terms favored by the hawk. However, if cooperation is possible at all, this should push the terms of the deal closer to the preferences of the hawkish actor, leading to more favorable deals for the country with divided government. The possibility of cooperation also declines when the more hawkish actor holds greater internal decision-power. The implications of Milner's findings are pessimistic: domestic politics makes cooperation less likely and changes the terms of the agreement that could be made. Even realists may have overestimated the likelihood that states will cooperate with one another.³⁸

In short, by relaxing the assumption of the state as a unitary actor and laying out clearly the logic behind the hypotheses linking domestic politics to the negotiation and ratification of international agreements, Milner's *Interests, Institution and Information* and other studies inspired by it have advanced the research agenda on two-level games. But these works look more at how domestic interests and institutions affect the prospects for international cooperation, than at how they affect the effectiveness of threats and the probability of trade wars. It is thus both necessary and possible to develop a two-level game approach to understanding threat effectiveness that includes more systematic analysis of domestic interests and institutions and their impact on international negotiations. Such an approach ought to allow us to better understand the interaction

³⁷ Helen Milner, *Interests, Institutions, and Information: Domestic Politics and International Politics*. Princeton, N.J.: Princeton University Press, 1997, 37-43.

³⁸ *Ibid.*, 234-240.

between the domestic and international games and to generate new, fruitful observations about the dynamics of international trade bargaining.

Theoretical Framework and Hypotheses

While this study draws on the concept of two-level games to address the two puzzles concerning threat effectiveness and the instances of trade wars, it also aims to improve on the two-level game approach in two ways. First, it develops a model for understanding when threats are likely to be ratified by domestic interest groups. Second, it specifies the conditions under which domestic institutions will be united in support of trade sanctions. I take a system-level variable -- the structure of trade among nations (specifically, whether the parties involved have a complementary or competitive trade relationship) -- and show how it systematically affects both the level of unity among domestic interest groups and the level of divided government in the sender of threats.

When two countries have a competitive trade relationship, both domestic interest groups and the government institutions in the sender of threats are more likely to be united in their policy preferences than when trade relations are complementary, enhancing the credibility of threats. Thus the United States will almost always find it more difficult to extract concessions from countries with whom it has complementary trade relations than those with whom it has competitive ones. Paradoxically, the same set of variables, by producing stronger pressure for brinkmanship in bilateral trade games, also makes democracies more war-prone in their trade relations. While democracies may indeed be

more pacific in their security relations, the fact that a fair number of democratic regimes happen to have highly competitive trade relations shapes their domestic politics in a way that pushes democracies towards less cooperative stances on trade. The contrasting pattern of “democratic peace” in security relations and the lack of it in trade therefore should have important implications for the theory of democratic peace in general.

Defining the Structure of Trade

As summarized above, John Odell’s examination of two empirical cases shows that the presence or absence of support for sanctions makes a major difference to negotiation outcomes, but that examination does not lead to a more general theory predicting when support for sanctions is likely to be present. My study fills this gap by hypothesizing that the configuration of domestic interests, which bears importantly on threat effectiveness and the likelihood of trade wars, is affected to a considerable extent by a system-level variable -- the structure of trade between the two parties, specifically, whether the trade relationship between the two is “complementary” or “competitive.”

Trade complementarity/competitiveness refers to the extent to which two countries engage in the production and export of a similar range of commodities. When two nations’ comparative advantages differ, each has an incentive to concentrate on the production of those commodities which best utilize its comparative advantage and produce the highest profit margin, and trades them for goods that it cannot produce at a reasonable cost at home. To illustrate this situation, if the United States specializes in the

manufacturing of technology-intensive products and exports them to countries such as China in return for imports of labor-intensive products (such as shoes, toys and textiles) which it no longer produces at home, then the trade structure between the two can be considered complementary. In contrast, when two countries' comparative advantages converge, both will specialize in the same set of products that will allow them to capture the greatest profits. Since their economic structures are similar, each will have home substitutes for imports from the other and, as a result, trade is more "competitive." Trade between the United States and Japan (or Europe) provides an example of a competitive trade structure, as both focus on the export of technology-intensive products.

John Conybeare uses the terms "complementary" and "competitive" in a way very similar to the way I employ the terms here. In his study of bilateral trade wars throughout history, Conybeare finds that trade complementary/competitiveness is an important variable affecting the likelihood of bilateral trade wars. He gives the trade pattern in the ancient world as an example of a complementary trade relationship. In ancient times, the structure of trade consisted of complementary exchanges of essential commodities such as food and raw materials. Each country produced only one or a few commodities in which it had a clear comparative advantage, and exchanged them for commodities which it was incapable of producing efficiently. He contrasts this pattern of trade with that in the contemporary world, where countries import commodities (such as autos, steel, and

televisions) for which they have close substitutes at home. In this case, countries have higher elasticities of demands for imports and hence trade is more “competitive.”³⁹

Conybeare’s book looks primarily at the effects of the structure of trade on the likelihood of trade wars, but his insights have implications for understanding threat effectiveness as well. Conybeare considers trade relations in the contemporary world to be generally more competitive than those in the ancient world, but I would argue that there remains in the modern world a fair degree of variation in complementarity.

Countries that export a similar set of products face a competitive trade structure, whereas those whose exports concentrate on a different range of commodities have a primarily complementary trade relationship.

To determine whether the United States, for example, has a complementary or competitive trade relationship with a specific country, we can compare the list of commodities that the U.S. exports with the list of commodities it imports from that trading partner. If there is considerable overlap between the two lists (in other words, if the leading items in U.S. exports to a country are similar to the leading commodities it imports from that trading partner), then the trade relationship can be said to be competitive. But if the items on these lists differ considerably (i.e., if the U.S. imports from its trading partner very different commodities that it exports to that country), then the trade relationship can be regarded as competitive. An examination of the number of overlaps between the top 20 commodities the United States exports and the top 20 commodities it imports from

particular countries reveals a wide range in the degrees of competitiveness in U.S. trade relations with its major trading partners. (See Table 2.1) Using my earlier definitions of trade competitiveness, we can see that the United States has the most competitive trade

Table 2.1: Number of overlaps between the top 20 commodities the United States exports to and the top 20 commodities it imports from major U.S. trading partners.

Country	Total volume of trade Ranking	Number of Overlaps
United Kingdom	5	12
Canada	1	11
Germany	6	11
Mexico	3	10
Japan	2	9
Switzerland	21	9
France	10	8
Israel	24	8
Singapore	9	8
Belgium	16	7
Hong Kong	15	7
Netherlands	13	7
Taiwan	7	7
Malaysia	11	6
Philippines	19	6
Australia	22	5
Italy	12	5
South Korea	8	5
Thailand	18	4
Brazil	14	3
China	4	2
India	25	2
Indonesia	23	2
Saudi Arabia	20	2
Venezuela	17	2
Argentina	31	0

Source: U.S. Department of Commerce data. Top 20 commodities in U.S. trade with individual trading partners are sorted by 1996 values and are based on 3-digit SIC codes. Total volume of trade ranking is based on 1997 data.

³⁹ Conybeare, *Trade Wars: The Theory and Practice of International Commercial Rivalry*, 1987, 47-48.

relationship with Japan and the European Union, but has far more complementary trade relationships with countries such as China, Brazil, and India.

In his study, Conybeare considers trade structure to be a determinant of the strategic game structure of bilateral trade wars. He argues that trade wars are more likely to break out between countries with competitive economies than complementary ones because the costs of disrupting trade with the former are less severe: "Trade complementarity implies low elasticities of demand for each other's products, and high costs to a trade war. Countries with similar economic structures would have substitutes for each other's products and a higher elasticity."⁴⁰ Thus, trade structure is believed to influence outcomes of international bargaining primarily through the effects it has on the actors' evaluations of their material gains or losses from the disruption of trade. This approach is concerned primarily with factors at the system level and says nothing about domestic politics. It is possible, however, that trade structure can influence international bargaining outcomes by shaping the ways in which domestic forces respond to international structural factors. In the following sections, we will see how trade structure can affect both threat effectiveness and the likelihood of trade wars by influencing the level of divergence of domestic interests as well as the degree of divided government in the sender of threats.

Explaining Variations in Threat Effectiveness

An important way in which trade structure may influence threat effectiveness is by determining the degree of *divergent preferences* among domestic interest groups. It is interesting to notice that when trade relations are competitive (that is to say, when the two nations compete in the same product lines), the nation issuing the threat would most likely have large export-seeking and import-competing sectors specializing in the production of the same commodities as the target country. In some cases, the firms seeking exports may even be the same as those that are competing with imports in the home market. U.S. efforts to pry open the Japanese construction market in 1987-88 may help to illustrate this point. In the late 1980s, convinced that U.S. construction firms, especially those involved in high-tech services, have been excluded from the Japanese public sector construction market by unfair Japanese practices, the U.S. Trade Representative announced that a ban would be imposed on Japanese firms' participation in U.S. public works construction unless Japan modified its government procurement policy.

In this case, the U.S. construction firms pushing for trade sanctions were mainly large international firms that wanted to expand their presence in the Japanese construction market. At the same time there were also many U.S. construction firms that felt threatened by Japan's increasing success in the American construction market. These firms supported sanction threats because they would benefit from the restrictions on Japanese competition in the U.S. building market if sanctions were carried out against

⁴⁰ *Ibid.*, 47.

Japan.⁴¹ Given this situation, American threats to impose sanctions unless Japan opened its market presented American industries with a no lose situation. If sanction threats succeeded in extracting concessions, export-seeking interests (the larger international firms) won by obtaining greater access to Japan's market. If the threats failed, and sanctions had to be imposed, import-competing interests (firms threatened by Japanese competition in the U.S. market) won. Because they produced the same things as the target, protectionism promises to provide them with "rents" previously unavailable under free trade. Sanction threats under these conditions consequently enjoyed much more unified support from affected organized interests and were therefore more likely to be effective.

In contrast, in the case of complementary trade relations, domestic interest groups are more likely to be divided, thus reducing the credibility and effectiveness of threats. This hypothesis derives from the observation that when trade relations are complementary, the nation making the threat is likely to have both a large export-seeking industry and a virtually non-existent import-competing sector. Trade relations between the United States and China, two countries with a complementary trade relations, provide an example of this dynamic. Since the United States imports from China commodities that are no longer efficiently produced at home, there is a large import-using sector in the United States

⁴¹ Ellis S. Krauss, "U.S.-Japan Negotiations on Construction and Semiconductors, 1985-1988: Building Friction and Relation-Chips," in Peter B. Evans, Harold K. Jacobson, and Robert D. Putnam, eds., *Double-edged Diplomacy: International Bargaining and Domestic Politics*, Berkeley: University of California Press, 1993, 278; Brian Woodall, *Japan Under Construction: Corruption, Politics and Public Works*, Berkeley: University of California Press, 1996.

comprised of footwear, toy, and apparel manufacturers and distributors that supported trade sanctions. At the same time, there were virtually no import-competing interests in the United States that wanted to see sanctions carried out against the Chinese. Although, in some cases, export-seeking firms (such as the intellectual property rights industry) supported efforts to use trade sanctions to open up the Chinese market, their effectiveness was undermined by active opposition from import-using industries. Not surprisingly, these domestic divisions severely reduced the credibility of American threats in the eyes of the Chinese.

Indeed, the logic developed here may help us understand the contrasting results of the two case studies described by Odell. As we have seen earlier, Odell's comparison of U.S.-EC and U.S.-Brazilian negotiations illustrates how difficult it is for the United States to carry out a credible threat without strong, unified support from the affected groups. The question Odell did not ask, however, was why American interest groups were more divided in the EC enlargement case than in the informatics case involving Brazil. But if the argument developed above has any validity, then we will see that one reason that American negotiators faced virtually no domestic opposition in the EC enlargement case is the competitive trade relationship between the United States and Europe. American feedgrain farmers, who wanted the EC to eliminate its subsidies on export in an effort to expand American exports, were also the ones competing with EC farm imports. Not surprisingly, the feedgrain sector was prepared to face the possible consequences of EC counterretaliation. Even those groups targeted by EC counterretaliation (the corn gluten

feed farmers) did not press for accommodation because they have “their own zero [duty] binding in the EC.”⁴² The situation was completely different in the case of Brazil. Since trade relations between the United States and Brazil are complementary (note that Brazil is located near the bottom of the competitiveness index in Table 2.1), threats to impose sanctions on Brazil enjoyed backing only from U.S. computer companies. There were no import-competing interests that supported the sanction threats. With this structure of interests, it is no wonder that the credibility of American threats were substantially reduced.

Summarized briefly, the above analysis suggests that the structure of trade has an important impact on domestic interests in the country issuing the threat: U.S. threats to impose economic sanctions will enjoy more unified domestic support and hence be more credible when the target has a competitive, rather than complementary trade relationship with the U.S. But in addition to this, trade structure may also affect threat effectiveness by influencing the level of *divided government* in the sender of threats.

As mentioned in the previous section, the effects of institutions on agreements to cooperate have been investigated systematically. Helen Milner argues that divided government diminishes the prospects for international cooperation. Because the hawk exercises important veto power over the terms of the deal, the dove will be forced to modify its position and to accede to terms favored by the hawk. As the policy preferences

⁴² Odell, “International Threats and Internal Politics: Brazil, the European Community, and the United States, 1985-1987,” 241-243.

of the two government branches diverge, the dove will have increasing difficulty getting the agreement ratified and will now have to negotiate agreements that lie closer to the hawk's preferences. As a result, divided government poses a major obstacle to international cooperation.

It should be noted at this point that in international negotiations it sometimes takes threats to get a country to move toward a cooperative deal. But for the threat to be credible, it has to be ratifiable. Typically, even though the executive and legislative branches share a common interest in retaining office, they may have different policy preferences due to their different constituency concerns. These differences in executive-legislative preferences lead to divided government. But since the ratification of threats requires the approval of both the legislative and executive branches, the more dovish actor -- the one whose policy preferences are closer to that of the target -- now has a veto over whether the threat can be approved. In this case, the logic that Milner describes works in reverse and the credibility of threats will again depend on the level of divided government, or the policy space between the executive and legislative branches. If the policy preferences of the executive happen to be closer to that of the legislature, the target country will perceive that the threat will have a greater possibility of being approved by the executive and of being implemented. Consequently, U.S. threats will be more credible. On the other hand, when the policy preferences of the two branches differ considerably, threats will be less credible in that it will lead the target to believe that there is only a slight chance that threats could be ratified and imposed. In short, greater unity between the two

government branches increases the credibility of U.S. threats to impose trade sanctions, whereas divided government reduces threat credibility.

Which factors influence the degree of division between the two institutions? This study further hypothesizes that the structure of trade (i.e., whether trade relations are competitive or complementary) plays an important role in the level of divided government. Studies of American foreign economic policy have shown that the U.S. executive's responses to industries seeking protection will be determined by the combination of ideological considerations and institutional role pressures a particular type of industry exerts on the executive. Ellis Krauss and Simon Reich argue that the embedded American ideology of free and fair trade implies that state intervention is legitimized only if the industry is perceived as "competitive" and is therefore likely to be able to eventually stand on its own. Noncompetitive industries, on the other hand, are more likely to be allowed to decline and disappear if they are not efficient enough.⁴³ Meanwhile, different types of industries tend to invoke different kinds of institutional role pressures. Specifically, since high-tech industries are perceived as crucial to the future well-being of the United States and often also to national security, they tend to invoke the role pressure of state interest on the President. On the other hand, although they may not be perceived as vital to the well-being of the country as a whole, non-high tech industries also may induce the executive to act if they can bring to bear enough political pressure.

⁴³ Note that here the word "competitive" means something very different from the way it was used earlier in this chapter. Whereas earlier the word "competitive" refers to the degree to which two countries

Using this logic, Krauss and Reich predict that since high-tech industries such as supercomputers and satellites are both crucial to the future health of the economy and can compete in foreign markets, the American executive is likely to adopt the “fair trade” principle and attempt to open foreign markets for U.S. firms. Industries such as automobiles and machine tools are ones that traditionally have enjoyed a home market advantage and are thus generally perceived as competitive. Even though these are non-high tech industries that have suffered a certain degree of decline, they are likely to exert sufficient pressure on the executive to act due to their political clout. In such cases, the executive is expected to come up with a moderate response by providing temporary relief for the industry and to adopt informal managed trade agreements that do not institutionalize protectionism.

U.S. industries that do not enjoy a home market advantage, on the other hand, are perceived by the executive to be undeserving of state intervention based on the executive’s free trade ideology. The President will be quite reluctant to intervene in certain non-high tech industries facing long-term structural decline such as textiles and steel. But, in light of the pressure from organized labor to provide relief, and out of practical electoral considerations, the executive would resort to “structural protectionism,” adopting a series of measures to maintain the industry’s employment level and to minimize the effects of terminal decline on labor. Finally, due to the executive’s free trade ideology and the lack

engage in the production and export of a similar range of commodities, here it means that a given U.S. industry enjoys a home market advantage, or a competitive edge over foreign producers.

of strong political pressures, the executive branch will be least likely to undertake a major initiative on behalf of those high-tech industries (for example, high-definition TV and fiber optics) that are unable to compete in foreign markets.⁴⁴

Having posited when and how the American executive is likely to respond to domestic interests threatened with foreign competition, I now argue that since trade conflicts between countries with competitive trade relations are most likely to occur in sectors in which U.S. firms are competitive (either high tech sectors or mature/non high-tech industries which have considerable political clout), the U.S. executive will be more likely to deviate from the free trade ideology to accommodate domestic pressure for protectionism or strategic trade policy when disputes involve these industries. This accommodation should bring the executive position closer to that of the legislature which tends to be more hawkish in most trade disputes,⁴⁵ increasing the possibility that threats to impose sanctions will be ratified by the more dovish actor.

⁴⁴ Ellis S. Krauss and Simon Reich, "Ideology, Interests, and the American Executive: Toward A Theory of Foreign Competition and Manufacturing Trade Policy," *International Organization* 46, 4 (Autumn 1992), 861-865.

⁴⁵ Numerous studies of American foreign trade policy have shown that Congress is likely to be more protectionist than the president. Since Congressmen seek reelection, they are primarily responsible to their own local constituents. Designing policies that benefit these constituents help to increase their chances of reelection. The executive, in contrast, is charged with overseeing the general performance of the economy and is therefore less likely to be driven by special interests to provide protectionist policies that are inefficient. The importance of constituent demands in the formation of legislators' preferences explains why legislators are more protectionist than the executive. David Mayhew, *Congress: The Electoral Connection*. New Haven: Yale University Press, 1974; Susanne Lohmann and Sharyn O'Halloran, "Divided Government and U.S. Trade Policy," *International Organization* 48 (1994), 595-632; Robert E. Baldwin, *The Political Economy of U.S. Import Policy*, Cambridge, Massachusetts: The MIT Press, 1985.

To be sure, trade conflicts between countries with competitive trade relations have taken place in non-competitive, non-high tech industries such as textiles and steel. But even here one would expect the American executive to respond more forcefully to domestic industries seeking relief from competition from a country with whom the U.S. has a competitive trade relationship than one with whom it has a complementary one because the level of threat posed by the former would be perceived to be higher than that from the latter.

Conversely, since trade conflicts between the United States and a country with whom it has complementary trade relations are most likely to take place in non-competitive, permanently declining industries, the U.S. executive is less likely to respond to domestic protectionist pressure, even though the industry under consideration still may hold some political power. Moreover, the interests of the import-using sectors in the continuation of normal trade relations should give the executive an additional incentive to resist the tougher approach. The policy space between the two government institutions will be wider, and there will be a higher possibility that threats may not be approved by the dove. The wider gap between executive and legislative preferences should make U.S. threats of sanctions less credible to the target.

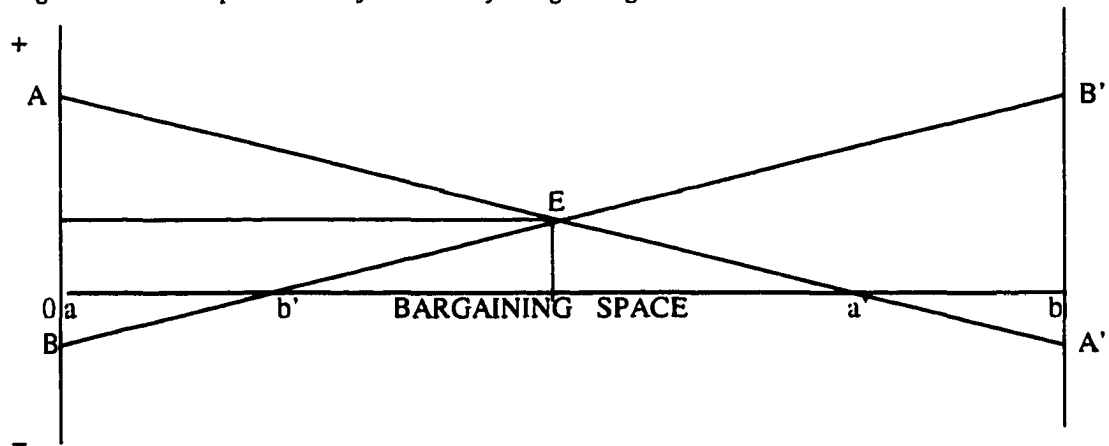
The following charts use a simple model of two-party bargaining to illustrate how domestic politics may affect the credibility of threats.⁴⁶ Figure 2.1 depicts the basic

⁴⁶ For an elaboration of the model, see P. Terrence Hopmann, *The Negotiation Process and Resolution of International Conflicts*. Columbia: University of South Carolina Press, 1996.

bargaining situation between two parties. To simplify the situation, it is assumed that the two parties bargain over a single issue. This issue dimension is depicted along the horizontal continuum. In theory, an agreement may be reached at any position along this continuum. The vertical dimension reflects the various values of an agreement for each of the parties. At the midpoint of the Y axis, the value of an agreement is zero for each party. The value of an agreement is increasingly positive above the midpoint and increasingly negative below it. The two parties' indifference curves (lines A-A' for actor A and B-B' for actor B) summarizes the outcomes of payoffs for each of the parties for agreements reached at any point along the issue dimension. In Figure 2.1 we can see that actor A prefers agreements toward the left end of the issue dimension (point a on the horizontal line), since it is able to derive substantial positive value from an agreement in this region. Conversely actor B prefers agreements toward the right end of the issue dimension (point b).

Since neither party will accept an agreement that produces a negative outcome for itself, the bargaining space, or the range of space within which agreements may occur, is set by the points of indifference (points a' and b') for the two parties. Outside these points of indifference one of the players will be able to gain more by acting unilaterally than through a negotiated agreement and therefore will no longer find an agreement beneficial. If the two parties have symmetrical positions, and if both seek a fair or

Figure 2.1: A Simple Model of Two-Party Bargaining



equitable solution, then agreement should occur at point E, where the preferences of the two parties intersect.

Figure 2.2(a) and Figure 2.2 (b) show how threats may change the negotiation positions of the parties and why they work less well to extract concessions from the target when greater divisions among the preferences of domestic actors are involved. As we will see, an important effect of threat is to alter the bargaining space by raising the cost of nonagreement to the target country. Suppose that country B threatens country A. This means B indicates that it will punish A or remove a reward from A if A does not comply with B's wishes. For A, this means the cost of nonagreement is now higher. Compared with the alternative of nonagreement, agreement on B's terms becomes more positive in value. In figure 2.2 (a), A's preference curve shifts to the right to a new level reflected by line A*-A'* and the location of a "balanced" agreement moves from position E to position E*. At the new equilibrium point E*, the benefits of an agreement to A increases substantially (from distance r to distance p at the left margin). A's point of indifference

moves from a' to a'^* , thus expanding the bargaining space. What this means is that A would now be willing to accept an agreement that lies further away from its preferred outcome.

Assuming that the target country A has incomplete information about B's domestic politics, how far B's threat can push A's preference curve to the right is determined by two factors: B's capability to implement the punishment multiplied by A's estimate of the probability that B will actually carry out the threat. This is summarized by the following equation:

$D = C * P$ (where C represents A's capability to implement the punishment, P represents A's estimate of the probability that threat will be carried out, and D the expected costs of punishment to A. D is also equal to the difference between the benefit A would have received at level r and the amount received at p).

Since C remains constant, D, the amount that A's indifference curve will move to the right now depends on the magnitude of P, or A's estimate of the probability that the threat will actually be carried out. As we have seen above, when trade relations are complementary, not only are the two government branches in B more divided, the differences in the preferences of domestic interest groups are also greater. As a result, A will perceive that it is highly unlikely for B to carry out the threats and hence P is likely to be quite small, resulting in a lower level of expected costs for A. But when trade relations are competitive, both the two government institutions and domestic interest groups will be more united, leading A to believe that B will most likely implement its threats.

Consequently, the value of P will be larger and A 's costs of nonagreement higher. This makes the relative benefits of agreement compared to nonagreement more

Figure 2.2 (a): Effects of Threats With Complementary Trade Relations

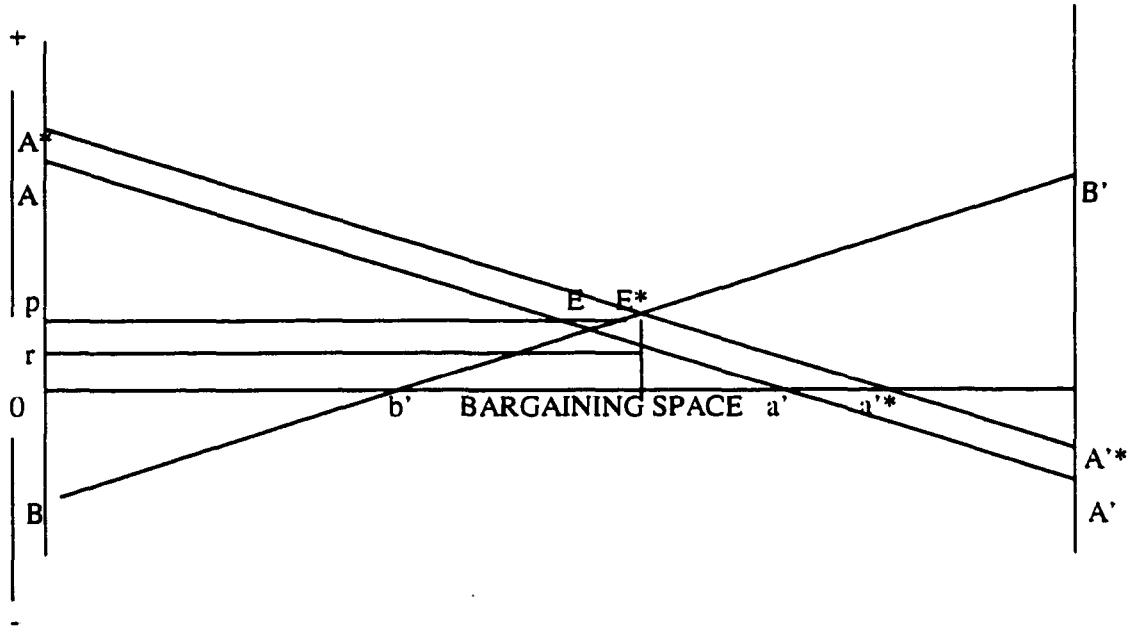
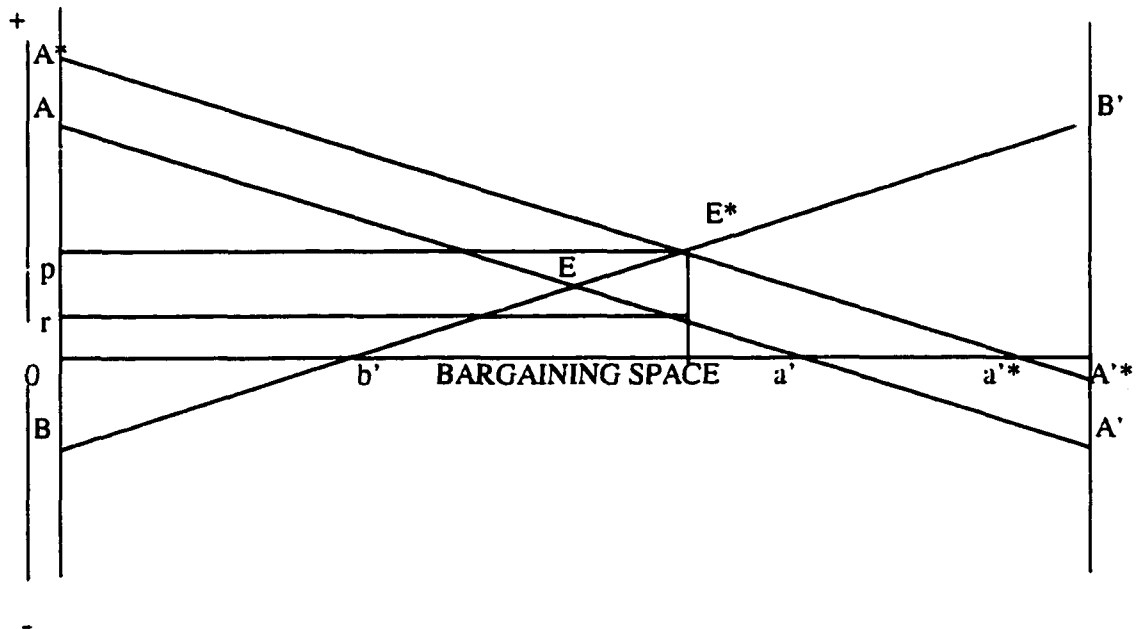


Figure 2.2 (b): Effects of Threats With Competitive Trade Relations



attractive. Accordingly, when trade is competitive, A would be willing to compromise and settle at a point E^* that is further away from its preferred outcome than when the trade relationship is complementary. This allows B to achieve a higher level of gains (the difference between distance q and p at the left margin), improve the terms of the deal in its favor, and better able to move A's policy from where it would have been in the absence of threats toward B's demands.

The above analysis leads to one of the key hypotheses of this study: the U.S. will be able to make more effective use of threats to extract concessions from nations with whom it has competitive trade relations (such as Japan or Europe) than it will from nations with whom it has complementary trade relations (such as China). In the case of competitive trade, not only are domestic interests more likely to be united in favor of trade sanctions, the degree of division between the two government institutions will also be considerably lower, making the use of threats more effective. In the case of complementary trade, on the other hand, divisions in domestic interests and a more divided government all serve to undermine the credibility of U.S. threats.

Explaining Patterns of Trade War

Having developed a modified two-level game approach to explain the variations in the effectiveness of U.S. coercive diplomacy, there is still the question of why there have been more trade wars between democracies. This study proposes that the same factors that account for the variable degrees of threat credibility can also help us understand the

lack of “democratic peace” in trade. The structure of trade, by influencing the structure of societal preferences, the preferences of the executive, and the degree of divided government, alters the incentives created by the nature of the regime (whether a state is democratic or not) that prevent democracies from going to war with one another in the security realm. Since a good number of democracies happen to be advanced industrial countries whose trade with one another tends to be competitive, strong domestic pressure for sanctions, coupled with an executive more inclined to go along with the tougher approach, will likely push these democracies towards less cooperative stances in trade disputes, resulting in higher instances of trade wars among democracies.

In the case of competitive trade, domestic interest groups are generally unanimous in support of aggressive trade negotiation strategies, since both exporting and import-competing interests gain from aggressive tactics that promise benefits whether the threat succeeds or fails (and results in sanctions). This should produce strong pressure for brinksmanship in bilateral trade disputes. Meanwhile, for the reasons enumerated above, the executive is also more likely to approve of the need to impose sanctions if he or she perceives that domestic pressure for compensation is strong enough or that an industry vital to the future economic well-being of the nation is genuinely threatened by foreign competition.

When it comes to trade disputes between two countries with complementary trade relations, the structure of domestic interests differs. Divisions between exporting and import-using interests mean that an internal consensus will be harder to obtain. When one

group of actors clamor for policies that will restrict the target's access to the home market, chances are that this will be offset by the pressure from another group that has an interest in the continuation of normal trade relations. This should reduce the incentives for defection in bilateral trade. Moreover, the more hawkish legislative branch will find it more difficult allowing the decision to be ratified by the executive, whose policy stance will differ even more sharply with that of the legislature. Given the difficulty of securing domestic ratification of threats, it is hardly surprising that the U.S. has rarely imposed sanctions to initiate a trade war with a trading partner with which it has a complementary trade relationship.

The following charts illustrate how greater domestic divisions can actually help to prevent trade wars from taking place. In Figure 2.3 (a) and Figure 2.3 (b), two countries negotiate over a range of possible outcomes. The horizontal axis represents the utility of a possible bid to A, and the vertical dimension measures the payoff to party B at the time of settlement. Since one always has the option of abandoning the negotiation if the settlement falls below some minimum, the possible payoffs to each party are given a lower bound. This lower bound represents the Maximum Level of Concession (MCL) the parties are willing to make. When B threatens to impose sanctions on A and when the preferences of the actors in B differ, then instead of there being a single MCL, the hawk and the dove in country B each has its own MCL. Assuming that the hawk is protectionist and highly unwilling to make compromises, the preferences of the dovish actor, who has

the ability to veto the threat, become crucial to the outcome. To the left of the A's MCL and below B dove's MCL, no agreement is possible.

Figure 2.3 (a): Possibility of Agreement with Internal Unity

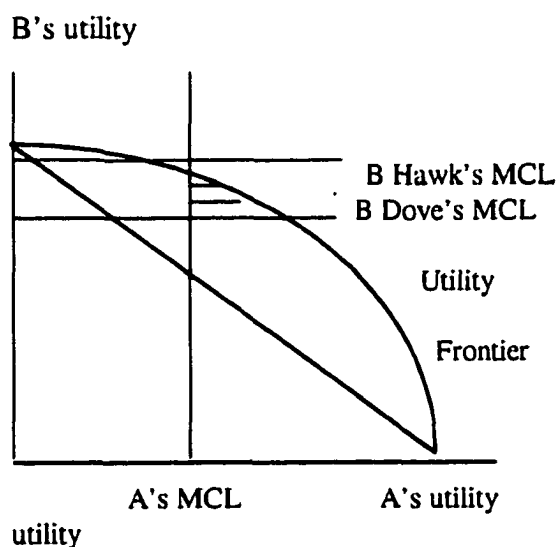
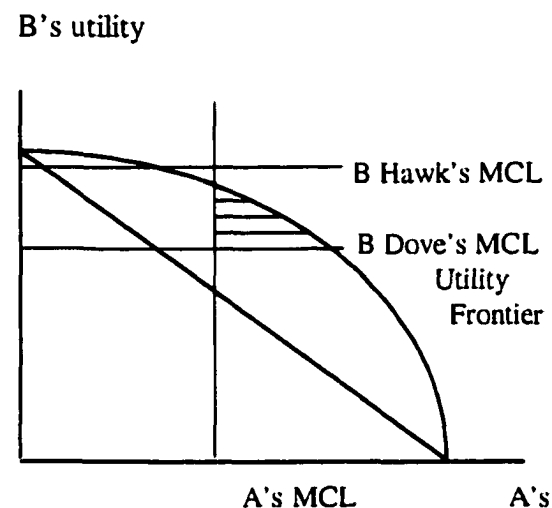


Figure 2.3 (b): Possibility of Agreement with Internal Divisions



When the dove's preferences are close to that of the hawk, as in Figure 2.3 (a), the likelihood that the intersection of the MCL of the dove in country B and country A's MCL will lie inside of the parties' utility frontier (the zone which maximizes utility to both players) will be small, resulting in greater chances of no-agreement, or trade war outcomes. When B dove's preferences begin to move away from those of the B hawk, domestic divisions rise (see Figure 2.3b). As the dove is increasingly willing to veto sanction threats, the chances that the parties' Maximum Concession Levels will produce some realistic bargaining range increase, pushing the two countries further away from the trade war outcome.

As we can see from the above analysis, the degree to which domestic actors are united over sanction threats plays an important role in determining the likelihood of trade wars. Having domestic groups opposed to sanction threats not only reduces threat effectiveness, but also makes trade wars less likely. Similar to John Conybeare's analysis of bilateral trade wars, this study emphasizes the importance of trade structure in affecting the outcomes of international commercial conflicts. But the argument advanced here also differs from that of Conybeare in important ways. For Conybeare, the structure of bilateral trade games is the primary factor determining the outcomes of commercial rivalries. Trade structure is important in so far as it affects the structure of payoffs in bilateral trade wars. Even though he considers the impact of domestic politics in some of his cases, he essentially adopts a game-theoretic approach that treats states as rational, unitary actors. In his framework, the influence of domestic politics is peripheral. The approach adopted here, in contrast, seeks to disaggregate the effects of trade structure at the domestic level by showing how it can affect states' propensity to engage in trade wars by influencing the level of polarization among domestic interest groups and the level of divided government. In doing so, it provides a plausible theoretical mechanism linking domestic and international variables.

In short, even though the theory of democratic peace would have led us to expect less democratic trade wars, the fact that most democratic countries happen to have highly competitive trade relations generates societal and institutional forces that make

democracies more war prone with one another in trade.⁴⁷ While the theory of democratic peace may have considerable validity when applied to security issues, it does not fully capture the dynamics of international trade conflicts: democracies may be no less inclined to fight trade wars due to forces that can be traced to trade structure. The one strand of the “democratic peace theory” which is most applicable to trade issues -- the theory of “democratic signaling” emphasized by James Fearon -- obviously has trouble explaining the pattern of trade wars we have observed. In the concluding chapter, I will further discuss the implications of this finding for both trade policy-making and for the “democratic peace” literature.

Conclusion

This chapter develops a framework showing how the structure of trade among nations, by influencing the structure of domestic interests and the level of divided government in the sender of threats, affects international trade negotiation outcomes. It advances explicit hypotheses about the influence of domestic politics on international behavior. This framework will be used to organize the following analysis of America’s negotiation record with its major trading partners. We will find that the factors emphasized in this chapter do have the hypothesized effects on threat effectiveness and the probability of trade war. Because of the way in which its domestic topography is shaped

⁴⁷ Chapter 3 will provide evidence showing that the vast majority of democracies do have fairly competitive trade relations.

by varying trade structure, the United States not only has considerable difficulty imposing its demands on its weaker trading partners, but has also been involved in a fairly large number of trade wars with its democratic trading partners, a pattern that clearly is not explicable in terms of the “democratic peace” theory.

~ 3 ~

The Empirical Record

The analysis in the previous chapter provides a plausible explanation for the two empirical puzzles laid out in the opening pages of the dissertation by looking at the interaction between domestic and international politics. If the theoretical mechanism suggested here is what really drives the negotiation dynamics, then the reason that U.S. pressure is more effective with countries such as Japan than with countries such as China resides in the different structure of these dyadic trade relationships and the ways in which trade structure divides or unites domestic actors. Before delving into detailed case studies to see how these factors play out in the negotiation processes, I will first provide an overview of the record of trade negotiations between the United States and its major trading partners to establish the empirical validity of the research questions and to show that rather than deliberately setting up an analytical straw man, the dissertation explains two puzzling patterns that do exist in the real world.

Drawing primarily on the data base on Section 301 cases provided by Thomas Bayard and Kimberly Ann Elliott, I show that substantial differences exist in the effectiveness of American pressure across countries and that these differences cannot be readily explained by the degree to which the target countries depend on the U.S. markets for exports. Rather, trade competitiveness/complementarity seems to better predict the variations in threat effectiveness. This chapter also looks at the record of trade conflicts

initiated by the United States and shows that with the exception of one trade war between the United States and China,¹ trade wars have taken place almost exclusively between the United States and its democratic trading partners. The instances of trade wars are higher between democratic dyads than between dyads that combine democratic and authoritarian regimes. Although the theory of “democratic peace” may offer accurate predictions of the pattern of inter-state military wars, it does a less good job describing the pattern of trade wars among nations. Once again, my quantitative analysis shows that trade competitiveness/complementarity better explains the pattern of trade wars.

Trade Structure and Threat Effectiveness

Chapter 1 briefly outlined the variations in American threat effectiveness across countries. Based on a few examples, I argued that U.S. pressure was more effective with countries such as Japan, Taiwan, and South Korea than with countries such as China, Brazil, and India. This contrast is given more empirical weight, however, if I can illustrate, through a more general survey of the record of negotiations between the United States and its major trading partners, that American economic coercion has produced more tangible results with competitive trading partners than complementary ones. Toward this end, I examine the overall record of Section 301 negotiations conducted by the United States between 1975 and 1995. Relying primarily on Bayard and Elliott’s evaluation of

¹ This study looks primarily at trade conflicts initiated by the United States under both the GATT/WTO framework and Section 301 of the 1988 Omnibus Trade and Competitiveness Act. I had to limit my analysis to U.S.-initiated disputes due to the lack of comprehensive data on trade structure. Further study could test the argument developed in the previous chapter against a larger sample of dyads that includes cases initiated by countries other than the United States.

the effectiveness of U.S. economic coercion in Section 301 cases and on Elliott and Richardson's updated and expanded data set, I calculate the average concession rates of major U.S. trading partners.

In both Bayard and Elliott and Elliott and Richardson's classification schemes, the United States is "largely successful" if there is substantial compliance with U.S. demands in all issue areas; "partially successful" if the target capitulates to American demands on some, but not all, of the issues under dispute; "nominally successful" if the issue reoccurs or if the target fails to implement the agreement; and "not at all successful" if the United States fails to reach any agreement with the target.² Following these criteria, I rate "not at all successful" cases as "0" up through "largely successful" cases as "3" and average the results of American pressure by country. The results, reported in Table 3.1, indicate that the effectiveness of American pressure varies widely for each bilateral relationship. Some U.S. trading partners turned out to be more responsive to American pressure than others. For example, while Japan, Taiwan, South Korea and Canada are among the U.S. trading partners most responsive to American pressure, China, India and Argentina end up on the lower ends of the responsiveness scale. The Japanese, who were most responsive to American pressure, achieved an average score of 2.07, compared with only 1 for China and 0.5 for India.

² See Bayard and Elliott, *Reciprocity and Retaliation in U.S. Trade Policy*, 59-64, 355-369; Kimberly Ann Elliott and J. David Richardson, "Determinants and Effectiveness of 'Aggressively Unilateral' U.S. Trade Actions," in Robert C. Feenstra, ed., *The Effect of U.S. Trade Protection and Promotion Policies*, Chicago: Chicago University Press, 1997, 221-225.

Table 3.1: Effectiveness U.S. Pressure Under Section 301

Cases involving Japan	Degree to Which U.S. Objectives Achieved	Quantitative score
Thrown silk (1977-78)	Largely successful	3
Leather (1977-85)	Partially successful	2
Cigars (1979-81)	Nominally successful	1
Pipe Tobacco (1979-81)	Nominally successful	1
Footwear (1982-85)	Partially successful	2
Semiconductors (1985-91)	Nominally successful	1
Cigarettes (1985-86)	Largely successful	3
Citrus (1988)	Largely successful	3
Construction (1988-91)	Partially successful	2
Satellites (1989-90)	Largely successful	3
Supercomputers (1989-90)	Partially successful	2
Wood products (1989-90)	Partially successful	2
Auto parts (1994-95)	Nominally successful	1
Agricultural products (1997)*	Largely successful	3
Average result	Partially successful	2.07

Cases involving China	Degree to which U.S. objectives achieved	Quantitative score
Market access (1991-92)	Nominally successful	1
IP protection (1991-92)	Nominally successful	1
IP protection (1994-96)*	Nominally successful	1
Average result	Nominally successful	1

Cases involving E.C.	Degree to which U.S. Objectives achieved	Quantitative score
Egg albumin (1975-80)	Partially successful	2
Canned fruit and vegetables (1975-79)	Nominally successful	1
Malt (1975-80)	Not at all successful	0
Wheat flour (1975-83)	Not at all successful	0
Canned fruit (1976-80)	Nominally successful	1
Soybeans and soymeal (1976-79)	Nominally successful	1
Citrus (1976-86)	Partially successful	2
Wheat (1978-80)	Nominally successful	1
Sugar (1981-82)	Not at all successful	0
Poultry (1981-84)	Nominally successful	1
Pasta (1981-87)	Partially successful	2
Canned fruit and raisins (1981-85)	Nominally successful	1
Corn, sorghum, oilseeds (1986-87)	Largely successful	3
	Not at all successful	0
Meatpacking (1987-89)	Not at all successful	0
Beef (1987-89)	Nominally successful	1
Soybeans (1987-90)	Largely successful	3
Fabricated copper (1988-90)	Partially successful	2

Canned fruit (1989)	Partially successful	2
Corn, sorghum, oilseeds (1990)	Nominally successful	1
Meatpacking (1990-93)	Partially successful	2
Banana (1995-98)*	Nominally successful	1
Enlargement (1995-96)*	Partially successful	2
Modified starch*	Partially successful	2
Average result	Nominally successful	1.3

Cases involving Canada	Degree to which U.S. objective achieved	Quantitative Score
Eggs (1975-76)	Largely successful	3
Broadcasting (1978-84)	Not at all successful	0
Fish (1986-90)	Partially successful	2
Beer (1990-93)	Nominally successful	1
Service (1994-95)	Partially successful	2
Periodicals (19976-97)*	Partially successful	2
Average result	Nominally successful	1.67

Cases involving Brazil	Degree to which U.S. objective achieved	Quantitative Score
Footwear (1982-85)	Partially successful	2
Soybean oil and meal (1983-85)	Partially successful	2
Informatics (1985-89)	Partially successful	2
Pharmaceuticals (1987-90)	Nominally successful	1
Import licensing (1989-90)	Largely successful	3
Intellectual property (1993-94)	Nominally successful	1
Automobile (1996-1998)*	Partially successful	2
Average result	Nominally successful	1.86

Cases involving Argentina	Degree to which U.S. objective achieved	Quantitative Score
Marine insurance (1979-80)	Nominally successful	1
Leather (1981-82)	Not at all successful	0
Air couriers (1983-89)	Partially successful	2
Soy bean oil and meal (1986-88)	Partially successful	2
	Nominally successful	1
Textiles (1988-89)*	Nominally successful	1
Average result	Nominally successful	1.2

Cases involving Korea	Degree to which U.S. objective achieved	Quantitative Score
Insurance (1979-80)	Nominally successful	1
Footwear (1982-85)	Partially successful	2
Insurance (1985-86)	Partially successful	2
Intellectual property (1985-86)	Nominally successful	1
Cigarettes (1988)	Partially successful	2

Beef (1988-90)	Partially successful	2
Wine (1988-89)	Partially successful	2
Agricultural market access restrictions (1994-1995)*	Partially successful	2
Automobile (1997)*	Partially successful	2
Average result	Nominally successful	1.78

Cases involving Taiwan	Degree to which U.S. objective achieved	Quantitative Score
Home appliances (1976-77)	Largely successful	3
Rice (1983-84)	Partially successful	2
Motion picture films (1983-84)	Partially successful	2
Customs evaluation (1986)	Partially successful	2
Beer, wine, tobacco (1986)	Partially successful	2
Intellectual property (1992)	Partially successful	1
Average result	Partially successful	2

Cases involving India	Degree to which U.S. objective achieved	Quantitative Score
Almonds (1987-88)	Partially successful	2
Investment (1989-90)	Not at all successful	0
Insurance (1989-90)	Not at all successful	0
Intellectual property (1991-92)	Not at all successful	0
Pharmaceuticals (1996-98)*	Nominally successful	1
Average result	Not at all successful	0.6

Note: Unless indicated by an asterisk, degree to which U.S. negotiating objectives achieved is based on Bayard and Elliott (1994) and Elliott and Richardson (1997).³

If we look closely at the effectiveness of American coercive diplomacy in cases involving Japan and China, the contrast in negotiation outcomes is obvious. American pressure on Japan was largely successful 5 out of 14 times, resulted in partial success in another 5 cases, and was only nominally successful in the remaining 4 cases. In contrast,

³ Since Bayard and Elliott's data only covers cases resolved as of 1992 and Elliott and Richardson only dealt with cases resolved as of 1995, evaluations of the cases completed after 1995 are made using similar criteria.

American pressure produced only nominal success in both of the section 301 cases against China.⁴

Indeed, China proves to be one of the least responsive American trading partners, second only to India. In recent years, American negotiators have repeatedly found themselves defeated in efforts to force the Chinese to reduce tariffs and other trade barriers, improve the transparency of their trade regime, police intellectual property protection, and strictly adhere to quota restrictions on textile trade. As the detailed case studies in Chapter 4 and Chapter 6 suggest, the United States was able to extract very few meaningful concessions from China in these sets of negotiations and had to several times re-invoke threats of trade retaliation in order to get the Chinese to move closer to American demands. The re-emergence of these issues in bilateral trade negotiations itself suggests the ineffectiveness of American pressure.

The ineffectiveness of U.S. pressure in changing Chinese policies stands in sharp contrast to the results of U.S.-Japan negotiations. In comparison with the China cases, U.S. pressure against Japan has proved to be remarkably successful. The claim that Japan is the trading partner most responsive to American pressure is perhaps hard to believe given the enduring complaints about Japanese trade barriers emanating from industry officials and their representatives on Capitol Hill. In particular, critics are apt to question

⁴ We can also evaluate the two cases discussed below involving China not covered by Section 301 negotiations, MFN and textiles, according to the criteria specified by Bayard and Elliot. The MFN case can be considered a failure since U.S. policy of threatening to revoke China's MFN status produced virtually no tangible changes in Chinese policies in the areas of trade, human rights, and weapons proliferation. The textile case can be classified as a partial success since even though a bilateral textile agreement was reached, the Chinese side frequently evaded the quota restrictions by transshipping textile

the extent to which Japanese concessions have produced genuine market-opening outcomes.⁵ But as Bayard and Elliott's study points out, the United States has derived significant economic gains from the concessions Japan made during Section 301 negotiations. For example, under threats of Section 301 retaliation, the United States was able to increase its exports of cigarettes to Japan from less than \$50 million to more than \$1 billion by 1990. U.S. exports of beef to Japan increased by \$750 million, from \$350 million to \$1,100 million between 1987 and 1990. Similarly, the semiconductor agreement allowed U.S. producers to increase their exports to Japan by \$1 billion a year. The beef, tobacco and semiconductor cases together accounted for more than three-fourths of the total gains the United States derived from the use of Section 301.⁶ While market barriers remained in Japan, the level of trade barriers would have been a lot higher in the absence of American pressure.

The high-profile semiconductor trade conflict between the United States and Japan provides an example of the effectiveness of American pressure in opening the Japanese market. In this case, described in more detail in Chapter 5, sustained American pressure, backed by the threat and actual implementation of trade retaliation, played a crucial role in helping American manufacturers gain enhanced market access in Japan and in preventing Japanese firms from dumping in the U.S. market. As a result of Japanese concessions, American producers were able to increase their shares of the Japanese market, capturing

exports through third countries. If we add these two cases, China's level of responsiveness to American pressure remains the same as that evaluated by Bayard and Elliott.

⁵ For example, interview with a former government official involved in negotiations with both China and Japan offers a rather different view of U.S. negotiation outcomes. According to the interviewee, the United States has been able to get the Chinese to alter their policies to a greater extent than the Japanese.

\$1 billion in additional sales between 1987 and 1990.⁷ While U.S. firms might have hoped to achieve even more through trade negotiations, U.S. coercive diplomacy clearly helped to resuscitate a critical industry on the edge of extinction.

American pressure also turned out to be highly successful in the two super 301 cases over supercomputers and satellites that will be examined in more detail in Chapter 5. In these cases, 301 threats of retaliation led to the conclusion of bilateral agreements that helped to address industry complaint about Japanese “targeting” of high-technology industries and opened Japanese government procurement to foreign bidders.

To be sure, the fact that the United States was more successful in negotiations with Japan than in negotiations with China does not mean that U.S. pressure has been uniformly successful in extracting concessions from the Japanese. In fact, a fair amount of variations existed in the degree to which Japan has yielded to U.S. demands. While the United States largely achieved its negotiation objectives in a number of section 301 cases involving such products as thrown silk, cigarettes, citrus, and satellites, it has had considerably less success in extracting Japanese concessions in other areas.

For example, in U.S.-Japan negotiations over satellites in 1989-1990, for example, the United States largely achieved its negotiating objectives. Under strong U.S. pressure to open up Japan’s public procurement of satellites, the Japanese government eventually acceded to virtually all American demands, committing itself and entities under its control

⁶ Bayard and Elliott, *Reciprocity and Retaliation in U.S. Trade Policy*, 68.

⁷ Laura D’Andrea Tyson, *Who’s Bashing Whom? Trade Conflict in High-Technology Industries*, Washington, D.C.: Institute for International Economics, 1992, 106-113. Fred Bergsten and Marcus Noland, *Reconcilable Differences? United States-Japan Economic Conflict*, Washington, D.C.: Institute for International Economics, 1993, 127-140.

to “procure non-R&D satellites on an open, transparent and nondiscriminatory basis, and in accordance with the GATT Procurement Code.”⁸ Not only did Japanese observers consider the agreement “a complete acceptance of American demands” in all respects, U.S. trade officials also regarded it as a significant setback for Japanese commercial satellite development.⁹

But if the United States has largely achieved its negotiating objective of opening Japanese government procurement to foreign bidders in the satellite case, it has had considerably less success extracting Japanese concessions in other areas. American efforts to open up Japan’s public sector construction market in 1988-91, for example, only partly succeeded in improving access for U.S. firms. U.S. retaliatory threats to bar Japanese firms from bidding for U.S. public contracts led the Japanese government to commit itself to a more open and competitive bidding system and to establish more objective and transparent standards for bidding and contracting procedures. But although the list of projects open to U.S. bidding was increased, it was not implemented as the United States would have wanted. Actual U.S. export gains also appeared to be rather limited. Furthermore, U.S. firms seemed to have difficulty bidding on projects not on the list. Even though the subsequent agreement addressed additional U.S. concerns, there was much more the U.S. hoped to achieve through the negotiations. The outcome in this case therefore appears to represent only partial fulfillment of U.S. objectives.¹⁰

⁸ Bayard and Elliott, 1994, 118.

⁹ Ibid.

¹⁰ Ibid., 445-448.

Moreover, there were also areas in which the United States failed to induce Japanese commitments to specific American objectives. For instance, in the years between 1993 and 1995, the Clinton administration stepped up the pressure on the Japanese government to increase the use of U.S.-made auto parts in Japanese cars and to enhance access to dealership networks by foreign car-makers. Under U.S. threats to impose prohibitive tariffs on \$5.9 billion on imports of Japanese luxury cars, Japan eventually entered into an agreement with the U.S. in 1995. The 1995 auto accord, however, contained only very vague language on the expected direction and scope of change. The “results” specified in the accord was mostly based on “voluntary plans” announced by the Japanese automakers. Without any explicit criteria, the United States had found it very difficult to monitor Japan’s enforcement of the deal in any meaningful way.¹¹ In this case the Clinton administration was unable to achieve its core objectives through coercive diplomacy.

The above brief survey of the record of U.S. trade negotiations with Japan is intended to show that even though U.S. pressure on Japan is highly effective overall, there are also cases in which U.S. pressure only marginally succeeded in affecting Japanese behavior. What is most important for the purposes of the present study, however, is that when compared with America’s other trading partners, Japan still shows up as the country most responsive to American demands.

In view of the wide variations in U.S. threat effectiveness described above, one may want to ask to what an extent these variations could have been explained by the

differences in the contexts of U.S.-Japan and U.S.-China trade negotiations. For example, it may be argued that the United States was able to achieve greater success in negotiations with the Japanese because the U.S. trade relationship with Japan is both more developed and sector-specific than U.S. trade relations with China. It may also be argued that the variations in threat effectiveness described above may be better understood in terms of states' power balances, a variable emphasized by the realist theory.

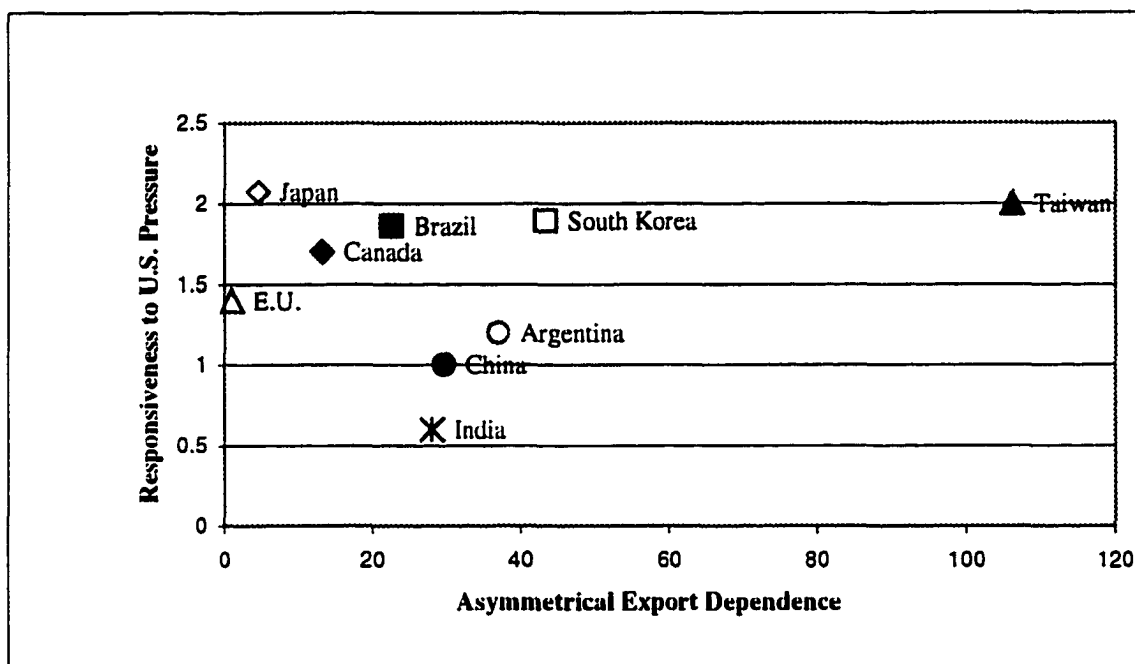
But, as the following table suggests, not entirely in line with realists' predictions, many nations' level of responsiveness to American pressure differs from what one would predict based on their level of asymmetrical export dependence on the United States. Here I measure asymmetrical trade dependence by comparing the percentage of a target country's exports to the United States in the target's GDP to the percentage of U.S. exports to the target country in U.S. GDP.¹² Using this procedure, I calculate the level of asymmetrical trade dependence for the countries listed below in each of the years between 1975 and 1995 and arrive at an average for each country. I then construct a responsiveness index based on the average results reported in Table 3.1. The results, plotted in Figure 3.1, reveal that countries that are least responsive to American pressure (such as China and India) have a lower level of asymmetrical export dependence on the United States than several of America's other trading partners. Japan, the trading partner most responsive to American pressure, actually has one of the lowest asymmetrical export

¹¹ Schoppa, *Bargaining with Japan*, 267-270.

¹² Export figures are obtained from the IMF *Direction of Trade Statistics Yearbook* and U.S. *Foreign Trade Highlights* published by the International Trade Administration, various years. GDP figures, which are in nominal dollars, are based on the World Bank's *World Tables*.

dependence levels on the American export market. The European Community, while its responsiveness index is comparable to those of Canada and Argentina, does not rely on the U.S. export market as much as these two trading partners. Therefore, it seems that

Figure 3.1: Asymmetrical Export Dependence and Responsiveness to U.S. Pressure

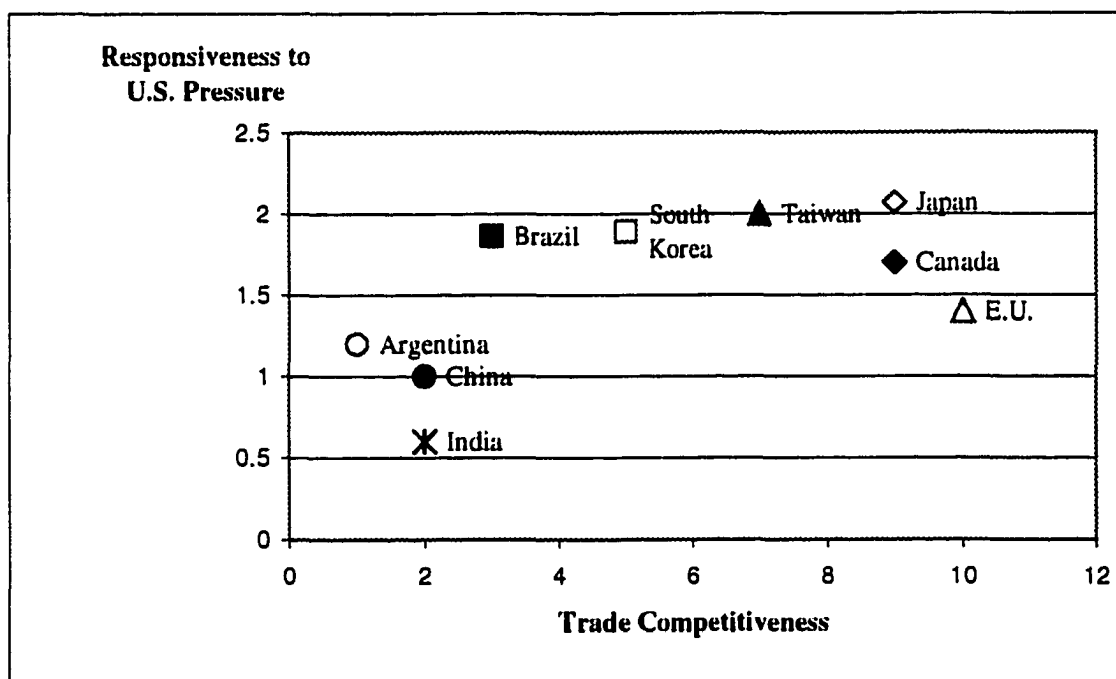


states' power balances do not fully explain these patterns. It is necessary for us to look at factors other than raw material power and to unpack the blackbox of domestic politics in order to account for these paradoxical outcomes.

If variables emphasized by realism cannot adequately explain the pattern of U.S. threat effectiveness, how well does the alternative variable emphasized by this study explain this pattern? Figure 3.2 presents the relationship between trade structure and the degree of responsiveness of several major U.S. trading partners. As we can see, there is a

generally positive relationship between trade structure and threat effectiveness: countries having more competitive trade relations with the United States (such as Japan, Canada,

Figure 3.2: Structure of Trade and Responsiveness to U.S. Pressure



Note: See Table 3.2 for the responsiveness index. Trade competitiveness index is constructed using data in Table 2.1 with larger numbers indicating a higher level of trade competitiveness.

South Korea, and Taiwan) also are the ones that have yielded more frequently to American pressure. In contrast, countries having a primarily complementary trade structure with the United States (countries such as China and India) are significantly less responsive to America's sanction threats.

To better assess the relationship between trade structure and threat effectiveness, I estimate a model of the level of success the United States achieved in using Section 301 to open overseas markets. The estimation sample is based primarily on Bayard and Elliott's (hereafter B & E) comprehensive evaluation of seventy-two Section 301 cases concluded

by 1994.¹³ But it also takes into account six cases from Elliott and Richardson's (hereafter E & R) updated and expanded sample of Section 301 cases settled by 1995.¹⁴ After dropping cases with missing data, the resulting sample consists of a total of seventy-two Section 301 cases. To test the influence of trade competitiveness on Section 301 success, I essentially replicate B & E and E & R's earlier analyses by including all of the variables in their earlier analyses and adopting the same statistical methods they employed. I then run the same model adding my trade competitiveness/complementary variable.

The dependent variable SUCCESS, based on the degree to which the United States was able to achieve its negotiation objectives in each individual case, is a dichotomous variable. It equals 0 if American negotiators were "not at all successful" or "nominally successful" in pursuing their negotiation objectives in a given case; 1 if the United States partially or largely fulfilled its negotiating objectives. Both B & E and E & R used the same coding scheme, although the latter did assess the influence of various explanatory variables on an ordinal-scale measure of the target's responsiveness to U.S.

¹³ In Bayard and Elliott's original study, 19 cases were excluded from the total of 91 investigations initiated between 1975 and June 1994 for various reasons. For a list of these cases, see Bayard and Elliott, 1994, p.59.

¹⁴ Kimberly Ann Elliott and J. David Richardson, "Determinants and Effectiveness of 'Aggressively Unilateral' U.S. Trade Actions," in Robert C. Feenstra, ed., *The Effects of U.S. Trade Protection and Promotion Policies*, Chicago: University of Chicago Press, 1997, 221-25. Of the fifteen observations included in Elliott and Richardson's updated database, I exclude all of the eight cases from the so-called "p-list" of Section 301 petitions filed but not formally investigated by the USTR and a case involving Taiwanese footwear (case no. 301-38) for which no clear evaluation of U.S. negotiation success is available. The six cases I take from Elliott and Richardson's modified sample include: E.C. meatpacking (301-83), Chinese market access (301-88), Taiwanese intellectual property protection (301-89), Brazilian intellectual property protection (301-91), Japanese auto parts (301-93), Canadian country music cable TV (301-98).

pressure, in addition to the dichotomous measure of success.¹⁵ My statistical tests using the ordinal measure success variable yielded very similar results to those described below and hence are not reported here.

To better evaluate the effect of trade structure on the odds of section 301 success, I first estimate a model (Model 1) which incorporates all of the variables, measured in exactly the same ways, as those used by Bayard and Elliott in their 1994 study.

Explanatory variables for Model 1 include the following:

TBAL. The trade balance between the United States and the target country (TBAL) is included because it is expected that larger U.S. trade deficits would produce greater protectionist pressure toward the target, increasing the chances of a successful outcome. Elliott and Richardson regard the bilateral trade balance as a crude measure of reciprocity in international trade negotiations: the United States is both more likely to carry out the threat and to obtain a favorable outcome with countries running trade surpluses with the United States. In both B & E and E & R's studies, this variable proved to be a rather consistent predictor of the degree of success. Data for the size of the U.S. bilateral trade balance are drawn from *U.S. Foreign Trade Highlights* and *IMF Direction of Trade Statistics Yearbook*.

TXDEP. To test the realist argument that power resources in one's favor would enhance one's bargaining leverage and chances for successful outcomes, the degree of the target's export dependence on the American market (TXDEP) is included in the analysis.

¹⁵ In E&R's analysis, the dichotomous measure of success (OPENING) takes on a value of 1 if the ordinal-scale measure (SUCCESS) equals 2 or 3. OPENING equals 0 if SUCCESS is 0 or 1.

It is expected that 301 threats can be more effective in shifting the target country's policy away from the status quo the more heavily dependent the targeted country is on the American export market.¹⁶ TXDEP is measured by the percentage of the target's exports to the United States in the target's GDP during the year(s) of the dispute.

RULING. The variable RULING makes a distinction between those cases in which a GATT panel issued a ruling against the target country (in which case RULING is set to equal 1) and those in which the GATT did not issue such a ruling during the dispute settlement process (in which case RULING equals 0). It is expected that a negative GATT panel ruling can increase the chance for a successful outcome by raising the costs to the target government of defying international rules.¹⁷ Again, the coding of this variable is based on the summary table of section 301 cases provided by B & E.

BORDER. Previous studies on the effectiveness of Section 301 in opening markets overseas have found that the type of trade barriers involved in the dispute has an important bearing on the ability of the United States to achieve its negotiation objectives. Compared to such trade barriers as subsidies, "domestic" regulatory access barriers, services trade, or intellectual property protection, unfair border barriers to U.S. exports (such as import and export quotas and tariffs) are considered to have a better chance of

¹⁶ Many studies consider the U.S. ability to harm the target country an important component of bargaining power and a significant determinant of 301 success rates. See, for example, John McMillan, "Strategic Bargaining and Section 301," in Jagdish Bhagwati and Hugh T. Patrick, eds., *Aggressive Unilateralism: America's 301 Trade Policy and the World Trading System*, Ann Arbor: The University of Michigan Press, 1990, 207; Marcus Noland, "Chasing Phantoms: The Political Economy of USTR," *International Organization* 51: 3 (Summer 1997), 381-382.

¹⁷ A GATT panel ruling of noncompliance can shore up U.S. credibility by enhancing the perceived legitimacy of American threat. According to Ryan, trade officials in East Asia often regarded GATT as

success because of their transparency, ease of definition and measurement, and greater likelihood of being GATT-illegal.¹⁸ Thus, following the lead of earlier studies, a dummy variable BORDER is included to control for the effect of different types of trade barriers on the success of U.S. negotiation strategy. This variable is coded as 1 if the case involves traditional border barriers that impede merchandise access and 0 if otherwise.

COUNTER. Bayard and Elliott have found some evidence that American negotiators' perceptions of U.S. vulnerability to counterretaliation, shaped in part by whether the target has responded to U.S. aggressive negotiation tactics in the past with similar moves, plays an important role in determining outcomes. The variable COUNTER is thus included to capture the effect of U.S. concerns about possible counter-retaliation. COUNTER is set to equal 1 if the target has retaliated against the United States in a past trade dispute (whether under Section 301 or not); otherwise it is 0. Of all the countries targeted under Section 301, only three -- the European Union (in various disputes between 1982 and 1991), Canada (1986, 1991 and 1993), and China (in the textile dispute in 1983) -- have ever counterretaliated against the U.S. in past disputes. Bayard and Elliott coded all disputes with countries with a record of counterretaliation as 1. However, since it seems reasonable that the United States would only be concerned about counterretaliation from a specific trading partner after it took place, I only coded those disputes that occurred after the counterretaliation episode as 1. It turns out that this

the key because "it may determine win or lose for the U.S. If U.S. has a strong GATT case, the case will go differently. The U.S. can use GATT as a very effective tool." See Ryan 1995, 43.

¹⁸ Bayard and Elliott 1994, p. 85; Elliott and Richardson 1997, 228-29.

modification to Bayard and Elliott's original coding method did not affect the interpretation of the relationship between COUNTER and SUCCESS.

TPAP. Finally, following the lead of B & E & R, I include a time-related dummy variable, TPAP, in Model 1 to see if the adoption of more aggressive negotiation tactics by the USTR since the mid-1980s, especially after the announcement of President Reagan's Trade Policy Action Plan (TPAP) in 1985, played any role in increasing the effectiveness of U.S. negotiation strategy. TPAP equals 1 if a case was settled before September 1985 and 0 otherwise.

All of the above variables are adopted by Bayard and Elliott in their model estimates. Estimates for Model 1 are shown in Table 3.4. To see how trade structure, a key variable distinguishing this research from earlier studies of the effectiveness of aggressively unilateral U.S. trade action under section 301, would affect model estimates, I run a second model (Model 2) adding the degree of trade competitiveness (COMPET) between the United States and its trading partners to Model 1. By adding COMPET to B&E and E&R's analysis, I am testing the influence of trade structure on threat credibility. The causal logic developed in the previous chapter would lead us to expect a positive relationship between the degree of trade competitiveness and the dependent variable. The trade competitiveness index for each case is calculated using the procedure described in Chapter 2.¹⁹ Because it is possible for a country having a highly competitive trade

¹⁹ It is also possible to measure trade competitiveness by looking at the number of overlaps between the top 20 sectors in which the U.S. produces goods and services and the top 20 products the U.S. imports from a particular country in a given year. This procedure is not followed here because of the incomplete coverage of the industrial production data and the difficulties of converting industrial production data into trade data.

relationship with the U.S. in a given year to nevertheless have a relatively small absolute number of overlaps, the raw data for each dyad year is adjusted in relation to that of the country with the most overlaps in that particular year.²⁰ This procedure ought to provide a more objective basis for comparing trade competitive indices across dyad years.

Based on these results, I estimate a third model (Model 3) which takes into consideration a couple of other control variables that Elliott and Richardson examined in their study that could potentially affect the probability of section 301 success, in addition to the above. These control variables are:

INITIATE. The ability of U.S. negotiators to make a threat public has been hypothesized to be another factor that could potentially increase threat credibility. Issuing a public threat may enhance the effectiveness of U.S. negotiation tactics by signaling to the target country that the issue was high on the U.S. negotiation agenda and that “the administration meant business.” By tying the issue to the credibility of American negotiators in future negotiations, it raises the costs to the United States of backing down in the dispute and increases the chances that the United States will make good on its threat should the target fail to concede to U.S. demands.²¹ Thus, with regard to Section 301 investigations, it is hypothesized that USTR initiation of a case will have a positive effect on threat credibility and the successful pursuit of U.S. negotiation objectives. To test this

²⁰ Specifically, the country with the most competitive relationship with the U.S. in a given year is assigned a number of 10. The competitiveness index for other U.S. trading partners in that year is adjusted accordingly.

²¹ Bayard and Elliott 1994, 84.

hypothesis, I include a dummy variable **INITIATE** that takes on a value of 1 if the USTR self-initiates a case and 0 otherwise.

BULLY. This variable measures the number of cases initiated against a particular target country as a percentage of all Section 301 cases started over a three-year period. A negative association is expected between this variable and the likelihood of success due to the phenomenon of diminishing returns. E & R in their study produced only limited support for this variable.

One variable that may be an important control to the above test but has nevertheless been left out is the nature of the political-military relationship between the United States and the target. It may well be that American demands will encounter far less resistance from countries with some kind of alliance relationship with the United States because of their reluctance to jeopardize the security relationship with the U.S. Unfortunately, while adding a variable measuring the target's security relationship with the U.S. is worthwhile, it does not seem to be feasible in the context of Section 301 investigations in that with the exception of a few cases involving China and India, the vast majority of Section 301 investigations involved alliance partners of the United States. Because of the lack of variation in the alliance patterns between the United States and the targets, I did not include this variable as a control.

Table 3.2 and Table 3.3 provide a concise description of the dependent and explanatory variables and their frequency distributions.

Table 3.2: Variable Descriptions

	Name	Description
Dependent Variable	SUCCESS	Ordinal measure of the degree to which the United States successfully achieved its negotiation objectives: 0 = not successful at all; 1 = nominal success; 2 = partially successful; 3 = largely successful
Explanatory Variables	COMPET	Ordinal measure of the degree of trade competitiveness between the U.S. and the target country in a particular dyad-year. Ranges between 0 and 10.
	TBAL	Trade balance between the United States and a given trading partner.
	TXDEP	The percentage of the target's exports to the U.S. in the target's GDP. Averaged over the years in which the dispute was active.
	COUNTER	1 if the target has retaliated against the U.S. in past trade disputes; 0 otherwise.
	RULING	1 if a GATT panel issued a ruling against the target; 0 otherwise.
	BORDER	1 if the dispute involved a border barrier to merchandise trade (such as import and export quotas and tariffs); 0 otherwise.
	TPAP	1 if a case is settled before September 1985; 0 otherwise.
	INITIATE	1 if the case is initiated by the USTR; 0 otherwise.
	BULLY	Number of cases initiated against a given target country as a percentage of all investigations started during the current year and two preceding years. The number of cases in 1973 and 1974 is set to equal 0.

Table 3.3: Descriptive Statistics of the Estimation Sample

Variable	Obs.	Mean	Standard Deviation	Min	Max
SUCCESS	72	1.5	.8721	0	3
COMPET	72	6.3247	2.9156	0	10
TBAL	72	-9141.377	16673.231	-65942.5	10822
TXDEP	72	6.853e-02	8.313e-02	.003	.36
COUNTER	72	.3611	.4837	0	1
RULING	72	.1528	.3623	0	1
BORDER	72	.3056	.4639	0	1
TPAP	72	.3333	.4747	0	1
INITIATE	72	.7919	.4090	0	1
BULLY	72	.2393	.1772	.05	.7

To understand the pattern of section 301 success, I use the same statistical method adopted by B & E & R -- the probit approach -- to assess the influence of the

aforementioned variables on Section 301 negotiation outcome (SUCCESS). The probit method is appropriate for estimating a dichotomous variable such as success/failure. The estimates for the above models, reported in Table 3.4, lend strong support to the hypothesis about the relationship between trade competitiveness and the degree of section 301 success. In both Model 2 and Model 3, the variable measuring the degree of trade competitiveness, COMPET, holds up quite well. Regardless of the mix of variables included in the analysis, the relationship between COMPET and SUCCESS is consistently positive and significant, reaching a significance level of 95 percent in both models. This result seems to be quite robust considering the relatively large number of control variables included in the analysis.

Table 3.4: Probit Estimates For the Success of Section 301 Investigations (Model 1-3)

Explanatory Variable	Model 1			Model 2			Model 3		
	Coeff.	S.E.	t-statistic	Coeff.	S.E.	t-statistic	Coeff.	S.E.	t-statistic
TBAL	-5.81e-06	.00001	-.510	.00003	.00002	1.549	.00003	.00002	1.644
TXDEP	7.443	3.087	2.411**	8.82	3.279	2.689*	7.782	3.421	2.275**
COUNTER	.099	.412	.240	-.879	.577	-1.524	-.817	.581	-1.407
RULING	-.992	.583	-1.703***	-1.335	.637	-2.096**	-1.349	.663	-2.034**
BORDER	2.033	.563	3.611*	2.278	.607	3.751*	2.234	.612	3.712*
TPAP	-1.511	.525	-2.876*	-2.342	.689	-3.397*	-2.203	.714	-3.085*
COMPET	_____	_____	_____	.283	.119	2.382**	.314	.128	2.453**
INITIATE	_____	_____	_____	_____	_____	_____	.091	.509	.177
BULLY	_____	_____	_____	_____	_____	_____	-1.183	1.714	-0.691
Log likelihood	-32.32			-29.087			-28.84		
N	72			72			72		

Note: * indicates significance at the 99 percent level; ** indicates significance at the 95 percent level; *** indicates significance at the 90 percent level.

The type of trade barriers under consideration (BORDER) and the time-related variable (TPAP) also perform quite well in these tests. Consistent with the findings of both Bayard and Elliott and Elliott and Richardson, traditional, transparent border barriers enhance the ability of U.S. negotiators to liberalize foreign markets through section 301 negotiations. The coefficient for this variable is significant at the 99 percent level as well. Also corroborating previous study results is the finding that legislative and executive changes in the mid-1980s (TPAP) have contributed to the significantly higher success rates of section 301 investigations in the late 1980s and early 1990s. The Trade Policy Action Plan, by signaling U.S. negotiators' increasingly tough posture towards trade issues, has increased the odds of obtaining a successful outcome.

The results also provide some support for the variable representing the degree of the target's vulnerability to U.S. retaliation (TXDEP). The United States did wring more concessions from its relatively weak trading partners.

The variable emphasized by liberal institutionalism, the presence of a negative GATT ruling against the target, while statistically significant in each of the three models, has the opposite sign than we had expected. A GATT panel finding of impairment and nullification actually decreased, rather than increased, the probability of obtaining a successful negotiation outcome.

Statistical tests fail to establish the importance of a number of variables that are presumably important to understanding the pattern of section 301 outcomes. U.S. concerns about possible counterretaliation (COUNTER) proved to have no effect on the effectiveness of U.S. threats in section 301 cases in any way. The relationship between

COUNTER and SUCCESS is not statistically significant in any of the models. In addition, the trade balance between the United States and the target (TBAL), a rough measure of reciprocity in trade relations, did not reach statistical significance in either of the models either.²²

The addition of the trade competitiveness variable in Model 2 and the two control variables in Model 3 did not affect the sign and significance of the variables in Model 1. These additional tests lend strong support to the hypothesis about the relationship between trade competitiveness and the degree of section 301 success. In both models, the variable measuring the degree of trade competitiveness, COMPET, exhibits a positive and statistically significant relationship with SUCCESS.

Finally, the two control variables, INITIATE and BULLY, did not appear to add any leverage. Public announcement of U.S. negotiation resolve, represented by US Trade Representative's initiation of Section 301 investigations, did not have the expected credibility-enhancing effect. Nor did the variable representing the intensity of U.S. investigation activities against a specific target country (BULLY) play any role in explaining section 301 success. Although, similar to Elliott and Richardson' findings, a period of concentrated activities against a particular country results in decreased, rather than improved, credibility for American negotiators, this variable did not reach statistical significance in Model 3.

²² Bayard and Elliott did find a positive and statistically significant relationship between TBAL and SUCCESS. This discrepancy in test results may be due to different sample composition.

I also experimented with a few alternative specifications of the above models, including using the ordered probit approach to assess the probability of success with the ordinal-scale measure of success. These tests yielded fairly similar results to those described above. Regardless of the variables added or dropped, the degree of trade competitiveness, the nature of the trade barrier, the degree of the target's trade dependence on the United States, and the adoption of the trade policy action plan have generally retained their sign and significance.

In conclusion, after taking into account other potentially confounding factors, trade competitiveness still has a statistically significant effect on the degree of threat effectiveness. The evidence from my statistical analysis provides overwhelming support to my argument.

Democracy and Trade War

The second empirical puzzle that is of particular interest to this study is why trade wars have broken out so frequently between democracies. The growing literature on "democratic peace" provides substantial evidence that democracies are indeed less war prone in their security relations.²³ The connection between regime type and the likelihood of trade wars, however, has been understudied. To see whether democracies are indeed more war prone in their trade relations and the extent to which the key variable

²³ Zeev Maoz and Nazrin Abdolali, "Regime Type and International Conflict, 1816-1976" *Journal of conflict Resolution* 33 (March 1989), 3-36; William Dixon, "Democracy and the Peaceful Settlement of International Conflict," *American Political Science Review* 88 (March 1994), 14-32; Jack Levy, *Domestic Politics and War*, *Journal of Interdisciplinary History* 18 (Spring 1988); Stuart Bremer, "Dangerous

emphasized by this study, the structure of trade, can help us predict the outcome of international trade conflicts, I examine the record of bilateral trade disputes between the United States and its top 25 trading partners between 1980 and 1995. The subsequent study will first present a brief summary of those trade disputes initiated by the United States (mostly GATT/WTO and section 301 cases) that have escalated into tit-for-tat trade wars or into unilateral retaliation. It will then provide a regression analysis of the effects of trade structure, regime type, and a number of other factors on the probability of trade war and of aggressive escalation resulting in the imposition of trade sanctions by the United States. Furthermore, the regression confirms that trade wars *are* more likely among nations with competitive trade relations. Both the summary of recent trade conflicts and the regression analysis yield evidence supporting the contention that there is no “democratic peace” when it comes to trade. The United States has more frequently been engaged in both trade wars and in unilateral retaliation against countries with whom it has competitive trade relations, even after controlling for variables that could potentially influence the chances for trade retaliation. This result lends further support to my argument that competitive trade relations can increase the risks of aggressive escalation in trade disputes.

Dyads: Conditions Affecting the Likelihood of Interstate War, 1816-1965”, *Journal of Conflict Resolution* 26 (June 1992), 309-41.

Trade Wars: the Cases

In Chapter 1, I defined trade war as a sustained, high-intensity trade conflict involving at least one round of mutual retaliation. If we apply these criteria to examine the record of trade conflicts involving the United States (mostly those waged under the framework of GATT/WTO and section 301 of U.S. trade law), we will see that the frequent use of aggressive tactics in international trade disputes did not spark a large number of trade wars. Where trade wars did occur, however, they have been fought almost exclusively between the United States and its democratic trading partners (see Table 3.5). Unfortunately, due to the lack of data on the composition of U.S. imports and exports from each trading partner for years prior to 1980, I had to limit the scope of this research to cases that took place after 1980. I also had to restrict my data set to pairs involving the United States because of the difficulty of compiling an exhaustive list of trade wars that covers all available country dyads. Despite these limitations, the evidence presented below ought to provide a useful first cut at the relationship between trade structure and the probability of trade war.

The history of trade wars between the United States and the European Community can be traced back to the Chicken War in the 1960s and the Turkey War in the 1970s, both of which occurred as a response to E.C.'s scheme for protecting its agricultural sector, the Common Agricultural Policy (CAP). In the 1980s, the increasingly heavy protection that CAP afforded to European farmers again engendered several heated agricultural trade confrontations between the two sides of the Atlantic, including the dispute over E.C. agricultural export subsidies in third markets, E.C. tariff preferences in

Table 3.5: Trade Wars Involving the United States, 1980-1995.

Target Country	Duration	Issue	Amount of Trade Retaliation
EC (301-6)	1982-1985	<i>Agricultural subsidies in third markets:</i> In 1983 the Reagan administration announced a \$250 million subsidy to farm exports (mostly to Egypt) in response to EC subsidies on agricultural products. The EC replied by announcing a subsidized wheat sale to China in 1983. In 1985 the U.S. announced another subsidized wheat sale to Algeria and allocated \$2 billion through the Export Enhancement Program (EEP) to subsidize agricultural exports.	The subsidy war cost the United States over \$2 billion in additional outlays.
China	1983	<i>Textiles:</i> In 1983 the United States failed to negotiate a new bilateral textile agreement with more stringent quota restrictions on Chinese textile exports and, as a result, imposed a new unilateral agreement with a substantial increase in the number of product categories subject to quantitative restrictions. China retaliated by suspending agricultural imports from the U.S.	Chinese retaliation resulted in \$600 million in loss for U.S. farmers.
EC	1983-1984	<i>Specialty steel:</i> To prevent European producers from dumping in the U.S. market, the U.S. in 1983 imposed quotas and higher tariffs on the import of specialty steel. The EC demanded compensation and, when no agreement could be reached on the appropriate level of compensation, retaliated against U.S. exports of chemicals, plastics, and selected other products.	EC's total share of the U.S. steel market decreased from 6.31% to 4.64% as a result of the U.S. quota restrictions. E.C. retaliation against U.S. quotas was worth \$160 million annually.
EC (301-11)	1985-86	<i>Tariff preferences on citrus, export subsidies for pasta:</i> In 1985, in retaliation for EC tariff preferences in favor of Mediterranean citrus fruits, the U.S. imposed penalty duties of 25 to 40 percent on EC pasta, prompting EC counterretaliation against U.S. lemons and walnuts. Both sides withdrew their penalty tariffs in 1986.	The U.S. retaliation led to a 28 percent decrease in EEC pasta exports, worth about \$36 million. U.S. exports of nuts in shells and lemons to the E.C., which averaged about \$33 million a year, plunged by 85 percent in the first five months of E.C. retaliation.
EC (301-54)	1986-1991	<i>Accession of Spain and Portugal:</i> The EC placed new restrictions against third country agricultural imports (particularly feedgrains) when Spain and Portugal acceded to the EC in 1986. The US imposed retaliatory QRs on EC agricultural	The quotas the United States imposed in May 1986 on E.C. imports in response to the EC's quantitative restrictions on oilseeds and grains in Portugal amounted to \$500 million a

		exports in retaliation for the Portuguese quotas on U.S. soybeans and soybean oil. The U.S. also imposed a 200 percent ad valorem tariff on E.C. agricultural products in response to import levies on Spanish imports. The E.C. promptly retaliated against the U.S. sanctions with similar tariffs and QRs.	year.
Canada	1986	<i>Timber products:</i> In 1986 the Reagan administration ruled that Canada was subsidizing its lumber producers and imposed tariffs on imported Canadian softwoods. Canada retaliated by imposing a 70 percent countervailing duty on corn imported from the United States.	The 15 percent export tax Canada eventually agreed to levy on softwood lumber exports to the U.S. translated into \$450 million in lost sales a year.
EC (301-62)	1989	<i>Beef hormone:</i> In 1989 the EC announced a ban on imports of meat treated with growth hormones. The United States retaliated against the ban by blocking \$100 million EC exports to the U.S. The EC counter-retaliated against \$100 million worth of U.S. exports.	U.S. retaliation and E.C. counterretaliation each affected \$100 million worth of imports from the other side.
Canada	1991-1992	<i>Softwood lumber exports:</i> In 1991 Canada suspended the Canada-U.S. softwood lumber agreement. The U.S. imposed a bonding requirement on Canadian lumber exports to the U.S.	The ITA imposed a 11.54 percent countervailing duty on softwood lumber imports from Canada.
Canada	1992	<i>Provincial restrictions on beer sales:</i> In response to Canadian restrictions on beer imports from the U.S., the U.S. imposed a 50 percent duty on beer imported from Ontario in 1992. Canada retaliated by imposing a 50 percent duty on U.S. beer exported to Ontario.	The U.S. retaliation affected \$80 million in Canadian imports.
Canada	1993	<i>Steel:</i> In 1993 the U.S. imposed duties on a variety of Canadian steel products. Canada fired back by placing provisional duties on some steel exports from the U.S.	U.S. duties on Canadian steel products were as high as 68.7 percent, whereas Canadian duties on U.S. steel exports ranged between 4.5 per cent and 124.2 per cent.

Source: Compiled from Hudec 1993; Section 301 case summaries, in Bayard and Elliott, 1994; and various newspaper articles.

favor of Mediterranean citrus fruits, and E.C. enlargement which imposed new restrictions against third country agricultural imports. All of these disputes resulted in the mutual imposition of trade sanctions and are discussed in greater detail in Chapter 7.

In addition to agricultural trade wars, trade battles also took place in the steel industry between the United States and the European Community. The American steel industry, which had been in serious decline, started to focus on the competitive threats that Japan and the European Community posed in the domestic U.S. market in the late 1970s. In December 1981, American steel producers filed dumping charges against specialty steel imports from France, West Germany, Italy, Britain, Brazil, Austria, Sweden, and Spain. In June 1983 the United States announced that it would place quotas and higher tariffs on the import of specialty steel. The EEC initially refused to bargain for the market share quota, and later filed a claim with GATT for compensation. When negotiations between the two sides broke down, the EEC retaliated in 1984 and imposed quotas and tariffs against U.S. exports of chemicals, plastics, and sporting goods.

A more recent trade war took place between the United States and Canada over Canadian provincial restrictions on U.S. beer exports. In 1990, U.S. beer manufacturers filed a Section 301 petition alleging that Canadian provincial restrictions on distribution of beer discriminated against imports and violated both the GATT and Canada-United States Free Trade Agreement (FTA). The two sides managed to reach an agreement in April 1992. At the end of April, however, Ontario decided to double its tax on nonrefillable cans of beer, wine, and spirits. In June, it announced additional new rules for beer imports which directly affected the U.S. In July 1992 the United States imposed a 50 percent duty

on beer imported from Ontario. Canada retaliated by imposing a 50 percent duty on U.S. beer exported to Ontario.

It is fairly obvious that all of the trade wars described above have been fought between democratic countries. Trade wars did occur between dyads that consist of a democracy and an autocracy, but far more sporadically. For example, as explained earlier, the United States and China did engage in a trade war over textiles in the early 1980s. In 1983, unable to curb the flow of Chinese textile exports to the U.S., the United States unilaterally imposed quantitative restrictions on Chinese textile imports. China retaliated by suspending their imports from the United States of chemical fibers, cotton, soybeans, and wheat, products for which China was an important international market.²⁴

However, other than this case, trade conflicts between democracies and authoritarian regimes have rarely escalated into full-blown trade wars. Trade relations between the United States and China since the early 1980s, for instance, have been characterized by the complete absence of trade wars. In almost all contentious issue areas, the United States had threatened to impose economic sanctions on China, only to refrain from doing so in the end. The overall pattern of trade peace was most obvious in the two Section 301 investigations in the areas of intellectual property rights and market access, where the U.S. always managed to reach an eleventh-hour agreement with the Chinese despite its various sanction threats.

²⁴ Nicholas Lardy, *China in the World Economy*, Washington, D.C.: Institute for International Economics, 1994, 83-84

In the area of market access, the United States initiated a Section 301 investigation into China's overall practices restricting the entry of U.S. goods into the Chinese markets. The alleged unfair practices, which were not sector-specific, included quantitative restrictions (QRs), import licensing requirements, technical barriers to trade, and lack of transparency of laws and regulations pertaining to restrictions on imports. The Chinese argued that some of these measures were necessary as infant industry protection, and therefore were unwilling to set specific timetables for phasing out their QRs and other trade restriction. In August 1992 USTR threatened to impose retaliatory tariffs on \$3.9 billion worth of Chinese exports, including goods that topped the Chinese export list (such as footwear, silk apparel, leather goods, minerals, industrial hardware, and electronics products). China responded with its own list of U.S. exports worth US\$4 billion (including aircraft, computers, chemicals, wood products, and cotton) that could suffer retaliation should Washington carry through with its threatened sanctions.

But right before the deadline, the two sides reached an agreement in which China pledged to publish all "laws, regulations, policies and guidance" regarding trade; eliminate most quantitative restrictions within two years and on products such as telecommunications equipment by the end of 1992; reduce some tariffs; and resolve problems involving phytosanitary and other technical standards.²⁵ A trade war was thus averted at the last minute.

Even textile trade, an area where the two sides failed to conclude a negotiated settlement in the early 1980s, has become more cooperative in outcome. In the 1990s, in

response to industry complaints of Chinese textile and apparel quota non-compliance in the forms of counterfeit export visas and country-of-origin evasions, the U.S. government on several occasions threatened to substantially reduce Chinese quotas. But although China protested and threatened to impose retaliatory tariffs on various U.S. products, the two countries eventually signed new bilateral textile agreements and managed to head off potential wars at the threatened deadline.

The above survey of the record of bilateral trade wars involving the United States suggests that the “democratic peace” argument fails to provide accurate predictions of the pattern of trade war. With the exception of one case, trade disputes between the United States and authoritarian regimes have rarely resulted in trade wars. Trade disputes between the United States and its democratic trading partners, in contrast, have shown a greater propensity to escalate into trade wars. Since the signaling strand of the “democratic peace” literature predicts that democracies’ greater capacity to signal their true preferences in a crisis situation should help to prevent disputes from democracies from escalating into war, the lack of “democratic peace” in trade, as far as cases involving the United States are concerned, thus presents a major challenge to the theory.

The above review also points to the structure of trade as a possible alternative explanation for the pattern of trade war. As we can see, most of the countries that have been involved in tit-for-tat trade retaliation against the United States also are the ones having highly competitive trade relations with the U.S. For instance, Canada and the European Community, two trading partners that are the frequent targets of U.S.

²⁵ Bayard and Elliott, *Reciprocity and Retaliation in U.S. Trade Policy*, 460-461.

retaliatory action, have trade competitiveness scores of as high as 11 with the United States. In contrast, very few of the trade war cases listed above involved a partner country with complementary trade relationship with the U.S. Indeed, only one trade war was directed against such a partner country (i.e., China with a trade competitiveness score of only 2). My preliminary review of the trade war cases thus suggests that trade structure may potentially play an important role in explaining the pattern of trade war.

Cases of Unilateral Retaliation

In addition to helping us understand the pattern of trade wars, the logic developed in Chapter 2 ought to help us understand the likelihood of aggressive escalation of trade disputes leading to the unilateral imposition of trade sanctions. Since competitive trade structure can help to solidify domestic support for aggressive bargaining strategy, we should not only expect the United States to be engaged in a greater number of trade wars involving mutual retaliation with countries with whom it has highly competitive trade relations, but should also expect the United States to more frequently resort to aggressive escalation and to unilaterally against unfair trade practices pursued by these trading partners. To examine the extent to which trade structure is related to the probability of this set of trade conflicts of slightly lower intensity, I compile a list of all section 301 and GATT/WTO cases where the United States has undertaken retaliatory measures against foreign trade barriers but where such retaliatory measures have failed to provoke foreign

retaliation. Table 3.6 presents Section 301 and/or GATT/WTO cases in which the United States has resorted to unilateral retaliation.²⁶

There were two more recent instances where the United States has undertaken unilateral retaliatory measures against its trading partners. Both cases took place in 1999

Table 3.6: U.S. Unilateral Retaliation under section 301 and/or GATT/WTO

Countries Involved	Case No.	Dura-Tion	Issue	Form and Amount of Retaliation
U.S.-Japan	301-13 301-36	1977- 85	Quotas on leather and footwear	Increased tariffs on \$24 million worth of Japanese leather products as part of negotiated compensation agreement
U.S.- Canada	301-15	1978- 84	Border broadcasting/advertising	Passed mirror legislation; no resolution.
U.S.- Argentina	301-24	1981- 82	Bilateral agreement on hides	Withdrew tariff concession; no resolution.
U.S.-Japan	301-48	1985- 91	Barriers to semiconductor exports	Increased tariffs on \$300 million worth of Japanese exports in 1987; lifted when new agreement was signed in 1991.
U.S.- Brazil	301- 61	1987- 90	Patent protection for pharmaceuticals	Increased tariffs on Brazilian exports worth \$39 million; lifted when agreement was reached in 1990
U.S.- Thailand	301-82	1992	Copyrights	Some GSP privileges withdrawn.
U.S.- Thailand	301-84	1989	Patent Protection	Some GSP privileges withdrawn.
U.S.-India	301-85	1992	General Intellectual Property	Some GSP privileges, worth about \$60 million, were withdrawn in 1991.

and involved the European Union (E.U.). In one case, the United States imposed 100 percent *ad valorem* duties on E.U. products with an annual trade value of \$116.8 million

in retaliation against the E.U. ban on imports of meat from animals treated with growth hormones. In the other, Washington decided to raise the tariffs on E.U. products worth \$191.4 million a year as a penalty measure against the E.U. banana regime restricting American producers' banana distribution system in central America. Unfortunately, while these cases are important examples of the escalation of trade disputes, they had to be dropped out of the data set as they took place so recently (after 1995) that data on trade structure was not available. The cases listed in Table 3.8 thus constitutes the universe of observations on which the following analysis of the probability of unilateral retaliation is based.

Statistical Analysis of the Determinants of Trade War and of Unilateral Retaliation

While the United States seems to have fought a greater number of trade wars with its competitive trading partners, it is plausible that factors other than the structure of trade could have contributed to the higher probability of trade war between these countries. For example, one might expect the probability of trade war to be higher if the two parties traded more with each other or if the target country enjoyed a larger trade surplus with the United States. Thus, in this section, I report the results of my statistical analyses of the relationship between trade structure and my two dependent variables, the probability of trade war and the probability of unilateral retaliations. These results suggest that even after controlling for other potentially confounding variables, the level of trade

²⁶ There are overlaps between these two sets of trade disputes as some Section 301 cases were also handled under the GATT adjudication procedure.

competitiveness still shows up as a significant factor in explaining the patterns of trade retaliation.

In the first place, to test the relationship between trade structure and the probability of trade war, I estimate a model which takes into consideration the following explanatory variables: the degree of trade competitiveness, the regime type of the U.S. trading partner, the volume of trade, the size of the bilateral trade balance, the size of the target economy, and the target country's dependence on the American export market.

The above model is evaluated on the basis of dyad years. Given the limited availability of data on the composition of bilateral trade for the years prior to 1980 as well as the difficulties of capturing all bilateral trade wars in which the U.S. is not a party, the analysis focuses on trade disputes between the United States and its top 25 trading partners between 1980 and 1995.²⁷ The resulting data set encompasses 16 years for a total of 400 dyad observations.

My two dependent variables are the probability of trade war and the probability of unilateral retaliation (which I will discuss later in this chapter). The probability of trade war (TRWAR), simply refers to the odds that a trade war breaks out in a given dyad year. It is coded as 1 if a trade war occurs and 0 otherwise. Trade wars that lasted several years are coded as 1 in each year they were in place. Explanatory variables for this analysis include the following:

²⁷ The 25 U.S. trading partners are: Canada, Japan, Mexico, China, the European Union, Taiwan, South Korea, Singapore, Malaysia, Brazil, Hong Kong, Venezuela, Thailand, the Philippines, Saudi Arabia, Switzerland, Australia, Indonesia, Israel, India, Argentina, Columbia, Dominican Republic, Russia, and Nigeria.

COMPET. The degree of trade competitiveness (COMPET) is the key explanatory variable in this test. It is expected that highly competitive trade relationships are likely to result in higher incidences of trade wars as discussed in the previous chapter.

REGIME. To see if states' regime type is related to the probability of trade war in any way, I include the trading partner's regime type into this analysis. If the "democratic peace" theory, particularly the audience cost version of that theory, is valid, then we should expect a statistically negative relationship between democracies and the likelihood of trade war.

The definition of "democracy" I adopt here is consistent with the commonly used definition of democracy seen in the "democratic peace" literature which emphasize the competitiveness and openness of the process through which a country's government is brought to power, the degree to which a country's chief executive's decision making authority is bounded by the institutionalized rules and arrangements, and the degree of political participation within a country. In addition, this definition provides that a state should have established these democratic institutions and processes for a reasonable amount of time so that both its citizens and its adversaries regard it as one governed by democratic principles.²⁸ According to this criteria, the E.U. and Canada, two trading

²⁸ The literature on democracy and democratization includes fairly similar criteria. Huntington, for example, considers a democratic system to be one in which "the most powerful collective decision makers are selected through fair, honest, and periodic elections in which candidates freely compete for votes and in which virtually all the adult population is eligible to vote." Samuel Huntington, *The Third Wave: Democratization in the Late Twentieth Century*, Norman: University of Oklahoma Press, 1991; see also Robert Dahl, *Polyarchy: Participation and Opposition*, New Haven: Yale University Press, 1971. The above criteria have also been used in various studies of the relationship between regime type and international security conflicts. For example, Bruce Russett, *Grasping the Democratic Peace*, 1993; Henry S. Farber and Joanne Gowa, "Politics and Peace," *International Security* 20 (1995), 123-146;

partners that have frequently fought trade wars with the United States, are clearly democracies, while China, which has been involved in only one trade war with the U.S., is not.²⁹

The widely used Polity III data developed by Jagers and Gurr is used to measure the regime type of each of the major U.S. trading partners (REGIME).³⁰ The Polity III data (and earlier versions of them) have been used by various studies of the relationship between regime type and international security conflict.³¹ The data set emphasizes the competitiveness and openness of the process through which a country's chief executive is brought to power, the degree to which a country's chief executive's decision making authority is bounded by institutionalized rules and arrangements, and the degree of political participation within a country. Jagers and Gurr develop a measure of a state's democratic characteristics (DEMOC) on a 1-11 scale and another measure of its autocratic characteristics (AUTOC) on a 1-11 scale. The measure of a state's regime type is derived by subtracting its autocratic index from its democratic index, i.e., $REGIME = DEMOC - AUTOC$. This summary measure is a continuous variable with values ranging from -10 for a highly autocratic state to 10 for a highly democratic one.³²

Edward Mansfield and Jack Snyder, "Democratization and the Danger of War," *International Security* 20 (1995), 5-38.

²⁹ Since the E.U. is not rated in Jagers and Gurr's data set described below, the E.U.'s democracy score is derived by averaging all member countries' democracy scores in a given year.

³⁰ Jagers and Gurr 1996.

³¹ For example, the data has been used by Russett 1993; Mansfield and Snyder 1995; Gowa and Farber 1995; and O Neal and Russett 1997.

³² The REGIME index could be treated as a dichotomous variable if we recode the original REGIME score greater than 10 as 1, and those smaller than 10 as 0. Statistical tests using the dichotomous variable give essentially the same results.

VOLUME. I include the volume of trade between the United States and its trading partner (**VOLUME**) to account for the possibility that since countries which trade more with one another tend to have more trade disputes, the chances for such trade disputes to escalate into trade war will be higher. Volume of trade statistics is derived primarily from U.S. Foreign Trade Highlights.³³

TBAL. In addition, trade balance between the United States and the target country (**TBAL**) is taken into account because it is expected that the size of the trade deficit could either increase or decrease the likelihood of trade wars. A more negative trade balance could make trade wars more likely because one would assume that there would be stronger domestic pressure for trade sanctions against countries enjoying large trade surpluses with the United States. But it is also plausible that having a larger trade deficit with the target country could reduce the chances of trade wars because the United States would have a greater demand for goods produced in the target country. The costs of having to restrict trade with the target would consequently be higher.

GDP. To control for the possible influence of country size on the probability of trade war, I take into consideration each of America's trading partner's Gross Domestic Product (**GDP**) in each of the years between 1980 and 1995. It is expected that the United States ought to be involved in fewer trade wars with its relatively small trading partners who are unlikely to be able to resist U.S. pressure.

TRDEP. Finally, I include a measure of a country's dependence on trade with the United States (**TRDEP**), measured by the percentage of the total volume of trade between

the target and the United States in the target's GDP, to account for the vulnerability of certain countries (besides their small size) to U.S. retaliation. A negative relationship is expected between each of the above two variables and TRWAR.

The parameters in the equation are estimated using the logit model. The logit model has been widely used to estimate the effects of a set of regressors on a binary dependent variable (such as the probability of war or deterrence). Regression analysis using the logit model yields the following results: (See Table 3.7)

As expected, the relationship between the volume of trade and the probability of trade war is positive and is statistically significant at the $p < 0.1$ level. This suggests that trade wars did break out more frequently between countries which trade more with one another. The size of the trade surplus, which is significant at the $p < .05$ level, turns out to

Table 3.7: Logit Estimates for the Probability of Trade War (the Full Model)

TRWAR	Coefficient	Std. Err.	Z	P>z
VOLUME	.0000489	.0000188	2.606	0.009
REGIME	.0198122	.0792202	0.250	0.803
TBAL	.0000554	.0000218	2.538	0.011
COMPET	.4104274	.2042226	2.010	0.044
GDP	-1.32e-06	7.50e-07	-1.761	0.078
TRDEP	-19.71206	10.19106	-1.934	0.053
CONSTANT	-5.128019	1.302359	-3.937	0.000

log likelihood = -35.363; chi2=57.21

be positively associated with the probability of trade war: the United States has been involved in more trade wars with countries with which it enjoys larger trade surpluses, rather than those with which it has larger trade deficits. This result supports the second hypothesis of the relationship between trade balance and the likelihood of trade war,

³³ Data for 1980-81 are based on *IMF Direction of Trade Statistics Yearbook*.

suggesting that even though the United States may be confronted with stronger pressure to reduce its bilateral trade deficit through some form of trade sanctions when it has a large trade deficit with the target country, the fact that the U.S. also has greater aggregate demand for goods produced in the target may have dampened the incentive for defection, reducing the chances of trade war between such states. The two variables representing the target country's vulnerability to U.S. retaliation (GDP and TRDEP) also performed well in this case. The coefficients for both variables are in the expected directions and are statistically significant at the $p < .10$ level.

Consistent with theoretical expectations, after controlling for the confounding influence of other explanatory variables, trade competitiveness has a robust and independent effect on the probability of trade war. The relationship between trade competitiveness and the probability of trade war is positive and is statistically significant at the $p < .05$ level. Although the trade competitiveness variable did not achieve statistical significance at the $p < .01$ level, this may have to do with specific attributes of the statistical analysis (such as the magnitude of the raw data) and in no way indicates that trade competitiveness is less significant than trade volume or the size of the trade deficit in predicting the trade war outcome.

Also of great interest is the finding that the regime measure has failed to achieve statistical significance. When the influence of other relevant variables are taken into consideration, regime type clearly plays no major role in predicting the trade war outcome.

Since the regime measure is clearly insignificant, I re-ran the model without it (see Table 3.8). The likelihood ratio test yields a P value that is greater than 0.05, indicating

that removal of the regime variable had no significant effect on the model. In addition, the log likelihood of the constrained model (-35.396) was nearly identical to that of the full model (-35.363). These results suggest that the constrained model is superior than

Table 3.8: Logit Estimates for the Probability of Trade War (the Constrained Model)

TRWAR	Coefficient	Std. Err.	Z	P>z
VOLUME	0.000503	.0000181	2.786	0.005
TBAL	0.000556	.0000218	2.552	.011
COMPET	.4211558	.2012265	2.093	.036
GDP	-1.36e-06	7.39e-07	-1.846	.065
TRDEP	-20.34195	9.935	-2.036	.042
CONSTANT	-5.055402	1.264576	-3.998	0.000

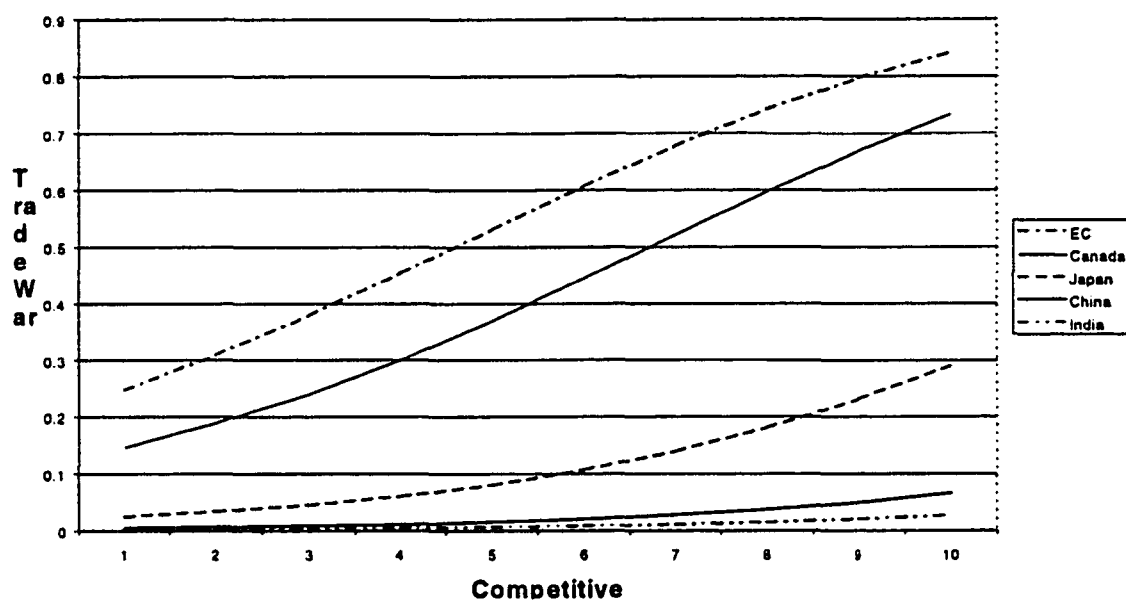
Log likelihood = -35.396013; chi2=57.14

Likelihood ratio test chi2=0.88; prob.>chi2=0.3481

the full model in predicting the trade war outcome as the reduction in the number of independent variables makes the specification somewhat more parsimonious. Note that in the constrained model trade competitiveness remains statistically significant at the $p < .05$ level.

To illustrate the impact of trade competitiveness on the probability of trade war, I report the changes in the probability of trade war with the United States for several of America's leading trading partners for a model consisted of three variables (i.e., VOLUME, TBAL, and COMPET), holding both trade volume and trade surplus constant and varying only the competitiveness ratio. In Figure 3.3, I show how each of America's five leading trading partners -- given their trade volume and trade surplus (the maximum

Figure 3.3: Probability of Trade War Given Max Trade Volume and Max Trade Surplus



for each over the sample period was used) -- would be affected were their competitiveness index to change. The chart suggests that varying the trade competitiveness index will result in substantial changes in the probability of trade war. For example, the European Community, whose average trade competitiveness index was approximately 9 on a 10-point scale between 1980 and 1995, would be 60 percent less likely to be involved in a trade war with the United States (the probability drops from 0.8 to 0.3) were its competitiveness ratio to fall to 2. Similarly, Canada would be two-thirds less likely to fight a trade war with the United States (the probability falls from 0.60 to 0.19) if its trade competitiveness index dropped from an average of 8 over the sample period to 2. Conversely, the probability that China will have a trade war with the United States will be 7.3 times higher (the probability increases from 0.006 to 0.05) if its

competitiveness index rises from 2 to that of the EC's level (9 on a 10-point scale). In reality most countries' competitiveness index had remained more or less constant over the years; nevertheless, the above chart reveals the effect that increasing competitiveness ratios would have had on the probability of trade war when the other two variables are held at a given level.

In addition to the above statistical analysis of the determinants of the probability of trade war, I conducted a similar analysis of the probability of unilateral retaliation. In this test, the dependent variable (RETALIATION) is the imposition of binding retaliation by the United States. Again it is a dichotomous variable taking on values of 1 if the United States imposed binding retaliation against its trading partner in a particular dyad year and 0 if otherwise. Cases of U.S. retaliation that did not provoke foreign retaliatory measures are based on the U.S.' use of threats of retaliation in both section 301 and GATT/WTO cases up until 1995. The independent variables in this analysis are the same as the ones used in the above regression, since the theoretical expectations regarding the relationships between each of the independent variables (trade volume, trade balance, the degree of trade competitiveness, and the trading partners' regime type) and the probability of trade war ought to hold in cases of aggressive escalation leading to unilateral retaliation.

Estimates for the model are shown in Table 3.9:

In this regression analysis, a few variables that proved important to understanding the probability of trade war -- the volume of trade, the trade surplus between the United States and its trading partner, the GDP of the U.S. trading partner -- lost their significance. The regime type of the U.S. trading partner is not relevant to the likelihood of U.S.

Table 3.9: Logit Analysis of the Determinants of Unilateral Retaliation

RETALIATION	Coefficient	Std. Err.	Z	P>z
VOLUME	0.0000172	.0000188	2.606	0.296
SURPLUS	- 0.000163	.0000218	2.538	0.456
REGIME	.04222808	.0792202	0.250	0.495
COMPET	.325743	.204226	2.010	0.054
GDP	-9.27e-07	10.19106	-1.934	0.180
TRDEP	-12.66598	7.50e-07	-1.761	0.094
--constant	-4.376082	1.302359	-3.937	0.000

Log likelihood = -41.35; chi2=18.05

N=400

unilateral retaliation either. The trade competitiveness index and the trading partner's trade dependence on the United States, however, proved to be statistically significant. This result again lends support to the argument regarding the importance of trade competitiveness in determining the probability of aggressive escalation in trade disputes.

In view of the results of my statistical analysis of the determinants of trade war and of unilateral retaliation under Section 301 and GATT/WTO, I estimate a summary model of the likelihood that the United States will be involved in aggressive escalation leading to either unilateral retaliation or trade war. To capture the gradations of aggressive escalation leading to either unilateral retaliation or the mutual imposition of trade sanctions, I construct an ordinal-scale variable ESCALATION which equals 0 if neither the United States nor its trading partner undertook any retaliatory measures in a particular dyad year, 1 if the United States imposed some form of trade retaliation without provoking counterretaliation in that dyad year, and 2 if tit-for-tat retaliation occurred. The estimation sample and the independent variables are the same as the ones used for the statistical analyses above. The model is estimated using the ordered probit approach. Model estimates, reported in Table 3.10, suggest that the United States has a greater

tendency to undertake escalatory measures with those trading partners that it trades more, enjoys a trade surplus, or has a competitive trade relationship. It is also more likely to

Table 3.10: Ordered Probit Estimates of the Probability of Aggressive Escalation

ESCALATION	Coefficient	Standard Error	Z	P>z
VOLUME	.0000174	6.17 ⁻⁰⁶	2.818	0.005
TBAL	.000018	9.23e-06	1.955	0.051
REGIME	.018411	.0259028	0.711	0.477
COMPET	.1554506	.071902	2.162	0.031
GDP	-3.63e-07	2.64e-07	0.169	0.169
TRDEP	-6.008401	3.161977	0.057	0.057

Log likelihood = -64.978; chi2=67.95

N = 400

take the dispute to the brink with those partners that are more heavily dependent on trade with the U.S. The statistically significant relationship between trade competitiveness and escalation highlights the salience of trade structure in influencing the probability of dispute escalation.

In summary, the above statistical analysis suggests that as important as states' regime type may be to determining the outcome of security conflicts, it is clearly irrelevant to the analysis of trade wars. Instead, the structure of trade between states turns out to be the key variable influencing the trade war probability. As the regression analysis indicates, even after controlling for the influence of other potentially confounding variables, the structure of trade still has a significant and positive effect on the probability of trade war. These results directly challenge the democratic peace thesis, particularly the one strand of the theory emphasizing how certain informational properties of democratic regimes prevent democracies from escalating their conflicts to the level of "war" and reduce the

overall chances of war between democracies. They also provide strong support for the alternative explanation laid out in the previous chapter.

Conclusion

The empirical analysis in this chapter confirms the two puzzling patterns that motivate this study. U.S. sanction threats proved to be more effective in opening markets in some countries (such as Japan, Canada, and the EC) than in others (e.g., China, Brazil, and India). Interestingly, these variations seem to be better accounted for by trade structure among states than by the realist emphasis on states' power balances. It has also been shown that the likelihood of trade wars was higher between democracies than between dyads that include at least one party that is non-democratic. If these puzzling patterns do exist in the real world, and if neither realism nor the "democratic peace" thesis can adequately explain these patterns, then how can we best go about tackling these puzzles? To what extent does the structure of trade affect the pattern of trade war and threat effectiveness? Does domestic politics exert such an important influence on negotiation outcomes? Through detailed case studies of trade negotiations between the United States and some of its major trading partners, the following chapters will piece together the answers to these questions and show how trade structure, by shaping the domestic political landscape, drives the negotiation dynamics and helps to produce the puzzling patterns observed above.

~ 4 ~

American Threats and China's Most-Favored-Nation Status

The question of whether to renew China's Most-Favored-Nation (MFN) status has occupied center stage in U.S.-China economic relations since the late 1980s. Reports of China's unfair trading practices such as weak intellectual property protection, market access issues, and other practices seen as inimical to U.S. interests repeatedly appeared in the media, prompting Congress and organized groups to press for a tougher approach to deal with China and its growing trade surplus. Given the tremendous pressure exerted by various domestic constituents and the power asymmetries between the two countries, one would expect that the United States should have had considerable success getting the Chinese to comply with its demands in these cases. But has it? Has Beijing made substantial modifications in its trade practices in response to American pressure? To what extent did American coercive diplomacy succeed in changing China's trade practices?

If we examine the period when the United States threatened to revoke China's MFN status in order to obtain *unilateral* concessions, the compromises won by the United States over many years, measured against the original American demands, have been paltry. Whether the issue concerned the linkage of China's preferential trade status to Beijing's performance in the areas of intellectual property protection, market access, weapons proliferation, or human rights, the United States has by and large failed to obtain

the desired concessions. Although, with the conclusion of the U.S.-China bilateral agreement on terms for China's accession to the World Trade Organization (WTO) in November 1999, the United States does seem to have won a significant market opening in exchange for Chinese firms' greater access to the American market,¹ it seems fair to say that America's unilateral sanction threats against China have yielded only sub-optimal results.

For example, in the area of market access, the United States has at best only partly achieved the objective of securing greater access for American businesses to China's market through the use of Section 301. Although Beijing agreed to make its trade regulations more transparent and to cut tariffs on a wide range of U.S. goods in a bilateral market access accord in 1992, the agreement signified the beginning, rather than the completion, of the process of moving China's foreign trade regime closer to international norms and practices. Later China threatened to halt the implementation of the 1992 agreement for alleged U.S. failure to keep its commitments. Instead, it charged the United States with impeding the development of bilateral trade relations by keeping in place the post-1989 sanctions and by failing to keep its commitment to support China's bid for WTO membership.² In the end, the United States failed to achieve concrete results in the

¹ For example, as part of the WTO agreement, China committed over a span of five years to reduce tariffs and eliminate quantitative restrictions on both industrial and agricultural products. It also agreed to open a broad range of services, including telecommunications, insurance, banking, securities, and professional services, to foreign service providers. These concessions, unprecedented in their scope, offered the prospect of greatly expanded market access to China for a wide array of U.S. industries and sectors.

² Jing-dong Yuan, "Sanctions, Domestic Politics, and U.S. China Policy," *Issues and Studies*, 33: 10 (October 1997), 110-112.

market access talks. Partly because of the continued existence of trade barriers, American trade deficits with China continued to soar in the 1990s.

With regard to the American attempt to get China to provide more adequate protection for American intellectual property rights (IPR), the United States' pursuit of aggressive market-opening strategies did succeed in forcing Beijing to adopt a "world-class" legal regime for intellectual property protection. But despite the proliferation of laws and regulations, enforcement remained a serious problem and, as a result, piracy of American copyrighted works and trademarks continued to be rampant in many parts of China. By the mid-1990s, not only did piracy rates continue to soar in all major Chinese cities, particularly those along China's increasingly prosperous east coast, but Chinese companies had even begun to export pirated products in large volume to overseas markets. Frustrated with China's failure to enforce the 1992 IPR agreement, the United States had to twice again resort to aggressive strategies of market opening through Section 301 of the U.S. trade law, in 1995 and 1996 respectively. In short, implementation and enforcement problems and the fact that the United States Trade Representative (USTR) had to re-open the negotiations indicate only a partial fulfillment of American negotiation objectives.

Moreover, the MFN case that will be discussed in detail in this chapter represents an almost complete failure of U.S. policy objectives. China has made virtually no meaningful concessions in the issue areas that are of particular concern to the Americans. American efforts to link the granting of MFN status to China's performance in the areas of

trade, human rights, and weapons proliferation, for example, have been repeatedly rebuffed by the Chinese authorities. These efforts backfired in some cases, prompting charges of blatant meddling in China's domestic affairs.

For example, the Americans were perhaps least successful in their efforts to link the renewal of China's preferential trading status to its human rights record. By 1994, four years after the initiation of the MFN debate, virtually all U.S. policymakers agreed that, despite some concessions, China had not met U.S. demands on human rights. Beijing did not adequately improve its treatment of dissidents, or allow inspection for use of prison labor, or make substantial progress on ending other human rights violations. On the eve of U.S. Secretary of State Warren Christopher's visit to China in March 1994, Beijing, in apparent defiance of American pressure, went so far as to deliberately detain a number of high-profile democracy activists. In their meetings with Christopher, Chinese leaders insisted that China would endure U.S. sanctions rather than succumb to pressure.³

American attempts to pressure China into accepting Western arms-transfer guidelines through the withholding of advanced technologies also produced mixed results. Although, at times, China has exercised restraint and has made good on its pledges, this behavior, to a large extent, has reflected Beijing's assessment of its national interests, weighing expected rewards (Western technologies) against forsaken commercial opportunities (missile/nuclear transfers). On the whole, Beijing has resisted overt U.S.

³ See Robert S. Ross' chapter on the China sanctions in Richard N. Haass (ed.), *Economic Sanctions and American Diplomacy*, New York: Council on Foreign Relations, 1998, 17.

pressure on proliferation issues, as seen in its reported efforts to continue to transfer missile components to countries like Pakistan.⁴ It is not an exaggeration to say that the United States lost the MFN battle. As one China scholar summarizes the MFN debacle:

The process has produced virtually no discernible change in Beijing's policies and has weakened the elite and popular base of those in China most inclined toward genuine reform; it has locked successive administration and Congress in unproductive debate annually for eight years; it has encouraged presidents to make commitments they cannot keep; and all this has made U.S. administration look impotent to Beijing and dangerously unpredictable to allies and friends in the region and throughout the world. In short, the MFN debate has been the poorest imaginable way to make coherent policy or to be credible to Beijing.⁵

In view of the failure of American pressure, one may ask why the United States, as the world's largest economy and as the country that provides most of China's hard-currency, has encountered so much resistance from Beijing? The following empirical study finds answers to this question in the realm of domestic politics. Trade complementarity between the two nations structured political forces in the United States in a way that prevented the emergence of a unified and coherent *American* position credible to Beijing. Whenever human rights advocates, groups concerned about China's protectionist trade policies, or the intellectual property industry tried to strike out against China, they met uniform resistance from other business groups who favored continued normal relations with China. Moreover, the executive branch, due to its institutional prerogatives and priorities, tended to emphasize the importance of a viable commercial relationship with China and thus opposed the tough approach advocated by Congress.

⁴ Yuan 1997, 102-109.

⁵ David M. Lampton, "Ending the MFN Battle," *NBR Analysis* 8 (July 1997), 7.

These divisions in American politics sent highly mixed and confusing messages to the Chinese and sharply reduced the credibility of American threats.

The detailed case study that follows traces the evolution of U.S. policy toward China's MFN status and intellectual property protection. Using the "process-tracing" method, it illuminates the competing interests and pressures in American politics as well as their effect on threat effectiveness. As we will see, the cacophony of domestic voices in the United States, which arise from the highly complementary trade relationship between the two states, made it exceedingly difficult for the United States to extract any significant concessions from China. Most importantly, the presence of a large import-using constituency consisted of American importers and retailers of such Chinese products as footwear, toys, and apparel provided a powerful counterbalance to forces supporting MFN revocation. Thus, consistent with theoretical expectations, the high level of trade complementarity between the United States and China exacerbated domestic divisions in the United States, reducing the credibility of American threats to the Chinese. By weighing my argument against other competing explanations, the following pages will show that there exists a causal logic, not simply a statistical correlation, between trade structure and threat credibility.

Background: Tiananmen and the Initiation of the MFN Debate

Most-Favored-Nation (MFN) status is actually a misnomer. It is the normal, nondiscriminatory treatment that the United States extends to almost all of its trading

partners. It entitles the exports of a “most favored nation” to the lowest tariff rates the United States charges its other MFN partners. Communist countries, however, are an exception to this general rule. Under the Jackson-Vanik Amendment to the Trade Act of 1974, the President was authorized to waive the freedom of emigration requirements of the amendment and to extend MFN tariff treatment to “non-market” economies only if he could certify that the country in question permits free emigration and/or that such an extension would substantially promote the amendment’s objectives. The waiver must be renewed annually and Congress can reject the president’s waiver by approving a joint resolution.⁶ MFN status was first granted to China through a trade agreement in February 1980 under the Carter administration and has been renewed annually since then on the basis of a presidential waiver. Until 1990, the renewal of that status had been a routine event: the president announced his decision to renew it, and Congress, by failing to enact (or usually even to consider) a resolution of disapproval, consented to the president’s action. However, the Tiananmen incident changed the whole process.

The Tiananmen incident of June 4, 1989 ushered in several important changes in U.S.-China relations. First, it altered the past policy norm of “encouraging Chinese domestic political and socioeconomic reforms, but not making U.S. policy contingent upon Chinese domestic practices.”⁷ Second, it reflected the diversification of China policy goals and the pluralization of the policymaking process. The end of the Cold War

⁶ U.S. Congress, House, *Disapproval of Extension of Most-Favored-Nation Treatment to the Products of the People’s Republic of China*, House Report 102-632, Washington, D.C.: GOP, 1991, 1-2.

⁷ Qingshan Tan, *The Making of U.S. China Policy*. Boulder: Lynne Rienner Publishers, 1992, 1.

removed much of the rationale that governed Sino-American relations in the 1980s and significantly altered China's position in the American strategic calculus. As a result, U.S. China policy has been conducted less on the basis of geopolitics alone and has incorporated a wide range of domestic interests and objectives to address bilateral political, economic, human rights and arms sales issues. U.S. China policy objectives became more diversified and the policy process more pluralized and decentralized. Third, Tiananmen marked the breakdown of a decade of consensus on China policy in the United States and brought about an explicit change in the congressional orientation toward China. Partly because of the diversification of China policy objectives, Congress became increasingly assertive on issues related to China's domestic practice. Differences between the executive and legislative branches on China policy priorities and approaches began to loom in the immediate aftermath of Tiananmen.

The Bush administration responded to Tiananmen both by swiftly introducing a series of sanctions against China and by limiting the impact of such sanctions on the overall bilateral relationship. Although these actions were initially commended by many in Congress, congressional support soon began to unravel because of the perceived "softness" of the executive response. In particular, the disclosure in late 1989 that the President had sent two secret missions led by National Security Advisor Brent Scowcroft to Beijing in the months after Tiananmen, coupled with Bush's selective enforcement of the sanctions he himself had imposed, alienated many in Congress because it appeared that the President wanted to prevent the legislative branch from serving as an equal partner in

the policy process.⁸ Throughout late 1989 and early 1990, the President took personal charge of U.S.-China relations and strove to maintain a balanced policy that would allow for continued U.S. involvement with China. However, his policies failed both to successfully still congressional debate and to restore a consensus on U.S. China policy. By early 1990, increasingly frustrated with the perceived failure of existing policies to affect Chinese behavior, Congress turned to the annual renewal of China's Most-Favored-Nation (MFN) status as the key to influencing the general direction of U.S.-China policy.

Each year between 1990 and 1994, the U.S. Congress attempted dozens of pieces of legislation which would have made China's eligibility to receive MFN contingent on a number of conditions requiring presidential certification. Although the specific conditions each bill contained differed, they broadly reflected congressional dissatisfaction with Chinese practices in the areas of human rights, trade and arms proliferation. Some of these legislative proposals, for example, threatened to cut off China's MFN status unless it could be shown that the Chinese government had stopped arrests of pro-democracy activists, ceased the export of products made with prison labor, provided U.S. exporters non-discriminatory access to Chinese market, ended unreasonable and discriminatory unfair trade practices against the U.S., and adhered to multilateral non-proliferation agreements.⁹

⁸ Kerry Dumbaugh, "The Making of China Policy Since Tiananmen," *China Business Review*, January-February 1992, 17-18.

⁹ For example, the bill introduced by Senate Majority leader George Mitchell in 1991 (S 1367) and another legislative proposal introduced in 1992 (HR 5318) contained similar language.

However, during both the Bush and Clinton administrations the United States did not follow through on its threat to impose sanctions. Bush repeatedly vetoed legislation seeking to revoke or to attach conditions to China's MFN renewal. After President Clinton announced his decision to delink trade from human rights in 1994, members of Congress tried, but eventually failed, to amass enough votes to pass any MFN conditioning bills. Thus, despite considerable U.S. bluster and threats, China had consistently called America's bluff. By the end of the Bush administration, China's performance in the three targeted areas remained far from satisfactory to Washington. For example, the American trade deficit with China swelled from \$6.2 billion in 1989 to \$18.2 billion in 1992.¹⁰ Trade barriers limiting opportunities for the sale of American goods and services remained formidable. Also, concerns grew that China was using convict labor to produce goods that subsequently were exported to the United States. On human rights, the Chinese had released a handful of political prisoners. But for human rights activists, these measures were purely symbolic. Moreover, the basic human rights situation had not improved substantially. At the same time, although China had agreed to abide by the guidelines and parameters of the Missile Technology Control Regime (MTCR), which bars the transfer of medium- and long-range missiles, there were a number of reports showing that Beijing continued to sell M-11 missiles to Pakistan.¹¹

¹⁰ Department of Commerce data.

¹¹ "U.S. Faces Dilemma in Setting China Policy," *Washington Post*, March 9, 1993, A28.

One might expect that the coming to power of President Bill Clinton, who had accused President Bush of “coddling the dictators” in Beijing, and who had promised to “get tough” with the Chinese government during his presidential campaign, might have reversed this situation. After he was sworn in, Clinton did initially keep his campaign promises and confronted Beijing on unfair trading practices and human rights abuses. On May 28, 1993, he signed an executive order linking trade preferences granted by the United States to China’s human rights behavior. Administration officials expected that such a policy, while moderate enough not to break the back of U.S.-China relations, should have put sufficient pressure Beijing to alter its domestic policies. In the end, however, the executive order again proved ineffective. China did not budge in the face of American pressure and, as a result, Clinton had to abandon the linkage policy. Clinton’s 1994 decision to “de-link” marked a clear recognition of the futility of attempts to force changes in China’s domestic practices through MFN. In the executive order, Clinton acknowledged that

The Chinese did not achieve overall significant progress in all the areas outlined in the executive order relating to human rights, even though clearly there was some progress made in important areas. ...

The question for us now is, given the fact that there has been some progress but that not all the requirements of the executive order were met, how can we best advance the cause of human rights and the other profound interests the United States has in our relationship with China.

I have decided that the United States should renew Most Favored Nation trading status toward China. This decision, I believe, offers us the best opportunity to lay the basis for long-term sustainable progress in human rights, and for the advancement of our other interests with China. ...

I am moving, therefore, to delink human rights from the annual extension of Most Favored Nation trading status for China. That linkage has been constructive during the last year. But I

believe, based on our aggressive contacts with the Chinese in the past several months, that we have reached the end of the usefulness of that policy, and it is time to take a new path toward the achievement of our constant objectives. We need to place our relationship into a larger and more productive framework.¹²

That the MFN sanction threats against China were so ineffective was not surprising if we take into consideration the divisions in American politics on the MFN issue. First, since the United States is no longer a major producer of such goods as apparel, toys, shoes and consumer electronics, there is a large constituency in America heavily dependent on imports of these materials. These import-using interests strongly opposed MFN conditionality or withdrawal, arguing that such a measure would impose significant costs on American consumers and retailers. Second, there existed considerable differences between the policy preferences of the executive and legislative branches. President Bush, for example, had consistently opposed efforts to attach any conditions to China's MFN renewal. His repeated assertion that he would veto any legislation denying or placing further conditions on China's MFN eligibility made any potential legislative action on conditionality appear more symbolic than substantive. Moreover, even though President Clinton had initially taken a tough stance on the MFN issue, he was soon forced by the reality of U.S.-China relations to reverse course and pursue a more realistic policy with China. The fact that China did not pose a competitive challenge to American industries prompted the executive branch to accord higher priority to America's overall economic and strategic relationship with the Chinese.

¹² "Press Conference of the President," Office of the Press Secretary, the White House, 26 May 1994.

The net effect of these competing forces in American politics -- the trade lobby's campaign for normal trade relations and the different policy orientations of the executive and legislative branches -- was to substantially reduce the effectiveness of U.S. threats against China. They contributed to Beijing's perception that it was highly unlikely that the United States would carry out its threats and that therefore China did not need to kowtow to American pressure. In the end, Washington was forced to acknowledge that China had made only minimal concessions. We will now take a closer look at the evolution of U.S. policy toward China's MFN status and intellectual property protection and the role of different political forces in the policymaking process to explain the failure of American pressure tactics.

The China Trade Lobby

An important factor weakening the credibility of American threats was the business community's active support for continued MFN tariff treatment for China. As the debate over MFN unfolded, affected interest groups rushed to Capitol Hill to make their cases. While human rights advocates, trade unions, and groups concerned with China's unfair trade practices lashed out at China, a large pro-MFN coalition had been formed to push for unconditional renewal of China's trade status. The pro-MFN forces, comprised of toy makers, apparel manufacturers, farmers, aircraft manufacturers as well as businesses in Hong Kong, launched a massive campaign defending U.S. trade with China, swamping

Capitol Hill with letters and position papers detailing the damage that denial of MFN status or its equivalent -- conditional MFN -- might inflict on the U.S. economy.

What was most distinctive about this pro-MFN coalition was that it united both American exporters and importers behind a major trade-expansion. Because United States exports to China very different commodities from what it imports from the Chinese (Figure 4.1 depicts the lack of overlap between the top five commodities the U.S. exports to and imports from China),¹³ American importers of toy, apparel, footwear, electronics, and other consumer goods coalesced into a major political force actively opposing the imposition of sanctions which could adversely affect their sales in the United States. At the same time, exporters, who normally support sanction threats when they are used to open markets in the target country, opposed efforts to link trade with human rights, a linkage which, they worried, could hurt both their exports to and investment in China. As a result, both American importers and exporters mobilized early in defense of China's trade status.

¹³ Since the mid-1980s, the growth of China's exports to the United States have taken place primarily in labor-intensive industries in which China had been able to take advantage of its abundant labor force and low wage level to build strong comparative advantages. The bulk of Chinese exports to the U.S. were in the following labor-intensive sectors: miscellaneous manufactured articles such as toys, games, footwear, clothing and apparel, baby carriages, watches, and instruments; manufactured materials including textile manufactured materials, fabrics, machine tools, and paper products; and mineral fuels. In contrast, a large portion of U.S. exports to China have concentrated on technology-intensive products such as machinery and equipment, especially aircraft and parts, industrial machinery, civil engineering plant and equipment, automatic data processing machines and machine tools. For example, between 1986 and 1990, China was able to increase its exports of toys, games, sporting goods, and baby carriages from roughly \$370 million to \$2.2 billion, footwear from \$76 million to \$1.5 billion, and more than double the value of its exports of suitcases, textiles and apparel to the U.S. *U.S. Foreign Trade Highlights*. Washington: International Trade Administration, various years. See also Dennis A. Rondinelli,

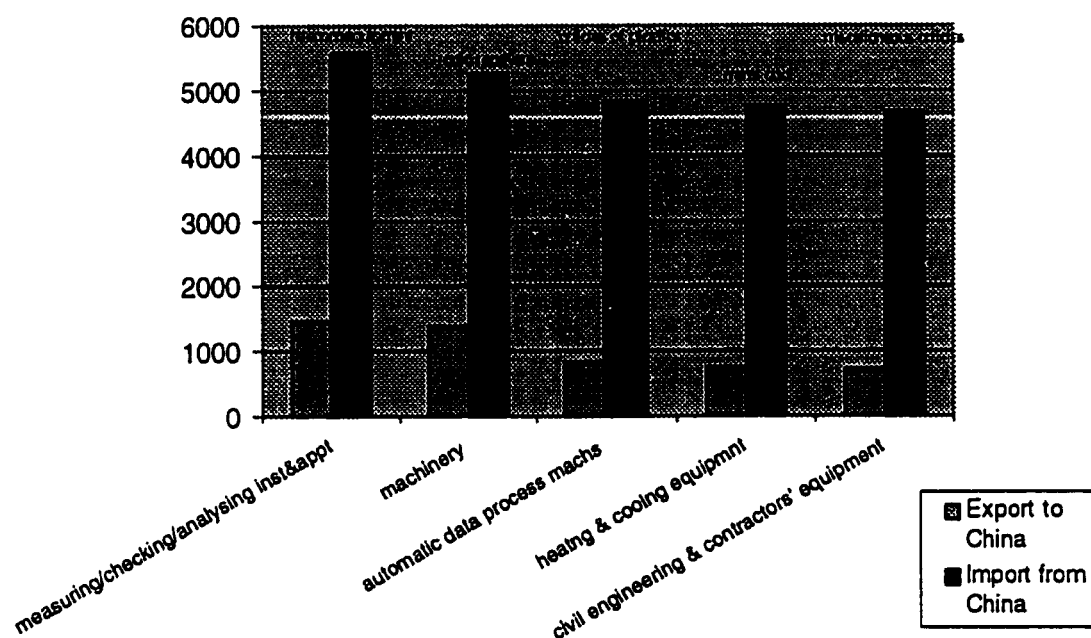
In 1991, large companies and leading trade groups, including the Emergency Committee for American Trade (ECAT), the U.S. Chamber of Commerce, the 500-member National Foreign Trade Council, and the U.S.-China Business Council, a Washington-based group representing the interests of companies doing business with China, formed an umbrella organization -- the Business Coalition for U.S.-China Trade -- in support of President George Bush's position for unconditional extension of MFN. By 1996, the coalition had expanded to include over 800 member companies and trade associations heavily involved in trade with China. The composition of the association ranges from firms importing labor-intensive manufactured goods made in China to exporters to high-tech, agricultural, aviation, telecommunications, agricultural, and transportation goods.¹⁴ Also outspoken on the MFN issue were business groups representing both American exporters and importers doing business with China (such as the American Association of Exporters & Importers, the National Association of Wheat Growers, the North American Export Grain Association, and the Toy Manufacturers of America).¹⁵

"Resolving U.S.-China Trade Conflicts: Conditions for Trade and Investment Expansion in the 1990s," *Columbia Journal of World Business* 28: 2 (Summer 1993), 66.

¹⁴ Robert G. Sutter, *U.S. Policy Toward China: An Introduction to the Role of Interest Groups*, Lanham: Rowman & Littlefield Publishers, Inc., 1998, 56-57.

¹⁵ U.S. Congress. House. *United States-People's Republic of China Trade Relations, Including Most-Favored-Nation Trade Status for China: Hearing Before the Subcommittee on Trade of the Committee on Ways and Means, House of Representatives, 102nd Congress, 1st session, 1991.*

Figure 4.1: Top Five Commodities in U.S. Trade with China, 1995 (million \$)



Source: *Foreign Trade Highlights*, Department of Commerce.

In dollar terms, U.S. companies importing from China had a higher stake in the battle over MFN than firms exporting to China. For the three years before 1991, American exports to China held at roughly \$5 billion a year, while Chinese exports to the United States increased rapidly during the same period, reaching a record high of \$15 billion in 1990.¹⁶ For American importers, MFN could be a crucial competitive advantage. If MFN were revoked, U.S. tariffs on Chinese-made toys, footwear, apparel, and other goods would soar to prohibitive levels. With MFN, for example, the tariff on imported

¹⁶ U.S. Department of Commerce data.

toys was 6.8 percent; without MFN, it would be 70 percent.¹⁷ Therefore, terminating MFN would require a vast number of US importers and retailers to find new sources for goods upon which many low-income consumers had come to rely. For large manufacturers and retailers who could shift some of their manufacturing to other countries, there would be added costs to production because new factories would have to be reconfigured for new lines and increased output. For many smaller manufacturers who simply couldn't find sources elsewhere, the effects of MFN revocation would be devastating.

Toy makers and apparel manufacturers argued along these lines. For example, at an economic conference held in Little Rock in December 1992, soon before Clinton's swearing-in, Jill Barad, the president and chief executive officer of the American toy company Mattel, explicitly warned Clinton of the repercussions of MFN withdrawal on American toy makers. She argued that since the sanctions would cost companies such as Mattel significant market shares as they would raise toys imported from China to a prohibitive 70 percent level. She further asserted that the consequences of MFN withdrawal would not be limited to toy manufacturers. MFN revocation would also hurt American shoe companies which acquired 60 percent of their products from China and textile importers who imported nearly \$4 billion of textile and apparel from China each

¹⁷ "Sentiment Grows in Congress to Reject MFN for China," *Congressional Quarterly Weekly Report* 49: 17 (April 27, 1991), 1044.

year.¹⁸ In addition, retailers such as Toys “R” Us and J.C. Penney contended that trade restrictions would hurt American consumers by driving up the cost of Chinese goods and that lower-income consumers in particular would bear a disproportionate burden in such an event.¹⁹

Footwear distributors made a similar claim, pointing out that China was the biggest supplier of imported footwear to the United States, accounting for 38 percent of all shoes sold in the United States in 1990 and 63 percent of all low-priced shoe imports.²⁰ China’s share of the American footwear market increased further in the early 1990s so that by 1994 China accounted for one of every two shoes sold in the United States.²¹ Footwear Distributors & Retailers of America argued that since it was difficult to find competitive alternatives for footwear outside of China, American consumers, particularly low- and middle-income families who depended on China-produced shoes, would be the real losers should China lose its MFN status.²² Athletic footwear companies such as Nike shared this view, as the company sourced about one-third of its shoes in China.

While importers emphasized the costs of MFN denial to American consumers, exporters focused on the consequences of a closed Chinese market to the United States. They argued that since China had become a consistent importer of American goods, rescinding MFN and the subsequent Chinese retaliation would not only result in lost sales

¹⁸ James Mann, *About Face: A History of America’s Curious Relationship with China, from Nixon to Clinton*. New York: Alfred A. Knopf, 1999, 275-276.

¹⁹ “Will China Remain a Most-Favored Dictatorship?” *Business Week*, July 29, 1991, 38.

²⁰ Jim Mann, “U.S. Firms Lobby for China Trade Benefits,” *Los Angeles Times*, July 15, 1991, A15.

²¹ Edward Garage, “Gauging the Consequences of Spurning China,” *New York Times*, March 21, 1994.

over the short-term, but also lost markets to European and Japanese competitors, forcing a cut in U.S. production and employment.²³ Importantly, since China does not produce the same high-technology products as the United States, American exporters had nothing to gain whether sanctions were carried out or not. Indeed, if the United State made good on its promises to impose sanctions, likely Chinese retaliation would only limit American firms' access to the Chinese market. This contrasts with U.S. negotiations with trading partners with whom it has a competitive trade relationship (e.g., Japan), where exporters would be able to benefit from expanded market access to the receiver of threats if the latter capitulated to American demands.

U.S. aircraft manufacturers who held 76 percent of the huge Chinese market would face severe losses if China's trade status were revoked. Since the late 1980s, companies such as Boeing and McDonnell Douglas had been wooing Chinese authorities, bidding to supply China's domestic route airplanes well into the next century. By 1993, China was already Boeing's biggest overseas market next to Japan; one of every six aircrafts produced by Boeing went to China.²⁴ Both companies were vying with European aerospace companies for the Chinese market. They worried that withdrawal of MFN and subsequent Chinese retaliation would give the Europeans a crucial competitive advantage. It was estimated that failure to renew MFN status for China would give Airbus an edge on

²² Mann, 1991.

²³ U.S. Congress, House, *Disapproval of Extension of Most-Favored-Nation Treatment to the Products of the People's Republic of China*, 1991, 208.

²⁴ Robert Keatley, "U.S. Firms, Anticipating Huge Market, Worry China May Lose Its MFN Status," *Wall Street Journal*, 1 May 7, 1993, B8B.

the \$41 billion in deliveries that would possibly occur in China by the year 2010. In light of these potential costs, the aerospace industry began early to urge Congress to renew China's MFN status, arguing that denying MFN status to China would not only close off the opportunity to cut lucrative deals with the Chinese, but also cost jobs at home.

Companies such as AT&T, General Electric, IBM, General Motors, and Motorola all made China their top international goal. GE looked for sales in a wide range of products including aircraft engines, power-generation equipment, locomotives, medical equipment, plastics, and electric lighting.²⁵ GM's joint venture in northern China expected to be assembling 50,000 trucks by 1998. For Motorola, China already was its biggest market outside the United States by 1993. The company expected its phone sales to grow at a 20% to 30% annual rate for the next decade.²⁶

Similarly, AT&T, which had been locked out of the Chinese market for years, was able to conclude a landmark deal in 1993 to help upgrade China's overburdened telecommunications system. The company considered the agreement an important breakthrough in its plan to develop the Chinese market since China was planning to expand its phone system more than tenfold by the year 2000. Furthermore, the increase in Chinese consumers' purchasing power following the implementation of reform also led to expanded opportunities for U.S. consumer-product companies. As a result, a host of U.S.

²⁵ "China Fever Strikes Again," *Business Week*, March 29, 1993, 46.

²⁶ *Ibid.*, 47.

consumer-product giants were finding a booming business in China and expressing optimism about the China market.²⁷

In short, U.S.-China trade relations had expanded so rapidly that by the early 1990s, a broad spectrum of American business, including both importers and exporters, had come to have a huge stake in the China trade. The pro-MFN coalition maintained that ending MFN status would inaugurate a trade war with China that would increase the price of Chinese imports to American consumers, reduce American exports, yield market shares to foreign competitors, and threaten the viability of American investment in China. As outlined in a position paper prepared by the U.S.-China Business Council, revoking or conditioning MFN would likely increase consumer prices and the U.S. trade deficit, lead to the loss of a major export market and over 100,000 American jobs, dampen the nearly \$5 billion investment in China, and seriously harm Hong Kong and the semi-private sector in South China.²⁸ In light of the cost of revoking China's MFN status, business groups strongly urged the government to adopt policies other than MFN to influence Chinese behavior. The pro-MFN coalition focused in particular on influencing votes in the Senate to help sustain Bush's veto on conditioning MFN.²⁹

While business groups were relatively restrained in their campaign for unconditional MFN under Bush by strongly negative media coverage of developments in China and by negative popular opinion in the United States, they became increasingly

²⁷ Ibid.

²⁸ "The Case for China's MFN Status," *China Business Review* 19, no. 4 (July-August 1992), 14-16.

²⁹ Robert Sutter, *U.S. Policy Toward China*, 1998, 57-58.

assertive and vocal in pressing their demands during the Clinton administration. In 1992, following Deng Xiaoping's visit to southern China, Beijing abandoned the austerity measures adopted in the aftermath of Tiananmen in favor of a more open, liberal economic policy. This reorientation of economic policy brought the Chinese economy out of the recession toward a period of more sustained growth. Between 1993 and 1994, China achieved remarkable annual growth rates of 12 to 13 percent. Rapid economic growth not only resulted in rising U.S. business activity in China, but also reinforced U.S. business' perception of the importance of the Chinese market.³⁰ As a result, the business lobby gained in intensity and effectiveness during the Clinton administration.

An important part of the business strategy between 1993 and 1994 was to show elected officials that the MFN issue had electoral consequences. In 1993, with the election for the entire House of Representatives (and one-third of the Senate) approaching, more than 400 California companies in the Business Coalition for U.S.-China Trade wrote to President Clinton reminding him that MFN revocation would put at risk California's \$1.7 billion worth of exports to China and the 35,000 jobs generated by the China trade.³¹ In April, nearly 800 representatives of large and small businesses, trade associations and consumer groups wrote to Clinton arguing that a failure to renew MFN to China would "jeopardize over 180,000 high-wage jobs."³²

³⁰ *Ibid.*, 56.

³¹ Susumu Schoenberger, "Question of Conscience: Human Rights in China or Jobs in California?" *Los Angeles Times*, May 15, 1994, D3.

³² Business Coalition for U.S.-China Trade, "Business Leaders Urge U.S. to De-link Trade Sanctions and Human Rights," press release, May 6, 1994.

The National Association of Manufacturers, an organization representing 1,250 American manufacturers that account for roughly 90 percent of U.S. industrial output, said Clinton's decision would have a "profound impact" on U.S. firms, workers, and industrial competitiveness. The organization released a statement calling MFN "the minimum requirement of meaningful economic exchanges between the two countries." Since MFN was the "*sine qua non* of the U.S.-China commercial relationship," the Association argued, "it cannot be the basis for the exercise of U.S. leverage within that relationship."³³ NAM's active opposition to sanction threats against China presented a sharp contrast to its attitude towards U.S. trade disputes with Japan. As we will see in the next chapter, when the United States threatened trade sanctions against the Japanese for their protectionist practices concerning supercomputers and satellites under Super 301 provision of the U.S. trade law, NAM turned out to be one of the foremost advocates of sanctions threats. Since many of its member companies representing a broad range of industrial sectors were confronted with stiff Japanese competition, the Association supported the threatened sanctions which, if carried out, would help to bring down the level of competition that NAM members faced in both the Japanese and U.S. domestic markets.

Similarly, U.S.-China Business Council president Donald Anderson, whose association represents about 200 American businesses in China, said in a May testimony

³³ Amy Kaslow, "President Urges Renewal of China's Top Trade Status," *Christian Science Monitor*, May 28, 1993, 4.

before a panel of the House Foreign Affairs Committee that withdrawing or conditioning MFN status “would be a recipe for disaster for U.S. workers, consumers and employers.”³⁴ In May 1993, the business community sent Clinton a letter signed by 298 companies and 37 trade associations opposing any conditioning or compromising of MFN status. Prominent were firms such as Boeing, General Motors, AT&T, Coca-Cola, Caterpillar, and IBM, which feared loss of current and future export markets. Also active were wheat growers and footwear retailers. The latter, who “flooded the White House with letters from thousands of shoe store managers,” argued that they didn’t “have any leverage” with China, since few companies had the luxury of pulling out of China or having trade with China cut off.³⁵

Business interests were careful to supplement their lobbying campaign with efforts to influence public opinion. For example, when Chinese President Jiang Zeming attended the APEC (Asia-Pacific Economic Co-operation) leaders’ meeting held in Seattle in November 1993, his visits to the Boeing aircraft production facility and to a working family’s home received extra media coverage. Following Jiang’s visit, Representative Jim McDermott (D-Wash.), whose district is home to thousands of Boeing employees, submitted a letter to President Clinton signed by 106 congressional colleagues in May 1994.³⁶

³⁴ Mitchell Locin, “Trade Chief Hints China’s Status with U.S. May Not Change in ‘93,” *Chicago Tribune*, May 21, 1993, Sec. 1, 6.

³⁵ Donna Walter, “Firms Unshaken by U.S. Terms for China,” *Los Angeles Times*, June 7, 1993, D3.

³⁶ Peter Behr, “U.S. businesses waged year-long lobbying effort on China trade,” *Washington Post*, May 27, 1994, A28.

At this time, forces that favored revoking or placing conditions on China's MFN status were mainly to be found in human rights and religious groups, conservative-leaning organizations, a small number of U.S. industries hurt by the China trade (i.e., the textile industry), and some Chinese dissidents. While these groups had gained a considerable amount of influence in the early stages of the debate, their influence soon vanished because of the lack of financial strength and organizational cohesion. As Robert Sutter pointed out, even though these groups shared a common concern with China's offensive domestic policies, they often had different policy preferences due to their different ideologies and worldviews.³⁷ The lack of ideological and organizational cohesion severely undermined the coalition's effectiveness and strength.

On the whole, the China trade lobby achieved a considerable amount of success in pushing for its policy agenda. The coalition had been trying to reiterate to the White House the importance of maintaining a strong U.S. commercial relationship with China, to convince members of Congress to support an executive branch led China policy that would not pivot on the MFN issue, and to urge the Chinese government to continue talks with the U.S. on the three key issue areas. Their active lobby not only helped to influence a number of congressional members' position on the MFN issue, but also contributed to Beijing's perception that it had active supporters within the United States. Knowing that there was a large constituency in the United States that had vested interests in preserving

³⁷ For a more detailed discussion of the weaknesses of the coalition opposing China's MFN status, see Sutter, *U.S. Policy Toward China*, 1998, 54-56.

China's MFN status, Beijing could afford to resist American demands. The Chinese government capitalized on its leverage on several occasions, explicitly warning that U.S. businesses would suffer in the event of MFN withdrawal. Beijing's threats turned out to be entirely credible to the American business community. Given the business groups' divergent views on the MFN issue, there is little wonder that America's high-profile threats to revoke China's MFN status did so little to induce Chinese concessions.

Institutional Divisions under the Bush Administration

Differences between the executive and legislative branches over China policy goals and priorities was another important factor that reduced the effectiveness of U.S. pressure. While Congress repeatedly pushed for measures to punish China, the Bush administration consistently demonstrated a strong willingness to preserve China's normal trade status. The differences between executive and legislative preferences began to surface soon after Tiananmen. In the wake of Tiananmen, President Bush and his aides played a leading role in designing U.S. policy response toward the crisis. Essentially, Bush pursued a two-pronged strategy for dealing with the Chinese government: at the same time as he sought to avoid imposing what he saw as overly stringent measures on China demanded by Congress, interest groups, and the media, he privately pressed the Chinese authorities to take actions to improve the strained U.S.-China relationship.³⁸ Throughout the year, the

³⁸ Robert G. Sutter, "American Policy Toward Beijing, 1989-1990: the Role of President Bush and the White House Staff," *Journal of Northeast Asian Studies*, Winter 1990, 3.

administration adopted a considerably “lenient” China policy, as reflected by the sending of two secret delegations to Beijing soon after Tiananmen, the lifting of a number of sanctions imposed on Beijing in the immediate aftermath of Tiananmen, and Bush’s veto of the Emergency Chinese Immigration Relief Act, etc.

More importantly, the administration adopted a low public profile on the major issue of controversy in 1990 -- the annual waiver of China’s MFN status. In the face of strong domestic pressure, the president and his close advisors, who were determined to pursue an effective strategy in relations with China, managed to ensure that the State Department and other U.S. officials avoided comment on the issue until the president announced his waiver decision.³⁹ The executive branch’s low-key posture diminished opportunities for critics of MFN who wanted to use the issue to magnify the importance of American opposition to the Chinese government. In the end, even some critics of the executive policy toward China favored granting MFN with appropriate conditions.

By the end of 1990, although the House had passed two bills denying China MFN status, these actions came too late in the session for the Senate to take any action. Thus despite eight months of heated debate, no legislation had been sent to the President. But although Bush managed to successfully fend off any serious congressional challenge to the annual MFN waiver, he had not been able to still congressional criticism of China or reach a consensus with Congress on U.S.-China policy. Bush was perceived as relatively uninterested in human rights in China and overly sympathetic to Beijing’s interests.

President Bush's strong defense of China's MFN status can be attributed to his vision of U.S. China policy. Due to his experience as the chief U.S. diplomat in Beijing in the 1970s, Bush seemed to believe that he had a special understanding of China and could effectively deal with Chinese leaders. He favored a policy of maintaining continued and constructive U.S. involvement in China in order to foster greater interaction between China and the rest of the world. From his point of view, such a policy provided the best means for bringing about greater economic achievement, political stability, and improved human rights conditions for the Chinese people. Moreover, he judged that even though the end of the Cold War might have reduced China's importance as a lever against the Soviet Union, China remained important to the U.S. leadership role in the emerging world order because of its size, location, and potential impact on world developments.⁴⁰

U.S. preoccupation with the Gulf War in late 1990 and early 1991 temporarily diverted congressional attention from the MFN issue. However, as the war came to a close in 1991, a large number of congressional critics who remained discontent with Chinese behavior and the perceived ineffectiveness of presidential policy once again focused attention on China's trade status. New evidence that emerged in 1991 of China's irresponsible behavior in the areas of trade and weapons proliferation fueled congressional determination to force changes in Chinese policies. The hardening attitude of various

³⁹ Ibid.

⁴⁰ Ibid., 3-6.

interest groups critical of Chinese government policy further bolstered congressional attempt to challenge China's MFN status.

To mollify congressional frustration and avoid legislative restrictions on Chinese exports, the Bush administration became increasingly aware of the need to make adjustments in its policy and to take tougher actions to address the three key issues. Nevertheless, administration officials contended that continuation of China's MFN status and "engagement" with Beijing leaders should serve as the centerpiece of U.S. policy toward China.⁴¹ In offhand comments to reporters on May 15, 1991, President Bush indicated that he intended to renew China's MFN status for another year, saying that he wanted to see MFN for China continue and that the administration did not want to isolate China.⁴² On May 15, 1991, in a commencement speech at Yale University, Bush justified his efforts to keep MFN as a key element in U.S. engagement with China. In the Yale speech, the President outlined both the economic and political reasons for preserving China's preferential trade status. According to him, MFN revocation could impose additional costs on American importers and consumers, lead to reduced sales of American aircraft, farm products and other goods, and hurt Hong Kong's economy and the dynamic, export-oriented enterprises in southern China. In addition to the economic consequences of terminating MFN, Bush referred to China's ability to affect the stability of the Asian Pacific region as well as the entire world's peace and prosperity. Invoking moral

⁴¹ Ibid.

⁴² "China MFN Vote Falls Short of Veto-Proof Margin," *Congressional Quarterly Weekly Report* 49: 30, July 1991, 2056.

reasoning, he argued that continuing trade and other contact was the best way to strengthen contacts with the Chinese people, promote the spread of democratic ideals and create the conditions for democratic change.⁴³

The Bush administration supplemented such rhetoric with a series of tougher actions to demonstrate its resolve to deal with China's offensive policies. For example, during the first six months of 1991, American officials on several occasions met with senior Chinese officials to discuss human rights. In April, to convey to the Chinese authorities U.S. dissatisfaction, President Bush met with the Dalai Lama in the White House. On April 26, several weeks before the Congress would make the decision on MFN, U.S. Trade Representative Carla Hills cited China for inadequate protection of intellectual property rights and named it one of three "priority foreign countries" under the Special 301 provisions of the 1988 Trade Act. Also, a delegation led by assistant USTR Joseph Massey visited Beijing in June to discuss a wide range of trade problems with senior officials in Beijing.⁴⁴ These measures indicated to Congress and the public that the three issue areas were at the top of the administration's economic agenda and that the executive was pursuing a vigorous dialogue with Beijing on these questions.

Furthermore, the White House mounted an intensive lobbying campaign in the Senate against a bill sponsored by Majority Leader George Mitchell. It sought to persuade Republican senators to vote in line with the President's position. It also

⁴³ Don Oberdorfer and Ann Devroy, "Bush Seeks to Renew China Trade Status," *Washington Post*, May 16, 1991, A1.

⁴⁴ Sandy Hendry, "Limited Protection," *Far Eastern Economic Review*, 153: 29, July 18, 1991.

mobilized societal groups interested in preserving U.S.-China trade to press for unconditional MFN. Throughout 1991, tension remained high between the White House and Congress over U.S. China policy. Congressional dissatisfaction with China's performance in the three issue areas led to the passage of the United States-China Act of 1991 (H.R. 2212) sponsored by Rep. Nancy Pelosi and another concurrent Senate measure sponsored by Majority Leader George Mitchell (S. 1367) in July 1991. In the end, however, largely due to its active defense of China's unconditional MFN status, the White House managed to garner enough support in the Senate to sustain a presidential veto.

The tug of war between the President and Congress intensified in 1992. Congress became increasingly impatient with the Chinese government as more members of both parties were willing to impose sanctions on China. Congress approved two bills that would have attached conditions on China's MFN renewal in 1993. As expected, President Bush vetoed both bills and again successfully mustered enough support to sustain the vetoes in the Senate.

The Bush administration's opposition to congressionally mandated conditions was rooted in its perception of the significance of a viable U.S.-China commercial relationship to long-term U.S. interests. In addition, administration officials emphasized China's importance to U.S. diplomacy and referred to China's role in the Gulf War and the Cambodian peace accords as concrete examples of Beijing's strategic importance. They argued that although they agreed with the intention of the bill, threatening China with

trade sanctions or cutting off trade ties would be both unworkable and counterproductive. The consensus in the administration was that for all its shortcomings, extending MFN status was the best way to moderate China's behavior and to promote American economic interests.⁴⁵ As Bush asserted in the veto message, his decision to veto the bill was intended to "protect the economic and foreign policy interests of the United States."⁴⁶

Thus, throughout 1990-1992, the Congress, predisposed to place more emphasis on issues with strong domestic implications, repeatedly threatened to revoke or place conditions on China's MFN status. In contrast, the Bush administration was committed to a more moderate approach to dealing with China and consistently vetoed legislative proposals that would attach stiff conditions to China's MFN renewal. The President's determination to retain China's trade status was based primarily on considerations of the cost that MFN revocation would inflict on various sectors of the American economy. The impact of MFN withdrawal on the overall U.S.-China relationship also influenced administration officials' calculations.

From the Bush team's point of view, revoking or conditioning MFN would have reduced the volume of bilateral trade, cost the U.S. a major overseas market, and damaged the reputation of the U.S. as a reliable trading partner. If MFN status were withdrawn, Chinese goods would be subject to tariffs five to ten times as high as when the status was retained, significantly reducing Chinese exports to the U.S and imposing substantial costs

⁴⁵ "Two Bills Limiting Trade with China Vetoed," *Congressional Quarterly Almanac* 48, 1992, 158-159.

⁴⁶ "Messages to the House of Representatives Returning without Approval the United States-China Act of 1991," *Weekly Compilation of Presidential Documents* 28, March 2, 1992, 386.

on American importers, retailers, and consumers, particularly those who rely on China's low-end products. The Chinese retaliation provoked by the U.S. sanctions would in turn significantly reduce American exports to China, costing the United States a good number of jobs and large export contracts to its European and Japanese competitors. This reduction in bilateral trade and the resulting downward spiral in bilateral economic relations would likely exacerbate America's overall trade deficit, reduce further the flow of U.S. foreign direct investment into China, and negatively affect the most economically dynamic areas in southern China.⁴⁷

In addition to the above economic considerations, China's importance in world affairs also influenced the administration's stance on the MFN issue. Administration officials repeatedly affirmed that a comprehensive and institutionalized economic relationship with China would contribute to the stabilization of Asian affairs as well as a balanced global strategic posture. As Bush stated clearly in his Yale address:

China can -- easily can -- affect the stability of the Asian Pacific region and therefore affect the entire world's peace and prosperity. The Chinese play a central role in working to resolve the conflict in Cambodia, to relax tensions on the Korean peninsula. China has a voice now in multinational organizations and its votes in the United Nations Security Council against Iraq's brutal aggression helped us forge the broad coalition that brought us victory in the gulf.⁴⁸

Consequently, conditioning China's MFN status and the resulting deterioration in bilateral economic and political relationship would significantly affect the ability of the U.S. to develop strategic cooperation with Beijing at the global level. Since

⁴⁷ "The Case for China's MFN Status," *China Business Review* 19: 4, July-August 1992, 14.

⁴⁸ "Bush Says China MFN Status Will Be Catalyst for Change," *Congressional Quarterly Weekly Report* 49: 22 (June 1, 1991), 1459.

administration officials did not view China's trade practices as directly threatening the viability and survival of American industries, considerations for the overall economic and political costs of disrupting trade with China prevailed in the Bush administration's decision to extend MFN status to China without any conditions.

Indeed, Congress and the Bush administration were perhaps more divided on China than on any other foreign policy issue. The White House' repeated assertion that it did not want to see MFN for China to be withdrawn, its firm stance, and willingness to use the last resort of presidential veto, strengthened Beijing's belief that the threat to cut off its MFN status was mere bluff. These institutional divisions, reinforced by the sharply divergent interests held by interest groups, sent highly mixed signals to the Chinese and substantially reduced the effectiveness of American threats. Thus although the pressure on China to change various domestic politics was greater than any other time since the normalization of U.S.-China relations, in the end Beijing made no fundamental changes in its policies and only offered a few symbolic concessions to appease critics of the executive branch's "soft" approach.

By the end of 1992, Beijing had done little to lower its trade barriers to foreign businesses. It blocked inspection of factories that allegedly used prison labor to make export goods. Moreover, Chinese authorities had released only a limited number of Tiananmen prisoners. Chinese premier Li Peng directly told President Bush in a meeting in New York in January 1992 that human rights concerns were being used as an excuse by

outsiders to meddle in China's internal affairs.⁴⁹ By the end Bush's term, Congress and China critics remained deeply dissatisfied with Beijing's performance in the areas of human rights, trade, and weapons proliferation. They were hoping that the coming to power of a new President who had promised to get tough with Beijing during his presidential campaign could help to orchestrate a more unified policy that could exert sufficient pressure on Beijing. The extent to which the United States has been able to influence the direction of Beijing's policies under the new Clinton team will be the focus of the next section.

The Clinton Administration and MFN: 1993-1994

During the 1992 presidential election campaign, candidate Bill Clinton accused Bush of "coddling the dictators" in Beijing and promised that he would "get tough" with China once he came into office. After he was sworn in, Clinton did initially take a number of firm actions to deal with China's unfair trading practices and human rights abuses. In May 1993, he signed an executive order linking China's MFN status to its human rights behavior. However, as mentioned earlier, the unfeasibility of the executive order soon became apparent. In the face of tremendous pressure from the business community and China's continued resistance to American demands, President Clinton had to abandon the linkage policy in 1994.

⁴⁹ George D. Moffet, III, "Bush, Congress Clash on China," *Christian Science Monitor*, February 27, 1992.

From hindsight, it appears that a fundamental problem with Clinton's linkage approach was Beijing's belief that the President was not serious about his threat to terminate MFN status for China. The Chinese seemed to think that even in the highly unlikely event that Clinton implemented the threat, the divisions within American society would soon reverse his policy. They calculated that Clinton simply couldn't get his threats ratified by domestic business groups and his own economic team. For example, a week after Secretary of State Warren Christopher's visit to Beijing in March 1994, Chinese Foreign Minister Qiao Qichen reportedly recalled Christopher's meeting with representatives of major U.S. corporations in Beijing where all American business representatives "voiced their strong opposition to the revoking of China's trade status."⁵⁰ Beijing's calculations turned out to be right. Not only did the China trade advocates campaign aggressively to oppose the linkage policy, many of those in the administration who had publicly indicated approval of the President's executive order worked diligently to overturn the policy once it came into existence.⁵¹ Therefore, despite a temporary toughening of policy, Clinton was soon forced to reorient its China policy. The business community's increasingly aggressive lobbying effort during the Clinton administration has been documented earlier in this chapter. Here we will focus on the evolution of Clinton's China policy and the process leading to his policy reversal to show how highly conflicting forces in the U.S. government undermined the credibility of the MFN threat.

⁵⁰ Patrick E. Tyler, "Beijing Says It Could Live Well Even if U.S. Trade Was Cut Off," *New York Times*, March 21, 1994, A1.

Clinton's views concerning MFN tariff treatment for China evolved through several stages between June 1992 and May 1993. In the first stage, from mid-summer until September 1992, Bill Clinton attacked George Bush for his "ambivalence about supporting democracy around the world in a manner worthy of our heritage, our ideals, and our name.... There is no more striking example of President Bush's indifference to democracy than his policy toward China."⁵² Clinton's rhetoric and the language of the Democratic party's campaign platform indicated that were he to be elected, he would quickly move to support the *legislative imposition* of a broad range of conditions on the extension of MFN for China. During the second stage which lasted from September 1992 until November of that year, candidate Clinton maintained his position that legislative conditions were desirable. But he modified his position, arguing that MFN status would only be removed from state-owned enterprises if conditions were not met in order to avoid hurting the non-state and foreign-invested sectors of the Chinese economy. Shortly after defeating Bush, President-elect Clinton, reflecting on the prudence induced by the prospect of governing, entered yet another phase by acknowledging that the Bush administration had made certain progress and that the U.S. had "a big stake in not isolating China."⁵³

⁵¹ David M. Lampton, "America's China Policy in the Age of the Finance Minister: Clinton Ends Linkage," *China Quarterly* 139, September 1, 1994, 599.

⁵² Edward Walsh, "Clinton Indicts Bush's World Leadership," *Washington Post*, October 1992.

⁵³ Edward Walsh, "In his Own Words: Clinton on China MFN," *China Business Review*, January-February 1993, 18.

Acting on his campaign promises, promises which none of his advisors had yet told him were unrealistic, the new Clinton team appeared ready to work with the legislature at the outset. The administration demonstrated a willingness to step up the pressure on Beijing and to maintain “solidarity” with Congress.⁵⁴ But while Clinton indicated that he would take a harder line on China, the conflicting pressures had become more intense once he came into office. On the one hand, some congressional members implied that should the Administration’s policy failed to satisfy them, they would insist on using the annual renewal of China’s MFN status to moderate Chinese behavior. On the other hand, many in the business community and the administration emphasized China’s economic and strategic significance and were positively calling for unconditional MFN. Clinton began to tread a middle course between these two extremes.

By the spring of 1993, President Clinton had come to believe that administratively imposed conditions on future MFN renewal was a suitable compromise between the rhetoric of the campaign and the realities of growing U.S. economic interests in China. On May 28, 1993, Clinton officially informed Congress that he planned to renew China’s MFN status. In response to congressional insistence on some form of MFN conditions, however, he signed an executive order tying the next renewal of China’s performance on human rights. Specifically, the executive order required that China would have to have

⁵⁴ For example, Winston Lord, Assistant Secretary of State-designate for East Asian and Pacific Affairs, stated at his confirmation hearing in late March that “the theme of our approach on MFN is solidarity with the Congress... Conditional MFN is the position of the president and we will go forward on that basis, depending on the events.” See Susumu Awanohara, “China Consensus: Clinton and Congress Converge on MFN issue,” *Far Eastern Economic Review*, April 2, 1993, 43.

made "*overall, significant progress*" in seven areas related to human rights for the Secretary of State to recommend a continuation of its MFN tariff treatment in July 1994.⁵⁵

In opting for administratively-imposed conditions, Clinton adopted an approach that was a notch higher than that of the Bush administration, which repeatedly resisted all efforts by a Democratic Congress to attach any conditions to the annual renewal of China's trade benefits. But Clinton's policy toward MFN also was weaker in three respects than the one advocated by Congress over the past three years. First, during the Bush administration, Congress had wanted to impose a series of conditions on China's MFN status through legislation, which would be much more lasting and difficult to change than a presidential executive order. Second, the conditions Clinton specified in the executive order involved only human rights, leaving out the language on trade and arms exports that Congress had approved under Bush. This partly reflected the growing feeling, even among some China critics, that the MFN-conditioning bills in Congress were loaded with so many diverse and onerous requirements that they were tantamount to MFN-revocation bills. Third, the wording of the human rights conditions Clinton set for China was less detailed than those in the legislation that Congress passed and Bush vetoed.

Events during the year that followed transpired to undermine the very intent of the executive order. In the first place, much of the business community organized to

⁵⁵ The executive order established seven human rights-conditioning factors (including halting exports of goods produced by prison labor, allowing freedom of emigration, observing the Universal Declaration of Human Rights, protecting Tibet's distinctive culture, treating prisoners humanely, permitting international radio and television broadcasts in China, and releasing and accounting for prisoners held for the non-violent expression of political and religious beliefs.

articulate their interests more effectively to congressional members and to the administration. As mentioned earlier, prior to the executive order, corporate America was unwilling to argue vigorously and publicly for unconditional MFN for China because of highly negative media reports about Chinese policies. They relied mainly on Bush's presidential veto to protect their interests. But with the announcement of the executive order and with American businesses' growing stake in the Chinese economy, they were forced to take a proactive stance on MFN and to better orchestrate their activities.

More importantly, President Clinton and many in the administration soon began to realize that the executive order had given insufficient weight to economic interests. President Clinton himself, for example, began to have doubts about the executive order soon after its release. In the summer of 1993, U.S.-China relations underwent a downward slide, encouraging Winston Lord to come up with a classified memorandum for the President in mid-July advocating a policy of "comprehensive engagement" with China. The new policy became the basis for a series of high-level exchanges during the next year. Moreover, through his participation in the APEC meeting and his talks with President Jiang Zemin in Seattle in November 1993, the President came to see that China was "too big to punish and too important to isolate".⁵⁶ The President's doubts deepened with Secretary Christopher's March 1994 visit to Beijing, when Christopher received a reception "as frigid as the winter wind blowing down from Mongolia" trying to educate the Chinese on the need to improve their record on human rights.

A changing mood within the executive branch helped shape Clinton's perception. Following the release of the executive order, a growing number of administration officials voiced their concerns that revoking China's MFN status would adversely affect American interests. In particular, Clinton's economic team felt that the executive order overemphasized human rights at the expense of economic opportunity. They articulated those interests more forcefully when China's preferential trade status came up for renewal in 1994. At the Department of Treasury, Secretary Lloyd Bentsen came back from a January 1994 trip to China with a favorable assessment of China's economic growth and America's stake in that market. During his trip, he finalized the Memorandum of Understanding on prison labor exports to the United States, revived the Joint Economic Commission, and took a tougher line on Japan than on China. The Secretary maintained that unilateral U.S. economic sanctions would undercut U.S. competitiveness by ceding an important and rapidly expanding overseas market to its competitors.⁵⁷

At the Commerce Department, Under-Secretary for International Trade Jeffery Garten emphasized the importance of China's market and growth to American economic interests. In a classified economic report titled "U.S. Commercial Interest in China to the Year 2000", he called for the administration to more fully incorporate economic analysis into decisionmaking.⁵⁸ Commerce Secretary Ron Brown similarly argued that the pursuit of better human rights performance in China should not come at the expense of economic

⁵⁶ Lampton, "America's China Policy in the Age of the Finance Minister," 1994, 610.

⁵⁷ *Ibid.*, 616.

⁵⁸ *Ibid.*

growth in America.⁵⁹ The Commerce Department put China on the top of its “Big Emerging Markets” list.⁶⁰

The newly-established National Economic Council (NEC), led by Robert E. Rubin, also played a positive role in the campaign for the unconditional renewal of China’s trade status. Rubin, and his deputy Bowman Cutter, felt that the President’s executive order had attached excessive weight to the views of agencies such as the National Security Council (NSC). They urged the Clinton administration to ultimately adopt a China policy that would end the link between trade and human rights. The NEC turned out to be the strongest advocate of renewal in the MFN debate in both 1993 and 1994.⁶¹ Increasingly, officials at other agencies, including Treasury, Commerce, and the United States Trade Representatives Office, began to complain that Winston Lord still was placing excessive conditions on human rights and security issues at the expense of trade and economics. After they relayed their concerns to the NEC and the NSC, further adjustments in the policy process were made to give the economic officials a greater voice.

Changes in the international environment reinforced Clinton’s doubts about his China policy. By April 1994 the administration was confronted with a number of foreign policy problems in East Asia ranging from the growing crisis with North Korea over the latter’s suspected nuclear weapons program to the dispute with Japan over the

⁵⁹ Robert S. Greenberger and Michael K. Frisby, “Clinton’s Renewal of Trade Status for China Followed Cabinet Debates, Congress’s Sea Change,” *Wall Street Journal*, May 31, 1994, A18.

⁶⁰ Nancy Dunne, “Beijing and the Business of Human Rights,” *Financial Times*, March 16, 1994.

⁶¹ *Ibid.*; Robert S. Greenberger, “Restraint of Trade: A Cacophony of Official Voices Jumbled U.S. Message to China on Human Rights,” *Wall Street Journal*, March 22, 1994, A8.

“framework agreement” for dealing with the trade deficit. In addition, the broad international environment did not bode well for Clinton’s foreign policy. In light of unrest in Yugoslavia, unstable relations with Moscow, and uncertain ties with Japan resulting from political changes in that country, the Clinton administration increasingly felt that the United States could not afford to have uncertain relations with every major geopolitical center on earth. The lack of support for Washington’s policy on China’s MFN status from America’s traditional allies also prompted the administration to reconsider its China policy.⁶²

As a result, the President’s views on China had changed one hundred-eighty degrees by summer 1994. On May 26, 1994, the President renewed China’s favorable trade status without any conditions and announced that he would abandon his effort to use trade as a lever to force Beijing to make progress on human rights, although plainly acknowledging that China had fallen short. In making the announcement, Clinton offered perhaps the most eloquent defense of the Bush administration’s China policy ever uttered at the White House: “To those who argue that in view of China’s human rights abuses we should revoke MFN status, let me ask you the same question that I have asked myself: Will we do more to advance the cause of human rights if China is isolated, or if our nations are engaged in a growing web of political cooperation and contacts?”⁶³ In adopting such an approach, Clinton was acknowledging the growing importance of

⁶² Lampton 1994, 610-611.

⁶³ Thomas Friedman, “Clinton Votes for Business,” *New York Times*, May 27, 1994, A1.

economic concerns in foreign affairs. It seems justified to say that it was the economic officials and the China trade lobby that had prevailed in the decision to delink.

Chinese Perceptions and Strategy

The intense conflict between various domestic actors in the U.S. over the appropriate China policy detailed above substantially reduced the credibility of American threats to terminate China's MFN status. In particular, as various bureaucracies and individuals expressed their views about China's trade status both in private and in public forums in the process leading up to Clinton's decision to "delink", they also diminished the credibility of the administration's position in the eyes of the Chinese government.⁶⁴ A series of visits by high-ranking Chinese officials to the United States further confirmed Beijing's belief that China was viewed by the United States as a major force in world economics and geopolitics, that the U.S. wanted good relations with Beijing, that there was latent support both in corporate America and in the administration for good economic relations with China, and that there were serious divisions within the Clinton administration.⁶⁵ Confident that "it is the view of U.S. business to solve this issue once and for all," Beijing simply could not believe that Washington would revoke MFN and was thus able to avoid making any major adjustments in its domestic policies.⁶⁶ By early

⁶⁴ Sutter 1998, 50.

⁶⁵ Lampton 1994, 613.

⁶⁶ Greenberger, 1994, A8.

1994 Beijing seemed to believe that it could simply defy American pressure and that the administration would back down without obtaining any significant concessions.

Indeed, Beijing had adopted its own policy for dealing with American pressure. The “four nots” policy (not to desire confrontation, not to provoke confrontation, not to dodge confrontation, and not to be afraid of sanctions and to resist them) was based on the premises that the United States still needed China’s cooperation and that Clinton’s domestic and foreign policies reflected considerations for conflicts at the domestic level.⁶⁷

In short, Beijing’s leaders appeared to be convinced that American politics was fundamentally driven by economic interests and that it would be difficult for President Clinton, who placed so much emphasis on stimulating economic growth and improving competitiveness, to change his mind and cut off America’s ties with one of its most important trading partners.⁶⁸ As a result, Beijing felt it could mobilize the economically oriented segment of the American polity in the battle over MFN. The active cooperation that Beijing was able to forge with the American business community led some Clinton administration officials, including Winston Lord, to complain that business executives “were not only not supporting us, but they were undercutting us with the Chinese.”⁶⁹ An important strategy Beijing adopted towards that end was to carry out a series of high-level

⁶⁷ Jen Hui-wen, “Background to China’s ‘Four Nots’ Policy Toward the United States,” *Hong Kong Hsin Bao*, September 17, 1993, in *Foreign Broadcast Information Service*, no.179, 1-3.; Lu Yu-sha, “New ‘Eight-Character Principle’ of China’s policy toward the United States,” *Hong Kong Tangtai* 30.

⁶⁸ Patrick E. Tyler, “Beijing Says It Could Live Well Even If U.S. Trade Was Cut Off,” *New York Times*, March 21, 1994, A10. As Jiang Zemin commented on his meeting with Clinton in Seattle in 1993: the two sides “were of the same opinion that a long-term view should be taken of the development

trips to the United States, sometimes shopping trips carefully timed to coincide with major decisions on MFN, to showcase China's importance to America. For example, in April 1994, Chinese Trade Minister Wu Yi led "the largest Chinese trade initiative ever to the U.S."⁷⁰ Another part of Beijing's strategy was to show Washington that it was alone in threatening to impose sanctions on China and that it would yield market shares to its competitors if MFN were withdrawn. Beijing on several occasions awarded business deals to the Europeans and the Japanese ostensibly in retaliation for the U.S.' tough stance on the MFN issue.⁷¹

The result, therefore, was that Beijing ended up giving President Clinton just enough "face" by making a number of symbolic concessions so that he could reverse his earlier decision. As Secretary Christopher candidly conceded in his "Recommendations" to President Clinton, although the Chinese had made some concessions and progress, "these positive developments cannot be said to meet the expectations set forth in the EO [executive order]." The Chinese were right to see the realism in Clinton's China policy: "The U.S. is rather pragmatic when it sees its policies aren't working, so the Clinton administration will become more pragmatic."⁷²

of Chinese-U.S. relations, looking toward the 21st century." In "Jiang on Sino-U.S. Relations," Xinhua News Service, September 1994.

⁶⁹ James Mann, *About Face*, 1999, 296.

⁷⁰ Sheila Tefft, "China Sends Huge Trade Vanguard to the U.S.," *Christian Science Monitor*, April 8, 1994, 9.

⁷¹ Lena H. Sun, "China Detains Dissident as French Premier Tries to Mend Relations," *Washington Post*, April 9, 1994, A22.

Conclusion

By this point, it should have become clear why a threat as powerful as MFN withdrawal would have failed to extract significant concessions from China. The messages the United States sent to Beijing were so mixed and confusing that China simply did not find it necessary to make any concessions. As we have seen, due to the complementary trade relationship between the United States and China, a great number of business groups had voiced their opposition to threats to put restrictions on Chinese exports. In particular, American importers and retailers of toys, apparel, footwear, and consumer electronics, goods that the United States no longer produced itself, had staunchly opposed MFN revocation/conditionality, arguing that they could not always acquire these goods from other countries at competitive prices. Furthermore, because the United States produces a wide range of products that China had plans to purchase in large volume, American manufacturers of aircraft, autos and telecommunications equipment also actively lobbied against the imposition of sanctions, a measure that would cut off their access to the world's fastest growing economy and largest market. Thus, whenever the United States tried to strike out at China for its offensive domestic policies, it almost always had been hamstrung by strong opposition from the business community from doing so. While the human rights lobby and other conservative groups aggressively pushed for MFN revocation at the outset, they simply could not match the China trade lobby in terms of organizational cohesion and financial strength. Since they did not have a policy

⁷² Comment by a Chinese foreign relations analyst in Beijing in May 1994. See Lampton, 1994, 613.

alternative other than one that would result in Chinese retaliation and international isolation, these groups eventually lost ground to the MFN-advocates.

These divergent domestic interests were exacerbated by the divisions within the U.S. government. The legislative branch, more sensitive to issues with strong domestic implications, was determined to punish China's perceived intransigence through existing trade laws. In contrast, the executive branch, considering conflicting domestic pressures and long-term American economic and strategic interests in China, was more inclined to maintain the status quo. As we have seen, the Bush administration consistently opted to oppose efforts to attach legislative conditions to MFN status for China. It was committed to its own perspectives on U.S.-China relations and devoted considerable resources to deflect congressional pressure. The President even used the last resort of a presidential veto in order to preserve China's normal trade status. Later, President Clinton, even though he had initially confronted China on human rights issues, was compelled by the realities of U.S.-China relations to temper his rhetoric and to repudiate pressure tactics that have proved to be both futile and counterproductive. Clinton's about-face in part reflected intense pressure from the trade lobby, but it also stemmed from his economic team's determination to move toward positive bilateral economic co-operation. Since it knew MFN revocation/conditionality would adversely affect a broad sector of the American economy as well as the overall competitiveness of American industry, it was difficult for the executive to forge a long-lasting consensus with Congress on the need to terminate China's MFN tariff treatment.

Given these divisions in American politics, it is hardly surprising that American threats would have failed to extract any meaningful concessions from China. Although the United States was seriously interested in finding solutions to its trade problems, it was constrained by the structure of U.S.-China trade relations from obtaining a favorable outcome. Once the Chinese figured out they had nothing to lose, threat tactics lost much of its utility. With intense conflict among U.S. domestic constituencies and with MFN for China down on the executive's foreign policy priority list, it has been extremely difficult for the United States to carry out a credible threat. In the end, it was Beijing who was able to adopt a coherent strategy because it was a critical foreign policy issue and there was virtually no domestic constituency opposed to its policy. Ironically, as an authoritarian regime, Beijing turned out to be in a better position to play with American politics than vice versa. Because the United States is a democracy, the Chinese could see exactly what was going on in the United States by reading the editorial pages and listening to the debates. And because Beijing is an authoritarian regime, it could implement coherent policies, such as awarding contracts to the Japanese and European firms, to exacerbate the divisions in American society. There is little wonder, then, that American threats against China to modify its domestic practices have been so futile.

Some analyses suggested that part of the reason why Beijing proved so resistant to U.S. pressure, especially during the Clinton administration, was the elite's fear that concessions to Washington would exacerbate domestic instabilities. Moreover, it was argued that with Deng Xiaoping's death imminent, succession posturing by contenders for

power made it even more unlikely for the leadership to submit to American threats. These considerations certainly influenced Beijing's calculus, but as the analysis in this chapter shows, the basic explanation is far more complex. American threats simply were not credible to the Chinese; Chinese threats were entirely credible to the Americans. The public articulation of demands by Washington also "triggered every nationalistic reflex in the Chinese body politic." In the end, it is difficult to know what price the Chinese would have paid. The fact is that "they didn't believe they needed to pay much -- and they were right."⁷³

⁷³ Ibid.

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U.S.-Japan Trade Conflicts: Semiconductors and Super 301

The U.S.-Japan semiconductor trade conflict and the Super 301 investigations over Japanese government procurement practices in the supercomputer and satellite industries all involved U.S. concerns about the Japanese threat to the competitiveness of American industry in technology-intensive, strategic sectors. The negotiation over semiconductors was one of the most drawn-out and acrimonious between the two countries. It started in the early 1980s, when the United States began efforts to deal with the undercutting of the American semiconductor industry by increasingly competitive Japanese firms. Since then, sustained American pressure, backed by the threat of further action, helped to produce a major bilateral agreement in 1986 and another one in 1991 providing American chip producers with some relief from Japanese dumping in the U.S. market and with greater access to the Japanese market. Although some authors question the extent to which these agreements succeeded in addressing American concerns, there was substantial evidence showing that the agreements favored American firms. Although the negotiations were often protracted and difficult, tough talk by both the Reagan and Bush administrations forced Japan to halt its predatory pricing behavior and to open up its protected domestic market to American semiconductor products. American pressure played a crucial role in preventing the further slide of the U.S. semiconductor industry.

In the 1989 Super 301 investigations over Japan's protectionist policies toward the satellite and supercomputer industries, the United States complained that Japan, through policies of industrial "targeting" designed to promote the development of autonomous supercomputer and satellite industries, had effectively excluded American producers, who were very competitive elsewhere in the world, from its public-sector market. The negotiations in both cases allowed the United States to achieve its most immediate objective of opening Japanese government procurement to foreign bidders.¹ Although the United States may not have achieved the long-term objective of deterring Japanese government targeting of these industries, by prying open Japan's protected home market, it at least has been able to thwart the rapid ascent of Japanese industries in the global market.

Domestic interest groups' unified support for threat tactics was crucial to the American success in these cases. Unlike U.S. trade negotiations with China where efforts by export-seeking industries to impose sanctions on the target were often undercut by import-using interests who were unwilling to see their access to potential suppliers being cut off, the American semiconductor, supercomputer, and satellite industries did not encounter any major opposition from other segments of the business community. Indeed, since the United States and Japan competed in so many product categories, there was a large constituency in the United States who faced Japanese competition. Under these

¹ According to Bayard and Elliott, the United States had largely achieved its negotiation objectives in the satellite cases and partially fulfilled its objectives in the supercomputer negotiations.

circumstances, sanction threats won support not only from the semiconductor, satellite, and supercomputer manufacturers, who were interested in expanding U.S. market access in Japan, but also from other import-competing interests (such as electronics and auto manufacturers in the semiconductor case) who would benefit from the restrictions placed on Japanese exports to the United States. In the supercomputer and satellite cases, organizations such as the U.S. Chamber of Commerce and the National Association of Manufacturers which opposed sanctions in the China cases all came out in favor of the sanction threats. The pervasive feeling within the U.S. business community that Japanese nurturing of its domestic industries seriously injured American producers in various sectors further fed this protectionist sentiment. Since the sanction threats promised benefits to either the export-seeking interests (if sanctions succeeded in extracting concessions) or import-competing interests (if they had to be imposed), they enjoyed wide support from the U.S. business community. This unprecedented unity signaled to Japan that it could hardly escape some form of sanctions should it fail to make meaningful concessions, prompting the Japanese to take U.S. demands more seriously.

Reinforcing unified industry support was the executive branch's greater willingness to resort to managed trade to shape the dynamics of international competition in technology-intensive industries. With Congress pushing for a more proactive trade policy, the Reagan and Bush administrations both opted to go along with the considerably tougher approach advocated by Congress. The executive's greater assertiveness in these

cases had its roots in the strategic significance of these industries in both military and economic senses. The semiconductor industry, for example, had many spillover benefits for other sectors of the economy and provided linkage externalities (such as lower costs, higher quality inputs) for industries such as telecommunications equipment and computers which also had considerable long-term economic significance. Failure to intervene to ensure the competitiveness of these high-technology industries was therefore considered to have substantial negative implications for the overall competitiveness of the American economy. Given these considerations, the U.S. executive made the crucial turn from benign neglect to managed trade policy, taking an active role in reshaping comparative advantage in these leading industrial sectors.

Lack of strong domestic opposition, combined with the executive's greater willingness to intervene, demonstrated to the Japanese the U.S. resolve in seeking a fair trade outcome, indicating that sanction threats had the full support of the major domestic actors. Domestic unity enhanced American threat credibility, leading to the conclusion of several agreements which increased the U.S. share of the Japanese market. A highly competitive trade structure between the United States and Japan thus created the conditions that made it easier for the United States to extract concessions from Japan.

The U.S.-Japan Semiconductor Trade Conflict

The Semiconductor Competition from Japan and Its Implication for U.S.-Japan Trade

The remarkable growth of the Japanese semiconductor industry and the corresponding decline of the American semiconductor industry have been well documented. From the advent of the semiconductor industry in the 1940s through the mid-1970s, the United States has occupied the commanding position in this sector in terms of technology, innovativeness, and world market share. As the preeminent leader in scientific and technological capabilities and as the world's military hegemon, the United States possessed both the means and the incentive to propel technological development in the semiconductor industry in ways that enhanced national security. The American government, through heavy investment in Research and Development (R&D) and military and space-related procurements, played a central role in the early development of the semiconductor industry.²

While early government support was oriented toward military applications, over time a number of American firms successfully made the transition from catering to military needs to primarily serving the commercial market. Government-backed military

² For more detailed account of the development of the American and Japanese semiconductor industries, see Daniel I. Okimoto, Takuo Sugano, and Franklin B. Weinstein, *Competitive Edge: The Semiconductor Industry in the U.S. and Japan*, Stanford, CA: Stanford University Press, 1984; Clyde V. Prestowitz, Jr., *Trading Places: How We Are Giving Our Future to Japan and How to Reclaim It*, New York: Basic Books, 1988; Michael Borrus, *Competing for Control: America's Stake in Microelectronics*, Cambridge, MA: Ballinger, 1988; Michael Borrus, James E. Millstein, and John Zysman, "Trade and Development in the Semiconductor Industry: Japanese Challenge and American Response," in John Zysman and Laura Tyson (eds.), *American Industry in International Competition: Government Policies and Corporate Strategies*, Ithaca: Cornell University Press, 1983.

“technology push” generated substantial “spillover benefits” for the civilian economy.

According to Laura Tyson, the convergence of a number of factors shaped the distinctive nature of the U.S. semiconductor industry and provided the sources for its dynamism and strength. First, the U.S. government’s pattern of R&D sponsorship and procurement policies, by lowering the barriers to new entry, encouraged the development of new firms and helped to diversify firm structure. Second, the venture market provided the necessary financial capital for entry. Third, government funding for university research, by sustaining cooperative ties between industry and research institutions, aided in the diffusion of technological information needed for innovations. Fourth, continued defense purchases provided a stable market for semiconductor manufacturers, reduced the risks of investment, and allowed companies to adopt new technologies and upgrade their production skills in a timely fashion. Finally, the U.S. antitrust and patent policies encouraged the development of merchant firms rather than vertically integrated companies.³

The interaction of these factors gave rise to an industry structure dominated by merchant firms specializing in semiconductor products instead of vertically integrated systems producers. This distinctive structure and the patterns of competition that accompanied it became the driving force for the U.S. semiconductor industry’s vitality

³ Laura D’Andrea Tyson, *Who’s Bashing Whom? Trade Conflict in High-Technology Industries*, Washington, D.C.: Institute for International Economics, 1992, 90.

through the mid-1970s, when the Japanese started to pose a serious challenge to America's preeminence in fields in which it had traditionally held a comparative advantage.

As a latecomer state faced with the need for rapid economic catch-up, the Japanese government had assumed an even greater role in the development of the Japanese semiconductor industry. Unable to replicate the American pattern of development, Tokyo relied on a nonmilitary set of policy instruments to overcome the disadvantages generated by its latecomer status and to create a vibrant semiconductor industry which would in turn aid in the development of a competitive indigenous computer industry. As in other industrial sectors, the Japanese government pursued the classical strategy of infant-industry promotion and protection. For example, to protect the Japanese market from foreign competition, the government forbade the establishment of wholly owned foreign subsidiaries and joint ventures in which foreign firms held majority ownership. It limited foreign imports through the imposition of high tariffs and restrictive quotas. It also kept tight control over the acquisition and diffusion of foreign technology.⁴

In addition to these measures, the Japanese government managed to maintain close cooperation with business and to channel scarce financial resources into the semiconductor industry. As part of the promotion strategy, it targeted the development of particular products that proved vital to the competitiveness of the Japanese semiconductor industry. Government support for the VLSI (very large scale integration) cooperative

⁴ Okimoto et al., *Competitive Edge*, 1984.

R&D program in the 1970s, for instance, enabled Japanese companies to obtain the capabilities for the production of sophisticated memory devices and logic circuits which used to be monopolized by the Americans. As part of the VLSI program of 1976-1979, the Ministry of International Trade and Industry (MITI) earmarked \$200 million in funds and provided interest-free loans to several major manufacturers of semiconductors, allowing them to form cooperative laboratories to jointly develop basic semiconductor technology.⁵ In particular, the targeting of Dynamic Random Access Memories (DRAMs), the highest volume segments of the semiconductor industry, enabled Japanese firms to acquire large-scale production process technology that later proved to be essential to their efforts to control less standardized product lines in the 1980s.

By the late 1970s and early 1980s, these policies of protection and promotion not only helped to create a competitive domestic industry capable of challenging American dominance in the semiconductor market, but also produced an industrial structure which, by many accounts, constituted a formidable barrier to American manufacturers seeking to penetrate the Japanese market. Over the years, the Japanese semiconductor industry came to be dominated by six multidivisional, vertically integrated firms tied to various *keiretsu* groups. As part of a *keiretsu*, each of these six firms had forged close ties with other member firms through preferential sales arrangements. Their close relationships with one

⁵ Douglas A. Irwin, "Trade Politics and the Semiconductor Industry," in Anne O. Krueger (ed.), *The Political Economy of American Trade Policy*, Chicago: The University of Chicago Press, 1996, 26.

another and with various economic ministries have often been found to be an important source for American producers' continued difficulties in accessing the Japanese market.

The difficulties American manufactures faced in capturing a share of the Japanese domestic market was compounded by their loss of dominance of the world market. Since Japanese firms were often affiliated with a large bank through the *keiretsu* linkages, they had access to relatively cheap capital and could afford to make substantial investments or to incur sustained losses even during periods of cyclical downturns. Between 1978 and 1985, 28 percent of Japanese firms' sales went into capital spending, compared to only 16 percent for U.S. firms.⁶ By outinvesting most undiversified, mid-sized U.S. merchant firms during each major industry recession, the Japanese gained market share at the expense of the Americans. Between the end of the 1970s and mid-1985, U.S. firms' share of the world semiconductor market declined from 60 percent to 45 percent, whereas the Japanese firms' share increased from less than 30 percent to 45 percent. After the famous crossover in 1985, Japan continued to maintain its leadership position in the world market. The success of the Japanese strategy was perhaps most astounding in the DRAMS market. Massive investment spending allowed Japan to capture approximately 90 percent of the leading edge 236K DRAM market, 75 percent of the 64K DRAM market, and about 70 percent of the total DRAM market.⁷ The Japanese established an overwhelming

⁶ OECD (Organization for Economic Co-operation and Development), *Globalization of Industrial Activities, Four Case Studies: Auto Parts, Chemicals, Construction, and Semiconductors*, Paris: Organization for Economic Co-operation and Development, 1992, 147.

⁷ Borrus, *Competing for Control*, 1988, 173.

leadership position in this critical product and drove seven out of nine American companies from the production of DRAMS. By the mid-1980s, Japan had overtaken the United States in overall semiconductor production and Japanese companies had displaced American firms as the leading merchant semiconductor producers.

In short, Japanese producers' growing penetration of the U.S. market and the rapid growth of Japan's domestic market, a market reserved primarily for Japanese firms, led to the phenomenal rise in Japan's share of the global semiconductor market. Moreover, Japan's gains in the semiconductor sector had come at the expense of American manufacturers. Two forms of alleged unfair Japanese practices particularly irritated U.S. chip manufacturers: Japanese dumping in both the U.S. and the world market and the lack of market access to the Japanese domestic market. Since the mid-1980s, American semiconductor producers have spent considerable political capital to urge the U.S. government to resolve these issues in U.S.-Japan trade.

Industry Initiatives

The U.S. semiconductor industry began to seek trade relief in the early 1980s. Industry pressure forced the Japanese to enter negotiations with the United States under the auspices of the U.S.-Japan Working Group on High Technology in April 1982. U.S. negotiators sought through these talks not only to stop dumping but also to allow American producers to establish a secure and enduring position in the Japanese market

through long-term cooperation with Japanese suppliers. This early set of talks produced an agreement in which the Japanese government committed itself to use its authority to prevent dumping, to provide U.S. firms with greater access to Japanese patents, to refrain from copying U.S. propriety circuits, and to encourage Japanese firms to increase purchases of U.S. semiconductor products through administrative guidance.⁸

Throughout 1983, the semiconductor industry released numerous reports and studies with detailed account of the unfair trade practices pursued by Japanese chip makers and the Japanese government. It even drafted a Section 301 petition in the summer of 1983. Meanwhile, in April 1983, U.S. and Japanese negotiators began a second round of negotiations devoted primarily to addressing market barriers in Japan. U.S. semiconductor manufacturers firmly demanded a 30 percent share of the Japanese market, which they maintained was what they deserved if the Japanese market were open. Officials at the Department of Commerce and the U.S. Trade Representatives (USTR) were receptive to the proposal, but other administrative offices, notably the Office of Management and Budget (OMB), the Council of Economic Advisors (CEA), and the Justice Department, rejected the idea of negotiating a guaranteed share of Japan's domestic market due to their desire to preserve the free trade principle.⁹

Between 1983 and 1985, the situation of the semiconductor industry further deteriorated. By 1985, the aggressive pricing strategies of Japanese producers, the exit of

⁸ Timothy J. C. O'Shea, "The U.S.-Japan Semiconductor Problem," in Robert S. Walters, ed., *Talking Trade: U.S. Policy in International Perspective*, Boulder: Westview Press, 1993, 61.

almost all merchant American companies from the production of DRAM chips, and the sustained cyclical slump in industry demand combined to produce a sense of crisis among U.S. semiconductor manufacturers. American producers felt that should the U.S. government fail to adopt proactive measures to rescue the semiconductor industry, the United States would have let the larger, better-financed Japanese competitors continue to strengthen their dominance of the world market in the late 1980s and 1990s. Moreover, the aggravation of industry plight convinced U.S. semiconductor makers that ad hoc bilateral agreement such as the one brokered by the U.S.-Japan Working Group on High Technology were not sufficient and that it might take sanctions to get Japan to alter its behavior. Thus, in a crisis atmosphere, U.S. semiconductor producers began to call on the government to redress the trade balance. These actions dovetailed with mounting congressional and administrative concerns about the growing U.S. trade deficit with Japan. Through extensive and continuous lobbying activities, the semiconductor manufacturers exercised considerable political clout and successfully brought to the attention of the government and the public the connection between the industry's troubles and unfair Japanese competitive tactics.

The semiconductor producers' trade offensive was waged under the leadership of the Semiconductor Industry Association (SIA). The SIA was formed in 1977 explicitly to respond to the increasing competitive challenge from Japan. Between 1979 and 1986, the

⁹ O'Shea, 1993, 61-62.

SIA played an indispensable role in the industry's successful effort to realize a number of its trade policy objectives¹⁰, including the ones mentioned earlier in this section. By the mid-1980s, the SIA had developed into a major industry association representing fifty-seven American semiconductor producers, comprised of both giant "captive" producers such as AT&T, IBM, and Digital Equipment which manufactured for internal consumption and "merchant" producers such as Texas Instruments which supplied other semiconductor-user firms. While in principle the SIA favored free trade policies, most member firms argued that the United States was not obliged to extend this principle to the Japanese whose pursuit of a mercantilist strategy had placed the survival of American semiconductor industry in jeopardy.¹¹

With its members threatened with sustained losses in global market shares, the SIA began to actively search for measures to deal with the Japanese threat. Since informal, ad hoc bilateral negotiations had by then failed to enhance the industry's position, the SIA hoped that filing a formal petition under U.S. trade law would more effectively pressure Japan to change its policies. Thus in June 1985 the SIA submitted a Section 301 petition against Japan's unfair competitive tactics. In the petition, the SIA presented substantial evidence of market barriers in Japan: in 1984, the U.S. semiconductor industry captured

¹⁰ For example, SIA's lobbying effort led to the passage of a 1984 law providing intellectual property protection to chip manufacturers in the United States and a 1985 agreement between the United States and Japan eliminating tariffs on semiconductor imports in the United States. See David B. Yoffie, "Creating Political Advantage," *Harvard Business Review* 3 (May-June 1988), 55-62; also Dick K. Nanto and Glenn J. McLoughlin, *Japanese and U.S. Industrial Associations: Their Role in High-Technology Policymaking*, Congressional Research Service Report, June 6, 1991.

83 percent of sales in the American market, 55 percent in the European market, 47 percent in the other (mostly Asian) markets, but only 11 percent in the Japanese market.¹² The SIA also sought to invoke the rhetoric of “fair trade” by pinning the blame for both the dumping and market access problems squarely on the Japanese government. The SIA argued that the Japanese unfairly restricted American firms’ access to the Japanese market by erecting both overt barriers such as quotas and tariffs and other non-tariff barriers to American products. It contended that the Japanese government, through its anticompetitive practices designed to protect and promote an industry deemed essential to national development, created a market structure which discriminated against foreign producers. By condoning the “buy Japan” policies adopted by major producers and consumers, the SIA charged, the Japanese government reinforced this tendency. As a result, according to the SIA, American firms, which commanded a dominant position in all other semiconductor markets, had seen their market share in Japan hovering at the same 10 percent since 1975.¹³

The SIA further charged that by providing direct and indirect assistance to the domestic industry, the Japanese government helped reduce investment risks facing Japanese firms and encouraged their willingness to invest even during a recession, in effect promoting the dumping of semiconductors by Japanese firms. The SIA concluded that these Japanese policies denied American firms “fair and equitable market opportunities”

¹¹ Michael Ryan, *Playing by the Rules*, 1995, 99.

¹² Quoted in Douglas Irwin, 1996, 39.

and encouraged the USTR to monitor Japan's predatory export behavior and market barriers and to counter the effects of Japan's industrial targeting practices. Specifically, it called on the USTR to press the Japanese government to encourage its firms to increase their purchases from American semiconductor companies. It also requested the U.S. government to enforce U.S. antidumping laws against Japanese firms and to undertake investigations of the Japanese firms' antitrust behavior.¹⁴ Should Japan fail to substantially change its behavior, the SIA recommended sanctions against Japan.

Shortly after the SIA submitted the 301 petition, the small U.S. memory producer Micron Technology filed under U.S. antidumping laws a claim that Japanese producers (such as Fujitsu, Hitachi, NEC, Oki, Toshiba, and Matsushita) were dumping 64K DRAMS in the American market. In August 1985, the Justice Department initiated an investigation into possible predatory pricing by Hitachi. A month later, three more American firms -- Intel, Advanced Micro Devices (AMD), and National Semiconductor -- filed another antidumping complaint, alleging that Japanese producers were dumping high-density EPROMS, another memory device in which American producers still had a competitive edge.¹⁵ Later, Texas Instruments (TI) sued eight Japanese semiconductor producers for infringing various TI patents on semiconductor memory.

Political pressure on Japan was mounting. In November 1985, the International Trade Commission issued a preliminary finding that Japanese firms had harmed American

¹³ Ryan, *Playing by the Rules*, 1995, 97.

¹⁴ Wolf et al., "Petition of the Semiconductor Industry Association," 1-4.

industry. At about the same time, a “strike force” set up by the Reagan administration recommended that the U.S. government initiate unfair-trade complaints against Japan. Finally, in response to industry demands, the U.S. Department of Commerce initiated a claim on behalf of American producers hurt by Japanese dumping in the 256K DRAMS and 1M (one-megabyte) DRAMS markets. Commerce’s self-initiation without any industry petition was considered to be an unprecedented move. Since the Japanese dominated this product category, the threat of retaliation was intended to hurt the Japanese in the areas where they had the greatest strength.¹⁶

Meanwhile, the SIA stepped up the pressure on the administration to support its petition, writing letters to, and holding frequent meetings with, administration officials. It hired a public relations firm to expand media coverage and to draw greater public attention. The SIA also strengthened lobbying activities on Capitol Hill by organizing a support group of 20 congressmen. These contacts on Capitol Hill provided the SIA with greater access to key administration officials. For example, through meetings with Secretary of State George Schultz arranged by the congressional support group, the SIA was able to convince Secretary Shultz of the need to take firm action to respond to the Japanese challenge.

The rising influence of the SIA and individual chip manufacturers ensured a relatively unified American position. The SIA moved early on to overcome possible

¹⁵ Tyson, *Who's Bashing Whom?* 108.

¹⁶ Prestowitz, *Trading Places*, 57.

resistance from other domestic players. In the first place, since the semiconductor industry is composed of firms that produce different types of chips (e.g., DRAMS vs. EPROMS) as well as different types of companies (e.g., merchant vs. captive producers), the SIA first of all sought to reconcile the different preferences that member companies might have regarding the trade conflict with Japan. The SIA invoked the common objective of gaining greater access to the Japanese market to unite manufacturers of both DRAMS and EPROMS. Captive firms such as IBM, which was not particularly supportive of trade actions at the outset, eventually consented to the SIA's position under SIA persuasion.¹⁷

More broadly, the SIA did not encounter any obvious domestic opponents in its persuasion efforts. Many American business groups outside of the semiconductor industry (such as the electronics, automobile and machine-tools producers), were growing increasingly frustrated with continuing trade barriers and disappointed with the slow progress achieved under trade agreements with Japan, and they were demanding tough action from the U.S. government to dampen the effects of unfair Japanese competition. For example, representatives of the U.S. electronics industry felt that the trade dispute with Japan should be given priority in the U.S. trade policy agenda and urged the U.S. government to retaliate against Japan's failure to open up its domestic market and to stop dumping on the world market. The American Electronics Association (AEA), a trade

¹⁷ Ellis S. Krauss, "U.S.-Japan Negotiations on Construction and Semiconductors, 1985-88: Building Friction and Relation-chips," in Peter B. Evans et al (eds.), *Double-Edged Diplomacy*, 1993.

group representing over 3,500 U.S. companies with \$305 billion in global sales, launched a massive publicity campaign followed by lobbying efforts in Washington under the provocative banner "America's future at stake." AEA representatives contended that as the nation's largest manufacturing industry and as an important foundation for the rest of the economy, the electronics industry directly impacted on the U.S. economic and military security. The AEA called for a strategic approach to trade policy that would break down trade barriers in Japan and safeguard the interests of American producers.¹⁸

In addition, since the AEA represented major semiconductor users who might potentially object to the petition due to the increase in chip prices that could ensue, cooperation from the AEA would have been essential to the success of the Section 301 petition. As a result, the SIA had started early on to address the concerns of end-users who might be adversely affected by the increases in chip prices in the U.S. To compensate for American users, the SIA persuaded U.S. suppliers to agree not to push for additional quotas or floor prices on Japanese products as long as the Japanese were selling their products at prices above the individual firms' cost of production. As the negotiations with the Japanese proceeded, the SIA also engaged in frequent consultations with the AEA. The chairman of the SIA's public policy committee George Scalise worked particularly hard to secure AEA's endorsement of the Section 301 petition.¹⁹ Like the U.S. merchant semiconductor firms, many major users of semiconductors had come to believe that the

¹⁸ Louise Kehoe, "U.S. Savours Electronics Showdown," *Financial Times*, May 12, 1989, 6.

lack of fair market access in Japan would seriously jeopardize the interests of producers and users alike. Firms such as IBM and Hewlett-Packard indicated that they would not resist the semiconductor firms' trade initiatives, thus allowing the SIA to proceed with its 301 petition. Moreover, end-users such as the American computer industry both lacked consensus among themselves and wielded far less influence than the semiconductor manufacturers.²⁰ This enabled the SIA to forge a consensus with the end-users. In the end the AEA produced a letter to USTR supporting the petition.

With Japan's increasing penetration of the American market negatively affecting so many sectors, no other U.S. business groups visibly opposed the SIA's trade initiative. When American negotiators later threatened to impose sanctions on Japan should Japanese firms fail to stop dumping and increase market share for American firms, most of the products on the sanction list were ones (such as electrical devices) that posed a competitive threat to American manufacturers. Since these American producers could benefit from the restrictions on Japanese products in the event that sanction threats failed, they did not have any incentives to resist the sanction threats but rather had reason to egg the SIA on.

If U.S. producers in areas (such as electronics) likely to be affected by trade sanctions were not against the sanction threats, groups not directly affected by the Section 301 action (such as the automobile and machine-tools industries) had even fewer reasons

¹⁹ David B. Yoffie, "How An Industry Builds Political Advantage," *Harvard Business Review* (May/June 1988), 86.

to interfere with the SIA's actions. U.S. auto producers, for example, had themselves felt victimized by the influx of more competitively-priced, fuel-efficient Japanese auto imports which drastically reduced American producers' share in their home market. Not surprisingly, they did nothing to obstruct the lobbying efforts of semiconductor producers.

In short, the SIA was able to advance its trade agenda without encountering any major domestic resistance. This unity across industry borders strengthened the credibility of the SIA's rhetoric. It also created irresistible pressure on the Reagan administration to provide trade relief through some form of government action. In the following sections, we will see how, under strong congressional and industry pressure, an administration ideologically committed to free-trade had veered towards government intervention and managed trade and how U.S. domestic consensus gradually started to elicit a Japanese response.

The Reagan Administration Responded to the Petition

Unlike in many other trade disputes, sanction threats against Japan won strong support from Reagan administration officials. That the free traders of the United States would resort to government intervention in negotiations with Japan was truly unusual. But the shift toward managed trade was hardly surprising when one took into consideration the magnitude of the threat that unfair Japanese competition posed to the

²⁰ Ellis S. Krauss, "U.S.-Japan Negotiations on Construction and Semiconductors," 269.

very existence of a critical American industry. As the U.S. semiconductor industry faced the possibility of extinction, American policymakers were becoming increasingly concerned about the impact of Japanese industrial "targeting" on the ability of U.S. industries to compete effectively in international markets. The fact that the semiconductor industry, one of the most dynamic sectors of the U.S. economy capable of producing state-of-the-art technology, was turning to the government for help not only suggested the seriousness of the problem, but also signaled to the government the necessity of forging a close relationship with a critical domestic industry in an era when trade policy was having an increasingly important impact on industrial competitiveness.

For American policymakers, it had become clear that the Japanese government, through industrial targeting, was aiming to obtain comparative advantage in a range of high-technology sectors in order to ensure the continued international market dominance of the Japanese economy. The prevailing sentiment among administration officials was that the United States could not allow Japan to continue to capture the benefits of open international trade without also bearing the burden of competition in its own market. As Japanese companies were making substantial inroads at the expense of U.S. firms in a number of high-technology industries including the semiconductor industry, U.S. negotiators felt that the American government could not leave the Japanese threat unchecked and had to come up with a policy response to Japan's protectionist policies.

Recognizing the need to preserve a competitive U.S. industry, administration officials, particularly those in the Department of Commerce (DoC), had adopted a proactive attitude toward the semiconductor trade issue. Starting in the early 1980s, they had sought to exert strong pressure on the Japanese in order to create a level playing field for U.S. firms. Commerce officials such as Malcolm Baldrige and Clyde Prestowitz, who possessed prior industry knowledge and were fully aware of the depth of the problem, were known for their determination to save this strategic industry. Out of the belief that the industry's decline could have strongly negative implications for the competitiveness of the American economy as a whole, they had been engaged in a series of negotiations with the Japanese and had also taken a number of other measures to prevent the further slide of the semiconductor industry.

As the survival of the semiconductor industry became directly threatened by perceived unfair Japanese competition in the spring and summer of 1985, Congress and industry groups stepped up pressure on the Reagan administration to address the trade problem. What was most noticeable in this case was that despite some initial internal strains among different administrative agencies, administration officials had eventually forged a consensus on the need for an aggressive negotiation strategy and were therefore able to present a unified American position to the Japanese.

To be sure, soon after the section 301 petition was filed, senior Reagan administration officials came up with different responses. Officials at the USTR and

Commerce, seeing a vital American industry on the verge of demise, supported the petition. Enormous pressure exerted by the semiconductor industry also made it politically difficult for the President to justify government inaction. Furthermore, these agencies were afraid that by failing to support the semiconductor producers' petition and by allowing the antidumping and unfair trade cases to proceed to final rulings, they would have provoked Congress into passing retaliatory trade bills targeted specifically at Japan and supporting other highly protectionist trade legislation such as the Omnibus Trade bill which was then under consideration, thereby exacerbating the existing trade environment.²¹ Officials at the Central Intelligence Agency (CIA) and the Defense Science Board, due to their concern about the growing dependency of the Defense Department on foreign suppliers, shared this view.

Initially, other departments such as State, Treasury, and the National Security Council (NSC) were more reluctant to see sanctions being imposed on the Japanese, arguing that problems of the U.S. industry partly resulted from poor management and that the Japanese government had taken some steps to eliminate barriers to semiconductor imports back in the 1970s. The fact that Japan was both a friend and an ally of the United States further contributed to the reluctance of the Department of State and the NSC to name it an unfair trader.²² Furthermore, agencies such as the Office of Management and

²¹ O'Shea, 1993, 72.

²² As Prestowitz pointed out, "Because Japan is both friend and ally, and because the problem with Japan arose from a set of interrelated policies carried out over many years rather than from a specific trade

Budget (OMB), the Council of Economic Advisors (CEA), and Justice, because of their adherence to the free trade principle, objected even more strongly to the aggressive trade negotiation strategy endorsed by Commerce and the USTR. For them, negotiating for a guaranteed market share would likely violate GATT rules as well as U.S. and Japanese antitrust laws. These offices argued that since managed trade would interfere with the operation of dynamic markets and stifle technological development and innovation, it would most likely fail and incite a renewed trade crisis between the two countries.²³

On the whole, however, the Section 301 petition received sympathy from the Reagan administration. For one thing, the semiconductor industry was considered to be a high-technology sector having substantial spillover effects for the rest of the economy. It also had important links to the defense industry and was often viewed as a "strategic" component of U.S. defense. Government intervention would not only have important effects on competition and trade in the semiconductor industry itself, but would also profoundly affect the competitive position of a number of related sectors.²⁴ For another, the SIA's petition "was in line with the administration's emerging stress on opening foreign markets, did not directly advocate closing the U.S. market, and would help mollify congressional critics who wanted a tougher Japan policy."²⁵ Personal contacts also strengthened the SIA's case at USTR. Since the SIA's main counsel, Alan Wolff, had

action, there was great reluctance in Washington, particularly at the Department of State and the National Security Council, to brand Japan an unfair trader." Prestowitz, *Trading Places*, 1988.

²³ O'Shea, 1993, 72.

²⁴ This is essentially the strategic trade argument espoused by the trade agencies.

worked with both the new USTR Clayton Yeutter and his deputy Michael Smith, these high-level contacts ensured that the petition would be given serious consideration at USTR.

Thus the initial reservations that State and the NSC had about the petition did not prevent USTR Clayton Yeutter from proceeding with investigations of the SIA's charges. USTR led the investigation on market access; and the Commerce Department led the investigation on alleged dumping. At about the same time, Congress, frustrated with the ballooning U.S. trade deficit with Japan, again threatened stringent trade legislation. To fend off congressional assertiveness, President Reagan toughed his stance and announced the establishment of a "strike force" to deal with unfair trade activities. As mentioned earlier, under the initiative of the strike force, the Commerce Department initiated an investigation of Japanese dumping in the 256K market.²⁶ The products under investigation were defined to include both 256K DRAMs and all succeeding generations of DRAMs. The inclusion of the latter category implied that the United States would continue to pursue the investigations even as technological advances create a new generation of more advanced chips.²⁷ At this point, a small number of administrative agencies still had different opinions about the strike. At the crucial interagency meeting to

²⁵ Douglas Irwin, 1996, 41.

²⁶ Prestowitz provided a detailed account of the decision-making process at the Commerce Department. According to him, "Since shock treatment was needed in order to get some negotiating leverage, I recommended that the U.S. government do what it had the legal authority to do but never had done before: start its own dumping case on 256K RAM chips without waiting for private industry to file a suit, and thus move the government from the position of intermediary to one of advocate." Prestowitz, 1988.

consider whether to initiate the dumping case in October 1985, representatives from the National Security Council and the State Department voiced concerns that the investigation might jeopardize U.S. security relationship with Japan, particularly Japanese support for the Strategic Defense Initiative.²⁸ However, in view of the magnitude of the U.S. competitive reversals in the microelectronics market, they did not oppose the recommendation when it came up for a vote. The recommendation was approved by the President in December 1985.

As the investigations went under way in early 1986, several developments helped to dispel administration officials' lingering doubts about the threats against Japan. First, the two champions of the U.S. semiconductor industry, AT&T and IBM, whose viability was considered key to the health of the U.S. semiconductor industry, were beginning to call on the government for help. It was widely believed then that as long as these two captive producers could survive the Japanese competition, the decline of the merchant companies should be less consequential. By 1985, however, even these two once competitive firms were struggling to survive Japanese competition and had become sufficiently worried about the situation. Executives of these companies told Reagan administration officials that they had been forced by the decline of their equipment and materials suppliers to channel more resources into semiconductor development and, in the process, were becoming more dependent on the Japanese. As a top IBM executive

²⁷ Ryan, *Playing by the Rules*, 103-104.

²⁸ Prestowitz, *Trading Places*, 59-60.

commented: "You should not only act, you should act for the good of the nation."²⁹ The plea from these two semiconductor giants fully revealed the extent of the problem and helped administration officials to overcome their remaining doubts about the threats against Japan, spurring them into further action.

At the same time, the semiconductor manufacturers were consistently pressuring the Reagan administration to opt for coercive strategies. In a document submitted to the USTR in October 1985, the SIA presented substantial evidence of the Japanese firms' collusive behavior which excluded foreign producers from the Japanese market and undercut America's competitiveness in the global semiconductor market. It also condemned the Japanese government for implicitly encouraging such behavior. The SIA called on the U.S. government to be an active "advocate of legitimate commercial interests," rather than merely "an impartial adjudicator" of the dispute.³⁰

As mentioned earlier, the semiconductor industry had also devoted considerable energy to convince the Department of State of Japan's disproportionately small market for U.S. chips. In light of substantial and compelling evidence of dumping and of the continued difficulties American firms faced in accessing the Japanese market after repeated liberalization, State, and some other agencies who had traditionally come to the defense of Japan, had reached the conclusion that the Japanese market was effectively closed and that government action was necessary to ensure the survival of a critical industry. The fact

²⁹ Prestowitz, *Trading Places*, 59.

³⁰ Thomas R. Howell et al., "Reply of the Electronics Industries Association of Japan," cited in Ryan, 104.

that addressing the problem through trade laws was not a viable alternative as it would likely trigger legislative trade retaliation increased the attractiveness of a hawkish posture. Moreover, mounting political pressure on Secretary of State George Schultz and the State personnel to define American interests in both economic and political-security terms so as to enhance its credibility in Congress and the executive branch also led State to reconsider its policy toward the trade dispute with Japan.³¹ Thus, despite some initial resistance, the Department of State and agencies more concerned with national security issues generally ended up supporting Commerce and USTR. The sea change in their attitude provided trade officials with greater latitude to pursue an active trade agenda with Japan.

With a broad consensus on the trade problem with Japan in place, Commerce and the USTR moved ahead with the dumping and market access negotiations. On the market access issue, the Japanese contended that their market was already open and called on the U.S. to specify a market share figure. At this stage, American negotiators insisted on not responding to MITI with any specific market share target. Then, in December 1985 when the United States began to link the dumping problem to the market-access issue, Japan responded by agreeing to encourage its producers to purchase more chips so as to gradually increase the share of American chip manufacturers in the Japanese market.³² On dumping, the Japanese proposed to establish a floor price for all types of chips (i.e., Japanese firms agreed not to sell their chips below the agreed minimum export price). In

³¹ Ellis S. Krauss, "U.S.-Japan Negotiations on Construction and Semiconductors, 1985-1988," 267-268.

³² *Washington Post*, December 10, 1985, E3.

return, they requested that the U.S. terminate the Section 301 investigation as well as the anti-dumping cases. American negotiators rejected the proposal on the grounds that it would be difficult to establish a floor price that would take into consideration the variable production costs among Japanese firms and that the mechanism applied only to chips sold in the United States but not to the Japanese or third-country markets. The American side was concerned that by pushing prices higher in the U.S., the floor price system might only exacerbate the difficulties American producers faced in selling their products to Japan.³³

Negotiations during the winter of 1985 and early 1986 did not produce any breakthrough. The Japanese refused to guarantee the Americans a specific market-share target. In March 1986, the Commerce Department ruled preliminarily that Japanese companies were dumping EPROMs and 256K DRAMs. The ITC also determined that Japanese dumping was causing serious harm to American industry. In March, the Department of Commerce preliminarily ruled that Japanese companies were dumping EPROMs and 256K DRAMs.³⁴ In the same month, fifty U.S. senators produced a letter to President Reagan urging him to put the trade problem at the top of his agenda in his summit meeting with Prime Minister Nakasone scheduled in mid-April. They stressed that the United States should not make “unwarranted” concessions to the Japanese and that progress on the trade problem or the lack of it could heavily influence pending trade legislation. In May, the House of Representatives voted almost unanimously to

³³ See Krauss, 274.

³⁴ H.R. 4800, *Congressional Record*, May 21, 1986.

recommend that he impose sanctions if the two sides could not reach a satisfactory agreement.

Congressional and industry pressure prodded American negotiators to push more forcefully for their demands. At a meeting in Tokyo on May 28, Yeutter directly told Japan's Minister of International Trade and Industry Michio Watanabe that the United States would like a Japanese government pledge to establish an effective cost-price monitoring system to prevent dumping and to substantially increase the U.S. share of the Japanese market to a 20 percent target within five years. Then in late June, a deputy USTR announced that the United States would retaliate with economic sanctions if a settlement agreement could not soon be reached. The move was unusual in many respects. It indicated that the United States would no longer be willing, as it had been in the entire post-war period, to tolerate unfair Japanese trade practices in order to maintain a friendly overall bilateral relationship. In doing so, the American side indicated to Japan the seriousness it attached to the matter as well as its resolve to find an equitable settlement.

Relentless pressure from American negotiators apparently worked. On July 30, the two sides reached the third semiconductor agreement. The agreement, formally signed in September 1986, addressed major American concerns: access to the Japanese market and Japanese dumping in both the U.S. and third-country markets. With regard to dumping, Japan agreed to assign each of its chip producers a foreign market value based

on the firm's manufacturing costs to measure the extent of dumping. In addition, MITI agreed to monitor the costs and prices of semiconductor exports to both the United States and to third markets and to provide firm-specific manufacturing data to the Commerce Department to determine whether dumping had actually occurred. It also agreed to engage in consultations with the United States and to take appropriate action if American negotiators could present evidence that dumping was taking place. In return for Japan's pledge, the United States agreed to suspend the dumping investigations on EPROMs and DRAMS.

On the issue of market access, both governments indicated that they anticipated a substantial increase in foreign sales in Japan. The Japanese government committed itself to provide assistance to U.S. companies seeking to increase their sales in Japan and to help coordinate the relationship between Japanese users and U.S. suppliers.³⁵ The public agreement itself did not specify any target for foreign market share primarily because of U.S. negotiators' reluctance to openly renounce the principle of free trade. However, in a confidential side letter to the accord, the Japanese went further and explicitly undertook to increase the foreign makers' share of the Japanese market to a 20 percent target within the five-year term of the agreement.³⁶ The 20 percent target, if achieved, would effectively

³⁵ "Arrangement between the Government of Japan and the Government of the United States of America Concerning Trade in Semiconductor Products," September 2, 1986.

³⁶ According to the side-letter, "The Government of Japan recognizes the U.S. semiconductor industry's expectation that semiconductor sales in Japan of foreign capital-affiliated companies will grow to at least slightly above 20 percent of the Japanese market in five years," and that the Japanese government "considers that this can be realized and welcomes its realization." Letter to Ambassador Clayton Yeutter

double the foreign share of the Japanese market. Although the language of the agreement left Japan some room to maneuver, it was a clear indication that the Japanese government was willing to take measures to improve foreign firms' access to the Japanese market. The semiconductor agreement was widely hailed by SIA and government officials, but encountered criticisms from industrialists, economists, and journalists in the U.S., Japan, and Europe for violating the principle of free trade.

The 1986 semiconductor trade agreement was unprecedented for American trade policy. As authors such as Laura Tyson pointed out, not only was it the first time that the United States had threatened trade sanctions on Japan for failure to abide by the terms of a trade agreement, it was also the first trade agreement the United States entered into in a high-technology, strategic industry aimed at improving market access and regulating trade in both Japan and the global market. It set the precedent for U.S. demands for "voluntary import expansion" (VIE). It also showed that the United States, out of concerns about the possible erosion of American leadership in strategic high-technology industries, was increasingly willing to abandon the principle of free trade in favor of aggressive unilateralism and managed trade.³⁷ The agreement therefore signified a fundamental change in the U.S. government's approach toward competition in high-technology industries.

from Ambassador Matsunaga, quoted in Wolff et al., "Identification of Japan's failure to abide by the Semiconductor Agreement, Submission before the United States Trade Representative," March 1989, 8.

The Imposition of Sanctions

Soon after the signing of the agreement, several semiconductor manufacturers complained that Japanese firms were violating the terms of the dumping agreement. These complaints intensified in September and October, when it was found that the Japanese were dumping EPROMs in third-country markets.³⁸ American semiconductor manufacturers agreed almost unanimously that Japanese dumping of EPROMs was widespread. Not only was there continued Japanese-dumping in third-country markets, but also U.S. total sales in Japan did not improve. National Semiconductor Corps., one of the largest U.S. suppliers of chips, alerted the administration to the heavy losses the industry was suffering from unfair Japanese competition. Other semiconductor producers such as Classic Technology complained that trade with Japan was one-sided and again reminded administration officials about the consequences that the extinction of the semiconductor industry would have on other domestic industries such as the computer industry.³⁹

In late 1986 American negotiators held several negotiations with the Japanese about these problems. MITI explained that even though it was trying to address these problems through a variety of measures, it was having difficulty enforcing the agreement

³⁷ C. Fred Bergsten and Marcus Noland, *Reconcilable Differences? United States-Japan Economic Conflict*. Washington, D.C.: Institute for International Economics, 1993, 132; Tyson, *Who's Bashing Whom?* 109.

³⁸ *Far Eastern Economic Review*, September 25, 1986.

³⁹ Paul Karon, "A Chip Maker's Treaty: The U.S.-Japan Trade Agreement on Semiconductors," *PC Weekly*, 3:40 (October 7, 1986), 69.

on the entire Japanese industry. Repeated Japanese violations of signed agreements presented American negotiators with no other option but to consider the imposition of sanctions. The lack of results after more than six years of negotiation and bargaining led most administration officials, including the President and some of the more reluctant agencies, to conclude that in order to defend American national interests, it was necessary for the U.S. government to adopt measures to correct the market distortions caused by Japanese intervention. Thus, in January 1987, the USTR threatened to retaliate with trade sanctions if Japanese firms failed to conform to the terms of the agreement by April 1. Meanwhile, in view of unmistakable evidence of Japanese violations and of the spiraling U.S. trade deficit with Japan, both houses of Congress passed resolutions urging the President to retaliate. The SIA also submitted a recommendation urging retaliation. To shore up U.S. credibility, a sub-cabinet-level interagency committee under the Economic Policy Council (EPC) proposed trade sanctions if the Japanese did not stop third-country dumping and improve market access for American firms. By the end of March, the EPC determined that Japan had violated the 1986 agreement and recommended that the President proceed with trade sanctions.⁴⁰

With Congress and industry determined to punish Japan, the President accepted the EPC recommendation and, on March 27, announced the imposition of 100 percent retaliatory tariffs on \$300 million worth of Japanese electrical devices, including television

⁴⁰ *Wall Street Journal*, February 27, 1987, 44.

sets, laptop computers, disk drive units, stereo equipment, electric motors, and other consumer goods.⁴¹ Some of the retaliatory items on the list were ones for which American producers faced Japanese competition or were manufactured by the same corporations that were charged with violating the terms of the agreement (e.g., NEC, Fujitsu, and Hitachi). Since the sanctioned products were manufactured by a large number of American companies at competitive prices, they helped to prevent the large price hikes that otherwise would have occurred if trade between the two countries were complementary. The choice of these products allowed American manufacturers competing with Japanese products to benefit from the increased prices of Japanese goods, thereby strengthening and broadening the coalition in support of retaliatory measures.⁴² The announcement of sanctions suggested that U.S. trade policy had undergone dramatic shifts toward one that explicitly demanded results from Japan. That the United States would have strayed so far away from the principle of free trade was perhaps inevitable given the level of Japanese penetration of the American market and its implications for long-term U.S. economic and security interests. Even though the Reagan administration lifted \$51 million in sanctions at the Group of 7 summit meeting in Venice in June 1987 and another \$84 million by the end of the year on the grounds that Japanese firms have

⁴¹ *New York Times*, March 27, 1987, 1; *New York Times*, March 28, 1987, 1; *Wall Street Journal*, March 30, 1987, 1.

⁴² David B. Yoffie and John J. Coleman, "The Semiconductor Industry Association and the Trade Dispute with Japan (B)," Cambridge, Mass.: Harvard College 1987, 1-2. Stephen Keopp, "Fighting the Trade Tilt: The U.S. Fires Protective Tariffs at Japanese Electronic Products," *Time* 129 (April 6 1987), 50.

presumably ceased third-country dumping,⁴³ the imposition of sanctions on a major friend and ally reflected both the depth of the trade problem and the perceived threat of the Japanese challenge to American industrial competitiveness.

The Effects of the 1986 Semiconductor Trade Agreement and Subsequent U.S. Pressure

To what extent did Japan respond to the sustained application of American pressure and comply with the semiconductor agreement? A number of studies suggested that the agreement succeeded in stopping Japanese dumping in both the United States and third-country markets, even though the Americans had to apply sanctions in order to get Japan to comply with the agreement on third-country dumping. Additionally, the agreement played an important role in boosting American (and foreign) share of the Japanese market after 1989.

Evidence suggests that even though Japan continued to have an advantage in semiconductor production in the late 1980s, foreign firms were able to capture a greater share of the Japanese market after the United States imposed sanctions in 1987. The American share of the Japanese market increased from 8.5 percent at the time the agreement was signed to 14.3 percent by the end of 1991. Total sales by North American firms more than doubled, from \$1.2 billion in 1987 to \$2.8 billion in 1991. The increase in American firms' market share was most pronounced in MOS memory and logic chips, the

⁴³ The remaining tariffs, valued at half the original level, remained in place until 1991, when a new semiconductor agreement was negotiated. See USTR, *1990 National Trade Estimate Report*, 120.

most rapidly growing part of the semiconductor market.⁴⁴ An important reason for the increase in American sales, according to industry executives, was that the Japanese government had beefed up its efforts to more closely monitor the performance of its firms.⁴⁵ Furthermore, in response to relentless American pressure, Japanese semiconductor producers themselves made a conscious effort to meet the 20 percent target for foreign share in their own purchases. After the American retaliation, major Japanese semiconductor companies, in cooperation with the Electronic Industry Association of Japan (EIAJ), established EIAJ Users Committee and drew up detailed market access plans in an effort to increase their foreign semiconductor purchases. Combined with American companies' pursuit of effective strategies to increase their sales in Japan, these efforts led to increased presence of American firms in the Japanese market.

Starting in 1989, the U.S. share of the Japanese market, which had hovered at around 10 percent since 1985-86, began to increase steadily. The continued application of pressure by the Bush administration, coupled with the SIA's aggressive lobbying efforts, was instrumental in bringing about this large increase. Out of fear that the Bush administration might respond to the pressure from the SIA by naming Japan a priority country under the Super 301 provision of the 1988 trade act, Japanese companies undertook a serious effort to develop long-term relationships with American suppliers. By 1990, the increase in the American share of the Japanese market had generated more than

⁴⁴ Bergsten and Noland, *Reconcilable Differences?* 135.

⁴⁵ Tyson, *Who's Bashing Whom?* 111.

\$1 billion in additional revenues for American firms.⁴⁶ The gains to American semiconductor manufacturers were by no means insignificant.

With regard to American semiconductor firms' share in the global market, the agreement helped to prevent the further decline of the U.S. share of the global EPROM and DRAM markets. The American gain in the EPROM market was most dramatic. In the early 1980s, the American share of the global EPROM market experienced a sharp decline. By 1986, the U.S. share was less than half of that in 1978. The implementation of the semiconductor agreement reversed this situation as U.S. producers regained a significant share of the global market. By 1988, the U.S. share of the global market again surpassed that of their Japanese competitors.⁴⁷ The improvement was clearly important to American producers who considered EPROMs as one of the key products capable of driving technological advance. The situation in the global DRAM market was similar. American companies' share of the global DRAM market actually experienced a small increase, from 17.9 percent in 1987 to 19.8 percent in 1991. The Japanese share of the DRAM market, in contrast, dropped sharply from 80 percent in 1986 to 57 percent in 1991.⁴⁸ Japan's share of the overall world market also declined from 50.4 percent in 1989 to 46.5 percent in 1991.

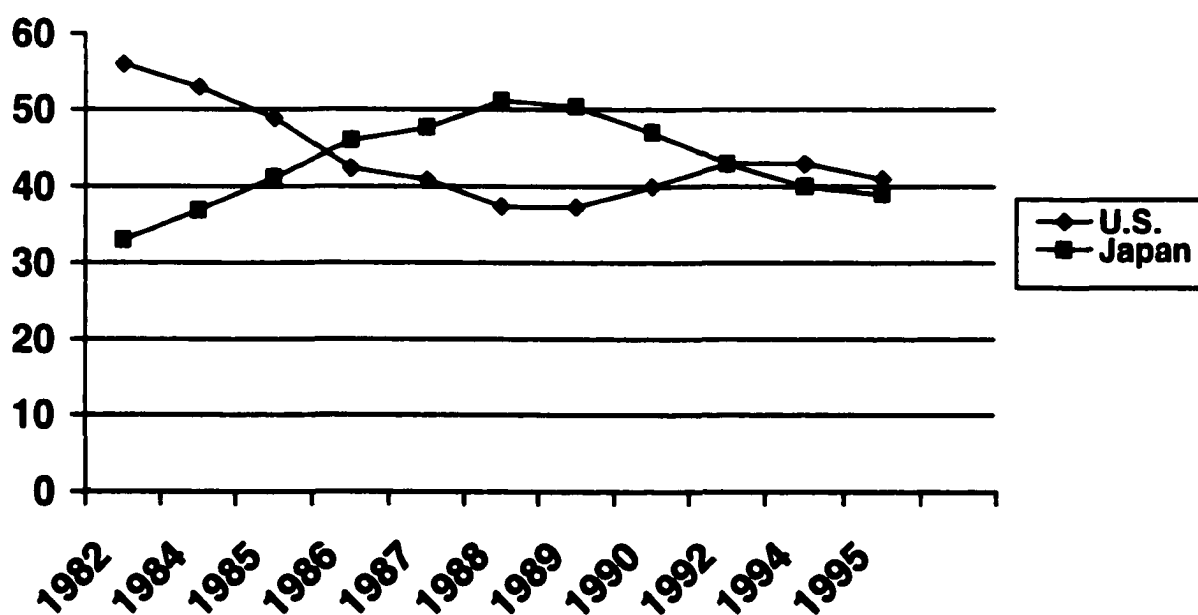
Therefore, even though the effects of the agreement were not particularly striking in the first few years after its signing, and the U.S. share of the Japanese market did not

⁴⁶ Semiconductor Industry Association data.

⁴⁷ Tyson, *Who's Bashing Whom?* 124.

immediately reach the 20 percent target, the agreement at least helped to halt the sharp decline of America's competitiveness in the semiconductor industry. Had the U.S. government refrained from the managed trade approach after 1985, Japanese producers "would probably have moved from a position of rough parity to virtual dominance." Laura Tyson considered the agreement a "qualified success" in achieving some of its objectives: it stabilized the U.S. share of the global DRAM market and halted the sharp decline of the U.S. share of the global EPROM market, producing a substantial increase

Figure 5.1: World Semiconductor Market: 1982-1995 (Selected Years) percentage share by country



⁴⁸ Tyson, *Who's Bashing Whom?* 125.

Figure 5.2: U.S. Semiconductor Market, 1982-1995 (Selected Years) percentage share by country

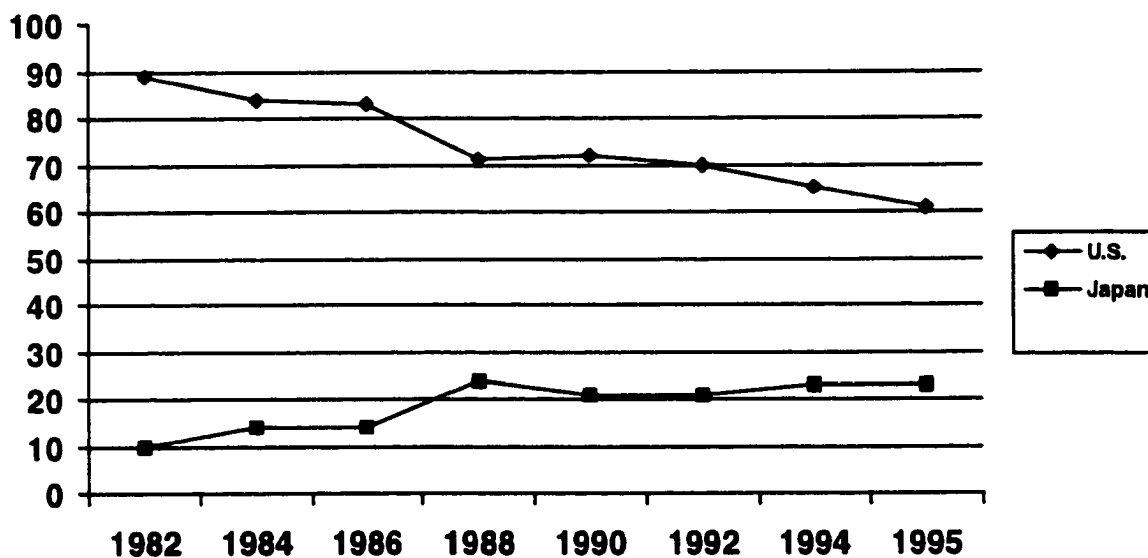
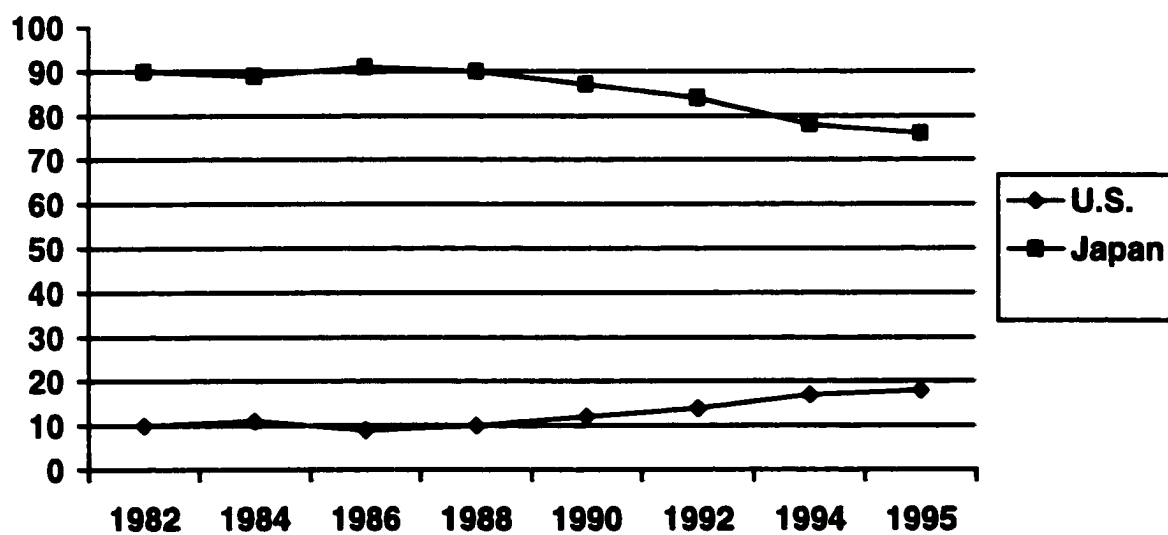


Figure 5.3.: Japanese Semiconductor Market, 1982-1995 (Selected years) percentage share by country



Source: Semiconductor Industry Association.

in American and foreign firms' share of the Japanese market.⁴⁹ In addition, by encouraging greater competition, the agreement helped to prevent Japan's monopoly of the global semiconductor market.

The 1991 Semiconductor Trade Agreement

Although the 1986 agreement helped to raise the U.S. share of the Japanese market from 8.6 percent in 1986 to about 14 percent in the first quarter of 1991, American producers still complained about the slow growth of their sales in the Japanese market. In bilateral discussions held in 1990, the U.S. negotiators began to raise these concerns to their Japanese counterparts. The Japanese government responded that it had implemented the more modest terms of the formal agreement, but denied that the side letter constituted a formal commitment to increase the share to 20 percent. It also proposed the establishment of a study group to explore means of improving sales in Japan.

In 1991, as the 1986 agreement was set to expire, the U.S. semiconductor industry, after obtaining the consent of computer manufacturers concerned about the rise in chip prices in the U.S., lobbied for the renewal of the agreement. Protracted bilateral negotiations produced a new five-year agreement. In the 1991 agreement, the United States agreed to remove the remaining sanctions against Japanese producers for violating the provisions of the 1986 agreement. It also restated the goal of a 20 percent market

⁴⁹ *Ibid.*, 106, 132.

share, extended the market access provisions of the 1986 agreement, and reduced the scope of its antidumping provisions. Although the new agreement did not specify any target for the foreign market share, American negotiators made clear their expectations of substantial progress toward improved foreign sales, threatening to re-impose sanctions should no satisfactory results were forthcoming. Japan in turn agreed to facilitate the development of long-term buyer-supplier relationships. On the dumping issue, Japanese producers agreed to facilitate antidumping investigations by providing data on cost and price to the American side. The agreement also contained provisions which would facilitate American firms' efforts to deter aggressive pricing strategies by Japanese companies. On both issues, the United States invoked threats of further actions.

Following the signing of the new agreement, the American government kept up pressure on Japan to abide by the terms of the agreement. Supplemented by a united front from the U.S. industry, sustained government action played an important role inducing Japanese companies to comply with an agreement that threatened their interests. As a result of sustained American pressure, foreign share of the Japanese market reached the 20 percent target in 1992 and 30 percent by 1997.

Domestic Politics and Threat Credibility

The above analysis suggests that despite the difficulties the United States encountered in trade talks with Japan, U.S. pressure on Japan to change its policies in the

semiconductor sector had nevertheless produced visible gains for American industry. Since any significant increase in the U.S. share of the Japanese market would curtail Japan's ability to use its closed market as a strategic production base from which to export, it seemed highly unlikely that Japan would have surrendered market share to the Americans in this important market segment in the absence of the substantial threat of trade sanctions. In this sense, unity among U.S. interest groups and the willingness of the Reagan and Bush administrations to resort to managed trade policy was critical to the achievement of U.S. objectives.

The semiconductor industry's campaign for trade relief played an important role in shaping the outcome of the trade conflict with Japan. The SIA, through its skillful and concerted lobbying effort, successfully impressed upon both the executive and legislative branches the necessity for government intervention at a time when trade policy was playing an increasingly important role in determining the outcome of international competition. What ensured the SIA's success, however, was that there were no obvious domestic opponents to the SIA's lobbying efforts. Most other industry groups acquiesced in, if they did not openly support, the SIA's position. Since trade between the United States and Japan was highly competitive, most U.S. industries (such as electronics and automobiles) didn't mind if sanctions were imposed on Japan, since they would benefit from the higher prices Japanese producers would have to charge their customers. Even

though semiconductor end-users were initially concerned about the impact of higher chip prices, they were eventually convinced of the merit of the SIA's case.

Credible threats of trade sanctions by the Reagan and Bush administrations were equally important to U.S. success in this case. Both administrations demonstrated a strong willingness to intervene on behalf of the semiconductor industry and to establish quantitative targets on trade flows. The U.S. government's willingness to come to the rescue of the semiconductor industry stemmed from the strong *prima facie* case for the economic and military significance of the semiconductor industry as well as substantial and compelling evidence of the dangers of Japanese market domination. The lack of concrete results after years of protracted negotiations convinced most administration officials that the Japanese market was closed to foreign producers and that without a forceful trade policy, it would be virtually impossible to maintain and enhance U.S. competitiveness in this industry. The strategic nature of the semiconductor industry reinforced the cogency of arguments along these lines. Hence an effective trade policy has come to be viewed as a prerequisite to initiatives aimed at strengthening U.S. industrial competitiveness. The general consensus was that government intervention was needed to check Japanese policies that were themselves antithetical to free-market principles and to prevent the elimination of strategically critical sectors such as semiconductors which were capable of transforming manufacturing and service of the U.S. economy. Out of these considerations, the U.S. government opted to commit its resources to retain leadership in

a sector that could serve as the basis for the emerging infrastructure of a high-growth domestic economy.

These economic considerations in many ways sidestepped concerns for free trade and for the U.S.-Japan security relationship. To be sure, the Reagan administration had brought with it a strong ideological commitment to the principle of free trade. Agencies responsible for security affairs were also wary of imposing trade sanctions against Japan for fear of damaging the bilateral alliance relationship. However, strongly negative domestic responses to the nature of the trade problem eventually altered the postwar U.S. policy framework toward Japan in which the maintenance of Japan's position as a strategic ally was virtually the only priority. As Congress passed a series of resolutions or pieces of legislation aimed at retaliating against Japan's perceived unfair trade practices and as business groups released public statements strongly critical of Japanese policies, the Reagan administration could no longer get away with gentle persuasion or compromise solutions, and was forced to come up with a more coercive trade policy response.⁵⁰

The fact that almost all the domestic actors supported the use of pressure tactics enhanced the credibility of American threats. Japanese firms and the Japanese government were finally forced to the negotiation table after it became clear that they could no longer evade U.S. pressure. The announcement by the U.S. of its intention to impose sanctions startled the Japanese who, for many years have rested content with the assumption that the

⁵⁰ Edward Lincoln, *Japan's Unequal Trade*. Washington, D.C.: Brookings, 1990.

United States would not risk taking overly drastic measures on trade that would jeopardize the U.S.-Japan alliance relationship, thus driving them into serious action. The results of the semiconductor trade disputes suggested that a unified industry stance, complemented by the executive branch's pursuit of aggressive negotiation strategies, was the key to enhancing threat credibility, leading the target nation to make costly concessions and producing market-opening outcomes for American industry.

Super 301: Supercomputers and Satellites

The next two cases in this chapter concern U.S.-Japan trade conflicts in supercomputers and satellites where a similar pattern of unified domestic support enhanced the credibility and effectiveness of U.S. sanction threats. In both cases, the Japanese by and large caved in to American pressure under threats of super 301 retaliation. Support from most American business groups, including not only the supercomputer and satellite manufacturers but also industries competing with Japanese imports ensured a coherent negotiation strategy on the part of the United States, thus intensifying the pressure the Japanese felt to act.

In 1989, in an attempt to deal with the perceived Japanese "targeting" of high-technology industries, the United States initiated two super 301 investigations over Japanese practices in supercomputers and satellites. The United States charged that Japan, through policies designed to promote autonomous domestic industries, had

excluded American producers, who were very competitive in other world markets, from Japanese public procurements. Negotiations in both cases led to the conclusion of bilateral agreements providing substantial benefits to American producers. Previous studies suggest that in both negotiations, the United States achieved its most immediate objective of opening Japanese government procurement to foreign (primarily American) bidders.⁵¹ Following the signing of the agreement on supercomputers, American producers were able to sell four of the fifteen supercomputers procured by Japanese-government controlled institutions between 1990 and 1993, and another six units in 1994.⁵² Likewise, the satellite agreement played an important role in ensuring continued U.S. domination of the global communications satellite market. Indeed, Japan conceded to almost all American demands in the satellite dispute. Not only did the Japanese agree to open up the process for the procurement of all non-R&D satellites, they were also forced to abandon their plans for the development of commercial satellites. By denying the Japanese the benefit of a protected market, both agreements helped to stall the development of these Japanese industries into powerful global competitors.

As in the semiconductor trade dispute, the relative success of U.S. pressure in these cases could be attributed to domestic unity. Not only did American supercomputer and satellite industries support the decision to designate Japan an unfair trader under U.S. law, other key business groups, who felt injured and threatened by Japanese competition in

⁵¹ Bayard and Elliott, *Reciprocity and Retaliation in U.S. Trade Policy, 1994*, 119.

⁵² Bayard and Elliott, *Reciprocity and Retaliation in U.S. Trade Policy, 1994*, 112.

their own industries, also favored threatening Japan with trade sanctions. The extent and intensity of trade competition between the United States and Japan, particularly in the areas of advanced technology, was such that sanction threats had considerable appeal to many in the U.S. business community. Moreover, the U.S. executive, having accepted policies advantaging the Japanese in the past, had by the mid-1980s become increasingly concerned about the effects of Japanese industrial “targeting” on America’s competitive position in advanced technology. Out of concern for America’s economic well-being and in response to congressional pressure, the Bush administration decided to resort to a high-profile trade weapon to thwart the development of Japan’s adolescent industries and to dampen the effects of Japan’s protectionist policies. The nature of the trade relationship between the United States and Japan thus helped to unite major domestic actors. Domestic unity provided U.S. negotiators with a clear advantage in trade negotiations with Japan, leading to two trade agreements which yielded substantial benefits to American producers.

Supercomputers

The Source of the Dispute

Supercomputers are extremely fast, powerful computers used to perform some of the most complex computing tasks in the automotive, aerospace, chemical, pharmaceutical, and petroleum sectors. Because of their key role in the most advanced

research and development, supercomputers are considered to be one of the most critical segments of high-technology industries. Because of their applications and high costs, government funding is often required for the purchase of most supercomputers. Government support has played an important role in fostering the development of supercomputers in both countries. As a result, as Japan's search for autonomous development began to induce a bitter confrontation with the United States, public procurement issues had become the focus of the dispute.⁵³

In the United States, an active industrial policy has been essential to the creation and early development of the supercomputer industry. In the early 1970s, the U.S. government targeted the creation of the supercomputer industry for defense purposes. Since then, it had invested heavily in research and development, actively promoting the application of supercomputers to research and commercial activities. Substantial government involvement enabled the U.S. supercomputer industry to dominate the world market in the late 1970s and early 1980s. Two U.S. firms, Cray Research and Control Data Corporation, essentially monopolized the production of supercomputers worldwide.

The Japanese government began to target supercomputers for development in 1981. Two sources of government support were particularly important to Japan's development of indigenous production capabilities. First, in the 1970s, the Ministry of International Trade and Industry (MITI) and Nippon Telephone and Telegraph (NTT)

⁵³ Bergsten and Noland, *Reconcilable Differences?* 144-145.

provided substantial support for very large-scale integrated circuits (VLSI), one of the most essential components of supercomputers. Advances in VLSI chips led to substantial increases in the speed of Japanese-made supercomputers, allowing Japanese companies to rapidly close the technological gap with American companies.⁵⁴ Second, between 1981 and 1989, through its major R&D program targeting supercomputers, the High Speed Computing System for Scientific and Technological Uses Project, MITI invested \$121 million in a research consortium composed of six Japanese firms to explore commercial opportunities and to enhance the technological capabilities of the Japanese supercomputer industry. The project enabled Japanese producers to acquire the technological building blocks (in terms of both components and overall designs) for making high-speed supercomputers.⁵⁵ A large number of government-sponsored projects focusing on massively parallel processing, high speed supercomputing, and artificial intelligence further contributed to Japan's ability to produce better supercomputers.

As a result of industrial targeting, Japanese firms were able to break up the American monopoly of the supercomputer market in the early 1980s. Two Japanese firms, Hitachi and Fujitsu, began to market supercomputers in 1983, followed by NEC in 1985. Japanese sales have grown rapidly since then. By 1986 Japanese-made supercomputers had captured more than one-fourth of the world market, and Japanese manufacturers had even begun efforts to penetrate the American market. In 1986, NEC

⁵⁴ U.S. Congress, Office of Technology Assessment, *Competing Economies: America, Europe and the Pacific Rim*, OTA-ITE-498, Washington, D.C.: U.S. Government Printing Office, 1991, 264-265.

won a bid to supply a supercomputer to the Houston Area Research Consortium (HARC). This purchase upset American producers such as Cray, who complained that NEC won the bid primarily because of its unfairly low price, thus turning supercomputers into a bilateral trade issue.⁵⁶

Japan's competitive assault and its closed domestic market posed very serious problems for U.S. manufacturers. U.S.-made supercomputers, which were clearly superior to Japanese machines in terms of both performance and availability of software at this time, encountered a number of difficulties entering the Japanese market. The two U.S. supercomputer producers, which accounted for 94 percent of the market outside of Japan, captured only 18 percent of the Japanese private market. Of the 22 supercomputers the Japanese government purchased between 1983 and 1986, 21 were made in Japan. American manufacturers complained that the Japanese did not notify them of upcoming procurements, that Japanese producers were given deep discounts, that the Japanese government did not specify performance criteria in the bids, and, that even if they did, the specifications clearly favored Japanese producers.⁵⁷

The U.S. government had initially sought to address Japan's discriminatory procurement practices through the low-key section 305 investigations and the Market-Oriented Sector Specific (MOSS) framework. In December 1986, the USTR launched an

⁵⁵ OTA, *Competing Economies*, 265.

⁵⁶ See Bayard and Elliott, 105.

⁵⁷ Bergsten and Noland, *Reconcilable Differences?* 1993, p.145; see also Tyson, *Who's Bashing Whom?* 77.

investigation of Japanese government procurement practices and the sales practices of Japanese firms under section 305 of the 1974 Trade Act. At the same time the USTR opened another set of talks on Japanese public procurement of supercomputers under the MOSS framework. The Section 305 negotiation concluded that Japanese government procurements had discriminated against American producers. Subsequent bilateral discussions, which were handled outside the MOSS framework, focused on two issues: government procurement practices which allegedly discriminated against American producers and the high discounts Japanese producers offered to government institutions.

During the negotiations, MITI Vice Minister Makoto Kuroda reportedly told his U.S. counterparts that the United States would never be able to sell supercomputers in Japan no matter how much it tried and that the United States would have to nationalize Cray Research in order to ensure its survival.⁵⁸ Kuroda's statements alarmed senior administration officials, forcing them to devote greater attention to the supercomputer issue. Under U.S. pressure, the Japanese government backed down and put pressure on NTT to purchase a second Cray.⁵⁹ The Japanese authorities also came up with an emergency budget that would provide public universities with increased funding for supercomputer procurement. Government intervention resulted in the purchase of two American supercomputers by Japanese public institutions.

⁵⁸ Office of Technology Assessment. *Competing Economies: America, Europe, and the Pacific Rim*. Washington: Government Printing Office, October 1991, 273.

⁵⁹ Marie Anchooguy, "Report on Japanese Policies for the Supercomputer Industry," Report for the Office of Technology Assessment, February 1991.

In August 1987, the negotiators reached a final agreement on supercomputers. The agreement included provisions which made the public procurement process in Japan more transparent. For example, Japan agreed to give advance public notification of public procurement, publish specific performance criteria on the bids, and establish specific procedures for making complaints and protests.⁶⁰ However, the agreement did not address the discounting problem nor did it establish specific performance criteria.⁶¹ The agreement has been criticized also for its inability to break up the preferential links between Japanese suppliers and their customers in the public sectors.

The 1987 agreement did make the procurement process in Japan more transparent. However, due to the deeply entrenched structure of the Japanese public market, the agreement did not substantially improve American firms' access to the Japanese public market. One report estimated that by the late 1980s American firms' share of the Japanese public sector supercomputer market, including Japan's universities, was a meager 6 percent.⁶² Between 1987 and 1989, Japanese public institutions purchased 51 supercomputers, but only 5 were obtained from foreign suppliers. Japanese companies such as Fujitsu continued their dominance of the Japanese supercomputer market. Not surprisingly, U.S. manufacturers complained that they faced continued difficulties selling to public institutions in Japan. Cray Research, for example, pointed out that its share of

⁶⁰ Tyson, 1992, 77-78.

⁶¹ OTA, *Competing Economies*, 1991, 25-28.

⁶² Kris Herbst, "A More Open Market for Supercomputers," *Datamation*, , 36: 18 (September 15, 1990), 123.

the Japanese market was substantially lower than its share in other parts of the world.

According to Cray Research, while it accounted for approximately 63 percent of the world market, 84 percent of the American market, and 81 percent of the European market, its share of the Japanese market was only 15 percent.⁶³ In light of American manufacturers' difficulties of selling to the Japanese market, Congress and American industry urged the USTR to undertake initiatives to enforce the market access agreement with Japan.

Negotiations Leading Up To The 1990 Supercomputer Agreement

The Super 301 investigation over supercomputers grew out of the Section 305 and MOSS talks detailed above. In May 1989, believing that Japanese public procurement policies still posed significant barriers to American producers, USTR Carla Hills designated Japanese government procurement as a priority practice under super 301.⁶⁴ In June USTR initiated an investigation under section 302 of the 1988 Trade Act. The USTR's decision to undertake super 301 investigations was, to a considerable extent, a response to industry pressure. The American business community, in general, has been pressuring the Bush administration to implement U.S. law fully and vigorously in order to expand U.S. exports. Not only did U.S. supercomputer manufacturers support sanction

⁶³ Tyson, *Who's Bashing Whom?* 78.

⁶⁴ According to the 1989 National Trade Estimate Report, "U.S. suppliers found themselves excluded from serious consideration in Japanese government procurements due to technical specifications favoring incumbent Japanese suppliers. Extraordinarily low Japanese government supercomputer budgets effectively require massive discounts of up to 80 percent off list price." *1989 National Trade Estimate Report*, 103.

threats to open the Japanese public sector market, other segments of the business community, because they faced competition with Japanese products, also approved of threats to impose sanctions against Japan.

The U.S. supercomputer industry claimed that it had been effectively denied access to the Japanese market. Citing the huge disparities in their market access to Japan and other world markets, American supercomputer manufacturers urged the government to address the discrimination they encountered in the Japanese market. The announcement by NEC that it could now produce the world's fastest supercomputer and the exit of Control Data from the production of large-scale supercomputers in April 1989 heightened the sense of urgency felt by the supercomputer industry. Following the company's demise, Control Data representatives warned that, since supercomputers were not only important as a market in themselves but also the means to developing other technologies and products, the United States would be in a very disadvantaged position to have to depend on its competitors for real value added or product differentiation.⁶⁵ Other supercomputer manufacturers also felt that the United States would need to take effective measures in order to catch up with the Japanese.

At a congressional hearing, the Institute of Electrical and Electronics Engineers, Inc. (IEEE), an organization devoted to assisting the government and the public to evaluate technological progress and opportunities, alerted the administration to the

⁶⁵ Willie Schatz, "Who's Winning the Supercomputer Race?" *Datamation*, 35:14 (July 15, 1989), 18.

vulnerability of the U.S. industry to the competitive threats from Japan, arguing that the “Japanese style of competition does present a significant threat to the U.S. high-performance computing industry through its systematic, targeted dominance of successive elements of the high technology ‘food chain’.”⁶⁶ Since Japanese manufacturers had extensive financial resources and were willing to spend large sums and endure sustained losses in order to win market share, American supercomputer manufacturers contended that the United States must take the Japanese threat seriously and adopt new approaches to achieve an acceptable trading relationship with Japan.

More importantly, as in the U.S.-Japan semiconductor dispute, threats to impose sanctions under super 301 obtained support from the U.S. business community as a whole. Many business groups within the United States felt victimized by unfair trade barriers and Japan’s “one-way street” approach to trade, especially because so many of them competed with Japan in the production of a similar range of items. For instance, the American Electronics Association (AEA), one of the main actors in the semiconductor saga, testified before a congressional trade panel in favor of the Bush administration’s decision to brand Japan an unfair trader under the 1988 trade law. Not only did the Association have strong grievances against Japan’s entrenched trade barriers that excluded foreign competition such as its government procurement policies and preferential purchasing arrangements among Japanese firms, it was also critical of Japan’s distortive trade practices which

enabled Japanese companies to capture an increasingly large share of the U.S. market and overtake American producers as the leader of technological advance. The AEA pointed to the semiconductor market as an example of a sector in which unfair Japanese trade policies worked to the detriment of the U.S. industry and welcomed the administration's move towards an aggressive negotiation approach with Japan.⁶⁷

Many other business groups likewise supported the results-oriented approach included in the Super 301 provision and pressured the Bush administration to take a hard line in implementing Super 301. In a congressional hearing, the U.S. manufacturing community expressed a broad willingness to stand by the stance adopted by the Bush administration, which they considered both responsible and pragmatic. The American Electronics Association, for example, expressed its satisfaction with the way the USTR dealt with the supercomputer issue. The National Association of Manufacturers (NAM) testified that "the administration has done a masterful job" in enforcing American trade law. NAM supported the administration's decision to designate Japan a priority foreign country, indicating that it was concerned about the manufacturing component of the U.S.-Japan economic relationship and the serious Japanese rivalry facing American

⁶⁶ Congress. House. *Is the Administration Giving Away the U.S. Supercomputer Industry?* Hearings before the Committee on Government Operations, Washington: U.S. Government Printing Office, 1992, 125.

⁶⁷ Robert LaRussa, "AEA Lauds U.S. Move on Trade," *Electronic News*, June 12, 1989, 35: 1762, 4.

companies.⁶⁸ The U.S. Chamber of Commerce also indicated its approval of the sanction threat.⁶⁹ In a formal comment to the U.S. trade representative, dated March 24, 1989, the U.S. Chamber of Commerce provided a list of “priority trade barriers and distortions.” charging Japan with “targeting” a wide range of American industries through “administrative guidance, public procurement and restrictive business practices.” Japanese officials, the American business organization argued, offered commercial “suggestions” and “advice” to businesses and public organizations over which they had regulatory jurisdiction. Since the Japanese government possessed “broad authority to provide or deny loans,” those official suggestions, the Chamber charged, constituted “implied threats” to deny government benefits or impose new restrictions on businesses that do not accept the advice. Japan imports fewer manufacturers than it would if its markets were as open as those of other developed countries.⁷⁰

The business community’s enthusiasm for trade sanctions dovetailed with the Bush administration’s determination to pursue a fair trade outcome for the supercomputer industry. The administration’s willingness to intervene was rooted in a number of considerations. First, the supercomputer industry was considered “strategic” because it could yield extremely high profits, produce beneficial spin-offs, and create knowledge that

⁶⁸ *Super 301: Effectiveness in Opening Foreign Market*. Hearing before the Subcommittee on International Trade of the Committee on Finance United States Senate, 101st Congress, April 27, 1990, 1-3.

⁶⁹ *USTR Identification of Priority Practices and Countries Under Super 301 and Special Provisions of the Omnibus Trade and Competitiveness Act of 1988*, U.S. Congress. House Ways and Means Subcommittee on Trade, Hearing, June 8, 1989.

was useful to other sectors of the economy. Supercomputers have been widely applied to solving problems involving complicated mathematical calculations such as weather and earthquake modeling, aerospace design, and crash analysis. Therefore, failure to intervene to ensure the health and size of the industry could have broader implications for the U.S. economy.⁷¹ Second, government action was considered necessary because of the supercomputer industry's importance to national defense and security. The supercomputer industry relied heavily on government purchases and government-funded R&D for its early development. Supercomputers played an important role in a number of defense programs, including the Department of Energy's nuclear weapons and NASA's aerospace program. Thus, maintaining a viable supercomputer industry therefore could play an important role in reducing U.S. reliance on foreign suppliers. Third, opening up the Japanese procurement market was considered essential for American producers to achieve maximum cost competitiveness and profitability and to head off Japanese competition in the U.S and world market in the long run.⁷²

In short, Bush administration officials believed that Japan's closed supercomputer market lent credence to the argument that Tokyo was targeting specific high-tech industries, keeping imports out to shelter domestic industries from the effects of foreign competition. They argued that by that time Japanese buyers would have already

⁷⁰ Leonard Silk, "Japan Tops Sanction 'Hit List'", *St. Louis-Dispatch*, June 3, 1989, 9A.

⁷¹ See Michael Mastanduno, "Setting Market Access Priorities: The Use of Super 301 in U.S. Trade with Japan," *World Economy*, 15: 6 (November 1992).

⁷² Bayard and Elliott, 101-102.

established stable relations with Japanese suppliers, and that it would be even more difficult for American producers to gain a foothold in the Japanese market. While the United States had sought to establish a liberal trading order for most of the post-war period, the trade problem with Japan had become so intractable that many administration officials called for a new approach toward Japan. Moreover, in the presence of large U.S. trade deficit with Japan and with many domestic actors from Silicon Valley to Capitol Hill calling for retaliation against Japan's one-sided trading practices that imperiled U.S. strength in key industrial and technological markets, the Bush administration felt compelled to respond with a more proactive trade policy. Thus, the designation of satellites and supercomputers under the super 301 framework was perceived as a means for the United States to challenge Japan's strategy of building a protected home market in selected high-tech industries.⁷³

To be sure, some administration officials were initially concerned about the political and diplomatic ramifications of citing Japan as an unfair trader. While USTR and Commerce urged the President to adopt an aggressive approach to enforce U.S. trade law, several other departments had some reservations about taking a harsh stance on trade with Japan. The President's chief economic advisor, Michael Boskin, and budget director Richard Darman, for example, warned that targeting Japan, one of America's most important trading partners and an ally in Asia, could lead to a trade war, damaging broader

⁷³ See Robert Pear, "Far-off Silver Lining in Dispute with Japan," *New York Times*, May 27, 1989, 29.

U.S. interests. Similarly, the State Department, the National Security Council and Office of Management and Budget warned that citing Japan for trade violations could harm the alliance relationship with Japan.

But the trade officials and White House political advisers were able to persuade State and other agencies who were reluctant to designate Japan for its unfair trade practices to go along with a tough approach on trade. They argued that while citing Japan as an unfair trading partner could have some negative impact on relations with Japan in the short run, the action could produce some long-term benefits and indeed help to strengthen ties between Tokyo and Washington by forcing the two sides to pay closer attention to enduring trade problems. They cautioned that failure to cite Japan might lead to a potential confrontation with lawmakers who were becoming increasingly vexed with American firms' persistent inability to gain a greater share of the Japanese market. A confrontation with Congress over the Super 301 decision, they pointed out, could lead Congress to seek to reduce the executive discretion over the Super 301 process in the future. It might also undermine the Bush team's preference for consultation and compromise with the legislature on major public policy issues.⁷⁴

Because of the trade officials' strong support for Super 301 designation, and in light of the festering trade problem with Japan, agencies such as State and NSC, which had previously spoken in favor of Japan, eventually consented to President Bush's

⁷⁴ Ibid.

decision. They had come to realize, even though with some reluctance, that the administration needed to take some tough action to placate Congress and that economic concerns were playing an increasingly important role in foreign policy. Thus, the threat of Japanese unfair competition had exerted sufficient pressure on officials concerned about the security relationship with Japan to modify their position on super 301. With a broad internal consensus, the Bush administration was able to proceed with the super 301 designation. This unity between the executive and legislative branches put strong pressure on Japan to come to terms with American demands.

The 1990 Supercomputer Agreement

U.S. pressure soon began to elicit a positive response from the Japanese. In June 1990 the Japanese government agreed to limit academic discounts to government entities to 50 percent. In July MITI announced a substantial increase in the fiscal 1990 budget for public supercomputer procurement. In order to reduce U.S.-Japan trade frictions, the Japanese government convinced NEC to withdraw from a public bidding, thus allowing Tohoku University to purchase a Cray supercomputer.⁷⁵ In March 1990, shortly before the scheduled deadline for designating Japan as a priority foreign country, the United States and Japan announced a new agreement on supercomputers.

⁷⁵ *International Trade Reporter*, July 1989; OTA, *Competing Economies*, 276.

The new accord improved upon the 1987 agreement in several ways. For example, it mandated that performance requirements be based on real rather than peak-performance data. To prevent Japanese companies from bidding for a product that did not yet exist (i.e., “paper machines”), it required that the machine had to be delivered by the announced delivery date. The agreement also responded to American complaints by setting more transparent and nondiscriminatory criteria for evaluating bids. It limited price discounting by outlawing bids that violated Japan’s antitrust regulations. A Procurement Review Board was established to consider complaints of violations of the accord’s provisions.

The 1990 agreement was considered a partial success by U.S. supercomputer manufacturers. The agreement addressed structural barriers to the Japanese market, leading to some short-term market-opening outcomes for American producers. Of the nine public procurements Japan conducted under the supercomputer agreement between 1991 and 1992, Cray did not bid on four contracts, lost two to Japanese firms, and won three competitions. According to some analysts, intervention by the Japanese government contributed to the temporary increase in Cray’s share of the Japanese market.

The long-term effects of the 1990 supercomputer agreement might have been somewhat ambiguous given both the entrenched preferential arrangement between Japanese suppliers and their public-sector customers and the distinctive economic structure created by Japan’s long-time policies of promotion. The U.S. government and

the supercomputer industry subsequently complained that Cray Research faced continued difficulties penetrating the Japanese public procurement market. In April 1993 the USTR opened a review of the agreement under section 306 of the 1988 Trade Act. The review found that American firms supplied 6 of the 15 supercomputers Japan purchased in 1991-92. Viewing these purchases as a positive development, the USTR decided not to retaliate. Although Cray remained concerned about a number of Japanese public procurement practices and other problems with the implementation of the agreement, the supercomputer agreement had gone a long way towards sustaining the competitiveness of the supercomputer industry. On the whole, therefore, the 1990 agreement had yielded significant benefits to American producers.⁷⁶

Satellites

Japan's Search for an Indigenous Space Program and Early U.S.-Japan Tensions over Satellites

The U.S.-Japan satellite dispute shared certain similarities with the supercomputer issue. Both grew out of Japanese policies of industrial targeting in high-technology which denied American firms the benefits of a free market. The Japanese government began efforts to develop an autonomous space industry in the 1960s. The search for autonomy was driven by practical considerations. The United States had played an indispensable role in the early development of Japan's satellite industry, providing Japanese firms with

the equipment and technology necessary to produce satellites. Under the 1969 U.S.-Japan Agreement on Space Cooperation, the United States undertook to provide technology transfers to improve the technological capabilities of Japanese firms.⁷⁷ As a junior partner in this bilateral cooperative relationship, Japanese firms acquired the technological capability for the production of both launchers and satellites. By 1978, Japan had developed a sufficient manufacturing base upon which to build an autonomous space program.

In the late 1970s and early 1980s, the United States became increasingly reluctant to export state-of-the-art space technologies to Japan. It also required that Japan obtain U.S. approval in order to apply Japanese launchers developed with American technology to commercial activities. These restrictions forced the Japanese government to search for an autonomous space program. A 1983 report prepared by Japan's Space Activities Commission entitled "Long Range Vision on Space Development" most clearly set out the goal of self-sufficiency. The report stated that "the introduction of technology and equipment hampers Japan with various restraints, rendering it impossible to undertake space activities independently" and forbade procurement of foreign satellites which could impede Japan's attempt to develop an indigenous satellite industry.⁷⁸

⁷⁶ See the evaluation of the 1990 supercomputer agreement by Bayard and Elliott, 119-120; Tyson, 79.

⁷⁷ Michael Mastanduno, "Do Relative Gains Matter?" *International Security* 16: 1 (Summer 1993), 94.

⁷⁸ Japan Space Activities Commission, Long Range Vision Special Committee, *Long Range Vision on Japanese Space Development*, July 1983, 6-7.

In order to reduce reliance on the United States, Japanese firms began a conscious effort to reduce and to eventually eliminate foreign content in satellite production in the mid-1980s. Government policies assisted in the Japanese companies' efforts to increase domestic content. The National Space Development Agency of Japan (NASDA) served as a gatekeeper for the space industry. It maintained tight control over market access by channeling all government satellite procurement to Japanese firms.⁷⁹ In addition, despite the lower price and superior quality of foreign satellites, the Japanese government in effect prohibited the procurement of all kinds of satellites -- broadcast, communications, earth resources, and weather. The ban also applied to the procurements of Japan's telecommunications giant, NTT. As a result, Japanese content in communications satellites has increased from 24 percent in 1977 to 80 percent in 1988, and local content in broadcast satellites has grown from 14 to 83 percent during the same period of time.⁸⁰

These policies aimed at fostering an autonomous space industry, not surprisingly, had become a source of trade frictions between the two countries. Following the announcement of the long-range vision on space development in 1983, U.S. negotiators on various occasions expressed their concerns about Japanese government discrimination

⁷⁹ *Japanese Space Industry -- An American Challenge*. Testimony of J. Michael Farren, Undersecretary for International Trade, U.S. Department of Commerce before the Senate Commerce Subcommittee on Foreign Commerce and Tourism, October 4, 1989, 14.

⁸⁰ William D. Wray, "Japanese Space Enterprise: The Problem of Autonomous Development," *Pacific Affairs* 64: 4 (Winter 1991), 469.

against U.S. aerospace firms.⁸¹ Japan responded that the issue had to do with its industrial development plans rather than with trade. But U.S. pressure nevertheless led Japan's Ministry of Post and Telecommunications (MPT) to agree to allow private companies to purchase foreign satellites and to compete with NTT in providing satellite communications services. Moreover, the MPT licensed the establishment of two joint ventures: Japan Communications Satellite (JCST) and Space Communications Corporation (SCC). Reflecting American firms' competitive edge in the space industry, these two companies soon purchased satellites from American manufacturers Hughes and Ford Aerospace. These gestures, however, failed to placate American negotiators. The American side pointed out that Japan continued to ban government agencies from purchasing foreign satellites, and that it was targeting space industries for commercial development.⁸² These American grievances led to the designation of Japan as a priority country under Super 301 in 1989.

Super 301 Designation and Subsequent Negotiations

The Bush administration provided the crucial impetus for the satellite designation. Because prior American pressure had already opened up a private market in Japan

⁸¹ The plan by Japan's telecommunications giant NTT to buy Hughes' satellite technology in 1983 reportedly "sent shock wave through Washington," leading American decision makers to direct more attention to the trade effects of Japanese public procurement policies. See Prestowitz's discussion of the incident. Prestowitz, 1988, 122-124.

⁸² See, for example, Undersecretary of Commerce Michael Farren's testimony before the Senate Commerce Committee on October 4, 1989.

favoring American firms, and aware that challenging Japan's strong commitment to space development would most likely lead to a political conflict, American officials might well have chosen to use bilateral discussions and private diplomacy to persuade Japan to further liberalize its public market. Nevertheless, the incoming Bush team eventually decided to invoke threats of sanctions under the "Super 301" provisions of the Omnibus Trade and Competitiveness Act of 1988 for fear that Japan would use its closed domestic market as a strategic base in an effort to catch up to, and to eventually surpass, the United States in this strategically important high-technology industry.

As Michael Mastanduno points out, concerns about the possible erosion of the competitive edge of the U.S. space industry vis-à-vis Japan figured prominently in the Bush administration's decision to designate satellites as a Super 301 target. It had become clear to many observers that the Japanese government's promotional policies posed a credible long-term threat to the U.S. lead in the space industry. In 1991 U.S. manufacturers received orders to produce 69 percent of the communications satellites in the global market. U.S. sales of communications satellites in the world market generated \$ 8 billion in revenues.⁸³ However, Japanese government procurement policies seemed to seriously challenge American superiority. Through its active collaboration with Japanese firms and its support for research and development, the Japanese government effectively executed policies of industrial targeting and created a captive government market which

⁸³ See Bayard and Elliott, 116.

allowed its firms to reduce costs and diffuse technology. As Japan had pursued similar strategies in other sectors such as semiconductors, consumer electronics, fiber optics and aircraft, there was a widespread fear in the United States that satellites could be one of the key industries in which Japan aimed for “world leadership.” To forestall the loss of market share and to prevent Japan from achieving relatively greater gains than the U.S., the Bush administration turned to Super 301 in an effort to preempt Japan’s ascent in space development.⁸⁴

Not only were U.S. satellite manufacturers clearly superior to their Japanese counterparts, but also Japan’s barriers to satellite purchases were considered to be fairly obvious and a clear violation of the rules of free trade. The need to counter the effects of Japan’s protectionist policies and to safeguard the principles of free trade therefore provided greater justifications for government intervention. In addition, targeting satellites could also complement and reinforce American efforts to eliminate trade barriers in the multilateral negotiations in the Uruguay Round.⁸⁵

Because of the above considerations, the Bush administration was able to forge an unusual internal consensus on the satellite issue. In particular, the trade agencies, notably USTR and Commerce, strongly favored using threats of trade sanctions to protect the long-term economic interests of the United States and to enhance the credibility of the executive in the eyes of the Congress. The leading proponents of the satellite designation

⁸⁴ Mastanduno, “Do Relative Gains Matter?”, 1991, 98-99. See also William D. Wray, “Japanese Space Enterprise: The Problem of Autonomous Development,” *Pacific Affairs*, 64: 4 (Winter 1991), 470.

within the U.S. administration, Deputy USTR Lynn Williams, Assistant USTR Joseph Massey, and Commerce Undersecretary J. Michael Farren saw the designation as a chance to preempt Japanese targeting of an important high-technology industry in which the United States enjoyed a strong competitive advantage.⁸⁶ In a testimony before the Senate Commerce Committee in October 1989, Farren contended that:

To the Japanese, satellites are not only an industry unto itself but a window on the whole space industry for the 21st century. Japan is emerging as a key participant in the global aerospace industry, a result of deliberate decisions aimed at establishing a world-class Japanese aerospace industry. Japan is looking to aerospace as a source for its future growth and prosperity. ... Our National Aeronautics and Space Administration has pointed out in a recent report that space is a new economic frontier, and that space commerce is directly linked to American competitiveness in the global market. NASA has noted that "a single \$100 million launch contract is equivalent in economic terms to the import of 10,000 Toyotas." NASA has published a report linking space technology spinoffs to 46 various industrial and commercial applications ranging from medicine to composites to the environment. The Japanese Ministry of International Trade and Industry has its own version of this report stressing that growth in aerospace leads to growth in other industry areas. MITI's "space industry tree" branches out into the automotive, energy and electronics among others.⁸⁷

Similarly, deputy USTR Williams argued that in line with Congress's intent in drafting the super 301 provision, eliminating the barriers in the satellite industry "would have the potential to increase U.S. exports significantly, both directly and by setting a precedent."⁸⁸ Trade officials thus recommended to the president that he take a hard line

⁸⁵ Mastanduno, "Do Relative Gains Matter?", 1991, 100.

⁸⁶ Williams, 1989; Michael Farren 1989, testimony before the Senate Commerce on the Japanese space industry, in *Japanese Space Industry -- An American Challenge*. Hearing before the Committee on Commerce, Science, and Transportation, U.S. Senate, 101st Congress, 1989; see also Wray, "Japanese Space Enterprise," 470.

⁸⁷ Farren 1989, 14.

⁸⁸ Williams, 1989, 7.

against Japan on the satellite issue. Although the State Department, which was concerned about the overall U.S.-Japan relationship and agencies such as the Council of Economic Advisors (CEA) and the Office of Management and Budget (OMB), which were traditionally less receptive of the use of section 301 provisions in general, were initially opposed to the designation of satellites, they eventually gave approval to the President's decision to go ahead because they too had concluded that Japanese government restrictions were so pervasive that they constituted a real threat to America's industrial competitiveness.⁸⁹

Thus, as in the semiconductor case, the perceived threat of Japanese industrial targeting to the viability of the U.S. space industry was such that it overcame the considerations of the traditionalists and the defense personnel for political relations and free trade. In the end, even though the more free-trade inclined OMB and CEA insisted that they could not accept a "managed trade" approach which specified a certain market share for American firms, they came out in favor of the Super 301 threat, targeting Japanese government's discriminatory procurement practices. This internal consensus reinforced Congress's insistence on a tough line against Japan, substantially enhancing the credibility of the American threat.

In this case, U.S. satellite makers reportedly refrained from openly pushing for super 301 designation for fear of losing potential sales or leasing opportunities to the

Japanese private sector and government institutions. Satellite manufacturers also seemed to be concerned about upsetting Japan's Ministry of Post and Telecommunications (MPT), which had control over the licensing of satellite imports.⁹⁰ However, they obviously did not interfere with a decision that promised substantially enhanced access to the Japanese market. Furthermore, the decision received overwhelming support from broad sectors of the U.S. manufacturing community which were also severely injured by Japanese competition. At a key Senate trade panel, groups representing a wide range of U.S. manufacturers asserted that the complex web of relationships among Japanese manufacturers, distributors and retailers posed significant barriers to American producers' efforts to penetrate the Japanese market. The National Association of Manufacturers once again opined that Japan's distribution of goods and corporate buying policies presented one of the biggest obstacles to U.S.-Japan trade and welcomed the action on satellites which in their view effectively signaled the government's determination to open up the Japanese market.

A large number of business organizations, all of which faced intense Japanese competition, favored invoking threats of sanction under the "Section 301" provisions of the Omnibus Trade and Competitiveness Act of 1988 to obtain a fair trade outcome. For example, the American Electronics Association (AEA), an organization representing over

⁸⁹ The State Department and the Council of Economic Advisors voiced their concerns that designating Japan could harm the bilateral political relationship and incite a trade war with Japan. See Bill Powell, Rich Thomas, and Bradley Martin, "Japan Makes the Hit List," *Newsweek*, June 5, 1989, 48-49.

⁹⁰ Mastanduno 1991, 97.

3500 firms in U.S. electronics industry, including components, computers, telecommunications, and software, went on record supporting administrative actions to designate Japan an unfair trader. The AEA argued that Japan's exclusionary business practices created tremendous barriers and distortions to U.S. electronics trade. The AEA referred to the United States' steadily deteriorating deficit with Japan in electronics trade and the substantial damage done by Japan to various segments of the U.S. electronics industry as evidence of the structural problems in U.S.-Japan relationship. The Association urged the administration to resort to aggressive negotiation strategies to address such outright hindrances to free trade.⁹¹

The National Association of Manufacturers (NAM) and the Chamber of Commerce expressed their strong support for Super 301 designation at the same hearing. NAM, which contributed to 85 percent of employment in manufacturing and 80 percent of America's manufactured goods, asserted that it was essential that the Administration name Japan a priority foreign country under Super 301 as a response to the profound Japanese challenge to U.S. international competitiveness. NAM representatives argued that Japan's ban on government procurement of satellites raised important questions for U.S. trade policy. They contended that if Japan's "indigenous development objectives" could take precedence over free trade in particular products, then the United States needed to clearly

⁹¹ *USTR Identification of Priority Practices and Countries under Super 301 and Special 301 provisions of the Omnibus Trade and Competitiveness Act of 1988*. U.S. House, 101st Congress, Hearing before the Committee on Ways and Means of the House of Representatives. Washington: U.S. Government Printing Office, 1989, 33-37.

identify its own “indigenous development objectives” and to ask how these development objectives could be affected by Japan’s trade policies. Accordingly, the Association urged American negotiators to forcefully enforce existing trade law in order to defend U.S. trade interests.⁹² Similarly, the U.S. Chamber of Commerce, taking into account the magnitude of trade distortions with Japan, called on the Bush administration to “more aggressively assert its legitimate trade rights,” arguing that the aggressive use of Super 301 procedures would “benefit not only U.S. exporters but also exporters from third nations” as well as manufacturers and consumers “in restricted markets who pay higher prices as a result of trade restrictions.”⁹³

Also testifying at the hearing were the Automotive Parts and Accessories Association (APAA) and the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). The APAA, representing various segments of the U.S. auto parts industry, welcomed the Administration’s more aggressive approach to redress the trade balance with Japan. Because APAA member firms, which were capable of producing competitively-priced, world-class automotive parts, have long been afflicted with the deluge of exports of cars and parts from Japan, they supported Super 301 retaliatory action which could demonstrate U.S. resolve and set the tone for future trade negotiations. In a similar fashion, the UAW recommended Super 301 trade retaliation,

⁹² *USTR Identification of Priority Practices and Countries Under Super 301 and Special 301 Provisions of the Omnibus Trade and Competitiveness Act of 1988, 1989, 41-56.*

⁹³ *USTR Identification of Priority Practices and Countries Under Super 301 and Special 301 Provisions of the Omnibus Trade and Competitiveness Act of 1988, 1989, 59.*

arguing that it would be the ideal forum in which to address the trade imbalance. The UAW contended that United States should use the threat of retaliation to stimulate negotiations about other structural impediments to trade and that downplaying the Super 301 process would continue to expose American workers and manufactures to the pernicious effects of Japan's unfair trading practices.⁹⁴

Such overwhelming industry support lent greater credence to the Bush administration's threat of retaliation. Strong industry and executive branch support revealed that the United States was willing to apply existing trade remedies to force Japan to the negotiation table for serious, comprehensive negotiations. Enormous U.S. pressure left Japan with little room for maneuver but to gradually come to terms with U.S. demands. The satellite agreement which came into being in 1990 reflected the extent to which sanction threats succeeded in opening Japan's highly protected domestic satellite market.

The 1990 Agreement on Satellites

The satellite negotiations carried out under the threat of 301 was quite strenuous because the United States "basically was telling Japan that it had to give up its quest to become a competitor in the world market for applications satellite."⁹⁵ Japan considered U.S. demands as an encroachment upon its sovereign right to develop an autonomous

⁹⁴ *USTR Identification of Priority Practices and Countries Under Super 301 and Special 301 Provisions of the Omnibus Trade and Competitiveness Act of 1988*, 1989, 100-101, 105-110.

space program with non-commercial objectives. The United States, in turn, criticized Japan for violating the principle of free trade. Japan did, however, adopt a number of measures to assuage U.S. pressure in the months before the Super 301 designation. In early 1989, Japanese companies such as NTT and NHK bought or leased satellites from American manufacturers. After several rounds of negotiations, the two countries reached a final agreement over satellite in June 1990.

The agreement was considered by many Japanese observers as representing “a complete acceptance of American demands.”⁹⁶ In the agreement, the Japanese undertook to “procure non-R&D satellites on an open, transparent and nondiscriminatory basis, and in accordance with the GATT procurement code.”⁹⁷ In other words, Japan agreed to open its communications satellite and all other commercial satellite markets to U.S. imports, though it reserved the development of research satellites for Japanese firms. The loss of the communications satellite program was judged to be likely to entail substantial short-term costs for Japanese producers and to accentuate the difficulties Japan faced in developing key satellite technologies. Since the agreement applied not only to communications satellites, but to all commercial satellites, the MPT commented that the “severity of the settlement was beyond expectations.”⁹⁸ Perhaps the most severe blow to Japan’s space program was in the area of communications satellites, as Japan was forced

⁹⁵ Japan Economic Institute, *JEI Report*, no. 16B, April 20 1990, 12.

⁹⁶ Wray 1991, 473.

⁹⁷ See Bayard and Elliott, 118.

⁹⁸ Wray 1991, 472.

to cancel its plans for the development of the fourth series of its communications satellite program (CS-4).

The 1990 satellite agreement produced substantial gains for American producers. Following the signing of the agreement, an American company, Loral Space Systems, which had acquired Ford Aerospace, won the bid to build two communications satellites valued at \$500 million for NTT in 1991. Hughes Space and Communications Group won the bid to supply two satellites to the newly established private satellite communications firm -- Satellite Japan. In 1992 General Electric won a competition to provide NHK with a broadcast satellite worth \$70 million. The agreement represented substantial fulfillment of U.S. negotiation objectives not only because it denied Japanese firms the benefit of a captive government market, but also because it helped to maintain and strengthen American communications satellite manufacturers' dominant position in the global market.⁹⁹ American satellite producers expressed their satisfaction with the agreement. A Hughes representative commented that the agreement "opens a few more opportunities" and, more importantly, it prevented Japan from sheltering "an infant industry that might eventually become a world-class competitor."¹⁰⁰

⁹⁹ U.S. communications satellite manufacturers held about 65 to 70 percent of the global market estimated at \$1.2 billion to \$1.4 billion annually in the early 1990s. See US Department of Commerce, *U.S. Industry Output 1992*.

¹⁰⁰ Robert D. Hershey, "A Basic Pact with Japan," *New York Times*, April 4, 1990, D1.

Conclusion

The semiconductor and Super 301 cases described in this chapter demonstrate very similar political dynamics. In all three cases, not only were domestic interest groups united in support of sanction threats, but also the Reagan and Bush administrations had shown a greater willingness to put aside the principle of free trade and to intervene on behalf of American industry. Such strong domestic pressure meant that the Japanese could no longer be secure in the knowledge that the United States would tolerate Japan's protectionist policies in the name of preserving the alliance relationship. Domestic unity strengthened the credibility of American threats, inducing Tokyo to make costly concessions that would threaten the interests of its powerful firms.

Unlike cases involving the United States and China, threats to impose sanctions on Japan enjoyed wide support from domestic interest groups. Most importantly, American semiconductor, supercomputer, and satellite producers, whose competitiveness was directly threatened by Japanese government's protectionist and promotional policies, were not the only groups in the U.S. supporting the aggressive use of threat tactics. Since trade relations between the United States and Japan are highly competitive, a large number of American manufacturers faced strong Japanese competition. Not surprisingly, the majority of business groups, even including those targeted by Japanese counter-retaliations, welcomed sanction threats which would allow them to enjoy the benefits of a

protected home market and to gain an advantage over their Japanese competitors. In all three cases, unity among interest groups contributed to the success of threat tactics.

Equally important to the enhanced effectiveness of American threats was the consensus the two government institutions were able to reach with regard to the appropriate trade strategy with Japan. Faced with Congress' call for tough action to deal with the spiraling U.S. trade deficit with Japan and with Japan's anti-competitive trade policies, the U.S. executive could have, as in the China cases, chosen to emphasize America's broader security and economic interests. However, the fact that Japan was pursuing unfair trade practices in strategic, high-technology industries which posed a grave threat to the survival of competitive U.S. firms precluded the resolution of the dispute through broad discussions. The rationale of government intervention in these industries conformed to the strategic trade theory. Since these high-tech industries were important "technology drivers" and were considered "strategic" for either economic or national security reasons, there was a strong incentive for the free-trader of the United States to adopt a managed trade policy to counter the effects of foreign government's protectionist policies which, if left unchecked, would have strongly negative implications for American economic and security interests.¹⁰¹ Consideration for America's long-run

¹⁰¹ For further discussions of the strategic trade policy, see Paul R. Krugman, ed., *Strategic Policy and the New International Economics*. Cambridge, MA: MIT press, 1986; Paul R. Krugman, "Strategic Sectors and International Competition," in Robert M. Stern, ed., *U.S. Trade Policies in a Changing World Economy*, Cambridge, MA: MIT press, 1987, 207-232; Wayne Sandholtz, Michael Borrus and John Zysman (eds.), *The Highest Stakes: The Economic Foundations of the Next Security System*, London and New York: Oxford University Press, 1992.

economic well-being and security needs convinced both Reagan and Bush administrations, even those administrative agencies more sensitive to U.S.-Japan political relations, of the need to adopt more aggressive tactics in dealing with Japan. With threats being ratified by both government institutions, Japan became aware of the U.S. determination to obtain a fair trade outcome and, as a result, gave in to American demands.

Unity among domestic constituents and the two government branches thus substantially increased the credibility of American threats, allowing the United States to substantially achieve its objectives in these negotiations. American pressure helped to halt Japan's competitive onslaught in the semiconductor case and helped U.S. supercomputer and satellite manufacturers secure a foothold in the Japanese public-sector market. Under heavy U.S. pressure, Japan reluctantly opened up its market to the United States. The gains to American producers were by no means inconsequential.

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U.S.-China Trade Peace: Intellectual Property Rights and Textiles

Through detailed case studies, the previous two chapters suggest that U.S. sanction threats were far more credible and effective against countries such as Japan than against countries such as China. The degree of trade competitiveness has been found to be an important variable influencing the degree to which interest groups in the United States are united in support of the use of aggressive pressure tactics, hence the varying degree of U.S. success in these two cases. Since trade structure exerts such a significant impact on the level of domestic unity, which is also a key factor affecting the likelihood that two parties will escalate their dispute to the level of a trade war, it seems reasonable for us to expect a positive causal linkage between trade structure and the probability of trade war. A highly competitive trade relationship is likely to enhance domestic support for sanction threats, thereby producing stronger pressure for brinkmanship and for trade war, while a complementary trade structure is likely to produce the reverse. The importance of this variable is likely to overwhelm the potential effects of regime type that might lead one to expect a “democratic peace” in trade relations.

The two chapters that follow extend the insights gleaned from analyses of the variable degree of threat effectiveness to examine the pattern of trade wars, contrasting the overall pattern of “trade peace” between the United States and China, which involves

bargaining between a democratic and an authoritarian state, with the frequent occurrences of trade wars between the United States and its democratic trading partners such as Europe and Canada. This comparison will reveal the importance of trade structure in shaping the dynamics of domestic politics and hence the negotiation outcome. The present chapter examines U.S.-China trade disputes over intellectual property rights and textiles to illustrate how complementary trade relations between the two nations, by reinforcing active domestic opposition, reduces the incentives for trade war.

In both the intellectual property rights and textile disputes, the frequent invocation of threats of trade sanctions rarely sparked a trade war. In the dispute over China's protection of intellectual property rights, the United States several times threatened to impose trade sanctions against China under Special 301 provisions of the U.S. trade law for its infringement of U.S. intellectual-property related products. But, on all of these occasions the United States eventually withdrew the sanction threats and managed to reach last-minute agreements with the Chinese. The fact that the United States repeatedly failed to fulfil its promises to close the American market to Chinese products would seem to be particularly puzzling for proponents of "democratic peace."

Textiles, too, have been a frequent source of friction in U.S.-China trade since the early 1980s, when China abandoned the policy of autarky and began to pursue a development strategy pivoting on the promotion of labor-intensive, light-manufacturing sectors. The reorientation of China's development strategy stimulated the rapid growth of China's textile industry. The resulting surge in Chinese textile and apparel exports caused

considerable disruption to American apparel manufacturers who, having had to confront Japanese and, later, Korean and Taiwanese competition in the 1970s, were now forced to adjust to the emergence of another major low-cost supplier across the Pacific. The rapid expansion of China's textile exports thus contributed to heightened tensions between the two sides in this area. The United States charged that Beijing resorted to unfair and often illegal measures to evade U.S. textile quota restrictions and has, on several occasions, threatened to cut textile imports from China. Indeed, U.S. sanction threats lead to tit-for-tat retaliation in the early 1980s, as Beijing reacted to the U.S. announcement of a unilateral reduction of quotas on Chinese textile imports by suspending purchases of American agricultural products.

However, this case was only a short episode in U.S.-China confrontation over textiles, and bilateral textile trade disputes have since been settled far more cooperatively. In the 1990s, in response to China's failure to halt the illegal transshipment of textiles, the United States once unilaterally reduced quotas on Chinese imports, but this action seemed to be a correction of China's violation of U.S. domestic rules affecting American imports from China. The dynamics of this set of trade disputes was somewhat different from those cases in which the United States threatened to restrict trade with its trading partners in retaliation for their protectionist policies limiting American firms' access to their domestic markets. Nor did U.S. sanction threats invite Chinese counterretaliation. These trade disputes, therefore, did not result in full-scale trade wars. The following study will seek to explain this overall pattern of "trade peace" between the United States and China in both

the intellectual property rights and textiles cases. It also suggests reasons for the anomaly of mutual retaliation that took place in the early 1980s.

U.S.-China Trade Disputes over Intellectual Property Rights

Besides the highly acrimonious MFN debate described earlier in this dissertation, the United States and China have also been involved in endless bickering over Beijing's protection of American intellectual property products. Since the early 1990s, the American government has attempted, through Section 301 of the U.S. trade law, to press Beijing to improve its protection of U.S. intellectual property rights (IPR) and to provide greater access to intellectual-property related products. The United States has three times (in 1991, 1995, and 1996) threatened to impose sanctions on China should Beijing fail to provide more adequate protection for U.S. intellectual property products. However, on all three occasions the United States managed to reach last-minute agreements with Beijing and withdrew the threatened sanctions against Chinese exports. Although the two sides have several times come to the brink of a trade war, a pattern of "trade peace" has by now become a distinctive feature of U.S.-China disputes over intellectual property rights.

The ability of the United States to stave off trade war with China in these cases can be explained by the divisions in U.S. domestic politics. Some reports and analyses seem to portray the intellectual property industries and the U.S. government as being more united

in pursuit of fair trade outcomes than in the MFN case.¹ But while domestic opposition to sanction threats seemed less vociferous in the IPR than in the MFN case, it did constrain domestic interests in the United States from emerging as a homogenous entity. As in the MFN debate, highly complementary trade relations between the two countries generated considerable opposition to escalation, in the process undermining the USTR's negotiation position. In this case, American industries adversely affected by Chinese piracy were the only group calling for trade sanctions against China. Instead, much of the U.S. manufacturing community, including both importers of labor-intensive products made in China and exporters seeking expanded market access in China in areas less affected by IPR issues, opposed attempts to close the American market to the Chinese. Furthermore, although certain administrative agencies (notably the USTR) seemed to favor protecting the IPR industries from unfair trade practices, heavy pressure from import-using groups interested in maintaining a steady flow of Chinese imports and other groups with a vested interests in China trade compromised the USTR's position. The belief that efforts aimed at seeking trade relief for particular industries should not jeopardize American economic and political interests in China also prevented the executive branch from pursuing an overly aggressive trade strategy.

Thus, similar to the MFN debate, the dispute over intellectual property protection exposed a fundamental dilemma in U.S. trade policy toward China: the United States could not punish China for its misbehavior without negatively affecting many powerful and

¹ Interviews with China experts also seem to be in favor of this interpretation.

active domestic constituents. The following analysis of the political forces that have played key roles in influencing the debate over IPR further illustrates this point.

Background

The controversy between the United States and China over IPR protection has its roots in the different cultural, historical, and economic background of the two countries. Above all, the relatively short history of the concept of intellectual property in Chinese society exacerbated the difficulties of reaching a lasting agreement. Indeed, it was not until the 1980s when China decided to embark on a policy of reform and opening to the outside world that intellectual property protection received any public attention. This delayed concern with IPR protection could be attributed to the fact that until then the concept of property rights in general had little importance or relevance to Chinese society. In both cultural and ideological terms, Western concepts of intellectual property are at odds with the deeply embedded socialist notion that public ownership extends not only to objects, but also to ideas. Economically, like most other developing countries, China could free ride on the intellectual property products of the developed world and therefore saw lax IPR protection as a means of acquiring necessary technology inexpensively.² As a result, China's growing economic exchanges with the outside world had accentuated the

² Robert B. Frost, Jr., "Intellectual Property Rights Disputes in the 1990s Between the People's Republic of China and the United States," *Tulane Journal of International and Comparative Law*, 4: 1 (Winter 1995), 119-137.

differences between Western and Chinese practices with regard to IPR protection, forcing China to address this gap and begin building a comprehensive regulatory framework.

Beginning in the early 1980s, in order to facilitate closer integration with the global economy, the Chinese government began adopting incremental measures to reform its IPR protection scheme to conform to international standards. The promulgation of the 1982 Trademark Law marked the beginning of this effort. The 1984 Patent Law for the first time provided protection to rights relating to invention. In 1985, the State Council set up a National Copyright Administration to implement copyright laws, administer copyright agencies, and investigate cases of infringement. The copyright law adopted in 1990 provided additional guarantees to copyright owners.³ The promulgation of these laws and regulations laid down the basis for a relatively comprehensive system of intellectual property protection. In addition to domestic legislation, China also stepped up its efforts to participate in international intellectual property conventions.

However, despite these positive developments, international concerns about China's ineffective intellectual property protection deepened in the 1990s. Not only did foreign companies and governments point to a number of deficiencies they saw in China's copyright scheme, they increasingly complained about the rampant infringement of foreign copyrighted or patented works that were taking place in many parts of China. In the first place, most of the new laws that China adopted in the late 1980s were considered to be vague and lacking by Western standards. American pharmaceutical and chemical

industries, for example, were particularly irritated by the fact that Chinese patent law did not protect pharmaceutical or chemical products. The period of protection afforded to some intellectual property rights such as computer software was shorter in China than in the United States. There also existed certain open-ended exceptions which permitted the Chinese government to deny copyright to any foreign software or other copyright subject matter.⁴ In short, international actors considered the scope of China's existing protection framework to be inadequate and in need of further expansion.

Even more frustrating to American businesses, however, was the government's lax enforcement of existing laws and regulations. Implementation of effective and adequate IP protection was particularly difficult in a country like China where there was little, if any public awareness of the importance of intellectual property protection. Regional protectionism and parochialism that resulted in failure to enforce final court judgments further compounded the difficulty. As a result, piracy of intellectual property was omnipresent. According to the International Intellectual Property Alliance (IIPA), Chinese piracy rates in computer software, motion pictures, sound recordings, books, and periodicals ranged from 90-100 percent. Reportedly over a million copies of Collier Macmillan's basic English textbooks were illegally reproduced in China without paying royalties. Video recordings of movies such as the "Lion King" went on sale in China even before they were released in the United States. Because of unauthorized copying, U.S.

³ Xiao-lin Zhou, "U.S.-China Trade Dispute and China's Intellectual Property Protection," *New York University Journal of International Law and Politics* 24: 3, 1992, 1118.

⁴ Peter A. Schloss, "China's Long-Awaited Copyright Law," *China Business Review* (September-October 1990), 24-28.

industries lost an estimated \$827 million in annual sales in China in the early 1990s.⁵ In the case of computer software, it was estimated that 95 percent of all software used in China was illegal, compared to a piracy rate of only 35 percent in the United States. On “Silicon Street” in Beijing, pushcart vendors had been caught selling pirated copies of computer hardware. Much of the offending software was even running on computers inside government agencies.⁶

With regard to audiovisual products, the situation was equally serious. In the late 1980s, Taiwan and Hong Kong-based pirate operations had shifted their base to China’s southern provinces, providing local Chinese businessmen with the necessary funds and technology to set up new compact disc factories. By 1995, the USTR estimated that there were a total of 31 officially-licensed factories capable of producing 54 million compact discs a year. Another 150 million units were being produced in underground factories.

Table 6.1: Estimated Losses in U.S. exports due to Chinese piracy

U.S./\$ million	Software	Motion Pictures	Records & Music	Books	Total
1991	225	12	16	100	353
1993	322	50	345	110	827
1995	1,700	124	527	125	2,476

Source: International Intellectual Property Alliance.

The bulk of these products were being exported to foreign markets in Asia, Latin America, and Europe where they posed a serious challenge to legitimate products.

⁵ “Will China Scuttle Its Pirates?” *Business Week*, August 15, 1994, 40.

⁶ Philip Shenon, “Chinese Accused of Pirating Disks,” *New York Times*, August 18, 1994, D17.

Chinese pirating of CDs and tapes reportedly cost the U.S. sound recording industry \$345 million in losses.⁷ Persistent and blatant piracy of American intellectual property rights thus ensured a drawn-out trade confrontation between the two countries.

In response to industry concerns about the loss of a potentially lucrative market to copyright theft, the Bush administration in 1989 for the first time designated China as a priority country under the Special 301 provision of the 1988 Omnibus Trade and Competitiveness Act. Under the Special 301 provision, the USTR was directed to identify those foreign countries that “deny adequate and effective protection of intellectual property rights, or deny fair and equitable market access to United States persons that rely upon intellectual protection”⁸ at the end of April each year. The USTR was empowered both to invoke threat of retaliatory sanctions against countries having the most onerous or egregious IPR policies and practices and to carry out negotiations with countries on the “priority watch” list in the absence of targeted sanction threats. In 1989 China was named a priority foreign country along with countries such as Brazil, India, South Korea, Mexico, Taiwan, and Thailand. Given the overwhelming evidence of piracy in China, there was a particularly strong imperative to negotiate with the Chinese to obtain enhanced IPR protection for American industries.

However, America’s attempt to get China to improve IPR protection met with strong resistance from Chinese authorities, who claimed that Chinese consumers could not

⁷ United States Trade Representative, *Intellectual Property Rights Enforcement in China*, USTR release (last modified May 16, 1996)

⁸ *Omnibus Trade and Competitiveness Act* (1988, sec. 1303). See Committee on Ways and Means (1989, 761).

afford Western books and that, as a developing country, China needed the knowledge to develop its economy. China's defiance of American pressure led the Bush administration in April 1991 to again designate China a priority foreign country and to launch another investigation of China's IPR practices under Special 301. When investigations were still under way, the United States threatened to impose sanctions on \$1.5 billion of Chinese exports such as beer, footwear, clothing, leather goods, televisions and watches unless China agreed to more stringent standards of IPR protection. Following more than six months of bilateral negotiations, the two sides reached an agreement on intellectual property protection in January 1992, shortly before the deadline for the threatened trade sanctions. In the Memorandum of Understanding (MOU) signed on January 17, 1992, China undertook to extend copyright protection to foreign owners of computer software, books, and sound recording, accede to two international copyright conventions, and remove prohibition against patenting of pharmaceuticals to conform to international standards.⁹

In the months following the signing of the MOU, China fulfilled its promises by joining the Berne Convention and the Universal Copyright Convention. It also established a special court in Beijing to adjudicate copyright and trademark disputes. These developments temporarily satisfied the United States by putting in place a relatively complete framework of copyright protection. However, disputes over IPR piracy remained unresolved. While acknowledging that China has made "excellent progress" in

improving the legal framework for IPR protection, United States copyright industries and the USTR soon shifted their attention to the gap between legislation and enforcement and the Chinese government's continued restrictions on the market access of U.S. intellectual products. American negotiators readily pointed out that in 1994 American businessmen lost up to US\$ 1 billion in China due to piracy and that the piracy rate of U.S. audio-visual products amounted to almost 100 percent.¹⁰ In the context of sharply rising U.S. trade deficit with China which approached \$30 billion in 1994, the Clinton administration increasingly recognized the necessity of using an aggressive trade negotiation strategy to quell industry criticism and to prevent Congress from tilting U.S. trade policy in a more protectionist direction. The Clinton team was also concerned that as China's rapid economic growth continued, infringement of U.S. patents would spread from book publishing and entertainment industries to pharmaceutical, chemical, and semiconductor industries.¹¹

Unconvinced about China's progress in IPR protection on the ground, the USTR initiated another Section 301 investigation in July 1994. American negotiators clearly stated their willingness to impose sanctions if China failed to provide adequate IPR protection. In December 1994, the Clinton administration made a preliminary determination that China's lax intellectual property right enforcement was "burdensome and unreasonable," and later announced a list of products worth about \$2.8 billion that

⁹ Lee M. Sands and Deborah Lehr, "IPR Watchdogs," *China Business Review* 21: 6 (November-December 1994), 16-18.

¹⁰ *Ibid.*

could be subject to tariffs up to 100 percent unless Beijing fulfilled a series of American demands. Specifically, the USTR requested that the Chinese government close the 29 factories across the country producing counterfeit CDs, strengthen IPR protection measures, and provide access to IPR courts.¹²

The ensuing negotiations failed to resolve the differences between the two parties. On February 4, 1995, the United States announced that it would impose 100 percent tariffs on \$1 billion worth of Chinese exports unless Beijing took measures to address the problem within three weeks. The Chinese in turn threatened counterretaliation, bringing the two sides to the brink of a trade war. At the same time, however, the Chinese government also made gestures indicating its willingness to defuse the dispute. It conducted highly publicized raids on street vendors of counterfeit CDs and computer software, shut down a number of prominent factories in southern China involved in illegal production and indicted some of the most offensive software retailers. Finally, as in previous U.S.-China intellectual property disputes, the two countries managed to reach an agreement on Feb. 26, 1995, the day the sanctions were supposed to take effect. In the agreement, China pledged to take concrete actions to address the piracy issue, including cracking down on producers and retailers of pirated products and strengthening enforcement of existing rules and regulations.¹³ The Chinese government committed itself to close all of the factories engaged in counterfeiting within three months, to establish a

¹¹ Michael P. Ryan, *Knowledge Diplomacy: Global Competition and the Politics of Intellectual Property*, Washington, D.C.: Brookings Institution Press, 1998, 81-82.

¹² Karl Huus, "Back to Normal: U.S.-China Trade War Looms Closer," *Far Eastern Economic Review*, January 19, 1995, 52.

centralized system for recording the details of infringement cases, and to seize and destroy counterfeit goods. It also agreed to improve court procedures and to establish interagency task forces to strengthen IPR enforcement. In addition, the agreement provided for greater market access for U.S. intellectual property products as soon as China agreed to eliminate restrictions on American audio-visual and music exports and to allow the establishment of joint ventures specializing in software production in various Chinese cities.¹⁴

The 1995 agreement, which was impressive in wringing China's written commitment, substantially raised U.S. hopes for improved IPR protection in China. However, this period of raised expectations again turned out to be short-lived. By the end of 1995, American negotiators became sufficiently frustrated with China's slow progress on the enforcement front to launch yet another Special 301 investigation of China's IPR practices. The United States found that while China had made credible efforts to eliminate the retail distribution of pirated sound recordings and computer software, it did not adopt adequate measures to punish the producers of these materials. The Clinton administration consequently demanded the Chinese government to take "decisive" action to fully implement the 1995 bilateral IPR accord. In May 1996, the USTR announced that it would impose \$2 billion in punitive tariffs on imports to the U.S. from China (including textiles and apparel goods, consumer electronics, bicycles, and sporting goods) if no

¹³ Lincoln Kaye, "Trading Rights," *Far Eastern Economic Review*, March 9, 1995, 16.

¹⁴ Ryan 1998, 83.

agreement on enforcement could be reached by June 17, 1996.¹⁵ The expectation in Washington was that since one-third of Chinese exports went to the United States, substantial threat of trade retaliation would force Beijing to strengthen its enforcement efforts.

Insisting that it was in compliance with the 1995 IPR agreement, China countered the American move with its own threat to retaliate against various U.S. exports and investment projects. Meanwhile, it announced the decision to purchase thirty aircrafts from Airbus rather than Boeing. Finally, in a pattern that was typical of U.S.-China disputes over intellectual property rights, the two sides reached another agreement at the last minute. In June 1996, the USTR announced that the United States would withdraw the trade sanctions since "China had reached a critical mass of enforcement actions," and that the "core elements of an operational intellectual property rights enforcement system" were in place.¹⁶ Another trade war had been averted. However, this time the Americans walked away from the negotiation table without obtaining any major concessions.

The above chronology of U.S.-China IPR disputes suggests two important points. First, as in the MFN dispute introduced earlier in this study, U.S. pressure on China to provide more adequate protection for American intellectual property products has been at best only partially successful. Although, in the negotiations prior to 1996, Beijing has agreed to U.S. demands on paper and has also made genuine efforts to transform its legal

¹⁵ Krishna P. Jayakar, "The United States-China Copyright Dispute: A Two-level Games Analysis," *Communication Law and Policy* 527, 1997, 544-545.

¹⁶ USTR Press Release 96-53, "Statement by Ambassador Barshefsky," June 17, 1996.

regime for IPR protection, it has repeatedly failed to follow through with enforcement. As a result, the United States had to constantly prod the Chinese to change their policies and practices. In the 1996 negotiations, the U.S. even withdrew the threat of trade sanctions with no concessions from China. On the whole, it seems fair to say that the U.S. has by and large failed to achieve its objective of obtaining improved IPR protection for American industries. This pattern confirms my findings in Chapter 4 about the ineffectiveness of American pressure against China.

The history of U.S.-China intellectual property disputes also lends support to my contention regarding the relationship between trade structure and the probability of trade war. Although the United States was sufficiently frustrated with China's poor record of IPR protection and has repeatedly threatened trade sanctions, it has consistently failed to make good on its threats. In each of the three episodes of the IPR disputes outlined above, the United States issued sanction threats, raising the spectre of a trade war, but has always backed down at the last minute and accepted Chinese promises of enhanced enforcement effort. Why was the United States willing to withdraw sanction threats and to resolve the IPR dispute cooperatively with China? Why did China's repeated failure to abide by the terms of signed agreements fail to provoke a more confrontational U.S. response? As in previous chapters, the following analysis will draw on the two-level game approach and seek answers to these questions by tracing the influence of trade structure on the constellation of political forces in the United States.

Explaining the U.S.-China IPR "Trade Peace"

As in the MFN debate, American threats to impose sanctions against China for its inadequate protection for IPR products suffered from factional conflict at the domestic level. Due to the complementary trade structure between the United States and China, the prospect of a trade war created a deep schism between American industries which focused on IP as a means of expanding their share in the Chinese market on the one hand, and American importers and retailers on the other. Opposition by those industries insisting on market access alone without any concerns about the existing IP practice in China further enhanced the power of the opposition. Although associations of United States copyright producers such as the Recording Industry Association of America (RIAA), the International Intellectual Property Alliance (IIPA), the Business Software Association (BSA), the Motion Picture Association of America (MPA), and the International Federation of the Phonographic Industry (IFPI) consistently pushed for trade sanctions, they were counterbalanced by other segments of the business community, most notably importers of labor-intensive products who have developed a high degree of reliance on the Chinese market. In this case, manufacturing industries such as automobile and aircraft manufacturers also advocated a position that conflicted with that of the copyright industry. The absence of solid support from the business community not only weakened the hands of the U.S. negotiation team, but also impeded American negotiators' ability to escalate the dispute.

U.S. copyright industries were the most forceful proponents of Special 301 investigations against China. For example, the International Intellectual Property Alliance (IIPA), which was made up of industry groups representing film makers, book publishers, the music industry, and computer software manufacturers, insisted that the USTR place China on the list of "priority countries" that would face retaliatory actions by the United States. The International Federation of the Phonographic Industry (IFPI) was particularly irked by China's illegal production and export of fake CDs, which displaced legitimate U.S. CD exports in world markets. The IFPI thus requested U.S. government to closely monitor China's CD exports.

Computer software industries were similarly concerned about rampant software piracy in China. The Business Software Association (BSA), a trade group in Washington representing large U.S. software publishers, together with organizations such as the Computer and Communications Industry Association, supported strong government action to ensure adequate IPR protection in China that would provide U.S. firms with genuine access to the huge China market.¹⁷

But although the motion-picture, recording, and software industries waged an impressive lobbying campaign to punish China for its IPR infringement, a greater number of industries protested the U.S.' threatened sanctions that promised to cut off one of their most important sources of imports. Since the Chinese products targeted for sanctions included almost all of the most popular U.S. imports from China such as textiles, toys and

¹⁷ *China Business Review*, 1994.

electronics, American importers and retailers who have become dependent on the Chinese market opposed the imposition of sanctions. In public hearings in January 1995, major U.S. importers, retailers, and manufacturers complained that they would be unfairly harmed by Washington's use of punitive tariffs to force China to crack down on infringement of intellectual property rights. For example, the National Retail Federation, which represents the largest U.S. retail chains, argued that Washington's pursuit of fair trade should not come at the expense of American consumers.¹⁸ The Federation asserted that the punitive tariffs, if imposed, would force U.S. retailers to raise prices to make up for the costs of purchasing the goods from elsewhere. Because some Chinese goods were so inexpensive or they were unavailable elsewhere, U.S. retailers would have to bear the costs of stiff tariffs in order to replenish their stocks. For example, it was estimated that the sanctions, if carried out, would raise the price of children's bicycles by 8 to 29 percent, increase the price of telephone answering machine by 31 percent, and nearly double the cost of a Chinese-made phone.¹⁹ The Federation further complained that textiles and apparel had been targeted "for the benefit of Hollywood monguls" and that sanctions would add \$100 million to America's clothing bill.

The American Association of Exporters and Importers agreed that USTR Mickey Kantor's proposed sanctions would negatively affect various U.S. business interests, including retailers. The Association warned that it would be difficult to reverse trade

¹⁸ Eduardo Lachica, "Plan for Tariffs Against China Provokes Many U.S. Retailers to Protest Strongly," *Wall Street Journal*, Jan 30, 1995, B6E.

¹⁹ Laurent Belsie, "China Trade Through Lens of Local Mall," *The Christian Science Monitor*, June 11, 1996, 4.

retaliation once it is started and suggested that Washington should give Beijing more time to develop an effective system for IPR protection.²⁰ In a similar vein, the International Mass Retail Association argued that since the punitive tariffs targeted kitchenware, lighting supplies, sporting goods and consumer electronics products for which China was a major supplier, the threatened sanctions, if implemented, would inflict severe pains on U.S. retailers.²¹

Besides the retailing community, American toy makers actively opposed the sanction threats. Toy manufacturers, who sourced most of their products from China, contended that the proposed trade sanctions would negatively affect the U.S. toy industry. The Toy Manufacturers of America asserted that since virtually the entire toy industry was based in China, it would be very difficult to replace toy imports from China. In 1995, Chinese toy production accounted for half of the world's total and Chinese toy exports to the United States reached \$5.4 billion. Toy makers thus remained apprehensive that sanctions would invite Chinese retaliation and shut off America's toy imports from China.²²

U.S. shoe manufacturers were concerned about the effects of retaliatory measures as well. Since China was the top supplier of footwear imports to the United States, shoe manufacturers have been campaigning to make sure that footwear would not be included in the U.S. hit list. A group of shoe manufacturers submitted a letter to the White House

²⁰ Milan Ruzicka, "U.S.-China Tension Building Over Piracy," *Journal of Commerce*, Feb. 1, 1995, 1A.

²¹ Milan Ruzicka, "U.S.-China Tension Building Over Piracy," *Journal of Commerce*, Feb. 1, 1995, 1A.

²² Lauren Belsie, "China Trade Through the Lens of Local Mall," *The Christian Science Monitor*, January 11, 1996, 4.

warning that higher tariffs on footwear imported from China would lead to a steep price hike for U.S. consumers.

In addition, some small U.S. businesses, which have become the targets of the USTR's sanction threats in 1995, felt particularly vulnerable to a trade war. A number of U.S. greeting card companies and bicycle importers, for example, pleaded with U.S. negotiators to withdraw the sanction threats, arguing that businesses dependent on low-cost imports from China would be hit hardest by a trade war and would have to bear the brunt of the costs of the dispute in such an event.²³

Even the electronics industry itself was split about the USTR's choice of trade weapons. Some members of the Electronic Industries Association (EIA) were high-technology companies whose products were being pirated in China. But other companies such as AT&T Corp. regularly import consumer electronics products such as telephone-answering machines, microphones, and magnetic-tape recorders from China. The EIA therefore complained that such products had been "disproportionately, if not unfairly, targeted for retaliation." It warned that a sharp increase in duties on these products could cause "severe business disruption" and negatively impact U.S. production.²⁴

The American Forest & Paper Association and power-tool manufacturers, who make extensive use of raw materials from China, voiced similar concerns. For example, power-tool manufacturers argued that the threatened sanctions would sharply raise the price of one of its most important inputs, thus giving Japanese competitors an advantage

²³ Ibid.

in world markets. Importers of electronic gear from China also opposed sanctions. They argued that while they could find alternative sources to build their products, the cost would be significant and it would have a major impact on U.S. sales.

To be sure, sanction threats did generate some mixed feedbacks from the American textile and apparel industry. While textile and apparel retailers opposed sanction threats, textile manufacturers and labor unions, less tied to Chinese production, took the opposite position. On the one hand, some locally based companies which relied heavily on imports from China to fill out their lines, pointed out that since China is the United States' largest source of apparel imports, followed by Hong Kong, the threatened sanctions would lead to higher prices and to scarcity of some goods. Although apparel manufacturers were not the primary victims of China's widespread IPR violations, they expressed fear that the escalation of hostilities would have a very negative effect on U.S.-China textile trade. According to the American Apparel Manufacturers Association, the United States imported \$3.5 billion of clothing made in China, or roughly 10 percent of all imported apparel. Certain items could be found only in China. Silk distributors, for example, were almost 100 percent dependent on China. These groups therefore argued that the implementation of trade sanctions against Beijing for its failure to protect American copyrights and trademarks would have devastated "hundreds of small American companies and thousands of workers."²⁵ The National Apparel and Textile Association

²⁴ Ibid.

²⁵ *Wall Street Journal*, Feb. 1, 1995.

commented that the association had no interests in waging a battle with China over IPR.²⁶ The U.S. Association of Importers of Textiles and Apparel also voiced concerns that the threat would be very disruptive to people doing business in China and would make life more uncertain for importers. The Association urged the administration to look more carefully at the impact of trade sanctions on the American manufacturing, retailing and consuming community when making its final decisions.²⁷

On the other hand, however, another segment of the American textile industry, less dependent on Chinese imports, supported retaliation. Trade groups such as the American Textile Manufacturers Institute or the California Fashion Association, whose members' products competed with cheap, Chinese made goods on which the punitive tariffs would be applied, welcomed the action which could help them boost their sales by forcing price increases on imports.²⁸ Textile manufacturers in the American south, including those in key electoral states, have been hurt by imported goods produced in low-income countries. As potential beneficiaries of the threatened sanctions, they adopted a position in favor of the sanction threats.²⁹

But, despite these textile manufacturers' support for sanction threats, the United States-China copyright dispute has exposed a fundamental dilemma for U.S. trade relations with China. While the United States would like to ensure more adequate protection for American intellectual property rights through aggressive market-opening

²⁶ Milan Ruzicka, "U.S.-China Tension Building Over Piracy," *Journal of Commerce*, Feb. 1, 1995, 1A.

²⁷ *New York Times*, Feb. 4, 1995.

²⁸ *Los Angeles Times*, May 15, 1996, A1.

²⁹ *The Strait Times*, May 15, 1996, 13.

actions, it also was not willing to expose the labor-intensive manufacturing sectors to the effects of counter-sanctions. Moreover, due to the high level of trade complementarity between the United States and China, there was a particularly large constituency reluctant to see sanctions imposed on China. This import-using constituency's active opposition to sanction threats did not help the U.S. position. It only served to diminish the credibility of American threats in the eyes of the Chinese.

Opposition from American exporters and investors further diminished the credibility of American threats in the IPR case. The three largest automobile manufacturers, for example, were strongly opposed to any measures that would upset the U.S.-China trade relationship. They were worried that sanctions, if carried out, would curtail their investments in joint ventures in the short run and would reduce their access to a potentially lucrative market in the long run. Ford Motor Co., one of the auto manufacturers with extensive investments in China, urged the administration to undertake high-level negotiations with China to find a solution to piracy that would avert sanctions.³⁰ Similarly, General Motors, which was negotiating an investment project worth \$2 billion in an automobile manufacturing venture in China, expressed the concern that a trade war might jeopardize both current and future investments.³¹ The big three auto manufacturers, who feared that they could be frozen out of one of the highest-potential markets in the world, thus became outspoken opponents of sanction threats in the IPR dispute.

³⁰ Richard W. Stevenson, "Tread Carefully with China, Business Leaders Urge U.S.," *New York Times*, May 11, 1996.

³¹ Craig S. Smith and Kathy Chen, "U.S. Business Concerned by China Tiff But Then, They've Seen It All Before," *Wall Street Journal* May 17, 1996, A10.

Aerospace companies, whose main concern is capturing a bigger share of an aerospace market that now ranks third behind the United States and Japan, also did not want to see sanctions imposed on China. Aerospace giants such as Boeing with heavy investments in China were concerned that they might become the target of counterretaliation in a trade row. These companies argued that in the event sanctions were carried out, China could easily turn to competitive European companies, causing a major setback to these aerospace companies' attempt to gain a greater share of the Chinese market. With access to the China market at stake, the aerospace companies vigorously opposed the Clinton administration's sanction threats.³²

More generally, executives of major U.S. industries expressed concern that the Administration's tough approach over Chinese piracy could lead to a wider trade conflict and endanger their ability to compete in the vast Chinese market, especially in view of the Chinese government's threat to suspend U.S. investment projects in China besides the threatened tariff reductions. The Business Council, an organization of chief executives from 100 of the country's largest companies, warned the administration that it should not allow differences with Beijing over piracy to poison the broader political and economic relationship between the two countries. Since most American companies saw China as one of their most promising foreign markets, they were worried that a trade confrontation with China would yield market share to European and Japanese competitors. Many company executives argued that imposing sanctions on China could backfire by making it

harder for the United States to use its economic influence to bring about commercial, social, and political change in China.³³ The prevailing view was that in fighting for Hollywood and Silicon Valley, the United States would be putting the U.S.-China commercial relationship in jeopardy for a narrow and limited segment of U.S. business in China.

States and regions with heavy trade flows with China were likewise leery of the sanction threats. In 1992, when the United States threatened to impose sanctions for China's IPR infringement, the Washington State China Relations Council, representing more than one hundred companies in the northwest that export to China, wrote a letter to USTR Carla Hills warning that "punitive measures imposed by the U.S. government and subsequent Chinese counter-retaliation would cost American companies hundreds of dollars in one fell swoop."³⁴ The Council stated that American companies would emerge as the major victim of trade retaliation as the Chinese would not find it too difficult to replace exports from Washington state with products from other countries. The Council urged American negotiators to reach a compromise settlement with the Chinese through negotiations.

As in the MFN debate, therefore, the Clinton administration was learning that it could not punish China for its misbehavior without encountering opposition from other segments of the business community. Highly mixed feedback from the business

³² Robert S. Greenberger and Jeff Cole, "China Sanctions Put U.S. Firms in A Bind," *Wall Street Journal*, May 30, 1996.

³³ Stevenson, "Tread Carefully with China," 1996.

³⁴ *Ibid.*

community weakened the position of USTR Mickey Kantor, making it more difficult for him to convince Chinese authorities of the U.S. determination to carry out the threat if China failed to satisfy U.S. demands. Acting on the assumption that the USTR himself was reluctant to impose sanctions, the Chinese delayed most negotiations until the last moment. With the deadline approaching but no agreement in sight, the USTR was placed in the disadvantaged position of having to find a quick solution to the dispute. Having no other alternatives, he had to accept Chinese guarantees of better copyright enforcement.

In terms of the policy preferences of the executive, it seems that the USTR initiated the Special 301 investigations out of a genuine concern about the harm that rampant piracy in China caused to American business interests. At first glance it appeared that the administration has adopted a sufficiently tough stance on the IPR issue in order to protect American jobs and economic interests. But a more careful analysis would suggest that the White House did not really want to see a trade war with China and that it threatened sanctions on IPR in part to defuse the broader movement in Congress to terminate China's preferential trading status. Indeed, as the negotiations over IPR unfolded, the administration came under strong pressure from large segments of the business community to soften its position. Broader economic and strategic concerns also constrained the administration from adopting an overly punitive measure. Hence, despite its tough rhetoric, the White House had strong incentives to avoid confrontation with China.

In the first place, as various domestic constituencies raised their complaints about trade barriers and other anti-competitive actions they faced in China in the Special 301 petition process, the homogeneity of the United States negotiation position was sharply reduced. The increase in the number of interested parties with different views placed a larger set of constraints on the principal negotiators of the United States. The executive was forced to find a compromise deal that could be ratified by all the major constituents involved in the dispute. Unwilling to expose importers and users of labor-intensive manufacturing products made in China to the effects of counter-sanctions or to see exporters losing out to Japanese and European competitors in the China market, the Clinton administration had to put together a “package deal” that would advance the agendas of all the groups without satisfying any one completely. The outcomes of the IPR negotiations reflected such “package deal”: the United States refrained from carrying out the threatened sanctions, much to the relief of the import-using interests in the U.S; China modified its copyright laws, partly satisfying the copyright industries. In each round of the IPR negotiations, the United States obtained concessions from China not large enough to fully satisfy the copyright industries, but sufficient to show Congress and the general public that progress was being made and to avoid imposing sanctions.³⁵

Considerations for the overall U.S.-China relationship complicated the decision-making process. For example, after the USTR threatened to impose sanctions on China in 1996, a number of Clinton administration officials expressed concern that the imposition

³⁵ Jayakar, “The United States-China Copyright Dispute,” 1997, 553-554.

of trade sanctions on China could jeopardize other vital United States interests. In particular, the State Department, a vocal advocate of a “soft line” towards the Chinese throughout the IPR dispute, argued that a trade war with China would endanger important U.S. interests such as the security of Taiwan, the termination of the sale of Chinese missile and nuclear weapons technology to Pakistan and the Middle East, and the improvement of China’s human rights record.³⁶ Administration officials were concerned that trade sanctions would merely reinforce Chinese intransigence. Since the U.S.-China trade was becoming more and more important, they were wary of having that relationship disrupted.³⁷

Thus, while Chinese piracy of American intellectual property products posed a threat to legitimate American interests, the White House did not consider it worthwhile to compromise broader American economic and strategic interests over a single trade dispute. In the process of addressing different constituency demands, the American negotiating team refrained from carrying out trade sanctions against China and ended up with incomplete solutions to the main problem -- better copyright enforcement in China.

Summary

In several rounds of U.S.-China trade negotiations over intellectual property rights, U.S. negotiators repeatedly failed to carry through the threatened sanctions because of

³⁶ David E. Sanger & Steven Erlanger, “United States Warns China over Violations of Trade Accord”, *New York Times*, Feb. 4, 1996.

³⁷ Douglas Jehl, “Warning to China on Trade,” *New York Times*, April 30, 1994.

highly contradictory domestic forces. The IPR negotiations revealed to American negotiators that trade sanctions were essentially a double-edged sword that could not be imposed on Chinese producers without also inflicting pains on this side of the Pacific. The negative repercussions of the sanctions would include increased duties on some U.S. importers, higher prices for consumers, and shortages of goods that could not be easily replaced. Even importers who could find alternative sources of supply would likely face higher prices for those goods. As diverse U.S. business interests voiced their opposition to the sanctions, they not only diminished the credibility of American threats, but also reduced the cohesiveness and persuasiveness of the IPR lobby and constrained U.S. negotiators from carrying through the threatened sanctions. In this sense, divided domestic politics created by complementary trade relations proved to be a key factor mitigating the propensity for trade war between the United States and China. In the U.S.-China textile and apparel disputes described below, trade complementarity again spurred textile and apparel importers and retailers into active opposition, reducing the chances for full-scale textile trade war between the two countries.

The U.S.-China Textile Wrangle

An Overview of U.S.-China Textile and Apparel Trade Disputes

Frictions in U.S.-China textile trade emerged as early as the late 1970s and intensified in the 1980s, as the influx of foreign direct investment facilitated the rapid expansion of China's manufacturing exports in sectors such as textile and apparel, toys,

sporting goods, and telecommunications equipment. In 1977, U.S. textile manufacturers filed the first petition with the International Trade Commission (ITC) against textile imports from China. The ITC conducted investigations under Section 406 of the Trade Act of 1974, but found no evidence of market disruption. This finding, while temporarily putting the issue aside, did not resolve the tension in U.S.-China textile trade. In 1979, in light of the failure of efforts to reach a bilateral agreement limiting Chinese textile exports to the American market, the United States unilaterally imposed quantitative restrictions on nine categories of textile imports from China.³⁸

In September 1980 the two sides managed to resolve the dispute by entering into a formal bilateral textile agreement. Under the agreement, the United States relaxed the quota restrictions on six product categories, allowing them to grow at an annual rate of three to four percent. This measure, however, did not appease Chinese manufacturers who continued to complain about overly stringent U.S. quota restrictions. In addition, Chinese producers' search for export expansion led to a surge in China's exports of textile products not covered by the agreement. According to a study by Nicholas Lardy, one year after the agreement came into existence, Chinese textile exports to the United States grew by nearly two-thirds.³⁹ Thus, beginning in 1982, American textile manufacturers pressured the U.S. government to undertake investigations of China's export practices and to strictly enforce U.S. trade laws if Chinese textile manufacturers were found to have violated the

³⁸ Nicholas Lardy, *China in the World Economy*, Washington, DC: Institute for International Economics, 1994, 83.

³⁹ Lardy 1994, 83.

agreement. In talks with the Chinese government, American negotiators aimed to place a one percent cap on the growth rate of a greater number of Chinese textile exports. When Beijing refused to accept the new quota levels, the United States in January 1983 imposed a unilateral agreement increasing the number of Chinese textile product categories subject to quantitative restrictions to 32 and reducing China's total quota allowances by 16-45 percent.⁴⁰ China retaliated against these stringent measures by suspending purchases of U.S. agricultural products, including cotton, soybeans, wheat, and chemical fibers.

After tough negotiations, and in response to pressure from influential legislators from farm states, the U.S. executive eventually reached a second textile trade agreement with China in July 1983 that fixed the quota restrictions on China's textile and apparel exports to the United States at a level more favorable to the Chinese.⁴¹ China withdrew its retaliatory measures after the agreement went into effect. Throughout the rest of the 1980s, U.S. textile trade policy toward China became increasingly protectionist. The 1985 Jenkins Bill placed further ceilings on U.S. textile imports from twelve of its major textile suppliers, including China. Under the revised Multi-Fiber Agreement that went into effect in 1986, the United States extended the quota restrictions to ramie and flax. The third U.S.-China textile agreement signed in December 1987 incorporated various other restrictive measures on Chinese textile exports to the American market. As a result of these protectionist trade measures, by the late 1980s, approximately 90 percent of all

⁴⁰ Zhang Jia-ling, "Maoyi Baohu Zhuyi Dui Zhongmei Liangguo de Weihai" ("The Impact of Trade Protectionism on the United States and China: An Analysis of U.S. Textile Trade Policies") in Wang Xi and Charles H. Holton (eds.), *Zhongmei Jingji Guangxi: Xianzhuang Yu Qianjing (China-U.S. Economic Relations: Present and Future)*, Shanghai: Fudan University Press, 1989, 113.

Chinese textile exports to the United States were subject to controls of one form or another.⁴²

Particularly frustrating to American trade officials was China's inability to comply fully with the terms of the bilateral textile agreements. In particular, as the United States began to implement stricter rules to identify the country of origin of all textile imports into the United States, Chinese textile producers increasingly adopted illegal means to bypass U.S. quota restrictions. According to the U.S. Customs Service, the most frequently used method was forging fraudulent country-of-origin certificates. As illegal transshipment of Chinese textile products via third countries became the focus of U.S.-China textile disputes in the 1990s, the United States threatened to impose sanctions against Chinese textile imports several times. Nevertheless, U.S.-China textile conflicts in the 1990s have become generally more peaceful in outcome.

In 1991, to forestall the flow of illegal Chinese textile imports, the United States threatened to cut back China's textile quotas, including quotas on high-end garment products. The measure, if implemented, would have affected \$US 50-100 million in Chinese exports. The U.S. side's toughened stance was intended in part to satisfy congressional critics irritated with the bilateral trade imbalance. However, the U.S.' stronger stance did not provoke a trade war. In January 1994, the two sides reached the fourth bilateral textile agreement in which both made compromises. The United States agreed to scale down the quota restrictions on Chinese textiles, and Beijing committed

⁴¹ Zhang Jia-Lin, 1989, 113.

itself to accepting reductions in quotas of up to three times the amount of illegal exports if evidence of fraudulent labeling were found.⁴³

U.S.-China textile trade dispute remained unresolved after the signing of the agreement. In January 1994, the Clinton administration, confronted by reports that China's illegal textile exports to the United States had reached \$2 billion a year, announced its intention to cut Chinese textile and apparel quotas by one-third. In October 1994, in retaliation against continued Chinese transshipment of textiles and apparel via Hong Kong, the United States unilaterally announced another quota reduction to go into effect in May 1995. The Chinese government protested the U.S. action, but did not retaliate.

This confrontation was not to be the last in the history of U.S.-China textile trade. In September 1996, the United States again announced plans to reduce quotas for thirteen categories of Chinese textiles in 1996. China, in turn, threatened to retaliate against U.S. textiles, fruits, and spirits unless the United States withdrew the threatened sanctions valued at \$19 million. But as in previous rounds of negotiations, the two sides backed off right before the threatened deadline, reaching the fifth bilateral textile agreement in February 1997. China's desire to join the World Trade Organization (WTO) at an early date reportedly facilitated the conclusion of the agreement. The agreement allowed the

⁴² Lardy 1994, 84.

⁴³ Jing-dong Yuan, "Sanctions, Domestic Politics, and U.S. China Policy," in *Issues and Studies* 33: 10 (October 1997), 116.

Americans to obtain a number of important concessions, including Chinese promises to reduce barriers on textile exports to the domestic Chinese market.

In summary, with the exception of one case in 1983, repeated trade conflicts between the United States and China over textiles did not evolve into a bruising trade war. While the United States imposed unilateral quota restrictions on one occasion in the 1990s, the measure was primarily intended to correct Chinese practices that clearly violated U.S. trade law. Here it is important to note that, unlike other U.S.-China cases described earlier in this dissertation which concerned U.S. exports to the Chinese market, the textile dispute mainly involved U.S. imports from China. In such import-related cases, protectionist forces generally play a more important role in the policy process. Moreover, U.S. textile restrictions against China took place against the backdrop of tightened U.S. textile import policies from developing countries in general. Nor did U.S. trade restrictions invite Chinese retaliation. Therefore the relatively less tranquil history of U.S.-China textile disputes needs to be viewed in relation to the issue dimension.

Nevertheless, even though it concerned an import-related issue, unlike the MFN and IPR trade disputes, the textile trade disputes were characterized by divisions among domestic groups in the United States. Although U.S. textile manufacturers had a strong interest in restricting Chinese textile exports to the American market, American importers and retailers of textile and apparel products lined up against the sanction threats. As in other U.S.-China cases, the existence of a significant import-using constituency rendered the two sides less confrontational in their handling of the disputes. This pattern of

domestic interest alignment could be easily discerned in the late 1980s and 1990s, after China established its position as America's largest supplier of textiles and apparel. During this period, opposition from textile importers and retailers undercut the effectiveness of textile manufacturers' efforts to obtain trade relief. In the early 1980s, U.S. importers also voiced opposition to the threatened sanctions. However, since Chinese textile exports had not yet achieved the prominence they later attained, U.S. import-using interests were far less powerful and active, and hence did not prevent the U.S. government from responding to the powerful, protection-seeking manufacturing interests. In the following sections, I compare the earlier U.S.-China textile dispute with the negotiations that unfolded in the 1990s, highlighting the importance of domestic coalitional patterns on the U.S.' propensity to be involved in trade wars with its trading partners.

Textile and Apparel Trade Dispute: The Early 1980s

American textile and apparel manufacturers started to press the government to restrict textile imports through various bilateral and multilateral arrangements as early as the 1960s. As textile trade between the United States and China expanded rapidly after the conclusion of the first bilateral textile treaty, threatening the dominance of U.S. textile manufacturers in the domestic market,⁴⁴ it drew the immediate concerns of American textile producers. Textile and apparel manufacturers were concerned that as the fastest-

⁴⁴ According to the Commerce Department, Chinese exports increased by 40 percent in 1980, 73 percent in 1981, and 23 percent in 1982. By 1982 China had become the fourth largest textile exporter to the U.S. market, supplying 10.5 percent of overall U.S. textile imports. The remarkable growth of Chinese exports

growing exporter to the United States, ranking only behind Hong Kong, South Korea, and Taiwan, China's huge export capacity would disturb the existing market balance. As a result, they increasingly sought consultations with China to maintain orderly trade.

In August 1982, U.S. textile producers submitted two petitions to the Department of Commerce (DoC) and the International Trade Commission (ITC) charging Chinese companies with dumping in the U.S. market and seeking penalty duties on Chinese made fabrics. The textile industry hoped that the trade complaint would send a clear message to the administration about the growing threat that China posed to the U.S. industry. In both cases, Chinese producers were found to have dumped in the American market. In October 1982, under intense pressure from both textile and apparel producers, U.S. negotiators attempted to reduce China's textile export growth in negotiations with the Chinese. By the end of 1982, frustrated with the slow progress of bilateral negotiations for a new textile agreement to replace the 1980 treaty, U.S. chief negotiator Peter Murphy threatened to impose unilateral quota reductions against imported Chinese textile products.

The attempt of textile producers to tighten import restrictions on China was opposed by importers of textiles and apparel from the very beginning. In November 1982, textile and apparel importers filed a suit with the United States Court of International Trade against the government's stringent import control program, claiming that the restrictive measures against textile imports, often taken without valid finding of market

took place at a time when the U.S. textile industry was suffering from a shrinking domestic market and

disruption, were in effect forcing importers and retailers to pay higher prices, to face delays and embargoes of goods, and to deal with alternative, less reliable suppliers.⁴⁵

While the suit was directed at the government's tight import control policy in general, it specifically challenged the U.S. textile policy towards China.

At the same time, the Reagan administration, while embracing free trade rhetoric, insisted on maintaining tight controls on textile imports. The objective of the Reagan administration was to peg overall textile imports to the United States from low-cost suppliers to the growth of the domestic market, pursuant to the guidelines of the Multifiber Agreement. The United States' target of a 1.5 percent annual growth rate, which was far below the 6 percent growth rate called for by the Chinese, exacerbated the difficulties of reaching an agreement. In January 1983, when talks failed to reach a successful conclusion, the United States announced the decision to impose unilateral quotas on Chinese textile imports. China reacted to the U.S. restrictions by immediately suspending imports of cotton, synthetic fibres and soybeans from the U.S, items that were among the most important U.S. exports to China.

The outbreak of a U.S.-China "trade war" over textiles presents an anomaly to the overall pattern of "trade peace" between nations with complementary trade relations outlined in Chapter 3, but is explicable in terms of the United States' overall textile trade policy and of the relatively lower level of China's textile exports to the United States in the early 1980s. In the first place, it should be noted that while the executive branch of

rising industry unemployment. U.S. Department of Commerce, *1985 U.S. Foreign Trade Highlights*.

the U.S. government had been traditionally a key advocate of liberal international trade policy, it had afforded special protection to the textile and apparel industry, on several occasions, in order to satisfy the large domestic constituency represented by the industry. Although the textile and apparel industry had suffered long-term structural decline and was facing major difficulties in remaining competitive in global markets, it was able to provide critical support in presidential elections because of its size and concentration in key regions. Domestic pressure, reflecting the combination of industrial alliance strength and the degree of institutional access, had, in the past, forced U.S. policymakers to provide trade relief to textile and apparel manufacturers despite their professed ideological inclination toward free trade.⁴⁶

The Reagan administration, in spite of its endorsement of free trade principles, was not insulated from protectionist pressures. Previous studies of American trade policy found that the Reagan administration, in part due to its institutional set-up, had developed a pattern of embracing free trade in principle but tightening protection in practice. Between 1981 and 1984, the Reagan administration in several cases had failed to mobilize countervailing interests against the protectionist forces in the early stages of the industry's

⁴⁵ *Washington Post*, November 21, 1982, 6A.

⁴⁶ For example, President John F. Kennedy, by promoting the establishment of the Short-Term and Long-Term Arrangements Regarding Textiles (the STA and the LTA) and President Richard Nixon, by fostering the development of the Multifiber Arrangement, had set precedents of offering policy concessions in exchange for political support. G. Hufbauer and H. Rosen, *Trade Policy for Troubled Industries*, Washington, D.C.: Institute for International Economics, 1986; H. Richard Friman, *Patchwork Protectionism: Textile Trade Policy in the United States, Japan, and West Germany*, Ithaca: Cornell University Press, 1990.

trade-relief campaign, thus allowing the powerful textile manufacturing interests to define the issue.⁴⁷

In the textile trade dispute with China in the early 1980s, the powerful and organized protection-seeking textile manufacturers enjoyed an advantage over importers and retailers who were driven by prospects of direct economic losses to oppose the protectionist forces. However, since Chinese low-cost exports had not penetrated the U.S. market as extensively as they would by the 1990s, sanction threats did not mobilize as wide a segment of the U.S. importing and retailing community into active and effective opposition. An early study of the relative strengths of the pro- and anti-protection forces in the 1983 textiles case found that the anti-protection potential of importers and retailers, measured by the employment figures of these directly affected sectors, was merely 21 percent of the pro-protection potential of textile and apparel manufacturers.⁴⁸ As the first group to begin working on textile trade policy towards China, the textile lobby was able to derive significant benefit from the policy process. As a result, resistance by importers and retailers of textiles and apparels, who were not yet organized at this time, did not undermine the ability of textile manufacturers to achieve their political objectives.

Developments in 1983 did nothing to dispel the tension in U.S.-China textile trade disputes. In March 1983, as the United States and China resumed negotiations towards a new textile agreement, textile producers launched a more intensive lobbying effort against

⁴⁷ I.M. Destler, *American Trade Politics*, 3rd ed, Washington, D.C.: Institute for International Economics, 1995.

⁴⁸ I.M. Destler and John S. Odell, *Anti-Protection: Changing Forces in United States Trade Politics*, Washington, D.C.: Institute for International Economics, 1987, 89-93.

liberalizing textile trade with China. In the same month, the International Ladies Garment Workers Union initiated a “spring offensive” against garment imports, calling on Congress to reduce the share of garment imports in the domestic market by 41 percent.⁴⁹ Textile producers also released reports emphasizing the need for protection in order to sustain their international competitiveness.

Retailers, meanwhile, protested textile producers’ demand for import restrictions. Uncertain about clothing supplies, retailers claimed that the Reagan administration’s tight import restrictions would raise retail prices of inexpensive clothing by nearly 20 percent. They argued that the unilateral quotas on Chinese textile imports violated the provisions of the Multifiber Arrangement’s provisions regarding quotas for textile-exporting countries. The retail industry further charged that the restrictions were “unprecedented... protectionist actions” very disruptive to the entire import and retail trade.⁵⁰

Consumers and farm interests entered the debate on the side of importing and retailing interests. Consumer groups complained to their representatives that it would be difficult for a large number of low-income families to find affordable clothing in the absence of inexpensive products from abroad. Agricultural groups, having already suffered more than \$500 million in lost sales by mid-1983 because of Chinese retaliation, also started to press the executive to negotiate new quota levels with China. Agricultural producers brought in Senator Robert Dole from Kansas to counter Congressmen Jesse Helms and Strom Thurmond, two major textile industry champions. As a result of these

⁴⁹ “A Spring Offensive,” *Wall Street Journal*, March 29 1983, 1.

conflicting domestic pressures, the Reagan administration reached an agreement on new quota levels with China in August 1983, allowing Chinese textile exports to increase by 3 percent a year, rather than the 1.5 percent originally demanded by the United States.⁵¹ China withdrew the restrictions on American agricultural products shortly after the conclusion of the agreement. The issue was thus reached to the satisfaction of American agricultural interests, but left U.S. textile and apparel producers discontent. Industry organizations such as the American Fiber, Textile, and Apparel Coalition and the Federation of Apparel Manufacturers reacted particularly strongly against the agreement and the large cumulative increase of Chinese textile imports that it would generate by 1987.⁵²

Unwilling to accept the terms of the new agreement, textile manufacturers started another round of concentrated lobbying effort in September 1983. In a surprise move, the American Textile Manufacturers Institute, the International Ladies Garment Workers Union, and the Amalgamated Clothing and Textile Workers Union submitted a petition to the Commerce Department charging that Chinese government's subsidization of textile and apparel export production had caused substantial material injury to the domestic industry and was actionable under U.S. countervailing-duty (CVD) law. The textile manufacturers contended that the Chinese government, by allowing its export-oriented enterprises to enjoy a more favorable exchange rate than the official exchange rate, in

⁵⁰ *Washington Post*, July 13 1983, 1F.

⁵¹ *Wall Street Journal*, September 7, 1983, 3.

⁵² *Journal of Commerce*, August 1, 1983, 5A.

effect subsidized its textile exports. They pointed to a number of other Chinese policies such as preferential access to raw materials, foreign-exchange loans, and preferential tax policies as additional evidence of government subsidization. The textile manufacturers argued that since the U.S. government in the past had levied countervailing duties against government subsidies by other countries, the Chinese case should be adjudicated according to these precedents.⁵³ The petition was significant because it was the first time that U.S. textile manufacturers had invoked the countervailing-duty statute against exports from non-market economies.

Divergent views about the wisdom of applying the countervailing-duty law against China were expressed at a public hearing held in November 1983. American importers and retailers of Chinese textile and apparel products were the major actors opposing the application of CVD law to a non-market economy such as China. Large textile retailers who depended on apparel imports from China, represented by the American Association of Exporters and Importers (AAEI), strongly objected to the textile manufacturers' position. By the early 1980s, China was already the world's largest textile producer and the fourth-largest exporter of textiles and clothing to the U.S. Due to the competitive prices of Chinese exports, most major U.S. department stores and specialty stores carried products made in China. Some retailers even had clothing produced in China to their specifications. Swelling Chinese exports, therefore, drove them into action.

⁵³ See Ryan, *Playing by the Rules*, 1995, 158-59.

Importers and retailers argued that unlike antidumping laws which contained specific language with regard to application to non-market economies, the CVD statute did not incorporate such provisions. Moreover, conceptual and measurement problems would exacerbate the difficulties involved in the application of law. The countervailing duties, if implemented, would also have substantially raised merchandise costs. Applying the CVD law to Chinese textile exports, the importers concluded, would be neither a realistic nor a feasible option. Large retailers such as Sears, Kmart, and J.C. Penny, members of the AAEI, contended that the proposed quota restrictions would disrupt merchandise delivery schedules and increase the price they would have to pay for Chinese products. In addition, they pointed out that since the data upon which the U.S. quota system depended was obsolete, the import restrictions the U.S. government was trying to negotiate was not entirely reasonable.⁵⁴ Also, the Retail Industry Trade Action Coalition (RITAC), another major opponent of the textile lobby representing such companies as Sears, Roebuck, and J.C. Penny, went on the offensive, arguing that current import restrictions would cost domestic consumers up to 27 billion dollars a year.

A number of other groups relying on inexpensive Chinese products supported the contention made by the American Association of Exporters and Importers (AAEI). The National Retail Merchants Association, Kmart Corporation, Federated Department Stores, the U.S. Wheat Associates, and the National Council on U.S.-China Trade were among the groups that opposed the textile manufacturers' petition. As China's low-cost

⁵⁴ Ryan 1995, 159-161.

manufacturing exports to the United States rose, U.S. importers and retailers became increasingly wary of trade sanctions that threatened to cut off their access to an inexpensive import market.

The dividing line in U.S. politics in this case was thus clear: on one side were U.S. producers of apparel, textiles, and textile fibers and their industry unions, who resolutely sought protection from imports. On the other side were American retailers, who strongly believed that it is in American consumers' interests to have access to inexpensive imports. Producers and importers' views on the issue were contradictory.

The textile producers' petition elicited heated debate among U.S. policymakers. Commerce Secretary Baldrige and White House Advisors Edwin Meese and James Baker, with an eye to the upcoming elections, supported going ahead with the sanctions. However, Secretary of State George Schultz, due to his concern about the broader U.S.-China relationship, and USTR Bill Brock, out of a reluctance to provide protection to a fading domestic industry at the expense of exporting interests, opposed the action. President Reagan, faced with substantial pressure from an industry considered by some to be "the most aggressive, vicious, demanding lobby in the country" and, in an effort to follow the patterns of bilateral textile negotiations established by previous negotiations,⁵⁵ eventually opted to overrule the majority of his cabinet, and in December 1983 announced decisions to enforce strict controls on Chinese textile imports through executive order. Under the executive order, the interagency Committee for the Implementation of Textile

Agreements (CITA) was authorized to engage in bilateral consultations with the Chinese government with regard to textiles and apparel products. CITA would be mandated to implement new restrictions if imports exceeded 20 percent of total U.S. production or if the annual growth rate of textile imports in specific product categories reached 30 percent. This new policy was not limited to China, but covered imports from America's major textile suppliers as well.⁵⁶ China's alleged failure to comply with the terms of the agreements hampered the ability of CITA to fully implement the executive order, leaving textile trade a major contentious issue throughout the rest of the 1980s and well into the 1990s.

U.S.-China Textile Trade Dispute in the 1990s

Chinese textile and apparel exports to the United States remained a focus of disagreement in the 1990s. American textile and apparel makers increasingly shifted their concern to illegal Chinese transshipment of textile products through third countries. Under the new country-of-origin rules of the U.S. Customs Service, apparels produced in China but sewn together in a third country would count against China's quotas, whereas in the past they would be charged against the third country. As a result of this new rule, Chinese producers increasingly sought to transship goods through other countries that had extra quota allowances (such as Hong Kong and New Zealand) in order to increase sales of

⁵⁵ Christopher Madison, "Textile Talks Will Put Reagan's Free-Trade Stance to a Real Test," *National Journal* 20 (1981), 883.

⁵⁶ Ryan 1995, 163.

Chinese textiles to the American market. For example, American textile manufacturers alleged that illegal Chinese transshipment in the early 1990s far exceeded the \$4.5 billion specified in the bilateral agreement, amounting to \$2 billion annually and costing more than 50,000 American jobs.⁵⁷ To ensure U.S. producers' share of the American market, the United States threatened to substantially reduce China's textile quotas unless the Chinese government took measures to address the problem.

For its part, Beijing acknowledged the existence of the transshipment problem, but questioned the U.S. estimate of the amount of illegal transshipment. It contended that although the Chinese government had taken steps to penalize enterprises involved in illegal transshipments, the lack of effective control over the behavior of non-state enterprises and trading companies made it exceedingly difficult to eliminate the problem. It was against this backdrop that the United States in 1994 and 1996 twice again threatened to restrict unilaterally Chinese textile and apparel imports.

The two rounds of negotiations that followed, as summarized briefly earlier in this chapter, did not spark a trade war. In both negotiations, the two sides were able to conclude new textile trade agreements and to avert the trade war outcome. American textile importers and retailers' vociferous opposition to the threatened sanctions was instrumental in weakening the case of textile producers, making it more difficult for U.S. negotiators to carry out the threat.

⁵⁷ Lardy 1994, 85.

For example, when USTR Mickey Kantor announced on January 6, 1994 that the United States would cut China's textile quotas by 25 to 35 percent if a new bilateral agreement could not be signed by January 17, reaction from domestic interest groups was highly contradictory. American apparel manufacturers, not surprisingly, supported the action which in their view would help to lessen the impact of competition they faced from Chinese products and preserve some American jobs. Textile manufacturers and unions, having lost market share due to swelling exports from China and other developing countries and disgruntled over the Clinton administration's failure to win them the long-term protection they had sought in the recently concluded global trade talks, also welcomed the threats to limit the imports of clothing and fabric from China. Protectionist pressure from the U.S. textile industry and some members of Congress thus contributed to the aggressive U.S. negotiation position.

But the Clinton administration's toughened stance also encountered criticism from American textile retailers, who were increasingly dependent on China's low-cost textile output. Retailers argued that sanctions would substantially raise the prices of their goods in the U.S. and urged the administration to reach a negotiated settlement with Beijing. The share of Chinese textile products in the U.S. market had increased substantially by the early 1990s. While in 1988 China was still the fourth-largest supplier to the United States, by 1993 it had become the largest supplier to the American market. Chinese textile exports to the U.S. increased from \$1 billion in 1983 to \$7.3 billion in 1994, supplying 20

percent to 25 percent of all the textiles and apparel sold in the United States.⁵⁸ The threatened cuts, if carried out, would have cost U.S. importers and retailers \$300 million in Chinese-made clothing. The textile dispute therefore pitted the politically influential textile industry against major U.S. retailers such as J.C. Penny Co., Gap Inc., Sears, Roebuck and Co. and Wal-Mart Stores, Inc., all of which relied on low-cost Chinese textile products.

U.S. retailing and importing associations spearheaded the lobby effort against trade sanctions. The American Association of Importers and Exporters, a main protagonist in the 1983 dispute, once again emerged as one of the most forceful opponent to the sanction threats. The Association pointed out that the administration had exaggerated the magnitude of the transshipment problem. It contended that most textile importers would suffer directly in the event of a trade war, as they would be forced to absorb the losses incurred from trade restrictions and the resulting political uncertainty. According to importers, although sanctions may not be devastating to most wholesalers, who had diversified sources of supply, they would force them to search for alternative sources of supply in other textile-producing countries and regions, where labor rates would be much higher or where U.S. importers would be required to make long-term commitments.⁵⁹

The National Federation of Retailers also charged that evidence on the scope of the transshipment problem was inconclusive. The Federation warned that if the United

⁵⁸ "U.S. Cuts Imports of Chinese Textile By \$1 Billion," January 7, 1994, *St. Petersburg Times*, 13A; "Ending the Textile Rift," *The China Business Review*, 21: 3 (May/June 1994), 9.

⁵⁹ *Ibid.*

States made good on its threats, it would restrict its access to an “important supplier of moderate-priced consumer apparel.”⁶⁰ The Federation pointed out that American consumers would be the real losers in such an event. It further commented that although American makers could theoretically fill the gap, they would not be able to do so “at the same quality and price.”⁶¹

USTR Mickey Kantor’s threat of trade sanctions brought cries of outrage from a number of other organizations and companies as well. The National Apparel and Textile Association, a Seattle-based organization representing a fair number of textile importers, argued that big retailers who depended heavily on China would suffer heavy losses if the sanctions were carried out against China. The United States Association of Importers of Textiles and Apparel based in New York made the familiar allegation that the U.S. had not offered sufficient evidence to back up its claims about the transshipment problem and criticized the Clinton administration for “playing with fire” through the threatened sanctions. Companies such as GAP Inc. cautioned that the cutback would have strained the production capacity of apparel factories in other Asian countries and raise the prices for American consumers, particularly low-income consumers.⁶²

Business associations directly involved in U.S.-China trade joined textile manufacturers and retailers in the battle against the quota reductions. The United States-China Business Council cautioned that since textiles accounted for a large portion of U.S.-

⁶⁰ Ibid.

⁶¹ “U.S.-China Trade War Looms Over Textiles,” *The Gazette*, January 8, 1994, C3.

⁶² Thomas L. Friedman, “U.S. Pares Imports of China’s Fabrics in a Punitive Move,” *New York Times*, January 7, 1994.

China trade, a major trade confrontation in this area would have far-reaching implications for overall economic and trade relations between the two countries. Echoing the concerns of export-oriented groups, the Council stressed that the U.S. brinksmanship might also induce Chinese retaliation against leading U.S. exports to China such as aircraft, computer, telecommunications and grain exports.⁶³

A senior U.S. Treasury official reportedly commented on the 1993-94 textile negotiations that "one of the things the Chinese need to understand is that for the first time in seven years, Washington is speaking with one voice."⁶⁴ But even with one voice, it was sending highly contradictory messages. With importers and retailers calling positively for an amicable settlement of the dispute, the USTR was placed in the middle of a dispute involving two politically active groups and had difficulty justifying the decision to impose the sanctions.

This pattern of interest group alignment repeated itself when the United States in 1996 again threatened to impose sanctions on Chinese textile and electronic goods for China's violation of the 1994 textile agreement. On the one hand, the American Textile Manufacturers Institute, representing textile manufacturers who had seen a steady loss in its market share due to the huge inflow of Chinese goods, charged that China had counterfeited textile designs and trademarks, illegally transshipped \$2-4 billion worth of textile and apparel products to the U.S. each year, and kept its market closed to American products. On the other hand, American importers and retailers had mounted a strong

⁶³ Ibid.

counteroffensive against the textile producers' position. The U.S. Association of importers of Textiles and Apparel, for example, questioned the government's estimate of the magnitude of the transshipment problem and criticized the Clinton administration for targeting textile imports in order to appeal to the powerful textile interests in a presidential election year. Importers asserted that the sanctions would make life more uncertain for them and urged the administration to more fully take into account the impact of the sanctions on the American manufacturing, retailing and consuming community.⁶⁵

Although the U.S. government claimed that most of the sanctions would be imposed on goods available from sources other than China and therefore would incur minimal costs, importers pointed out that the sanctions would cause considerable difficulties to small manufacturers who simply could not afford to shift production. Particular sectors of the apparel industry (such as the silk apparel sector) were especially worried about the possibility of Chinese retaliation due to their high vulnerability to restrictions on Chinese silk exports. The industry moved quickly to publicize its vulnerability to Congress and the USTR, emphasizing in particular the importance of a steady silk supply to the maintenance of jobs and stable price.⁶⁶

While the sanction threats brought importers into the fray, they energized export-oriented interests (including auto, wheat, and aircraft producers), who also feared the consequences of Chinese retaliation. As in the 1994 disputes, export interests argued that

⁶⁴ Ibid.

⁶⁵ Paul Green, "U.S. Textile Makers, Importers Clash Over Chinese Products," *Journal of Commerce*, May 16, 1996, 2A.

sanction threats might provoke Chinese retaliation, placing major U.S. exporting items to China in jeopardy. Given the prospect of a rapidly expanding China market, exporters urged U.S. negotiators to be more prudent in their choice of trade weapon. These countervailing forces in U.S. domestic politics, stemming from importers and exporters' concerns about potential economic losses, therefore placed a major constraint on American negotiators' actions.

Conclusion

In both U.S.-China intellectual property and textile trade negotiations, American negotiators failed to make good on threats to impose sanctions on Chinese products primarily because of opposition from the U.S. importing and retailing community. Some analysts may contend that, unlike in the MFN debate, U.S. business interests enjoy a much higher level of unity in both of these cases. But while opposition interests were far less vocal and prominent than in the MFN case, they nevertheless influenced the policy orientation and position of the executive in a way that made an open trade confrontation less likely. Despite efforts by U.S. IPR-related industries and textile manufacturers to penalize China for its trade infringements, active opposition from a large constituency dependent on low-cost labor-intensive products made it far more difficult for these industries to achieve their negotiation objectives in China. U.S. importers and retailers of such products as footwear, toys, apparel, and consumer electronics made the familiar

⁶⁶ Paul Green, "Trade Offices Brace for Lobbying Blitz to Keep Products Off China Sanctions List,"

argument that they would suffer severely if restrictions were placed on these Chinese imports, in effect constraining the IPR industries and textile manufacturers from escalating the conflict to a trade war.

The mutual imposition of sanctions in the textile case in the early 1980s seems to be an exception to the pattern described above. But it can be explained in terms of the relatively low level of Chinese textile and apparel exports to the United States and hence the absence of organized political opposition on the part of textile importers and retailers during that period. As the volume of Chinese textile exports to the United States rose rapidly in the 1990s, textile importers and retailers became a more active political force in opposing the threats against China. In a context of generally protectionist U.S. textile policy, such opposition at least prevented U.S. negotiators from pursuing overly aggressive trade policies, lessening the chances of trade war between the United States and China. Hence, U.S.-China trade disputes have preserved a degree of cooperativeness because of the domestic divisions generated by trade complementarity. The fact that the United States was a democracy and China was authoritarian did nothing to aggravate misunderstandings or otherwise increase the risk of a trade war.

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Democratic Trade Wars

The previous chapter reveals how the complementary trade relationship between the United States and China, by creating such deep divisions in U.S. politics, decreases the probability of trade war between the two sides. Although, according to the literature on crisis bargaining, trade conflicts between democratic and authoritarian regimes should more frequently escalate into trade wars, complementary trade relations between many of these dyads structure domestic politics in the sender of threats in a way that dampens the incentives for brinkmanship in bilateral trade disputes. Domestic division on the democratic side of the dispute compensates for any possible aggravation of relations caused by the inferior signaling capabilities of authoritarian states, preventing trade disputes between autocracies and democracies from escalating into trade war.

This chapter contrasts the pattern of trade peace between authoritarian and democratic regimes (such as that between the United States and China described in the previous chapter) with the greater frequency of democratic trade wars. Through detailed analyses of the dispute between the United States and the European Community over EC enlargement and U.S.-Canada timber trade conflicts, it highlights how trade competitiveness between democratic regimes creates stronger domestic pressure for the use of threat tactics, increasing the risk of trade war. In both the U.S.-E.C. and U.S.-Canada cases, sanction threats enjoyed widespread domestic support. In the enlargement case, since a wide range of U.S. agricultural interests faced the effects of unfair E.C.

competition, both U.S. interest groups seeking to eliminate the newly erected trade restrictions in the Iberian markets and those facing import competition lent their support to the sanction threats. Unlike trade negotiations between the United States and China, there was a particularly large import-competing constituency in the United States that welcomed sanction threats promising to restrict the imports of products that they had been trying to keep out of the U.S. market. Similarly, in the U.S.-Canada timber trade conflict, the U.S. softwood lumber producers' campaign for protection won the support of diverse segments of the forest products industry threatened with growing Canadian penetration of the U.S. market. Competitive trade relations solidified domestic industries' support for sanction threats, exerting strong pressure on the executive branch of the government to provide relief for domestic industry. Unified domestic support for sanction threats lowered the threshold for trade wars, leading the United States to opt for retaliatory measures in both cases.

EC Enlargement

Background: Earlier U.S.-E.C. Agricultural Trade Confrontation

The dispute over E.C. enlargement was the natural outgrowth of a series of U.S.-E.C. confrontations in the farm sector. Ever since the formative years of the European Community, the U.S. government and agricultural producers have been irritated by the E.C.'s highly protectionist agricultural trade policy. Americans argued that E.C. agricultural policies, by shielding European farmers from market competition, threatened the survival and competitiveness of the U.S. agricultural sector. Although, in the 1960s

and 1970s, both sides sought to limit the scope of trade frictions to prevent disruptions to the Atlantic relationship, they found it difficult to avoid trade wars even then due to diametrically opposed domestic interests.

The first agricultural trade war between the United States and the European Community, the famous Chicken War, followed on the heels of the launching of the Common Agricultural Policy (CAP), and erupted as a result of E.C. policies discriminating against poultry imports from the United States. In late 1962, the E.C. introduced a steep import levy on cereals, which translated into a heavy duty on the production of poultry. This duty provided a particularly high degree of protection for European farmers because of the higher costs of transforming grain into broilers in the E.C. Such formidable import barriers precipitated a sharp drop in U.S. exports of poultry meat to the E.C., which declined from \$52 million to \$21 million between 1962 and 1966.¹ To compensate for the substantial losses of American farmers, the United States retaliated in 1963 with a duty on imports of cognac from the E.C.

The Turkey War took place in 1976 for reasons similar to those that produced the Chicken War. In July 1974 the E.C. substantially raised levies on imports of turkey meat despite an earlier U.S. gesture to lower tariffs on brandy imported from the E.C. During bilateral negotiations between 1975 and 1976, American negotiators sought to reduce the level of E.C. restrictions. Although both sides claimed that they had made concessions,² negotiations again failed to produce a compromise solution. As a result, in November

¹ G. N. Yannopoulos, *Customs Unions and Trade Conflicts*. (London: Routledge, 1988), 113.

² The United States claimed to have reduced the tariff on brandy imposed in retaliation against the E.C. increased levy on poultry. The E.C., in turn, had reportedly scaled back increases in turkey levies in 1975

1976, the United States raised duties on imported brandy, provoking E.C. retaliation in the form of higher levies on turkey imports.

Throughout the 1960s and 1970s, American agricultural producers faced continued difficulties in expanding their exports to overseas markets. The EC's Common Agricultural Policy (CAP), with its highly visible protectionist market barriers, received the brunt of the blame for the lackluster performance of American agricultural exports in European markets. Consequently, the United States has focused on the removal of trade restrictions in an attempt to expand agricultural products.³ In the early 1980s, although U.S. agricultural exports to the E.C. increased sharply, from \$7,700 million in 1971 to \$41,000 million in 1980, the United States increasingly became concerned about E.C. practices in third markets which displaced American producers from their traditional agricultural markets. Indeed, as early as the 1960s, the United States began to raise objections to E.C.'s policies of subsidizing agricultural exports and of forging preferential trade arrangements with specific groups of developing countries. From the American point of view, such policies not only violated the principle of multilateralism which served as an important underpinning of the GATT system, but also posed a serious challenge to American farmers' position in third markets. As E.C. agricultural export policies became more aggressive in the 1980s, U.S. trade policy increasingly concentrated on combating the effects of E.C. subsidies and other preferential trading policies.

In 1983, after dispute-settlement procedures under the new GATT Subsidies Code failed to address U.S. grievances about E.C. wheat flour subsidies, the United States fired

and 1976.

the first shot in the export subsidy war by offering a generous subsidy to a wheat flour sale of one million tons to Egypt, a traditional European market. The U.S. wanted to reverse the serious decline of foreign sales and to prevent the further displacement of the United States from its traditional agricultural markets. As the U.S. initiative severely impeded the ability of the European Community to market wheat flour in Egypt, the E.C. retaliated with increased export subsidies on unmilled wheat and a 320,000-ton wheat sale to Egypt in the spring of 1983. In addition, the E.C. made new subsidized wheat sales to Iran, Syria, and Algeria. A few months later, the Europeans again caught the Americans by surprise with the announcement of a 600,000-ton subsidized wheat sale to China. The E.C. also intensified the competition with the United States over the wheat market in Latin America, a market it had neglected in the past.⁴

To forestall the EC's increasingly aggressive trade offensive, the United States attempted but failed to arrange a retaliation against the Community in 1983. Then two years later, in June 1985, the deterioration of U.S. agricultural exports prompted U.S. Congress to push for export subsidies on an even greater scale to remedy the situation. To prevent Congress from legislating an extreme subsidies initiative, the Reagan administration adopted a congressional proposal authorizing the establishment of the Export Enhancement Program (EEP), under which \$2 billion of surplus government commodities were made available to exporters. The U.S. action immediately provoked the Europeans into tit-for-tat retaliation. In September 1986, the E.C. directly challenged the EEP by increasing the export subsidies it offered to grain and flour sales to Algeria,

³ Paalberg, *Fixing Farm Trade*, 1984.

Morocco, Egypt, and Syria by \$11 per ton. The cross-Atlantic competition escalated even further in spring 1987, when the E.C. announced subsidized sales of 750,000 tons of corn to various importing countries in North Africa, the Middle East, and Eastern Europe. American farm groups subsequently began urging the U.S. government to broaden the scope of the EEP to extend subsidies to a greater variety of commodities as a defense against the European assault. Between 1982 and 1990, this export subsidy war had cost the United States and the European Community over \$2 billion in additional outlays, increasing the burden on both U.S. and E.C. budgets.

Besides the export subsidies issue, the United States also reacted strongly to the E.C.'s trading preferences in favor of citrus fruit imported from Mediterranean countries. As an important component of its preferential trading system, the European Community had granted lower customs duties to citrus fruit exports from a selected group of Mediterranean countries, allowing citrus fruit exporters from these countries to gain greater access to the E.C. market at the expense of American producers. Although the European Community had later abolished most of the reciprocal market access agreements with its Mediterranean trading partners and replaced them with bilateral development cooperation treaties, the Reagan administration, prodded by influential farm groups such as the powerful California-Arizona orange industry, continued to demand that the E.C. provide greater access to American citrus fruit producers, threatening to raise tariffs on pasta imports from the E.C. by up to 40 percent should the E.C. fail to open up its citrus fruits market to the United States. The United States specifically targeted pasta for

⁴ Paalberg, *Fixing Farm Trade*, 1984.

retaliation because American producers had complained about E.C. practices disadvantaging American pasta products. The E.C. swiftly retaliated against the U.S. move by raising its tariff on nuts in shells and lemons from 8 percent to 30 percent. Although the two sides soon found a negotiated settlement to the dispute, the agreement, by and large, had left intact the E.C.'s long-standing policy of subsidizing exports of processed foods. Moreover, the volume of trade affected by the U.S. and E.C. retaliations in this trade war was relatively small. Total U.S. exports of nuts in shells and lemons to the E.C. amounted to only \$33 million a year, whereas the U.S. retaliation impacted on \$36 million of E.C. pasta exports.⁵

Similar to the above trade conflicts, the U.S.-E.C. trade war that erupted in the mid-1980s over the accession of Spain and Portugal into the European Community stemmed from U.S. concerns about E.C.'s protectionist policies excluding American farmers from the Iberian markets. When Spain and Portugal acceded to the EC in March 1986, the E.C. implemented new trade restrictions against agricultural imports from third countries, particularly feed grains. Under the accession agreement, the EC raised Spanish tariffs on feedgrains from 20 to 100 percent, imposed new quotas on soybean and soybean oil imports, and reserved 15 percent of Portugal's grain import market for EC members. The United States, charging that these restrictions violated the spirit of the GATT as they disproportionately favored European farm interests at the expense of U.S. exporters of corn, sorghum, and soybeans, demanded that the European Community rescind the quotas and provide U.S. producers with full compensation. In early 1986, the United States

⁵ Yannopoulos, 1988, 115-116.

threatened retaliation on roughly \$1 billion worth of E.C. exports. In April, the E.C. threatened counter-retaliation and targeted politically active U.S. groups such as producers of corn gluten feed, wheat, and rice. When bilateral negotiations were still going on, the United States imposed nonbinding quotas in retaliation against the Portuguese restrictions on U.S. soybeans and soybean oil. The Portuguese quotas on oilseeds and the U.S. retaliatory quotas remained in effect until 1991.⁶ Although the Reagan administration later refrained from carrying through with threats to retaliate against the Spanish restrictions, the fact that both sides decided to go ahead with retaliatory measures in the Portuguese case indicated the intensity of the conflict.

The frequent escalation of U.S.-E.C. agricultural trade conflicts into trade wars, as seen in the few episodes cited above, can be explained in terms of the competitive trade relationship between the United States and the E.C. and the effect of this trade structure on the level of domestic support for aggressive negotiation tactics. A broad spectrum of U.S. farm groups, who competed with European farm products, have for years decried the E.C.'s anti-competitive trade practices. As a result, threats of trade retaliation garnered support both from groups seeking enhanced market access in Europe and in third markets and those who had to compete with European imports in the U.S. market. For example, in the U.S.-E.C. trade war over export subsidies mentioned above, most American agricultural groups saw subsidies as an effective instrument with which to correct the market distortions caused by the E.C.'s protectionist agricultural policies. Wheat producers, the main protagonists in this dispute, advocated an aggressive negotiation

⁶ Bayard and Elliott 1994, 428-30.

strategy. But other major agricultural groups such as corn and gluten feed producers also endorsed a proactive trade policy which, in their view, was the single most effective way to alleviate the competitive pressure they faced in the domestic market. Domestic opposition to the export subsidy program was thus muted, permitting a united front among U.S. producers.

Moreover, on most issues related to agricultural trade with the European Community, both the Reagan and Bush administrations favored a considerably tough posture. From the executive branch's point of view, agriculture is a crucial area of economic activity that is internally competitive and should be provided with a level playing field. Some form of government action was necessary to ensure the viability of agriculture. These considerations, reinforced by strong industry and congressional pressure for government support in the face of European intransigence, resulted in executive branch policies favorable to the agriculture sector. With the consensus among domestic interest groups and the government institutions for retaliation, the risk of trade war was much enhanced.

The dynamics of domestic politics in the E.C. enlargement case resembles the pattern of the few other U.S.-E.C. agricultural trade conflicts described above. In E.C. enlargement, as in the export subsidies war, America's sanction threats designed to eliminate trade restrictions in the Spanish and Portuguese markets obtained the support of both U.S. exporters seeking to gain a greater share of the E.C. market and importers hurt by subsidized European agricultural exports in the United States. Threats were also backed by Reagan administration officials who felt that government intervention was

necessary to prevent U.S. agriculture from withering away in the face of unfair E.C. competition. The following section will describe in detail the positions adopted by the various actors involved in the dispute to reveal how the complex interplay of political forces shaped the U.S. response.

The Issue

In 1985, after years of protracted and difficult negotiations, the ten members of the European Community reached agreement to expand E.C. membership to Spain and Portugal. Although the United States welcomed the political integration of the two Iberian states into the Atlantic alliance, it was not willing to accept the economic consequences of a more integrated Europe. Because the enlargement of the E.C. called for the harmonization of Spain and Portugal's farm policies and tariff structures with the Common Agricultural Policy (CAP), endangering the position of U.S. agricultural groups in the European market, it soon sparked an unexpected and bitter cross-Atlantic trade conflict.

Importantly, the accession of Spain and Portugal, which formally took place on March 1, 1986, entailed modifications in Spanish and Portuguese tariff systems in order to make them compatible with the common external tariffs of the E.C. The treaties of accession stipulated that during the transition period of ten years, Spain and Portugal would need to ease quantitative restrictions and reduce duties on manufactured imports from the current level of 15 percent to the E.C. level of 5 percent. However, these reductions in industrial barriers would be offset by the sharp increase in agricultural tariffs

as Spanish and Portuguese agricultural policies now would be brought into the orbit of the Common Agricultural Policy. For example, under the accession agreement, Spain was required to raise tariffs on imports of feed grains from 20 percent to over 100 percent, and Portugal would have to reserve 15 percent of its import market for grains to other E.C. member states and to levy new quotas on imports of soybean and soybean oil.

These new restrictions led to a sharp drop in U.S. agricultural exports to Spain and Portugal. The U.S. side estimated that the new quotas and tariffs could reduce American exports by nearly \$ 1 billion a year, causing an additional setback to the low level of U.S. farm exports to Europe. The restrictions on feed grains were particularly devastating to American feed grain farmers as the two Iberian countries depended heavily on imports of feed grains, especially those supplied by the United States, to make up for the shortages in their domestic markets. As a result, American feed grains farmers were loathe to see the protective walls that E.C. enlargement erected in the Iberian markets. In addition to the agricultural costs incurred by E.C. enlargement, the Americans also questioned the E.C. claim that these losses would be offset by the reductions in Spanish and Portuguese industrial tariffs. They contended that since the enlargement treaty required the *elimination* of Spanish and Portuguese tariffs on manufactured goods imported from other E.C. countries, American industries would be placed at a distinctive disadvantage vis-à-vis their European competitors. To prevent further agricultural losses, Washington immediately began negotiations with the E.C. to remove the new trade restrictions and to seek agricultural trade compensation.

U.S. Farm Interests and E.C. Enlargement

An important reason that the trade dispute over enlargement evolved into an open trade war was that almost all U.S. farm groups supported the sanction threats. As the case study by John Odell suggests, the enlargement case unified major elements of the U.S. farm lobby. U.S. feed grains producers were a major group that would be negatively affected by the restrictions the enlargement treaty placed on U.S. exports. But other groups targeted by EC retaliation, such as producers of corn (maize), barley, and grain sorghum also had strong grievances about the perceived unfair European agricultural policies.⁷ Consequently, they had little incentive to oppose the sanction threats. Broad sectors of American agriculture long have complained about the EC's protectionist agricultural policies that undercut American producers' ability to compete in the world market. At a time when U.S. farm exports and income were undergoing a steady decline, EC's import restrictions inevitably stirred American farmers into action.

For American farmers of feed grains, the situation was hardly tolerable. The Spanish and Portuguese feed grains markets were one of the most important for U.S. exports. In 1982, they absorbed 15 percent of U.S. exports. However, by 1985, their share of U.S. exports had declined to 8 percent. It was estimated that E.C. enlargement would cause the United States to lose additional sales of \$640 million per year in Spain and another \$55 million in Portugal. These losses were particularly damaging as they merely added to the existing problems of deteriorating farm exports and income. In the

⁷ John Odell and Margit Matzinger-Tchakerian, "European Community Enlargement and the United States," in Robert S. Walters, ed., *Talking Trade: U.S. Policy in International Perspective*, Boulder: Westview Press, 1993, 136.

mid-1980s, the U.S. farm sector was mired in a crisis induced by declining export demands and the appreciation of the dollar, which in effect raised the price of U.S. exports vis-à-vis other major agricultural suppliers. In 1981-1984, real farm income in the United States dropped to only half of the level in 1971.⁸ A series of farm closures and widespread unemployment accentuated the appeal of calls for government support. Naturally, the E.C.'s unfair trade practices, as embodied in the CAP, received the brunt of the blame for the problems plaguing the U.S. agriculture sector. American farmers accused the E.C. of supporting an inefficient farm sector through the use of variable import levies, thus displacing competitive world-market suppliers from both the European and third-country markets. They asserted that CAP policies were not only inefficient, but also undermined the accepted norms of the international trading system. U.S. farm interests also denounced the E.C. practice of using export subsidies to dispose of its agricultural surpluses onto the world market which, in their view, was the chief culprit behind the loss of U.S. export market shares. As one of the U.S. farm groups most severely harmed by the E.C.'s unfair trade practices, feed grains producers had insisted on full compensation in the dispute over enlargement. They remained unconvinced of the argument that the lower Spanish and Portuguese industrial barriers would compensate for the higher agricultural duties and refused to accept any settlement that failed to offer full compensation to U.S. farmers, stressing that they were the ones with their "dollars on the

⁸ Bruce L. Gardner, "The Political Economy of U.S. Export Subsidies for Wheat," in Anne O. Krueger, ed., *The Political Economy of American Trade Policy*, Chicago: The University of Chicago Press, 1996, 295.

line.”⁹

Other U.S. farm groups, such as producers of corn (maize), barley, and sorghum, who similarly felt victimized by unfair E.C. competition, also supported efforts to expand U.S. market shares in the Iberian states. American corn farmers, for example, relied primarily on the domestic market and, thus, did not have the extensive investments in foreign markets that would expose them to the risks of E.C. counter-retaliation. Between 1982 and 1985, even before the additional barriers associated with the Spanish and Portuguese entry came into place, U.S. corn exports to the European Community had already dropped from 14.2 million tons to 6.0 million tons.¹⁰ As a result, corn producers, far from opposing the sanction threat, had pushed for a tough negotiation position.

Thus, major U.S. farm interests, including not only the feedgrains group, but also corn, barley, and grain sorghum producers, had forged a unified position, forming a trade policy coordinating committee to protest the enlargement treaty. These groups urged the Reagan administration to take forceful action to press the E.C. to provide full compensation for U.S. farmers and to reduce agricultural export subsidies that dampened U.S. exports in third markets. U.S. producers insisted on the elimination of E.C. export subsidies because it was in this area that they felt most alarmed by E.C.’s unfair trade practices. However, this demand was also more sweeping and more difficult to meet than simply reducing the Spanish and Portuguese quotas to pre-accession levels.

The farm lobby obtained strong backing from legislators, who, in April 1986,

⁹ Letter from U.S. Feed Grains Council to U.S. Department of Agriculture, June 20, 1986, cited in Odell and Matzinger-Tachakerian 1993, 137.

¹⁰ John Odell, “International Threats and Internal Politics: Brazil, the European Community, and the

passed a resolution urging the president to retaliate. Representatives of the U.S. farm lobby visited European capitals in the summer to communicate directly with E.C. farm leaders and government officials about the U.S.' determination for a positive outcome. In the fall, farm groups launched an even more aggressive campaign for trade relief, explicitly making their endorsement of a GATT agreement on agricultural trade in the Uruguay Round contingent on the satisfactory settlement of the enlargement dispute.¹¹ At the end of the year the Feed Grains Council directly warned American negotiators:

Our membership has clearly indicated that the feedgrains sector is willing to face the possible consequence of E.C. counter-retaliation. What they are not willing to face is anything less than full compensation for the Spanish market, or a lack of resolve by our government if such compensation cannot be achieved. ... The time has come to draw the line and take a strong stand against the unfair trading practices of the European Community. Any further delay in the settlement of this dispute is totally unacceptable.¹²

Importantly, almost no interest groups took visible measures to undercut the effectiveness of the feed grain and corn growers. Importing interests, as well as a number of groups that could be hurt by possible E.C. counterretaliation, voiced their concerns about the sanction threats, but did not push their case as forcefully as the corn and feed grain producers. A number of interest groups targeted by E.C. counter-retaliation faced trade restrictions in Europe themselves and were willing to go along with the tough approach demanded by the corn and feed grain producers. As Odell cited a U.S. negotiator's reaction to the level of political activism of U.S. groups who potentially would be hurt by E.C. counter-retaliation:

Sure, we had heard from them [the groups targeted by E.C.]. We got a few letters saying

United States, 1985-1987," in Evans et al. ed., *Double-Edged Diplomacy*, 1993, 241.

¹¹ Odell and Matzinger-Tachakerian 1993.

¹² Letters to USTR, Dec. 2, 1986. Quoted in Odell 1993, 242.

they were concerned about it, but they were not beating our door down. It was not heavy-duty political pressure. The corn gluten feed people [targeted by Brussels] have their own zero [duty] binding in the E.C. They know that if they want us to go bat for them, they have to play along sometimes when we're working for somebody else. We did hear a lot from the import interests -- representing the French products, Belgian endive, and so forth.¹³

Thus, political pressure exerted by groups who could suffer from possible E.C. counter-retaliation was almost negligible. Neither was there much opposition from those whose imports might be cut off by U.S. retaliation, although these interests did raise some concerns. In short, since so many U.S. agricultural groups faced E.C. competition, both import-competing and export-seeking interests could benefit from trade retaliation and, hence, both backed threats to open European agricultural markets. Virtually negligible domestic resistance allowed the feed grains and corn producers to exercise considerable political influence, intensifying the pressure on the Reagan administration to pursue a more aggressive approach in negotiations with the European Community.

Reactions in Washington

U.S. farm groups' calls for trade sanctions were received favorably in Washington. Indeed, the Reagan administration itself had become concerned about the impact of E.C.'s export subsidies on U.S. agriculture. Agriculture is one of the most important American exports. As the world's agricultural "superpowers," both the United States and the European Community adopted domestic policies in favor of the agriculture sector. In particular, through export subsidies and other restrictive import policies, the E.C.'s

¹³ See Odell 1993, 242.

Common Agricultural Policy (CAP) played an important role in sustaining the steady growth of E.C. agricultural exports. By compensating E.C. farmers for the difference between the higher internal E.C. price and the lower world market price, the CAP helped European farmers to export their agricultural surpluses to the world market, in the process transforming the E.C. from a net food importer to the world's largest exporter of beef, sugar, poultry, and dairy products. For example, heavy subsidies allowed the E.C. to increase its share of the world export market for wheat and flour from 9.5 percent during the 1970s to 15.7 percent in 1984-85.¹⁴

However, such substantial gains to European agriculture had come at the expense of American farmers. As the E.C. moved from a net importer to a self-sufficient exporter of a variety of agricultural commodities, the United States lost the ability to export to the E.C. a number of products for which it used to be a major supplier. Between 1980 and 1984, U.S. agricultural exports to the E.C. plummeted from \$9.8 billion to \$6.7 billion. Overall U.S. agricultural exports declined from \$48 billion in 1981 to \$26 billion in 1986.¹⁵ The E.C.'s aggressive trading posture also induced a visible drop in America's share of world trade.

In an environment of steadily deteriorating farm exports, the executive branch had come under enormous pressure from Congress, the media, and various domestic constituencies to provide trade relief. The U.S. Congress, in particular, agitated for reform of domestic support policies to combat the effects of the CAP. Even before the

¹⁴ For example, E.C. agricultural subsidies in 1984 alone amounted to \$5.2 billion. Bruce Strokes, "Trade Disputes Are Straining the Ties That Bind America and Western Europe," *National Journal* (August 17, 1985), 1895.

dispute over E.C. enlargement took place, the Congress had passed, and sent to the President for approval, highly protectionist bills targeted at Europe. For many congressional members, the E.C.'s heavy reliance on subsidies was directly responsible for the plight of U.S. agriculture. Given the E.C.'s competitive assault on world markets, there was a strong sentiment among legislators that the United States could no longer condone the E.C.'s unfair trade practices that limited imports, drove down prices, encouraged overproduction, and displaced U.S. products.¹⁶

In particular, the E.C.'s attempt to use the accession of Spain and Portugal to further restrict U.S. exports of corn, sorghum and oilseeds became an excellent example of the distortions caused by unfair foreign trade practices. In a context of steadily rising U.S. trade deficits, the potential loss of another \$1 billion in trade that E.C. enlargement would incur did not appear to be an outcome that Congress was willing to accept. Thus, despite many legislators' professed willingness to support the political integration of Spain and Portugal into the E.C., there emerged a congressional consensus that E.C. policies had created excessive trade disruptions that could be corrected only through trade retaliation. As a manifestation of congressional determination, a group of 21 Senators, including the Senate Majority Leader Robert Dole, submitted a letter to President Reagan calling on him to retaliate against the E.C. by withdrawing equivalent tariff concessions.

As the U.S. Congress increasingly moved into the fray, the Reagan administration hardened both its rhetoric and policy stance. Indeed, since the early 1980s, the executive

¹⁵ "Close U.S.-E.C. Links Sometimes Result in Trade Strains," *Europe* 271 (November 1987), 46.

¹⁶ Statement by Rep. Doug Berueter (R-NE), member of the House Foreign Affairs Subcommittee on International Economic Policy and Trade, 1986.

branch has adopted an increasingly mercantilist approach to counter the protectionist policies of its leading competitor in agricultural trade. Government support and retaliatory strategy, where necessary, were justified by the objective of maintaining the share of the world agricultural market going to one of the United States' internally competitive sectors. After the enlargement treaty took place, the Reagan administration, with a view of protecting long-term U.S. agricultural interests, responded to the demands of Congress and farm groups and raised several objections to the enlargement treaty. First, Washington considered the 15 percent Portuguese quota reserved for E.C. countries to be clearly illegal under the terms of the GATT. It also strongly objected to the Spanish restrictions which nullified a prior bilateral agreement, raising the Spanish tariffs on imports of corn and sorghum from below 20 percent to over 100 percent. Washington insisted that, since the withdrawal of product concessions by the two countries had caused considerable damage to American producers, the United States was entitled under the GATT's international rules to full compensation. Second, Washington was irritated by the fact that the Community resorted to the action without prior consultation with the United States. The Americans complained that they did not receive advance notice about the consequences of entirely new tariff structures for the two Iberian states and, therefore, were caught by surprise by the E.C. move.

Third, Washington was concerned particularly about the substantial agricultural costs induced by E. C. enlargement. American officials pointed out that the Spanish tariffs would cut American exports of maize and sorghum animal feed by roughly \$500 million a year. At a time when Washington was increasingly occupied with its loss of world market

share in agriculture and with its \$170 billion trade deficit, including nearly \$30 billion with Western Europe, many administration officials felt that the United States could no longer countenance half a billion in trade losses in the name of preserving a harmonious alliance relationship.¹⁷ Moreover, since one of the products involved was soybeans -- the largest U.S. farm export to Europe with annual sales of more than \$4 billion, there was also a strong reluctance on the part of administration officials to surrender soybean export markets. Fourth, the Reagan administration emphasized that, contrary to E.C.'s claims, the U.S. loss in agricultural trade would outweigh the potential benefits of lower industrial tariffs in the E.C. and of the further integration of the two Iberian states into the Western alliance.¹⁸

Thus, as negotiations in late 1985 and early 1986 bogged down, the White House was running out of patience. U.S. Commerce Secretary Malcomb Baldrige began to refer to an exceedingly difficult situation in which trade disputes would take precedence over issues of geopolitical relationship. Later in the year, in a meeting with farm group leaders, Baldrige reassured them that the administration would not "sit by" and watch the farm sector continue its downward slide.¹⁹ Similarly, USTR Clayton Yeutter asserted that the United States could not accept the accession agreement without adequate compensation. The rhetoric of senior administration officials sent an unmistakable signal that the Reagan administration, having staved off protectionist pressures in the past, was no longer in a position to compromise on trade issues. Thus, unlike previous trade disputes with the

¹⁷ Clayton Yeutter, "Preserving the Atlantic Peace: EEC Tariffs," *Financial Times*, January 23, 1987, 23.

¹⁸ Address by Commerce Secretary Malcomb Baldrige before the American Chamber of Commerce, "U.S.-E.C. Trade Dispute," *Department of State Bulletin* 86, June 1986, 43.

E.C. in which Congress had usually played the leading role, the White House initiated the move for retaliation. Also, unlike past trade conflicts such as the Mediterranean citrus fruit case, the White House invoked the threat of retaliation at a fairly early stage in the dispute. These unusual moves reflected the changing American mood on agricultural trade conflicts with the E.C., indicating a shift of U.S. policy preference away from adjudication to a more coercive strategy. The executive's increasingly tough stance made a trade war more likely.

The Negotiations

In early 1986, when the enlargement treaty took effect, American negotiators immediately demanded adequate compensation. On March 3, 1986, U.S. Trade Representative Clayton Yeutter reportedly called E.C. Commissioner Willy de Clercq to express U.S. shock and anger at the unexpected E.C. tariff increases. To pacify the Americans, the Europeans suggested opening informal discussions about the issue.²⁰ Clayton Yeutter and Secretary of Agriculture Richard Lyng led the discussions.

When initial informal discussions failed to produce any change, the Reagan administration announced on March 31 that the United States would retaliate against the Portuguese quotas on oilseeds and grains by May 1, and the higher tariffs in Spain by July 1, unless the new restrictions were removed. The total amount of trade affected by the threatened sanctions was about \$1 billion, the estimated value that enlargement cost the U.S. farm sector. U.S. negotiators took care to pick items that would inflict the most

¹⁹ Oswald Johnston, "U.S. Europe Achieve Truce in Spain Trade," *Los Angeles Times*, July 3, 1986, 1.

harm on politically well-organized E.C. groups. Almost half of the retaliation was directed at French exports (including white wine, brandy, cheese, and chocolates), with the rest of the sanctions targeted at exports from Germany, Italy, the Netherlands, and Britain. Notably, unlike U.S.-China trade disputes where the U.S. retaliation list was composed primarily of items no longer manufactured in America (such as bicycles, toys, shoes, and consumer electronics), U.S. sanctions against the E.C. targeted a wide range of products for which American importers could find ready American-made substitutes, thereby neutralizing resistance from U.S. importers. President Reagan justified the retaliation as a means of preventing U.S. farmers from “once again” having to “pay the price for the European Community’s enlargement.” Agricultural Secretary Richard Lyng stated that the retaliatory measures were designed to “bring the E.C. to the negotiating table as soon as possible.”²¹ Although in the past the United States had threatened and actually implemented trade sanctions against the E.C., this time the move was unprecedented because it took place early in the dispute without several rounds of negotiations.

Meanwhile, the E.C. remained unmoved by American demands. The E.C. was one of the most important players in world trade, with exports contributing to about one fifth of world trade in 1985.²² Moreover, the Common Agricultural Policy had played an important role in creating and maintaining a sense of cohesion among E.C. member states. The CAP was particularly valued by countries such as France which viewed an enlarged

²⁰ *International Trade Reporter*, March 12, 1986, 332.

²¹ Odell and Matzinger -Tchakerian, 1993, 144-145.

²² *IMF Direction of Trade Statistics Yearbook*, 1986.

and protected market as a guarantee to the viability of its large agriculture sector. European farmers, who accounted for a much larger share of the E.C. labor force than their American counterparts, have firmly pushed for policies that would help maintain European food security and farm income. Due to the unwavering support of European farmers, who hold considerable political clout in European national capitals, the CAP had become one of the most entrenched policies of the Community. Consequently, any challenge to the CAP almost certainly would provoke a strong response from European farm interests. After the enlargement dispute took place, almost all E.C. member states agreed that the United States should not be given special agricultural compensation. E.C. officials defied the United States' confrontational approach, declaring that "the Community is determined that the fundamental objectives and mechanisms, both internal and external, of the common agricultural policy shall not be placed in question."²³ E.C. Commissioner de Clercq plainly told the Americans that "A European Community of 320 million people, conducting one-fifth of world trade, is not going to be pushed around."²⁴

Determined to defend what it viewed as its legitimate trade interests, the E.C. on April 9 responded to the U.S. sanction threats with vows to counter-retaliate. The E.C. carefully selected the products on the sanction list to target politically powerful U.S. groups, including producers of corn gluten feed, wheat, and rice. Since these products figured prominently in U.S. exports, the counter threats were considered to be the equivalent of "using a nuclear weapon in a trade war."²⁵ During subsequent negotiations

²³ Cited in Odell and Matzinger-Tchakerian 1993, 139.

²⁴ *Europe*, June 1986.

²⁵ Odell and Matzinger-Tchakerian 1993, 145.

in the spring, the two sides came up with various compromise proposals, but could not narrow their differences. At this point, it was clear that neither was bluffing and that both were actively preparing for the trade war that seemed likely to follow.

While discussions were still under way, the U.S. government announced decisions to impose nonbinding quotas on a range of Portuguese products to retaliate against the Portuguese restrictions on soybeans and soybean oil. The imposition of quotas not only indicated the Reagan administration's resolve to attack the E.C.'s continued assault on world markets, but also reflected the political clout and influence of U.S. soybean producers. The American Soybean Association had been long actively involved in trade disputes with the E.C. because of the importance of the European market to the U.S. soybean industry. In the 1960s, the U.S. government had made a pre-condition for its recognition of the CAP the European guarantee not to impose any tariffs on soybeans or corn gluten feed. This tacit agreement proved crucial to expanding American soybean exports to the E.C. As E.C. enlargement seriously challenged the soybean zero binding system, it nearly ensured that the soybean producers would launch an aggressive lobbying campaign against the new restrictions. The absence of opposition from other domestic groups, as described earlier, bolstered the soybean producers' chance of success in this case.

The retaliation against the Portuguese quotas still left the Spanish issue unresolved. Washington continued negotiations with the E.C. regarding Spanish restrictions throughout the year. On July 2, 1986, the two sides reached a temporary agreement whereby the E.C. promised to increase its imports of feed grains for six months in

exchange for a U.S. guarantee to suspend the retaliatory tariffs until December 31, 1986. In essence, the agreement amounted to a concession on the part of the E.C. to temporarily provide the United States with some compensation and to increase E.C. purchases of U.S. grain, measures that the E.C. would not have taken in the absence of U.S. pressure. It addressed some of the most immediate concerns of the United States, thus providing the two parties with more time for negotiation and bargaining.

This interim agreement, while welcomed by both American and European negotiators, drew sharp criticism from farm interests on both sides of the Atlantic. The U.S. Feed Grains Council, for example, was critical of the amount of compensation provided in the agreement, which was less than half of the losses feed grain producers claimed they had suffered from Spanish accession. The Council decried the agreement as "a bitter pill to swallow," stating that "any agreement that does not fully compensate the producers of corn and sorghum who have lost access to the markets of Spain and Portugal will be unacceptable to the U.S. Feed Grains Council and our members."²⁶ Then, towards the end of the year, as the negotiation deadline approached, the Feed Grains Council again urged American negotiators to stand firm, explicitly expressing their willingness to face the effects of E.C. counterretaliation.

U.S. and E.C. negotiation positions remained far apart throughout the year. By November it was clear that the E.C. did not increase its imports of feed grains to the amount specified in the interim agreement. There was also evidence that the E.C. deliberately manipulated its import levy system in a way that continued to disadvantage

²⁶ Odell and Martzinger-Tchzkerian 1993, 149.

U.S. exports. Given the lack of progress, the Reagan administration threatened to impose 200 retaliatory duties on \$400 million worth of European agricultural exports by January 30 1987 unless an agreement could be reached by then. Even at this point, the negotiations remained deadlocked. Washington clearly stated that it would carry through with the retaliation if no agreement were in sight. But, at the same time, U.S. negotiators softened their position somewhat: Washington reduced the total amount of compensation it demanded in the previous rounds of negotiations; it also contemplated the possibility of some form of industrial compensation.

The United States and the E.C. continued negotiations right up to the deadline and finally reached a settlement on January 29 1987. Brussels agreed to substantially increase its imports of corn and sorghum from third countries in the next four years, with two-thirds of these purchases guaranteed to go to American producers. Moreover, it guaranteed zero-duty binding for American soybean products and corn gluten feed exports in Spain and Portugal, eliminated the 15 percent restrictions on the Portuguese import market for grain, and offered to reduce import duties on a variety of industrial products. The removal of restrictions on the Portuguese grain import market was particularly important to American producers as it would increase substantially U.S. sales of cereal in the Portuguese market. Total E.C. agricultural and industrial concessions were estimated at \$400 million. The agreement was to be reviewed in mid-1990. While the E.C. eventually conceded on the Spanish issue, both the Portuguese oilseeds quotas on oilseeds and the U.S. retaliatory measure had remained in effect. It was not until 1991, when Portugal rescinded the oilseed quotas, that the United States removed the restrictions on

Portuguese imports.

The above analysis suggests that diametrically opposed domestic interests on both sides of the Atlantic was the main reason for the intense U.S.-E.C. trade confrontation over E.C. enlargement. Since American farmers faced across-the-board competition from the Europeans, E.C. enlargement united a broad spectrum of U.S. farm interests into aggressive lobbying campaigns. Not only did U.S. producers of feed grains and soybeans protest the enlargement treaty, but also, even those targeted by E.C. counterretaliation (such as producers of corn, barley, and grain sorghum) supported the sanction threats as they would benefit from the restrictions on these European imports if the sanctions had to be carried out. Furthermore, the dispute against the E.C. was supported by Reagan administration officials who felt that the new restrictions accompanying Spanish and Portuguese accession represented another episode in the history of unfair E.C. competition in the agricultural sector. U.S. retaliation in the Portuguese case resulted from, and reflected, these intense domestic pressures, which made the risk of trade war quite high.

U.S.-Canada Timber Trade Dispute

Background

The U.S.-Canada trade dispute over softwood lumber was the largest and most durable between the two countries, spanning more than fifteen years and costing industry and government officials on both sides of the border considerable time and financial resources. The dispute began in 1982 when the United States Coalition for Fair Lumber

Imports (CFLI) submitted a petition to the International Trade Administration (ITA) of the Department of Commerce calling for the imposition of countervailing duties on imports of softwood lumber supplied by Canada. The CFLI was comprised of 350 individual softwood-products companies and eight trade associations, with most of its support coming from the Northwest Independent Forest Manufacturers, a coalition of Pacific northwest sawmill companies, and a number of large integrated forest companies in the U.S. South.²⁷ The Coalition alleged that the Canadian stumpage price, the price at which Canadian authorities sold the rights to remove trees from public forests to private lumber producers, conferred a subsidy on Canadian producers, caused increased unemployment for the U.S. forest industry, and was thus countervailable under U.S. trade law.²⁸

The U.S. Department of Commerce conducted an investigation into these complaints, but found no evidence of systematic government support that would justify levying countervailing duties. In 1984, the ITA in its ruling turned down the U.S. industry's request for protection on the grounds that Canadian stumpage programs were freely "available within Canada on similar terms regardless of the industry or enterprise of the recipient" and that there was "no evidence of governmental targeting regarding stumpage."²⁹

²⁷ David Leyton-Brown, *Weathering the Storm: Canadian-U.S. Relations, 1980-83*, Toronto: C.D. Howe Institute, 1985, 47.

²⁸ Benjamin Cashore, *Flights of the Phoenix: Explaining the Durability of the Canada-U.S. Softwood Lumber Dispute*, Canadian-American Public Policy No. 32, Orono: the Canadian-American Center, 1997, 10-11.

²⁹ United States, Department of Commerce, International Trade Administration, *Preliminary Negative Countervailing Duty Determination, Certain Softwood Products from Canada*, Washington, D.C.: GPO, 1983, 1.

The ITA's negative determination temporarily resolved the issue, but did not prevent U.S. timber producers from mounting another major challenge to Canada's forest industry policies two years later. In 1986, in a prelude to the second softwood dispute, U.S. cedar shakes and shingles producers, confronted with growing import competition from Canada and declining supplies and rising costs of raw materials, submitted a petition under section 201 of U.S. trade law urging the U.S. government to restrict Canadian exports of shakes and shingles. The Reagan administration responded positively to the petition by announcing the imposition of *ad valorem* duties of 35 percent on wooden shakes and shingles supplied by Canada in June 1986. Canada retaliated almost immediately with its own duties on a variety of U.S. products such as computers, semiconductors, and books.³⁰ The U.S. sanctions remained in place until 1991. Although the shakes and shingles industry was relatively minor in both economies,³¹ this confrontation heralded a more serious trade battle that would emerge between the United States and its largest trading partner later in the year.

Shortly after the settlement of the shakes and shingles dispute, the Coalition for Fair Lumber Imports, with strong backing from congressional representatives, for a second time petitioned the International Trade Commission (ITC) for trade relief. The petitioners alleged that Canada's system of administratively determining stumpage prices enabled Canadian producers to sell timber products at a rate far below the "true market value." They pointed out that the difference between the Canadian rates for government

³⁰ Joseph P. Kalt, *The Political Economy of Protectionism: Tariffs and Retaliation in the Timber Industry*, Cambridge: Harvard University Energy and Environmental Policy Center, 1987, 1-2.

³¹ U.S. sales of shakes and shingles were \$80 million a year, with Canada being a major supplier to the

timber and the rates at which Canadian timber was sold in the United States constituted an explicit subsidy that would be countervailable under U.S. trade law. They further referred to a number of specific Canadian government programs and legislations as evidence of such subsidies.

This time the ITA determination affirmed the existence of government subsidization. Upon issuance of a final Commerce Department finding that subsidized Canadian imports had caused material injury to U.S. lumber producers, the Reagan administration imposed a 15 percent countervailing tariff on softwood (construction) lumber imports from Canada. U.S. importers were then required to post bonds of up to 15 percent on shipments of softwood lumber from Canada. The Canadians retaliated with a 70 percent countervailing GATT duty on corn imported from the United States.³² Canadian negotiators eventually reached an agreement with the United States to place a 15 percent export tax on softwood lumber exports to the United States, but the corn retaliation had remained in effect.

The magnitude of the softwood lumber dispute was unprecedented when one takes into consideration the size of the import sector and impact of the retaliatory duties on domestic prices. As Joseph Kalt has pointed out, the U.S. lumber tariff represented the largest countervailing/anti-dumping action undertaken by the United States within the framework of the GATT. In addition, the Canadian corn retaliation was not only the first countervailing duty ever imposed on the United States by its trading partner, but also one

United States.

³² Joseph Kalt, 1987, 3.

of the few countervailing duties Canada had ever implemented against any nation.³³ Moreover, the lumber trade war entailed considerable costs for both sides given the importance of the softwood lumber industry to both economies. Total annual sales of softwood lumber in the United States and Canada amounted to about \$10 billion and \$5 billion respectively. The share of the softwood lumber industry in the Canadian economy was larger than the aggregate share of agriculture, fisheries, metals, and autos. Canada exported about \$3 billion in softwood lumber to the United States each year, capturing nearly 30 percent of the U.S. market. As a result, a 5 to 15 percent duty could mean hundreds of millions of dollars in lost sales each year.³⁴

The 1986-87 lumber trade dispute was only the second in the series of timber trade confrontations between the United States and Canada. The U.S.-Canadian timber trade rift re-emerged in the 1990s. In 1991, when the Canadian government unilaterally eliminated the 15 percent export tax on the grounds that a series of stumpage pricing reforms had removed the subsidies to domestic producers, the ITA immediately self-initiated an investigation into Canadian stumpage policies. At the same time, the Coalition for Fair Lumber Imports (CFLI), at the invitation of the ITA, filed a petition claiming that Canadian stumpage and export control policies caused considerable harm to U.S. producers and remained countervailable under U.S. trade law. The ITA, in its final determination in 1992, found that the Canadian government both allowed loggers to purchase publicly owned trees at subsidized prices and provided sawmills with subsidized

³³ Joseph P. Kalt, 1987, 340.

³⁴ Joseph P. Kalt, "The Political Economy of Protectionism: Tariffs and Retaliation in the Timber Industry," in Robert E. Baldwin, ed., *Trade Policy Issues and Empirical Analysis*, Chicago: University

raw logs. The ITA subsequently imposed a countervailing duty of 6.51 percent on lumber imports supplied by several Canadian provinces, including Alberta, British Columbia, Ontario, and Quebec. A binational panel established according to the new free trade agreement between the United States and Canada subsequently reviewed the case and requested the ITA to reconsider its determination. The ITA in its remand found additional evidence of subsidization by British Columbia, and increased the countervailing duty to 11.54 percent.³⁵ In 1993, the binational panel turned down the ITA's determination on the grounds that there was no convincing evidence that Canadian stumpage and export controls were "specific" or distorted. The ITA appealed this challenge to its authority without success. The binational panel eventually overruled the ITA's decision, allowing Canadian producers an important victory in this third round of the dispute.

Table 7.1 summarizes the militant history of U.S.-Canada timber trade conflicts. As we will see from the following discussions, the durability of the U.S.-Canada softwood lumber dispute can be explained by a combination of relentless lobbying by the softwood lumber industry and sustained congressional pressure on the executive to deter Canada's aggressive pricing policies. The softwood lumber industry, as a unified, orchestrated group, went out of the way to persuade congressional representatives and administration officials of the existence of Canadian subsidies. The regional concentration of the industry further enhanced the lobbying power of lumber producers, permitting them to apply tremendous pressure on their congressional delegates, and, through them, on the

of Chicago Press, 1988, 340.

³⁵ Joseph P. Kalt, "Precedent and Legal Argument in U.S. Trade Policy: Do They Matter to the Political Economy of the Lumber Dispute?" in Anne O. Krueger ed., *The Political Economy of American Trade*

Table 7.1: U.S.-Canadian Timber Trade Disputes

Case	U.S. Charges	DOC Finding	CVD Imposed	Result
Phase I (1982-83)	Canada's below-market stumpage rates constitute countervailable subsidies	Canadian stumpage subsidy is not "specific"	None	No further action
Phase II (1986)	Canada's below-market stumpage rates constitute countervailable subsidies	Canadian stumpage subsidy is both specific and distorting	14.5% ad valorem	Canada retaliates against U.S. corn exports; eventually agrees to replace U.S. CVD with 15% export tax
Phase III (1992-94)	Canada's below-market stumpage rates and log export controls are countervailable under U.S. trade law	Both Canadian stumpage subsidy and export controls are specific and distorting	11.54% ad valorem	DOC finding overruled by binational panel

Source: Kalt 1987.

executive branch of the U.S. government in order to garner sufficient support for the countervail.

Moreover, the softwood lumber producers' petition won the support of various segments of the U.S. forest products industry, including producers of plywood, fir, and shake and shingle. Because Canadian producers have been capturing a growing share of the U.S. forest products market, these U.S. forest industries favored the sanction threats against Canada. Lumber users are a major group that had reason to object to the threats. However, these opposing interests did not have as great a stake in the outcome as did the lumber-producing interests. Their geographical dispersion and inadequate representation in individual constituencies further diminished their political influence on government

Policy, Chicago: The University of Chicago Press, 1996, 270-271.

action. Meanwhile, faced with the possibility of drastic action by Congress which would contradict and challenge the president's policy, the executive branch had found it necessary to act in order to preserve a measure of control over future trade policy. Although the Commerce Department and the ITA under it were sympathetic to industry demands, the Reagan administration seemed unwilling to fuel congressional support for more restrictive trade legislation or to frustrate a domestic industry with allies on Capitol Hill. As in the enlargement dispute, unity among domestic interest groups and government institutions heightened the risks of escalating the dispute.

Industry Coalition and the Countervail Petition

The U.S. timber industry started the campaign for trade relief in the early 1980s in light of deteriorating industry conditions. Starting in the early 1980s, the timber industry has experienced a steady erosion of comparative advantage due to shrinking sizes, declining productivity and quality of timber, and rising production costs of the extractive and processing sectors in the United States.³⁶ The success of timber producers in obtaining a favorable DOC determination in the second and third phases of the timber trade rift can be attributed not only to the regional concentration of the industry and its effective lobbying effort, but also to the absence of organized domestic opposition. The present analysis will focus on the second phase of the U.S.-Canada timber trade conflict, when both sides implemented trade sanctions, to illustrate the dynamics of interest group

³⁶ Luis Constantino and Michael Percy, "The Political Economy of Canada-U.S. Trade in Forest Products," in Russell S. Uhler ed., *Canada-United States Trade in Forest Products*, Vancouver: UBC Press, 1991, 56.

involvement.

In the 1986 U.S.-Canadian lumber trade dispute, the Coalition for Fair Lumber Imports (CFLI), the main industry pressure group, launched the CVD action and orchestrated a highly effective lobbying campaign in Washington. The CFLI, which represented major softwood producer and forest products associations, was responsible for 70 percent of softwood lumber production in the United States. It united both softwood lumber producers in the Northwest and those in the southern mountain states. In its 1986 petition to the ITA requesting administrative assistance, the CFLI presented a wide array of evidence supporting the contention that Canadian stumpage policy conferred a subsidy.

The CFLI sought to attribute the plight of the U.S. timber industry to unfair competition policies adopted by the Canadian government. The Coalition pointed out that several indicators of industry performance fully revealed the extent of the distress faced by the U.S. lumber industry. First, the Coalition argued that the penetration of Canadian imports of the U.S. market had deepened since the late 1970s. For example, between 1983 and 1985 the share of Canadian imports in the total U.S. consumption of softwood lumber had increased from 27.6 percent to 31.6 percent.³⁷ Second, profitability and productivity of the lumber industry had experienced a sharp decline over the last decade. Since the late 1970s, the growth rate of total productivity of the U.S. lumber industry had dropped by 2.63 percentage points per year. This distinctive lag in productivity growth would have sharply reduced the competitiveness of the lumber industry in the services of

³⁷ See Percy and Yoder, 1987, 23.

capital and labor in national markets.³⁸ Third, not only did sawmill capacity in the United States decline steadily, real U.S. lumber prices remained stagnant despite some improvement in demand. The Coalition took these indicators as unmistakable evidence that “something is not right” with the workings of the free market, asserting that Canadian stumpage policy was directly responsible for the lackluster performance of the U.S. lumber industry.³⁹

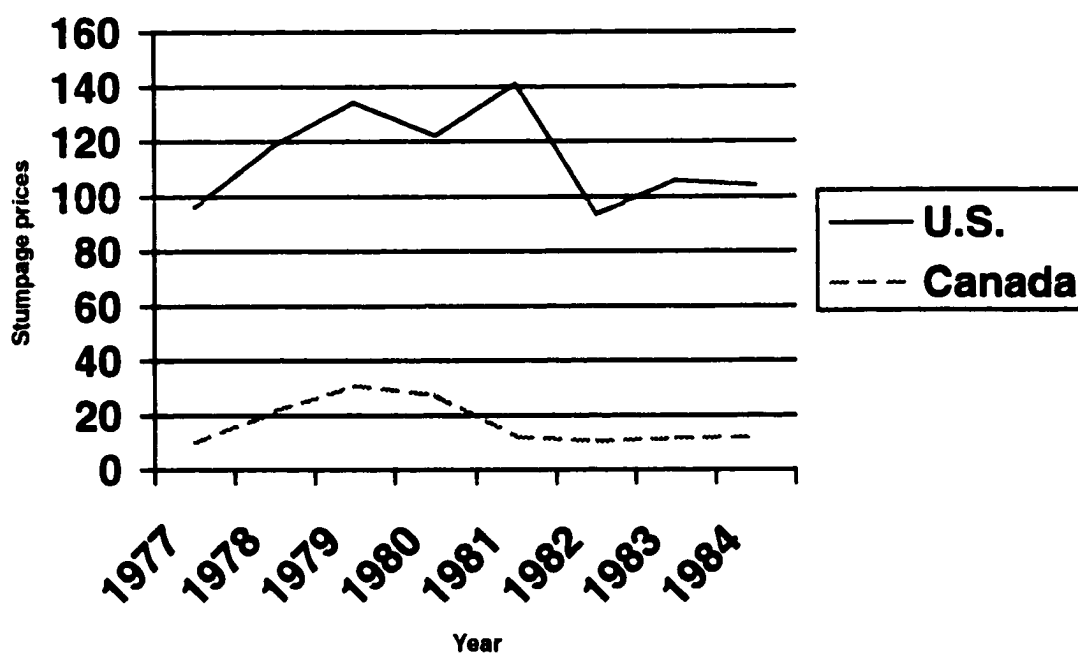
The CFLI emphasized that the U.S. stumpage price, the price at which private lumber producers and logging companies could purchase the right to remove trees from publicly owned forests, consistently outstripped the Canadian stumpage price (See Figure 7.1). It charged that Canadian stumpage fees, unlike those in the United States, were not derived through a competitive bidding process and hence failed to reflect their full market values. The result was that Canadian prices were only a small fraction of U.S. prices. According to the CFLI, this huge gap gave Canadian producers a crucial edge in the U.S. market; by 1984 Canadian softwood lumber imports had captured nearly one-third of the U.S. market.

The lumber producers defended their case by arguing that they were presenting new information regarding Canadian timber policies. They asserted that there had been a marked shift in the use of timber in Canada toward lumber production since 1983. In particular, government intervention at the provincial level channeled the bulk of timber

³⁸ Martin F. Bailey, “The Productivity Growth Slowdown by Industry.” *Brookings Papers on Economic Activity* 2, 1982, 437.

³⁹ Coalition for Fair Lumber Imports, *Petition for the Imposition of Countervailing Duties Pursuant to the Tariff Act of 1930, as Amended, In the Matter of: Certain Softwood Lumber Products from Canada*, vol. 1, Washington, D.C., May 19, 1986.

Figure 7.1: U.S. and Canadian Stumpage Prices (U.S.\$ per 1000 Board Feet (mbf))



Source: International Trade Commission (1985).

resources into lumber production, much to the benefit of Canadian lumber producers. The CFLI contended that Canadian stumpage policy, by subsidizing Canadian loggers, indirectly subsidized the lumber industry. The CFLI petition cited a number of other Canadian programs and regulations, such as preferential tax treatment, loan guarantee programs, and public reforestation programs, as additional evidence of the implicit subsidies provided by the Canadian government.⁴⁰ To back up its argument, the petition further referred to a 1986 report produced by the ITA, which concluded that Canadian lumber producers were benefiting from an unfair advantage.⁴¹

The Coalition for Fair Lumber Imports structured its petition around the above

⁴⁰ Joseph Kalt, *The Political Economy of Protectionism*, 1987, 8-9.

factual evidence in order to meet the criteria of “specificity” and “preferentiality” required by ITA for CVD action. The Coalition also sought to develop the concept of a “primary beneficiary” of a certain government program in order to bolster its assertion that Canadian lumber practices provided benefits to a specific group or industry. Drawing on lessons from its past failed countervail initiatives, the Coalition devoted considerable attention to gathering necessary legal expertise and advice. For example, in 1985 The CFLI hired the law office of Dewey-Ballatine as its legal and political advisor in order to help reverse the ITA’s earlier decision.⁴²

However, it was in the U.S. Congress that the Coalition spent most of their energy cultivating political support. The industry’s unique geographical distribution enhanced its ability to take advantage of U.S. trade law to obtain import protection. As a resource extracting and processing industry, the forest products industry in the United States is an important element of the “economic base” of the Pacific Northwest and of certain states in the South. Many communities within these regions depend on lumber products as a main source of income and went through a difficult period adjusting to the decline of one of the most important pillars of the regional economy. As a result, these timber interests brought a considerable amount of political pressure to bear on congressional representatives, especially in the Senate where they had strong representation. In view of the economic importance of the timber industry to the Pacific Northwest and to the South, senators and congressmen from these regions had responded to the petition positively, vigorously

⁴¹ Petition. Dewey, Balantyne et al., May 1986, Public Files, U.S. Department of Commerce.

⁴² Benjamin Cashore, *Flights of the Phoenix: Explaining the Durability of the Canada-U.S. Softwood Lumber Dispute*, Canadian-American Public Policy no. 32, Orono: the Canadian-American Center, 1997.

advocating trade protection on behalf of the timber industry. By 1986, the timber industry had established such a solid friendship with the Congress and a number of relevant administrative agencies that the Reagan administration found it difficult to ignore the demands of the timber industry and, in the end, was compelled to retaliate against softwood lumber imports from Canada, the largest U.S. trading partner and one of its closest allies.

As in the EC enlargement case, the absence of any organized, effective opposing domestic interests guaranteed the success of the softwood lumber producers' petition. Various segments of the U.S. forest products industry applauded the threats against Canadian softwood lumber products because Canadian producers' growing incursions into the U.S. market directly threatened competitiveness and employment in their own industries. For example, the American Plywood Association for several years had lobbied for a change in U.S. trade law to raise the tariffs on Canadian plywood imports. The Association argued that, without effective government protection, U.S. producers would continue to trail in the market place behind less efficient Canadian mills.⁴³ U.S. producers of douglas fir and white fir, two of the primary commodities that were being displaced in the U.S. markets by Canadian lumber exports, also called on the government to take measures to halt the Canadian forest industry's growing penetration of the U.S. market.

Shake and shingle manufacturers, another major component of the forest products industry that was confronted with a deteriorating market share, supported the sanction threats as well. For example, between the late 1970s and early 1980s, U.S. production of

11.

western red cedar shake had declined steadily so that total U.S. production in 1984 was only one-sixth of the 1977 level. The decline of U.S. production was accompanied by a perceptible increase in the Canadian share of the U.S. market, which rose from 21.3% in 1975 to an alarming 79% in 1984.⁴⁴ The U.S. Shake & Shingle Association had attributed this growing import penetration to Canadian government subsidies that allowed Canadian producers to consistently undercut U.S. mill prices. The Association urged the U.S. government to take actions to ensure the survival of the shake and shingle industry. Furthermore, the industry's successful section 201 petition earlier in the year reflected the industry's determination to deter Canada's aggressive pricing strategies. When the softwood lumber producers filed their countervail petition, the shake and shingle industry expressed its support for the action.

Lumber users, the group most likely to oppose trade sanctions, did not strongly lobby against the protection sought by lumber producers. The National Association of Home Builders (NAHB), which represented construction contractors, estimated that a 15 percent duty on Canadian lumber would have only a marginal effect on the price of housing in the United States.⁴⁵ Because trade between the United States and Canada was competitive, and because housing was a large U.S. industry with surplus capacity, the price import duty would be unlikely to induce sharp price hikes. As they could afford a small increase in lumber prices, the NAHB did not make a visible effort to oppose the lumber producers' trade initiative. Although a small number of lumber dealers, home

⁴³ Ibid.

⁴⁴ Carliner, 1996.

⁴⁵ Geoffrey Carliner's comments in Anne Krueger ed., *The Political Economy of American Trade Policy*,

builders, unions, and railroad and port organizations had organized themselves into an ad hoc body, the Coalition to Stop Unfair Wood Tariffs, to defeat both the countervail petition and the proposed restrictive congressional legislation, they had minimal influence on government action both because of the lack of strong political incentive and because of the geographical dispersion of its membership.⁴⁶ The absence of effective domestic opposition increased both the attractiveness and persuasiveness of the softwood lumber producers' countervail petition before the ITA.

Process and Rationale of the ITA Decision

U.S. lumber producers were highly successful in enlisting the support of individual congressmen and senators. Although these legislators were a minority in Congress, they were able to make substantial inroads in congressional debates. Meanwhile, in order to preempt a forceful and serious congressional challenge to the executive influence over trade policy, the Reagan administration responded favorably to industry pleas with full protection. Although the Commerce Department was supposedly more sympathetic to the perspective of business groups, the desire to avoid provoking Congress into adopting more restrictive trade legislation reinforced the appeal of policy proposals for trade relief. In particular, the International Trade Administration under the Commerce Department, despite its proclaimed political neutrality as a quasi-judicial body, turned out to be amenable to industry and congressional pressure. Additionally, considerations for the

Chicago: The University of Chicago Press, 1996, 289-290.

⁴⁶ Irving K. Fox, "The Politics of Canada-U.S. Trade in Forest Products," in Russell S. Uhler ed., *Canada-United States Trade in Forest Products*. Vancouver: UBC Press, 1991, 27.

viability of U.S. forest industries made the executive office more receptive to industry and congressional demands. The broad consensus that eventually emerged between the executive and legislative branches, reinforced by strong, unified industry pressure, resulted in a highly confrontational approach in the U.S. lumber trade dispute with Canada.

As mentioned earlier, U.S. lumber interests worked assiduously to impress upon congressional members the merit of their case and to lobby for a change in U.S. trade law in order to ensure the countervailability of subsidized natural resources. The softwood lumber issue appealed to many congressional representatives as a clear case of unfair foreign competition that placed U.S. producers at a disadvantage in international markets. Congress also was concerned about the economic viability of single-industry resource producers and, to some extent, about certain large regional economies. Many congressional members had linked the steadily rising Canadian share of the U.S. timber market to stagnant employment and investment levels at home. They alleged that the increasing ability of Canadian producers to penetrate the U.S. market did not reflect the two countries' comparative advantages in terms of the quality of natural resources and their costs of production. Rather, it had resulted from government pricing policies that subsidized resource producers.⁴⁷ Thus, in view of the threat posed by unfair Canadian competition, Congress entered the debate on the side of the softwood lumber industry.

Congressmen and Senators from timber-producing states in the South, Pacific Northwest, and mountain states played a crucial role in publicizing the plight of the industry and in extracting concessions from the administration. Their representation in

⁴⁷ Percy and Yoder, 1987, 1.

certain important congressional committees, particularly those in charge of international trade policy, created a highly visible platform for the lumber industry. For example, Senator Robert Packwood of Oregon was chairman of the Senate Finance Committee and a member of the Subcommittee on International Trade. Senator Packwood was reportedly “compelled to oppose [U.S.-Canada free trade] negotiations if no solution (to the Softwood Lumber dispute) appears.”⁴⁸ Senator Russell Long of Louisiana was the ranking minority member. In addition, Sam Gibbons of Florida was chairman of the Subcommittee on Trade of the House Ways and Means Committee.⁴⁹ Representative Don Bonker of Washington and Senator Max Baucus of Montana voluntarily stepped into the debate on behalf of the lumber producers and soon became strong advocates on Capitol Hill.⁵⁰

This emerging congressional coalition, at the urging of the CFLI, exerted tremendous pressure on the ITA to reverse its earlier ruling. Several legislative proposals were introduced to address the alleged unfair trade practices. Some of them aimed to place strict limits on Canadian softwood lumber exports to the United States; others sought to broaden the definition of subsidy so that there would be no doubt that Canadian provincial governments had subsidized their lumber industry.⁵¹

⁴⁸ Jennifer Lewington, “Senators Warn Canada to Chop Lumber Exports.” *Globe and Mail*, April 18, 1986, B 12.

⁴⁹ Irving K. Fox, “The Politics of Canada-U.S. Trade in Forest Products,” 1991, 27.

⁵⁰ Bonker in the House and Baucus in the Senate sponsored the Wood Products Trade Act of 1985, requesting that the President negotiate voluntary export restraints with Canada and to impose a 10 percent *ad valorem* duty on softwood lumber imports from Canada in the absence of voluntary restraints. See Charles F. Doran and Timothy J. Naftali, *U.S.-Canadian Softwood Lumber: Trade Dispute Negotiations*, Washington, D.C.: The Pew Charitable Trusts, 1988, 9.

⁵¹ Raymond Vernon, Deborah L. Spar, and Glenn Tobin, *From Triangles and Revolving Doors: Cases in U.S. Foreign Economic Policy Making*, New York, NY: Praeger, 1991, 30; Benjamin Cashore, *Flights of*

At the same time as the softwood lumber dispute unfolded, U.S. negotiators were seeking fast-track approval in the Congress for the upcoming free trade talks with Canada. Members of Congress quickly moved to make approval of a Canada-U.S. free trade agreement contingent upon satisfactory resolution of the softwood lumber dispute. In other words, an important part of the congressional strategy was to forge a link between acceptance of trade liberalization to a specific case of administered protection.⁵² Congress was positioned to do so because it would have been difficult for senators to justify free trade with Canada when Canadian import penetration was increasingly threatening a domestic industry that served as an important pillar of the economic base of certain regions.⁵³ To signal congressional determination to settle the dispute, a majority of senators sent a letter to President Reagan in late 1985 insisting that they would not proceed with the Canada-U.S. free trade negotiations before the lumber dispute could be resolved to their satisfaction. In February 1986, Senator Baucus, with the support of 15 senators, warned Canada to reduce softwood lumber exports or be prepared to face the consequences. Furthermore, half of the members of the Senate Finance Committee wrote to U.S. Trade Representative Clayton Yeutter in which they emphasized their

... concern about Canadian softwood lumber imports ... Any free trade agreement must be built on a foundation of mutually advantageous trade practices. Therefore, we believe the administration should seek an early resolution of the softwood lumber trade issues. This would facilitate Finance Committee consideration of any Administrative proposals relating to the negotiation of a free

the Phoenix: Explaining the Durability of the Canada-U.S. Softwood Lumber Dispute, 1997, 12.

⁵² Cashore 1997, 12.

⁵³ Robert Hayter, "International Trade Relations and Regional Industrial Adjustment: The Implication of the 1982-86 Canadian-U.S. Softwood Lumber Dispute for British Columbia. *Environment and Planning A*, no. 24; Francois Tougas, "Softwood Lumber from Canada: Natural Resources and the Search for a Definition of Countervailable Domestic Subsidy. *Gonzala Law Review* 24, 1988-89, 156-157.

trade agreement with Canada.⁵⁴

Yeutter responded that the administration already had taken measures to address the issue and also had persuaded the Canadians to come to the negotiation table. Dissatisfied with Yeutter's response, a group of senators, led by Senator Max Baucus, again brought up the issue on the Senator floor in February 1986. As Baucus reiterated the congressional position: "They [Canadians] cannot have it both ways. If they expect the United States to enter a free trade agreement, they must engage in free trade... . I am optimistic about the benefits of a free trade agreement might bring, but I cannot support such an agreement, so long as subsidized Canadian lumber makes a mockery of free trade."⁵⁵ In April, 1986, in an ultimatum to the Reagan administration, the Senate Finance Committee explicitly stated that it would deny fast-track approval of the Canada-U.S. free trade talks unless the softwood lumber dispute could be addressed to industry satisfaction.

Besides its active effort to link the softwood lumber dispute to broader issues in U.S. trade policy, the U.S. Congress also tried to broaden the definition of "subsidy" in order to ensure the countervailability of Canadian softwood lumber practices. Even prior to the lumber dispute, Congress tried to seek a re-definition of "subsidy." In 1984, Congress amended the Tariff Act of 1930 to include provisions that would have made certain "upstream" or "input" products countervailable.⁵⁶ This broadening of the legal definition increased the chances of success of the softwood countervail appeal because it

⁵⁴ Letter from ten senators to Clayton Yeutter, October 1, 1985. Reproduced in Glenn Tobin, "U.S.-Canada Free Trade Negotiations: Gaining Approval to Proceed," Case Program, no. c16-87-785, Appendix G, John F. Kennedy School of Government, Harvard University, 1987.

⁵⁵ Quoted in Vernon, Spar, and Tobin, 1992, 33.

assured that subsidized log production also constituted a countervailable subsidy to the lumber industry.

In the face of enormous congressional pressure, the Reagan administration veered decisively towards a trade policy favoring the forest industry. With future control of the Senate at stake, the administration could no longer shield Canada, one of its closest allies, from charges of violating free-trade principles. At a 1985 "timber summit" sponsored by the CFLI, Commerce Secretary Malcolm Baldrige came under intense pressure from the CFLI and their congressional representatives to provide trade relief. At this point Baldrige still emphasized that the administration would adhere to the position adopted by ITA in 1983.⁵⁷ By the spring of 1986, however, growing congressional support for the lumber industry had fundamentally altered the administration's calculus.

For fear that lack of progress on the softwood issue would fuel protectionist sentiment in Congress, the United States managed to persuade Canada to resume negotiations in early 1986. At the same time, the Administration undertook a series of initiatives to placate forest industry officials and their representatives in Congress. In his statements before the Senate Finance Committee, the U.S. Trade Representative Clayton Yeutter indicated a growing willingness to accept congressional proposals. Commerce and USTR officials also held meetings with industry leaders and senators from lumber-producing states, assuring them of the administration's willingness to resolve the dispute.⁵⁸ The executive department wanted to prevent Congress from derailing the talks with

⁵⁶ Tougas 1988-1989, 144.

⁵⁷ Doran and Naftali, 1988, 10.

⁵⁸ Jennifer Lewington, "U.S. Administration Courts Key Senators on Free Trade," *Globe and Mail* April

Canada over the Free Trade Agreement or from enacting more stringent, congressionally mandated legislation.

The changing mood of the administration was reflected in a discussion between President Reagan and the advocates of the lumber issue in the Senate Finance Committee on the eve of congressional vote where President Reagan finally succumbed to industry and congressional pressure. In a public letter to Senator Robert Packwood, President Reagan promised for the first time to resolve the softwood lumber dispute before reaching a bilateral free trade agreement with Canada. Reagan's political concessions signaled the evaporation of executive support that previously had protected Canadian softwood lumber from domestic protectionist pressure.

Furthermore, the Commerce Department, in which the ITA was located, was not insulated from political pressure from Congress. Indeed, Congress' threat to pass legislation targeted specifically at foreign, "underpriced," raw material imports to resource processors had posed genuine concerns to the Commerce Department. In the event such legislative proposals became law, the United States would be seen to have violated its obligations under the General Agreement on Tariffs and Trade (GATT), thus inviting retaliatory legislation by its trading partners. Such congressional action could have made billions of dollars of U.S. agricultural and primary manufactured exports easy targets of foreign retaliatory duties, leaving the Commerce Department with the problem of how to deal with increasingly contentious trade disputes with major trading partners. Thus, the choice facing the Commerce Department was clear: either to achieve a satisfactory

outcome in the softwood lumber dispute or to provoke a forceful legislative response that could affect other trade areas. The latter scenario was by no means appealing to the Department of Commerce. Consequently Commerce had decided to reverse its earlier ruling and to grant the softwood lumber industry a favorable determination.

Thus, when the ITA announced its determination on October 16, 1986, the result was hardly surprising. The ITA ruled that Canadian provincial stumpage programs conferred a subsidy on Canadian softwood lumber producers. Moreover, the ITA finding confirmed the CFLI' contention that Canadian subsidies were countervailable because they were targeted at specific lumber producers and caused distortions in the domestic lumber market. Given these findings and pursuant to U.S. trade law, the ITA imposed a 15 percent tariff on lumber imported from four Canadian provinces. Although the 15 percent figure was lower than the 25 percent duty sought by the lumber industry, U.S. lumber interests nevertheless emerged as the principal victors and beneficiaries in this dispute as the ITA decision effectively barred a significant portion of Canadian softwood lumber exports from entering the United States. The imposition of sanctions thus, by and large, satisfied a domestic industry that had put forth the most compelling political demands.

Conclusion

In both the E.C. enlargement case and the U.S.-Canada timber trade conflict, the United States escalated the disputes to trade wars because of the absence of major domestic opposition to sanction threats. In E.C. enlargement, both export-seeking and import-competing interests supported an aggressive negotiation strategy because both

competed with E.C. agricultural products and would win whether the threat was carried out or not. Hence, the enlargement case united both producers seeking to remove the restrictions in the Iberian market and import-competing interests targeted by E.C. counter-retaliation. Similarly, in the timber trade conflict, U.S. softwood lumber producers did not encounter domestic resistance. Since many U.S. forest product groups were alarmed by the growing Canadian penetration of the U.S. market and in the past had pushed for restrictions on Canadian products, they simply had no reason to object to the retaliatory measures. Moreover, import-users did not oppose the threats as they easily could substitute reduced imports with domestic products at comparable qualities without paying substantially higher prices, as import-users would have to if trade were complementary.

This unity among U.S. domestic interest groups was reinforced by the executive branch's willingness to level the playing field for U.S. industries it viewed as fundamentally competitive but suffering from unfair barriers and subsidies. With regard to E.C. enlargement, the executive was sufficiently concerned about declining farm exports and the deleterious effects of protectionist E.C. agricultural policies to initiate trade retaliation. It viewed the new E.C. trade restrictions as reflecting another conspicuous attempt by the E.C. to block U.S. products from the European market. In the dispute with Canada, the timber industry, which had traditionally enjoyed a home market advantage, was able to exert sufficient political pressure on executive action. Both in 1986 and in 1991, the lumber industry, with the help of Congress, had solidified its friendship with relevant administrative agencies and gained their full support in obtaining protection from Canadian imports. By 1991, this friendship was so strong that it led the

Commerce Department to take the unusual step of initiating a section 301 petition. Such sympathetic hearings from administrative agencies increased the chances of successful industry petition.

This pattern of unified domestic support contrasts with the highly divisive domestic politics in U.S.-China trade disputes. Because of competitive trade relations between the United States and its European and Canadian trading partners, there were very few import-using groups, as in the U.S.-China cases, who sought to undermine the sanction threats. Instead, import-competing interests entered the policy debate in favor of trade retaliation. Trade structures affected domestic politics in these two sets of cases in different ways, increasing the likelihood of trade wars in U.S.-E.C. and U.S.-Canadian cases, while reducing the chances of escalation in trade disputes between the United States and China.

~ 8 ~

Conclusion

The above chapters examine the conditions under which the United States would find the use of coercive trade bargaining strategies to be effective in securing concessions from the target country and the circumstances that increase the probability of trade war. Both the quantitative analyses and the detailed case studies suggest a causal mechanism that connects trade structure to the level of threat effectiveness and the probability of trade war via the effect of trade structure on domestic politics. The degree of trade competitiveness, by determining the extent to which domestic interests and institutions are united in support of sanction threats, plays an important role in explaining the pattern of trade war and threat effectiveness.

Piecing together evidence found in different parts of this dissertation, I present in the following pages a detailed summary of the groups involved in each of the case studies, their position, and their influence on the negotiation outcome. The views of export-seeking, import-competing, and import-using interests have differed under different trade structures, affecting both the ability of U.S. negotiators to elicit a positive response from the target country and the degree to which divisions within U.S. politics determine the possibility of escalation to trade war.

This research also raises questions that are not adequately dealt with by my initial hypotheses. I will discuss qualifications of this research which are not unimportant to the analysis of foreign trade policy, noting in particular the distinction between cases aimed at

gaining greater export market access and those intended primarily to prevent foreign exports from entering the home market, a distinction that also influences the degree of interest group support for aggressive negotiation tactics.

I then proceed to address a few questions that might be useful for further investigation, including the need to test my argument against a larger sample of dyads and to develop systematic, parallel analysis of the domestic politics in the target states. In the final section, I address the implications of this research for American foreign trade policy in the conduct of aggressive bargaining and, in particular, with respect to trade policies with China, suggesting possible avenues through which American trade negotiators may better achieve their policy objectives. I also place this research within the literature of “democratic peace” and discuss its potential for improving our understanding of the different strands of the “democratic peace” theory.

Towards A Systematic Analysis of Domestic Politics

Earlier scholarship on two-level game theory has emphasized the nexus between domestic and international politics. This dissertation contributes to the research program on two-level games by engaging in a systematic investigation of the domestic sources of international behavior and by developing a more complete characterization of the domestic game. Consistent with my initial hypothesis, trade structure affects both the pattern of domestic interest group alignment and the degree of institutional divisions, with important implications for the probability of trade war and the level of threat effectiveness.

Specifically, a more competitive trade structure produces greater unity in favor of over

aggressive negotiation tactics, leading to the adoption of tough bargaining strategies by policymakers. Domestic unity not only enhances the credibility of U.S. threats in the eyes of the target country, but also increases the risk of aggressive escalation to trade war. Conversely, a complementary trade structure aggravates divisions in domestic support for trade sanctions, resulting in reduced threat credibility and lower risks of trade war.

In each of the cases analyzed in this dissertation, four major groups of actors have played decisive roles in influencing the negotiation outcomes. Specifically, these groups are: (1) exporters seeking to improve the access of their specific products to the target market. This group of actors have often turned out to be one of the most vocal advocates of sanction threats; (2) firms exporting other goods to the target. The position of these groups differed depending on the specific negotiation context. They either supported sanctions if they expected that sanction threats against a particular product would have spillover effects that could help to improve their own sales to the target (as in most U.S.-Japan trade negotiation cases), or they opposed sanctions if they expected that sanction threats would invite foreign retaliation reducing exports of their products to the target (as in U.S.-China cases); (3) firms competing with products made in the target country. These import-competing interests tended to be another major force supporting sanction threats as they could benefit from the increased prices at which foreign producers had to market their products in the home country; (4) firms that import and use goods from the target. Since sanctions threaten to increase the costs or interrupt the flow of their supplies, the degree to which these importers and users supported sanction threats depended on the magnitude of the price increase, which was shaped in large part by the

availability of alternative sources of supply inside the United States. Under competitive trade, these groups had less incentive to resist sanctions because they could obtain the same products from other domestic suppliers at comparable prices. The following table (Table 8.1) identifies the main actors in each of the above categories and summarizes their positions and impact.

Table 8.1: Summary of the Position and Impact of the Main Actors

a) U.S.-China: MFN

	Representative Companies or Associations	Position	Impact
Directly-Affected Exporters	_____	_____	_____
Exporters (Not-directly Affected)	Emergency Committee of American Trade (ECAT); U.S. Chamber of Commerce; National Foreign Trade Council; U.S.-China Business Council; Business Coalition for U.S.-China Trade; American Association of Exporters & Importers; National Association of Wheat Growers; North American Export Grain Association; Aircraft manufacturers: Boeing; AT & T; GE; IBM, GM; Motorola; NAM	Sanctions would reduce American exports, yield market shares to foreign competitors, threaten the viability of American investment in China, jeopardize U.S. jobs, and lead to the loss of a major export market	Very influential in opposing sanction threats
Import-competing interests	Textile industry	Argued that Chinese textile imports hurt the American industry. Joined human rights and religious groups, conservative-leaning organizations, and other critics of China in pushing for trade sanctions.	Relatively visible in the early stage of the debate; eventually lost ground to the pro-MFN interests.
Import-using	Importers of toy, apparel, footwear,	Trade restrictions would hurt American consumers,	Very influential;

Interests	and consumer electronics; Toy "R" Us; J.C. Penney; Footwear Distributors & Retailers of America; Nike	particularly low- and middle-income families. It would be difficult to find alternative sources for many low-cost products outside of China.	launched intensive campaign against sanction threats.
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b) U.S.-China: Intellectual Property Rights

	Companies and Associations	Position	Impact
Directly-affected Exporters	International Intellectual Property Alliance (IIPA); Business Software Association (BSA); Recording Industry Association of America (RIAA); Motion Picture Association of America (MPA); International Federation of the Phonographic Industry (IFPI)	Alleged that rampant piracy in China impeded American industry's attempt to gain genuine market access.	Successfully brought the issue of IPR protection to the policy agenda
Exporters (Not-directly affected)	Automobile and aircraft manufacturers; Business Council; Washington State China Relations Council	Concerned that sanctions would curtail American manufacturers' investments in the short run and reduce their access to a potentially lucrative market in the long run.	Joined import-using interests to oppose sanction threats; very influential
Import-competing interests	_____	_____	_____
Import-using Interests	National Retail Federation; American Association of Exporters and Importers; International Mass Retail Association; American Apparel Manufacturers Association; National Apparel and Textile Association; U.S. Association of Importers of Textiles and Apparel; Toy Manufacturers of America; footwear manufacturers; Electronic Industries Association (EIA); American Forest & Paper Association; power-tool manufacturers	Argued that Washington's pursuit of fair trade should not come at the expense of the American importing and retailing community. Sanctions will increase the price they pay for imports.	Very influential in opposing sanction threats; provided an important counter-balance to the IPR industries.

c) U.S.-China: Textiles

	Companies and Associations	Position	Impact
Directly-affected Exporters	_____	_____	_____
Exporters (not directly involved)	National Council on U.S.-China Trade; U.S. Wheat Associates; auto, wheat, and aircraft manufacturers	Argued that sanction threats might provoke Chinese retaliation, placing major U.S. exporting items in jeopardy. Urged U.S. negotiators to be more prudent in their choice of trade weapon.	Were one of the most outspoken opponents of sanction threats. Their active opposition in the early 1980s played an important role in removing the sanctions.
Import-competing interests	American Textile Manufactures Institute; International Ladies Garment Workers Union; Amalgamated Clothing and Textile Workers Union	Argued that China's rapid textile export growth and illegal quota evasions caused market disruption. Advocated more stringent quota restrictions.	Supported highly protectionist policies; exerted considerable influence in the textile trade dispute.
Import-using Interests	American Association of Exporters and Importers (AAEI); National Retail Merchants Association; Kmart Corporation; Federated Department Stores; National Federation of Retailers; National Apparel and Textile Association; United States Association of Importers of Textiles and Apparel	Called for policies that would guarantee their continued access to inexpensive imports.	Actively opposed textile manufacturers' attempt to impose quota restrictions on Chinese imports.

d) U.S.-Japan: Semiconductors

	Companies and Associations	Position	Impact
Directly-affected Exporters	Semiconductor Industry Association (representing firms such as AT&T, IBM, and TI)	Contended that Japan's protectionist and promotional policies denied American firms "fair and equitable market opportunities". Called on the USTR to use trade sanctions to correct Japan's predatory export behavior and market barriers and to stop Japanese dumping in the American market.	Were instrumental in initiating the dispute; their aggressive pursuit policy demands increased the pressure U.S. policymakers felt to act.
Exporters (not directly involved)	Many of these are also import-competing interests, including producers of electronics, automobile, and machine-tools; American Electronics Association (AEA)	Frustrated with entrenched market access barriers in Japan; supported trade sanctions that would help U.S. firms pry open the Japanese market.	Helped bolster the SIA demand.
Import-competing interests	Producers of electronics, automobile, machine-tools; American Electronics Association (AEA)	Faced stiff Japanese competition and demanded tough action from the U.S. government to dampen the effects of unfair Japanese competition.	Their support for tough negotiation tactics reinforced the appeal of semiconductor manufacturers' policy demands.
Import-using Interests	Semiconductor users represented by AEA	Concerned about the price increases that trade sanctions would produce.	Eventually endorsed semiconductor producers' position.

e) U.S.-Japan: Supercomputers and Satellites

	Companies and Associations	Position	Impact
Directly-affected Exporters	Supercomputer manufacturers (Cray Research, Control Data Corporation); Institute of	Charged that Japan, through policies designed to promote autonomous domestic	Were instrumental in initiating the

	Electrical and Electronics Engineers; satellite manufacturers	policies, excluded U.S. producers from Japanese public procurements; advocated trade sanctions to open the Japanese public sector market.	dispute; their aggressive pursuit of policy demands increased the pressure U.S. policymakers felt to act.
Exporters (Not Directly Affected)	Many of these were also import-competing interests; representative organizations included the American Electronics Association, National Association of Manufacturers; U.S. Chamber of Commerce; Automotive Parts and Accessories Association (APAA)	Faced considerable market access barriers in Japan; supported aggressive market opening policies in general.	Bolstered the case for Section 301 action.
Import-competing interests	American Electronics Association (representing over 3,500 firms in U.S. electronics industry, including components, computers, telecommunications, and software); National Association of Manufacturers; U.S. Chamber of Commerce; Automotive Parts and Accessories Association (APAA); United Automobile, Aerospace and Agricultural Implement Workers of America (UAW)	Urged American negotiators to forcefully enforce existing trade law in order to defend legitimate U.S. trade interests and to correct the effects of unfair Japanese competition.	Their support for tough negotiation tactics reinforced the appeal of supercomputer and satellite manufacturers' policy demands.
Import-using Interests	_____	_____	_____

f) U.S.-E.C.: E.C. Enlargement

	Companies and Associations	Position	Impact
Directly-affected Exporters	Feed Grains Council (representing feed grains producers)	Demanded full compensation to American farmers caused by increased Spanish and Portuguese tariffs associated	Instrumental in pushing for trade sanctions.

		with E.C. enlargement.	
Exporters (not directly affected)	Other agricultural groups such as producers of corn, barley, and grain sorghum	Have long complained about the E.C.'s protectionist trade policy; came out in favor of trade sanctions.	Increased the pressure for proactive trade policy.
Import-competing interests	Producers of corn (maize), barley, and grain sorghum	Supported efforts to expand U.S. market shares in the Iberian states, as they similarly felt victimized by unfair E.C. competition.	Supported sanction threats; strengthened the impact of the feed grain producers
Import-using Interests	_____	_____	_____

g) U.S.-Canada: Lumber

	Companies and Associations	Position	Impact
Directly-affected Exporters	_____	_____	_____
Exporters (not directly involved)	_____	_____	_____
Import-competing interests	United States Coalition for Fair Lumber Imports (CFLI); softwood lumber producers; producers of plywood, fir, shake and shingle; American Plywood Association; U.S. Shake & Shingle Association	Claimed that Canadian stumpage and export control policies caused considerable harm to U.S. producers and remained countervailable under U.S. trade law.	Was the major actor pushing for trade sanctions.
Import-using Interests	National Association of Home Builders (NAHB)	Because there is a large domestic industry with surplus capacity, users did not face any price hike and therefore did not oppose the sanction threat.	Unlike in U.S.-China cases, did not oppose sanction threats.

This research has emphasized the contrasting patterns of domestic politics created by competitive versus complementary trade structure. If we compare U.S.-China trade disputes with U.S.-Japan or U.S.-European cases, we can see that in the former set of cases there are few, if any, firms that compete with imports from the target. In the MFN and textile trade disputes, textile producers did mount an attack on textile imports from China. However, they seemed to be unable to compete in the policy process with a fairly large constituency of firms that export to and import from China. Even exporters whose products were not targeted by trade sanctions opposed sanction threats out of fear that sanctions would provoke Chinese retaliation against their own products, thus threatening to reduce American's firms' access to the potentially lucrative Chinese market. Such highly polarized positions held by domestic interest groups lessened the credibility of sanction threats and at the same time minimized the chances for dispute escalation.

The dynamics of U.S. negotiations with Japan and Europe contrasts sharply with the above pattern. The extent to which both export-seeking and import-competing firms share the same pro-sanction policy preferences distinguishes these negotiations from U.S.-China cases. Since trade between the United States and these trading partners is highly competitive, there is a large constituency in the United States competing with European and Japanese imports. This import-competing constituency has no incentive to resist sanction threats because they could benefit from the restrictions placed on foreign imports were sanctions carried out. With such solid support from both export-seeking and import-competing firms, both the credibility of the U.S. negotiation position and the chances for aggressive dispute escalation were greatly enhanced.

To be sure, as with complementary trade, competitive trade creates its own winners and losers. In particular, competitive trade could generate opposition from downstream firms and from consumers whose welfare may be negatively affected by the increased prices induced by the new trade barriers. For example, in the U.S.-Japan semiconductor trade conflict, sanction threats met with resistance from semiconductor users who objected to the increased chip prices. Similarly, in the U.S.-Canada trade dispute over softwood lumber, lumber users and home builders raised concerns about increases in lumber prices. However, while competitive trade structure generated domestic opposition as well, these opposing interests were far less organized and coherent as a political force under competitive trade. When trade is competitive, a large import-competing industry with surplus capacity existed in the country issuing the threat. As a result, the price hikes generated by trade sanctions were not nearly as steep as if trade were complementary, nor did they affect as large a segment of U.S. business interests as in the latter case. This explains why import users have exhibited a far lower level of political organization and activism in U.S.-Japan trade negotiations than in U.S.-China cases. In short, the case studies suggest that trade structure is an important factor explaining the pattern of trade war and threat effectiveness. The distributional consequences of competitive versus complementary trade relations matter for international negotiation outcomes.

Qualifications

An important *caveat* follows from this research. My case studies reveal that in addition to the influence of trade structure on my two dependent variables, it also makes a difference whether threats are used to expand overseas export markets or whether they are employed primarily to reduce foreign imports into the home market. Compared to cases related to exports, issues concerning foreign imports on the whole seem to have generated stronger domestic pressure in support of trade retaliation. U.S.-Canadian negotiations over softwood lumber and the U.S.-China trade row over textiles are both examples of disputes in which aggressive trade negotiation strategies were used to prevent import penetration. In these cases, sanction threats did not engender exporters' active participation because they did not directly impinge on their interests except when these exporters faced the likelihood of retaliation. Exporters' inactivity in these situations allowed highly protectionist import-competing interests to define the issue and to exert considerable influence throughout the dispute to obtain trade relief. This partly explains why, although the United States was able to peacefully settle those disputes with the Chinese where threats were carried out to open the Chinese market (e.g., IPR, market access, and MFN), it had greater difficulty achieving cooperation in the textile dispute, which primarily concerned imports. Thus, the cases remind us that in addition to the structure of trade between two states, the nature of the trade dispute seems to be another important variable that needs to be taken into consideration in order to understand the dynamics of foreign trade policy.

Questions for Future Research

This dissertation raises several questions that merit further research. First, although the logic of my argument ought to be applicable to bilateral trade disputes involving different country dyads over a longer time span, the empirical analysis of trade negotiations in this study is confined to trade disputes between the United States and its top 25 trading partners between 1980 and 1995, largely because of the difficulty of obtaining standard trade structure data for other dyads. But if the argument developed above is valid, then it will be possible to test my argument against a larger sample of dyads over a longer period of time, including those disputes initiated by countries other than the United States. Such a comprehensive empirical investigation, by varying the power asymmetry between the parties involved in the disputes, will allow us to capture better the complexity of international trade bargaining to determine that the empirical patterns established above are not a unique feature of American trade policy or of trade negotiations between great powers.

Second, this analysis focuses almost exclusively on domestic politics in the sender of threats that affect international trade negotiations. But it would seem possible to develop additional hypotheses about the impact of competitive versus complementary trade structure on domestic politics in the target states based on a logic similar to the one above. For example, in the U.S.-China dispute over intellectual property rights, Chinese domestic politics seem to have also played an important role in determining the extent to which China acceded to American demands. As various reports suggest, the increase of piracy in China even when copyright laws proliferated can be traced to the central

government's decreased ability to enforce copyright laws and regulations at the local level at a time when so much decision-making power had been delegated to the localities.

In the IPR case, the lack of transparency in China's decision-making process inevitably poses problems to an analysis of the domestic game in China. Nevertheless, it is possible to discern the positions of major domestic constituents on the IPR issue from the reported activities of domestic actors. It should be noted that even before the USTR initiated the first Special 301 investigation over IPR in 1991, China had already taken a number of steps on the IPR front in an attempt to encourage the inflow of foreign investment. These included the establishment of the National Copyright Administration in 1985 and the promulgation of the 1990 copyright law, among others. It seems plausible that even in the absence of foreign pressure, a section of the Chinese government, most likely the reform-minded leaders at the central level, had advocated reform of China's copyright regime in order to facilitate China's integration with the world economy.¹

Politics at the provincial level, however, undermined the central government's ability to enforce its rules. As many analysts have pointed out, decentralization, an essential part of China's program of economic reform, has eroded Beijing's ability to discipline its own localities to obey international agreements and to abstain from opportunities for illegal gain. In the fledgling free market environment in the southern provinces of China such as Guangdong, local governments ignored pirating activities

¹ Krishina Jayakar makes a similar argument. See Jayakar, "The United States-China Copyright Dispute," 554.

which could generate handsome profits.² Furthermore, as various news reports pointed out, there possibly existed an intricate web of influence among local officials, military officers and the pirating industries. For instance, the USTR's section 301 investigations found that some Chinese military and civilian government agencies had connections with a few of the 29 factories allegedly producing pirated CDs.³

As China's central government officials frequently argued, they were doing their best to reform Chinese laws governing intellectual property rights but had little control over enforcement, the primary responsibility for which resided with provincial governments. Even though they were able to push through legislation, central government officials lacked either the political will or the ability to take any strong action against local authorities. The localities' interests in maintaining the status quo and their ability in resisting orders from Beijing partly explains why the Chinese only offered concessions on paper, but did not go further to satisfy American demands on enforcement.

The IPR example suggests that domestic political structures and processes in the target countries may have important bearings on the observed policy outcome. A more systematic cross-country comparison of the conditions in the target states may generate further insights into the interactive dimension of international trade diplomacy.

Third, with regard to U.S.-China trade negotiations, this dissertation has focused on the period when the United States threatened economic sanctions against China to obtain unilateral concessions from the Chinese. China's accession to the World Trade

² Interview with USTR officials.

Organization (WTO) may bring about some important changes in the pattern of bilateral negotiations described above. The scope and direction of change that the rules and procedures of the international trade body will introduce to the extant U.S.-China trade relationship is a topic that deserves close examination.

Finally, although the United States has a greater tendency to be involved in trade wars with its competitive trade partners, not all trade conflicts between such pairs have ended up in a trade war. For example, although the United States has threatened economic sanctions against Japan for its unfair trade practices numerous times and has on a few occasions imposed trade sanctions against Japan, none of the trade conflicts between the two countries has flared up into a tit-for-tat trade war. This raises the question of why states with a competitive trade structure are willing to risk trade war in some industries but not others? Why are they able to cooperate to resolve trade conflicts in some cases but not others? We may need to look more closely at the nature of each specific industry in order to answer these questions.⁴

Implications

When will the United States best be able to open overseas markets through the use of aggressive bargaining tactics? Under what conditions are tit-for-tat trade retaliations most likely to occur in international trade negotiations? With regard to the first question,

³ Seth Faison, "Copyright Pirates Prosper in China Despite Promises," *New York Times*, Feb. 20, 1996; Robert A. Senser, "Will China Kick the Habit?" *Commonweal*, May 5, 1995.

this dissertation posits that the United States is unlikely to obtain the same concessions from countries such as China, Brazil, and India as from countries such as Japan, the European Union, and Canada. Because the first group of countries produce commodities that are no longer manufactured on a large scale in the U.S., American sanction threats against these countries will almost always encounter strong opposition from domestic interest groups and hence will be less credible and effective.

The findings of this study suggest certain potentially effective policy postures for U.S. trade policy towards China. Since trade complementarity impedes the ability of American negotiators to secure unilateral concessions from China, the United States may find it more fruitful to integrate China into multilateral trade negotiation forums. Recent moves by the United States to integrate China into the World Trade Organization (WTO) have already produced some signs of change. By shifting from its current “aggressively unilateral” trade bargaining tactic to a strategy of “aggressive multilateralism”⁵ and by taking advantage of the WTO dispute settlement mechanism, American threats may enjoy added legitimacy and be more credible with the Chinese.

In addition, this dissertation addresses the literature on “democratic peace” by examining democracies’ proclivity to be involved in aggressive escalation in trade

⁴ Marc Busch, for example, provides one interpretation of why states are willing to fight for their national champions in some high-technology industries but not others. See Marc L. Busch, *States, Firms, and Strategic Policy in High-Technology Competition*. New York: Cambridge University Press, 1999.

⁵ The term “aggressive unilateralism,” coined by Bayard and Elliott, often refers to the active pursuit of policies aimed at correcting other states’ perceived unfair trade practices through such policy instruments as Section 301. See Bayard and Elliott 1994, 345; Jagdish Bhagwati, “Aggressive Unilateralism: An Overview,” in Bhagwati and Hugh T. Patrick, eds., *Aggressive Unilateralism: America’s 301 Trade Policy and the World Trading System*, Ann Arbor: University of Michigan Press, 1990. Aggressive

conflicts. Its findings support the hypothesis that democracies are not more cooperative in trade disputes. This conclusion, though similar to that drawn by a number of other studies, is based on a rather different logic.⁶ Because of the way in which competitive trade relations between many democratic dyads shape their domestic politics, democracies seem to experience more intense trade confrontation leading to heightened risks of either unilateral or tit-for-tat retaliation than mixed pairs. As such, this research fills in an important gap in the current literature on the democratic peace by sorting out the influence of regime type, trade structure, and other variables that may potentially impact on the probability of trade war.

The finding that domestic politics exerts has a major impact on states' propensity to fight trade wars has important policy implications. For example, it helps us to explain the two U.S.-E.U. trade disputes over bananas and beef hormones that almost escalated into trade wars in 1999 by looking more closely at the domestic sources of these trade disputes. Because of American and European farmers' competition for agricultural markets and the absence of any countervailing domestic forces, it is not surprising that these two trading partners had so much difficulty containing the escalation of these disputes, even with their close alliance relationship and the constraints of the World Trade Organization (WTO).

multilateralism, in contrast, refers to the use of multilateral dispute settlement processes such as the GATT/WTO in order to achieve one's trade policy objectives.

⁶ Reinhardt and Sherman, for instance, emphasize democracies' susceptibility to interest group pressure that make democratic dyads more disputatious in trade. Reinhardt 1999; Sherman 1999.

More importantly, this research should shed some light on the theoretical debate over “democratic peace”. The preceding analysis makes it clear that the “democratic peace” theory, as accurate as it may be in predicting the outbreak of military wars, does not hold in trade. The “audience cost” rendition of that theory, as explained earlier, emphasizes the information transmission properties of democratic institutions that help to strengthen democracies’ ability to send credible signals about their true intentions. In this view, threats of war made by a democracy better convey the state’s actual willingness to fight because of the high domestic audience costs involved. The other side, knowing that its opponent means business and fearing the costs of war, will be more likely to refrain from further escalatory steps that will bring the two parties to war. In short, from the point of view of the signaling literature, democratic institutions provide the key mechanism for the peaceful resolution of international conflicts.

Yet, in trade disputes, democratic regimes have found it difficult to take advantage of their superior signaling capacities to arrive at negotiated settlement. Instead, the alternative causal mechanism proposed by this study, the structure of trade, produces such significant domestic repercussions that it overwhelms democratic institution’s capacity of information provision and conflict aversion. As the structure of trade between the United States and a good number of its democratic trading partners is fairly competitive, pro-protection pressure from both export-seeking and import-competing interests make democracies more confrontational and disputatious in trade. Because of the way the structure of trade shapes their domestic politics, democracies have experienced a larger number of trade wars than what the “democratic peace” theory would have predicted

despite the fact that they are superior information providers and that many of them are members of world trade organizations such as the GATT/WTO and hence are in a better position to avail of the judicial dispute resolution proceedings of international trade institutions to reach negotiated solutions.

In sum, at least as far as trade is concerned, the informational properties of democratic institutions seem unable to reduce democracies' incentives to fight wars. This finding casts doubt on the 'democratic signaling' argument, which ought to apply to the analyses of both security and trade conflicts. Moreover, since the "democratic peace" theory has two major theoretical components, the norms-based and the institutional arguments, the fact that democratic institutions are not able to prevent trade wars between democracies ought to give us reason to believe that theories emphasizing the importance of democratic norms and principles in the prevention of escalation may offer more plausible explanations for the pattern of "democratic peace" that many analysts have observed in international security relations. This result not only reinforces the importance of democratic norms as a powerful constraint on the use of force among democracies, but also encourages efforts to spread democratic norms and ideas as a means to the construction of more peaceful international relations.

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