

No. 83

**HOW BARGAINING ALTERS OUTCOMES:
BILATERAL TRADE NEGOTIATIONS
AND BARGAINING STRATEGIES**

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**Institute of Defence and Strategic Studies
Singapore**

JUNE 2005

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ABSTRACT

This article considers bargaining strategies used by government negotiators in the context of bilateral trade disputes. I argue that trade officials reach the most durable agreements by using an integrative, or value creating, strategy and avoiding the use of threats. By contrast, a highly distributive, value claiming strategy coupled with loud public threats is unlikely to result in a durable agreement and frequently leads to deadlocked negotiations. The irony, however, is that American officials use the latter approach more frequently in bilateral trade disputes, rather than the former. These strategies are usually chosen unconsciously in response to perceptions of losses that drive negotiators to select risky approaches to resolve disputes.

By examining bargaining strategies in the U.S. disputes between Japan and South Korea over automobiles and auto parts in the 1990s, I demonstrate shifts in negotiation strategies. These shifts in approach closely track the outcomes in these two, deeply contentious disputes. After protracted and contentious negotiations with Japan, the final outcome represented a defeat of the Americans' most important goals. A less confrontational strategy with Korea ultimately resulted in greater market opening.

KEY WORDS

Negotiations, prospect theory, distributive strategies, integrative strategies, value creating, value claiming, threats, trade disputes

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HOW BARGAINING ALTERS OUTCOMES: BILATERAL TRADE NEGOTIATIONS AND BARGAINING STRATEGIES

THE ROLE OF STRATEGIES

U.S. negotiators have used a variety of threats and non-threats to resolve disputes. Officials also use a variety of negotiating strategies, from aggressive value claiming or distributive bargaining to more value creating or integrative approaches. It is the particular combination of these tactics and strategies that accounts for variation in outcomes from durable agreement to deadlock.

In this article, I examine American disputes with both Japan and South Korea over autos and auto parts in the mid 1990s. The United States was engaged in very intense negotiations with both states over limited opportunities and sales for American auto and auto parts manufacturers. Although the barriers to trade in both states were similar, the United States trade officials used different negotiating strategies to resolve the disputes. An aggressive value claiming approach with Japan led to limited market opening and a spiral of increasingly serious threats for both sides. In Korea, U.S. officials opted for more value creating strategies to resolve the dispute and ultimately achieved more market access for American firms.

The puzzle for policymakers, then, is why negotiators do not use value creating strategies for bargaining more often. The relative success of the negotiations in Korean autos is replicated in other examples of value creating approaches to resolving trade disputes. I argue that the basic problem is that negotiators are predisposed by a focus on the role of losses to use value claiming, not value creating, strategies.

Value claiming strategies are riskier approaches. In a position of loss, individuals consistently select risky options in hopes of reversing the loss. This contrasts with individuals negotiating from a position of gains (simply put—you will be better off tomorrow than you are today). As noted further below, negotiators from the domain of gains opt for risk adverse approaches.

The use of value claiming strategies, coupled with threats, often does not achieve the desired goal. In fact, these approaches often lead to greater losses and an increased predisposition to use stronger value claiming strategies in subsequent negotiations. The net outcome is often less trade opening and more deadlocked negotiations than durable agreements.

Strategies are the plan for bargaining held by each team of negotiators. They are composed of a sequence of actions designed to force changes in the position of the other actor (Odell, 2002). Within any given strategy, negotiators can choose from a range of tactics—each action or tactic adds up to an overall strategy. I view threats like the use of Section 301, a unilateral trade law available to American negotiators, as a tactic in a broader strategy. I focus particular attention on two types of strategies, value creating (or integrative bargaining) and value claiming (or distributive bargaining). These two approaches are at the opposite ends of a continuum.

Pure value creating strategies are not common in market access disputes. Market access disputes, like the discussions with Japan and Korea over autos and auto parts discussed in this article, get under way because the American side believes the target state (or the state on the other side of the table) has failed to provide fair access to the target state market for foreign firms. The target state has barriers to free trade greater than barriers to the American market.

Any changes made as a result of bargaining will result in one-sided changes to the status quo—the target state will dismantle or revise barriers to trade. The U.S. side does not need to make any reciprocal concessions, since the American market is already more open to target state exports.

Value creating strategies are more likely in other trade arenas, like the Doha round discussions over World Trade Organization (WTO) rule modifications currently underway. In this multilateral setting, U.S. officials can bargain their way to increased market opportunities for both sides. The United States, could, for example, trade concessions in agriculture for stronger support for e-commerce rules. All parties can look for creative ways to bring significant benefits to all sides beyond the no-agreement possibilities. The final agreement could bring about expanded trade opportunities for agriculture and e-commerce in all states (although not as much, perhaps, in either category as every state wanted at the outset).

In most bilateral market access disputes (which are narrowly defined), the possibilities for pure value creating strategies are limited. Nevertheless, U.S. officials have used strategies closer to value creating on occasion. In these disputes, officials have attempted find joint gains. They have refrained from making harsh public statements or perhaps even praised the other side, suggested that both sides state their objectives frankly and openly, considered new approaches to achieve the objectives of both sides and avoided using strong threats.

Value claiming strategies are at the opposite end of the spectrum. Under value claiming, officials make harsh public pronouncements about the other side, often blame the other side for any delay while simultaneously dragging out proceedings, conceal or otherwise

manipulate information, exaggerate the hardship caused by any concessions made while over-exaggerating the importance of concessions made by the other side, publicly commit to an outcome or establish a commitment to a particular outcome (Odell, 2000). An explicit threat—like the imposition of sanctions—is a strong value claiming tactic.¹ Value claiming strategies are common in market access disputes.

As these definitions make clear, threats are a tactic associated with value claiming strategies. In fact, under pure value creating, officials should avoid issuing threats at all. Threats should not be viewed as “bargaining chips” to be taken off the table if concessions are made later. The very suggestion of a threat like economic sanctions closes off possibilities that are best left open until negotiations conclude. Sanctions threats become public and lock officials into positions, limiting valuable flexibility.

As I noted, however, pure value creating approaches are rarely found in market access disputes. Even negotiators broadly committed to creating strategies will occasionally resort to the use of threats. Officials rely on threats to convince recalcitrant domestic interest groups to modify their demands or behaviours. In a two-level environment, negotiators must craft final agreements that not only satisfy the target state officials, but also the domestic interest groups that closely follow the negotiations (Putnam, 1988, Evans et. al., 1993). In the absence of a threat, domestic actors are often unwilling to make any concessions required by a bilateral agreement—especially when the domestic interest groups are likely to be harmed by market opening.

¹ By using threats, the United States commits itself to a particular outcome, and tries to shift the resistance point of the target state creating a new zone of agreement. See Odell, 2002: 32.

THE AUTO DISPUTES

A set of cases between the United States, Japan and Korea over autos and auto parts provide an excellent setting for investigating different negotiating strategies. In the summer of 1995, the United States and Japan came as close as they have ever come to being embroiled in a full-scale trade war over autos and auto parts. At issue were imports of American-built autos into Japan's market, the purchase of American parts by Japanese auto plants in both Japan and transplant firms in the United States, and the use of U.S. auto parts in the Japanese repair market.²

After years of highly contentious negotiations, the United States, under Section 301, had threatened to impose sanctions worth nearly \$6 billion on luxury automobiles imported from Japan if Japan did not loosen restrictions in the Japanese market for American products. Top U.S. officials insisted such a unilateral policy was required to force Japan to open its markets in this sector to foreign products. Japan responded by bringing a complaint against the U.S. in the WTO. If resolution was not forthcoming from the WTO, Japan reportedly had a list of countersanctions ready to apply to U.S. products. The net result of the sanctions and countersanctions would have been a direct loss of over \$10 billion in trade, with additional losses likely as this dispute spilled over into other economic areas. A final agreement was produced minutes before the Section 301 sanctions were to go into effect. The agreement, while hailed by both sides as a victory, was mostly a failure for the Americans who were unable to enshrine even their most cherished principles of quantitative and qualitative targets in the final document.

² Transplant firms refers to Japanese firms, like Toyota, that manufacture autos from within the United States in places like Kentucky. The incentives for creating transplant firms in the United States increased dramatically in the wake of the North American Free Trade Agreement (NAFTA) that included local content requirements for automobiles. In other words, a large and increasing percentage of autos for sale in NAFTA were required to be manufactured within NAFTA.

At almost the same time, the U.S. became embroiled in another market access dispute with South Korea over imports of American autos. While the dispute with Japan involved an American market share of roughly five percent, American automobiles accounted for less than one percent of the Korean market. U.S. and Korean negotiators announced an accord designed to remove the most obvious obstacles to U.S. exports following a week of negotiations in September 1995. After monitoring Korea's efforts to open up this sector, the United States Trade Representative's Office (USTR) initiated a Section 301 case against Korea in October 1997. Again, a short round of negotiations resulted in an agreement and the termination of the 301 case. Officials resolved this dispute with little of the heated rhetoric that characterised the Japanese case and did not publish lists of sanctions or counter-sanctions. The final agreement represented more significant market access improvements for the Americans than those granted by the Japanese.

This matched set of cases presents some interesting puzzles. Both cases involved the same sector of dispute (American exports of autos and auto parts), were handled by the Clinton Administration across a similar time period, used the same threats in Section 301 and were aimed at achieving the same outcome (increased market access for American manufacturers). Yet the outcomes in these two cases were quite different. After a long and bruising battle with the Japanese, the U.S. failed to achieve most of their negotiating objectives. In Korea, after fairly subdued negotiations, negotiators could point to success in two agreements that promised to remove significant barriers to access. Why did the U.S. achieve so little gain after such hard bargaining with Japan compared to Korea?

AN EXPECTED UTILITY THEORY EXPLANATION

In the auto disputes with both Japan and Korea, expected utility theory would predict that negotiators would use whatever means necessary, including the strongest possible threats, to achieve breakthroughs in autos. The potential benefits from increased exports in this sector were substantial and worthy of significant costs to resolve the dispute. An expected utility theory explanation, in fact, fails to predict the actual outcomes in these cases. American negotiators should have taken a more aggressive approach to the Korean case than they did in the Japanese case, but they did not.

Expected utility theory does not suggest specific methods, tactics or bargaining strategies that negotiators should select to resolve the dispute. It does indicate that the specific constellation of actors and interests active in both disputes should have driven the Americans to pursue all available avenues for resolution, including the use of the strongest possible trade threats.

The actors in both cases remained the same. The lead U.S. agency in both cases was the United States Office of the Trade Representative (USTR). American interest groups included the Big Three auto manufacturers (Ford, General Motors and Chrysler) and U.S. auto parts manufacturers. The industry was especially well represented by the Automotive Parts and Accessories Association, the American Automobile Manufacturers Association (AAMA), and the U.S. Parts Advisory Committee.

Automobile manufacturers employed a substantial portion of the American workforce. Table 1 highlights the employment figures from 1986-1996.³ The political action committees (PACs) from manufacturers and labor unions contribute significant sums to federal candidates seeking election. In the 1997-1999 election cycle, for example, automotive PACs contributed \$4,836,378 to federal candidates. The United Auto Workers (the largest union working in automobiles) contributed just over \$2 million.⁴

Table 1: Automotive Employment in the United States⁵

	Employment
1986	842,900
1987	845,000
1988	872,800
1989	838,000
1990	770,500
1991	799,200
1992	828,300
1993	847,200
1994	923,000
1995	937,700

The automotive industry had a long history of close ties to government. Any industry of such size and significance was guaranteed to receive careful attention to complaints of unfair market access barriers. The geographical dispersion of the auto industry also ensured that a large number of elected officials would closely follow negotiations that could result in changes in employment at the local level.

³ These figures understate employment, however, since they do not include all parts suppliers and subcontractors. They include Americans working at transplant firms in the United States.

⁴ Source: Federal Election Commission reports, various years. Not all UAW workers are in automobiles. The Big Three gave \$1,262,726 of the total in 1997-1999. For the 1999-2000 election cycle, the Big Three contributed \$1,222,300 of \$5,357,697 given by the larger automotive PAC groupings (which includes the Big Three, parts manufacturers, suppliers, automobile dealers, and leasing agencies).

⁵ Source: Bureau of Labor Statistics, Employment and Earnings, SIC 371, various years.

Furthermore, auto makers and government officials had cooperated in the past. The Big Three successfully limited Japanese exports to the United States for decades under a series of “voluntary export agreements” that continued through the early 1990s. When President George H.W. Bush visited Japan in 1992, he was accompanied by U.S. auto executives. The parts industry had succeeded in pressuring successive U.S. administrations to ensure that Japanese auto manufacturers commit to increasing levels of “voluntary” parts purchases of American-built auto parts in Japanese vehicles.

In this environment, it is unsurprising that U.S. officials were willing to escalate the dispute to the highest levels and use every possible lever to resolve the case with Japan. The potential benefits to breakthrough were substantial for interest groups, elected officials and government negotiators. If the Americans succeeded in removing all barriers to trade in autos and auto parts, all three sets of actors could reap enormous benefits. Interest groups stood to gain significant sales of finished American cars in Japan, sales of parts to Japanese consumers in the aftermarket and parts sales to Japanese firms in Japan and in the United States. Elected officials could have benefited from increased employment in the auto and parts sectors in their districts. And negotiators could have settled perhaps the single largest simmering trade dispute—certainly the largest share of the U.S. trade deficit with Japan could be resolved. Even if the United States succeeded in prying open only a portion of the Japanese market for autos or auto parts, all of the actors would still reap substantial benefits.

Expected utility theory does not point to any particular negotiating strategy, but a value claiming strategy is an aggressive approach. Under value claiming, negotiators use any and all means to resolve the dispute including repeated threats and harsh public statements. The use of threats and harsh public statements raises the costs of the case (since they must be

carried out if negotiations fail). These costs are justified under substantial potential benefits from resolution.

The increasingly heated negotiations with Japan over autos in the early 1990s strengthened government/business bonds. From the onset of the Korean dispute, U.S. auto and auto parts manufacturers were very effective in arguing their case. Elected officials were already following market access negotiations in this sector closely. The stage was set for a highly aggressive approach to opening the Korean market. Yet, despite strong incentives to do so, U.S. officials did not use value claiming strategies in the Korean case.

There was broad agreement that the Korean market, as noted below, was closed to imports. The degree of market penetration for American firms was even smaller than in Japan. Unlike the Japanese case, U.S. firms had made several, good-faith efforts to enter the market with more suitable products. No other auto manufacturers had made any more significant headway either. In short, there was a broad agreement that the market was closed to foreign imports. Unlike the Japanese case, U.S. officials in Korea had substantial domestic and international support for plans to pry open the Korean market.

Yet, as the case details make clear, despite conditions that suggest an aggressively value claiming approach to Korea, officials used a negotiating strategy closer to value creating. USTR opened a Section 301 case over autos, but short negotiations quickly gave way to an agreement. The talks took place out of the limelight. This approach to negotiations is unexpected.

THE ROLE OF LOSSES

Expected utility theory, then, does not explicitly discuss the specific process of negotiation. The theory suggests an aggressive approach to resolving the dispute with Japan and an even more aggressive approach to resolving the dispute with Korea. Negotiators should use all available means to achieve success, including the strongest possible threats.

By contrast, prospect theory suggests that the use of particular strategies should be conditioned by negotiator perceptions of domain. Negotiators will make decisions, not based on a cost/benefit calculus alone, but based on perceptions of gains and losses. At its most simple, the theory suggests that individuals make different decisions when they believe they are facing a loss than when they believe they are facing a gain (c.f. Kahneman and Tversky, 1979, 1981 and 1986; and Kahneman, Knetsch and Thaler, 1991).

Loss and gain are measured relative to the status quo—if a new situation puts decision makers into a better position than they currently hold, they are said to be operating in the domain of gains. If they believe that in the future they will be worse off than under the status quo, they are operating in the domain of losses. In market access disputes, American opportunities to gain market access have been denied. If this situation is not resolved satisfactorily, i.e., the barriers to trade removed by the target state, American business will be at a further disadvantage in the future.

Given the way individuals actually make decisions, as shown through extensive laboratory experiments, individuals in a situation of loss are more risk acceptant. They will be more willing to choose options that have a wider probability of success (or failure) than those with

smaller possibilities of success. They will, in effect, be more willing to take greater gambles in an attempt to recoup a large loss.

Negotiators operating in a domain of gains should be risk adverse. In this environment, they will seek less risky approaches. The tactics of value creating strategies carry fewer risks for officials. For example, since bargaining is handled “off-the-record” and out of the public eye, negotiators are not trapped by previous public statements that lock them into taking particular positions. They retain a degree of flexibility necessary for creating an outcome with gains for both sides. For example, if I have already stated loudly that I will not accept any agreement to sell my widgets for under \$1.00, I cannot consider options potentially on the table to do just that. If I have avoided making threats, I need not fear the risk of implementing the threat if negotiations get bogged down.

Value creating strategies are not limited to situations of gains alone, however. Negotiators operating in a position of modest losses may also elect to use value creating approaches to resolve a dispute. If value creating works, both sides stand to benefit from the outcome. Since both parties benefit, moreover, any agreement reached is likely to be long-lasting.

Value creating approaches should never be used, however, in a position of strong losses. In strong losses, negotiators opt for extremely risky approaches to resolve conflict. Only highly risky approaches hold the potential for recapturing the status quo or even moving into a position of gains. Value creating negotiation strategies are not risky.

All decision makers operating in an environment of uncertainty make choices that involve some degree of risk. Operationalising risk is tricky—it must be evaluated without reference

to outcomes or domain lest it become tautological. Decisions can instead be ranked by relative variance in outcomes (McDermott, 1998: 38-40). Options that have higher potential for large gains or losses are riskier than options that will net lower gains or losses. A gamble that pays out \$100 to the winner but takes \$100 from the loser is riskier than one that involves a possible gain or loss of only \$5.

Threats, by their very nature, are riskier tactics in negotiations. Threats such as Section 301 contain built-in negotiating deadlines and the use of automatic sanctions if agreement is not reached. Referral of cases to the WTO is a very risky strategy, since the United States can either “win” or “lose” the case. If the U.S. is successful, the target state will largely or completely dismantle the barriers to trade. If the U.S. is not successful, the target state can continue with business-as-usual. In conditions of losses, American negotiators ought to frequently select risky tactics to resolve trade conflict.

In a domain of strong losses, however, negotiators should use value claiming strategies to resolve the dispute. The tactics associated with value claiming, including using threats, making harsh public statements, blaming the other side, manipulating information, etc., all entail risk. Threats must be implemented if negotiations collapse. Officials can be held accountable for actions promised in harsh public statements. Target state officials may choose not to negotiate at all under conditions of blame. Accurate information could leak out. Target state officials may no longer believe any commitments made in bargaining. Negotiations could quickly spiral into mutual recriminations and riskier tactics and threats. If the predictions about domain hold, negotiators in a domain of gains should never use value claiming strategies. The risks associated with claiming tactics are high and in positions of gain, individuals are risk averse.

Figure 1 illustrates a hypothetical value function for negotiators. The right-hand side of the graph represents gains from the reference point, the left-hand side illustrates the domain of losses. The slope of the curve measures sensitivity to change and is steepest close to the reference point. The slope flattens out further away from the reference point in both directions, illustrating greater insensitivity to change, or diminishing marginal utility, further out from the reference point. The curve also highlights that people tend to be risk adverse in the domain of gains, but risk acceptant in the domain of losses.⁶ In fact, closer examination of the value functions reveals graphically that individuals are more sensitive to losses than gains, since the slope of the curve is asymmetric and steeper for losses than gains.⁷

The distance from the status quo matters because attitudes towards risk are driven by perceptions of gain or loss. A look at the hypothetical value function shown in Figure 1 confirms the point. The slope of the curve measures sensitivity to change. Each unit of movement along the X axis into the domain of losses results in an even greater propensity to take risks (up to a point).

The shape of the value function curve is similar across all individuals. The choice of risk acceptant or risk adverse choices is therefore driven by domain and not on any given individual's personal propensity for risk. Thus, it is possible to predict decision making behaviour based on domain, rather than on carefully pinpointing a particular individual's utility calculations. Prospect theory explains a common pattern of choice (McDermott: 20).

⁶ Risk aversion was not unexpected and is included in expected utility diagrams as well. The propensity of individuals to be risk acceptant in the domain of losses was the central, unexpected discovery of Tversky and Kahneman in 1979.

⁷ The marginal utility of gains decreases faster than the marginal disutility of losses. See Levy, "An Introduction to Prospect Theory," p. 17.

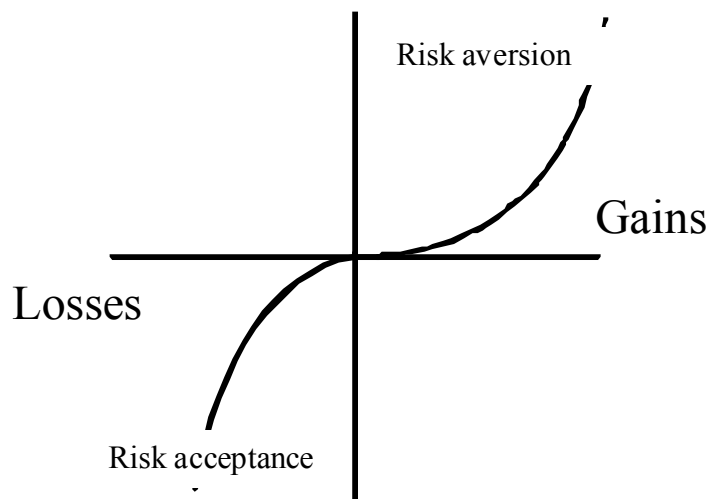


Figure 1: A Hypothetical Prospect Theory Value Function

THE JAPANESE CASE: ESCALATION IN AUTOS

These predictions about negotiator behaviour and domain can be tracked throughout both the Japanese and Korean auto and auto parts discussions. The argument is best illustrated through a careful process tracing of both disputes. The sections that follow represent a brief review of the evolution of both cases.⁸

The opening of the Japanese market to American imports of autos and automobile parts had been an important focus of attention for successive American presidents. Autos and auto parts were the subjects of repeated negotiations throughout the 1980s in the Market-Oriented Sector Selective (MOSS) talks. Although the U.S. “Big Three” (Chrysler, Ford and General Motors) commanded a significant share of the global auto market and U.S. auto parts manufacturers were also globally competitive, the American share of Japan's auto market was

⁸ For a fuller account, see Elms, 2003.

tiny. Total imported autos to Japan (from American and European manufacturers) were 127,071 units in 1989. The Big Three accounted for just over 11,000 units (Oishi, 1990).

These figures were especially grim given the size of the domestic Japanese auto market. Most Japanese consumers purchased a new car every three years. The turnover in the auto market was largely the result of a rigorous inspection system in Japan called the *shaken*. Every car was required to undergo extensive safety testing at the end of three years. These tests were so expensive that many consumers simply chose to purchase a new car at that time. The low penetration of American cars in the Japanese market also stood in stark contrast to the Japanese share of the U.S. auto market. In 1989, Japan exported 2.18 million units to the United States (Schoenberger, 1990).

Although American officials expressed concerns about extremely low levels of automobile exports to Japan, a primary focus was a rising trade deficit in auto parts. The U.S. deficit with Japan in auto parts rose from \$4.2 billion in 1987 to \$5.5 billion in 1989.⁹ The parts deficit was especially surprising given the global competitiveness of most American parts manufacturers and the size of the Japanese market for parts. After additional MOSS talks were held in June 1990, both sides reached an agreement to help promote cooperation between Japanese automakers and American parts suppliers in the design and development of auto parts. Japan's Ministry of Trade and Industry asked Japanese auto makers to submit business plans detailing purchasing plans twice a year and urged Japanese trading companies to buy American autos.

⁹ This, in spite of an overall shrinkage in the U.S. trade deficit with Japan from \$59 billion to \$49 billion over the same period. In response to rising deficits, the Commerce Department set up an advisory committee for auto parts. "U.S. Sets Up Panel on Auto Parts Trade," *Jiji Press Ticker Service*, February 18, 1990.

President George H.W. Bush and the CEOs of the Big Three traveled to Japan in January 1992. American firms claimed that poor auto sales in Japan were caused largely by closed distribution systems; high land costs that made opening independent dealerships prohibitively expensive; exclusionary business practices that could not be cracked by foreign firms; financial *keiretsu* (or cross-shareholding) relationships between Japanese auto manufacturers, parts suppliers, distributors and banks and unfair pricing policies.

Japanese officials disputed the claims, arguing that American sales were largely a result of a weak attempt by U.S. firms to penetrate the Japanese market. The Big Three did not offer auto models suited to the Japanese market, relied on Japanese distributors to sell American cars, and did a poor job of marketing their products. European firms, by contrast, had shown much better sales—indicating the openness of the Japanese market to determined manufacturers.

Announcement of Framework Talks

At the start of the Clinton administration's first term in office, as much as three-quarters (approximately \$43 billion) of the U.S.-Japan trade deficit involved trade in autos (*International Trade Reporter* or *ITR*, 1/13/93: 44). U.S. industry leaders and American negotiators both viewed the situation in autos and auto parts as one of continued American losses. Not only were American companies substantially unable to sell cars in Japan, but auto parts suppliers were unable to sell parts in Japan. Worse still, parts suppliers were unable to sell significant quantities even to Japanese transplant companies located inside the United States. This unhappy set of circumstances was taking place in the wake of long-term MOSS negotiations designed precisely to open the auto market.

In a domain of losses, prospect theory predicts the use of threats and value claiming strategies. Risk acceptant negotiators will be willing to use these approaches to resolve the dispute. At this point in the dispute, officials were facing moderately strong losses. American firms continued to make minimal progress in cracking the Japanese market, but Japanese officials and industry leaders were also promising greater openness in the near future. Under moderate losses, U.S. officials were willing to take some risky steps to resolve the dispute, but not move to the most risky approaches.

The Clinton Administration responded to complaints over autos by March 1993. United States Trade Representative (USTR) Mickey Kantor, in a meeting with MITI Minister Yoshiro Mori, called on the Japanese government to set numerical targets for government procurements (autos purchased by the Japanese government for official government use) and to make explicit the steps the government would take to increase auto parts purchases from the United States.

Autos and auto parts were folded into the U.S.-Japan Framework for a New Economic Partnership talks in July 1993. Deputy USTR Charlene Barshefsky said that the Framework talks represented an American desire for “a fundamental shift in the bilateral economic relationship”. The U.S., she said, was seeking “a series of qualitative indicators—which are quite detailed—and a series of quantitative indicators, which are also quite detailed” (*ITR*, 10/27/93: 1794). President Clinton and Prime Minister Hosokawa planned to announce an agreement in the auto and auto parts discussions by a scheduled summit for the Framework talks on 11 February 1994.

The American emphasis on numerical indicators increased the risk of negotiations. Any final agreement that did not contain such figures would represent a setback for the Americans. A value claiming tactic of committing to an outcome in advance makes it considerably more difficult to reach creative agreements. In developing this approach, U.S. officials drew heavily on their experiences with Japan in other sectors, including the semiconductor case from 1986. In semiconductors, the U.S. pressed for, and got (at least in a secret side letter), a specific numerical target of 20 percent market share that would demonstrate increased market access for American products. The U.S. continued to pressure Japan to live up to its obligations according to this agreement long after the document was signed, and, in fact, the U.S. experienced significant increases in market access for American semiconductors. The experiences of the semiconductor agreement and a desire for numerical targets provided the framing used by the U.S. in presenting its case on autos (Mastanduno, 1993). This also set the stage within U.S. policymaking and business circles for believing that such a target was a worthwhile goal to pursue in auto negotiations since it would allow the U.S. to clearly determine adherence to any agreement reached.

American insistence on using numerical targets potentially represented a serious loss for the Japanese. American products had been largely kept out of the Japanese market for decades. If U.S. officials were successful in getting Japan to agree to such measures of openness, it could lead to multiple problems. First, more American products would have to be let in. Second, agreed-upon targets would provide a clear yardstick of openness (or highlight any lack of progress). Third, the Japanese government was unwilling (and perhaps unable) to commit to such indicators, since the government repeatedly argued that it could not dictate to

private firms appropriate levels for parts purchases.¹⁰ Fourth, the Japanese government was increasingly unhappy with the U.S.-Japan semiconductor agreement that set up the first quantitative target and did not want to see this approach repeated elsewhere. Finally, if the Americans were successful in using indicators in autos and auto parts, they would look to incorporate such measures in every agreement under negotiation. In a position of potential losses, therefore, the Japanese government also began using a value claiming strategy. The shift in Japanese strategy was quite dramatic and unexpected for the Americans.

The initial position of the Japanese government, represented in the Framework talks by MITI, was that the lack of U.S. automobile sales in Japan was primarily the problem of American firms. For example, while 80 percent of the market in Japan was composed of autos priced under ¥3 million and less than 2,000cc engines, the Big Three offered no models in Japan that fit into this category. In addition, U.S. manufacturers offered few models with right-hand-drive steering wheels. Japan also argued that American efforts at marketing U.S. autos had been lethargic. While Washington insisted that high land prices in Japan made it difficult to open independent dealerships, Japanese officials pointed to the success that several European companies had in opening dealerships in the 1980s.

Negotiations were complicated by the collapse of the government in Japan during the summer of 1993. Although the Liberal Democratic Party (LDP) had ruled Japan since the end of World War II, it lost its majority hold on the legislature and the prime ministership. In spite of this change in government, President Clinton and the new Japanese Prime Minister Hosokawa still hoped to announce an agreement in the auto and auto parts discussions at their

¹⁰ This argument, however, seems disingenuous, since the Japanese government had done precisely that in autos for decades, including the “voluntary” restraint agreements.

first scheduled summit meeting on 11 February 1994. The continuing weakness of the Japanese government continued to plague negotiations throughout the auto and auto parts discussions.¹¹

The Americans were interested in obtaining additional market access for U.S. auto parts at both transplants and at Japanese plants in Japan, and improved access in Japan for finished cars made in America. The American side requested that the Japanese government use “administrative guidance” to ensure that Japanese manufacturers purchased U.S. parts. Administrative guidance was a term used frequently in U.S.-Japan negotiations over market access in a variety of sectors. It meant that the Japanese government should “urge” private industry to make changes. Given the tight government/industry links in Japan, the guidance was usually followed. This time, however, the Japan Automobile Manufacturers Association (JAMA) called U.S. demands “shockingly discriminatory and anti-market” since they would discriminate against Japanese-owned companies in the U.S. or any joint U.S.-Japanese firms in favor of American firms (*ITR*, 11/10/93: 1900). Despite initial indications of movement toward an agreement in autos and auto parts, by early 1994 U.S. trade officials were beginning to voice public frustration with a lack of progress.

First Deadline Passes

As movement in the Framework talks became increasingly problematic, the sense of loss for the Americans increased. Repeated MOSS negotiations had failed to open the Japanese market. Private industry promises of increased parts purchases were insufficient. American officials had chosen a new, higher risk strategy in requesting quantitative indicators and

¹¹ As I note later, however, domestic political shifts like the collapse of the LDP are indeterminate. The change in government could have represented either an obstacle or an opportunity for success in auto negotiations.

objective measures of market access. But this strategy did not appear to be working either. U.S. negotiators began meeting directly with Japanese business leaders to encourage them to purchase more U.S. parts and to assist American firms in selling more finished automobiles in Japan.

After the talks deadlocked, the Japanese government may have expected the Americans to give up on using quantitative indicators. If the United States retreated on its insistence on objective criteria, the crisis in autos might be manageable once again. Japan could take modest market opening steps and resolve the dispute. The Japanese government held a “small meeting” at the deputy-ministerial level on 17th February with key Japanese automakers and JAMA to discuss new measures to break the impasse, including the return to “voluntary” purchasing plans.

Secretary of State Warren Christopher flew to Japan in early March and suggested that the U.S. would consider resuming Framework talks, if the Japanese government could put forth a meaningful package for consideration. In the meantime, U.S. negotiators continued to announce that U.S. demands for qualitative and quantitative measures were not numerical targets but were intended to allow the U.S. and Japan to judge clearly whether progress was being made. Officials in other countries, particularly in Europe, began to publicly express concerns over U.S. trade demands. Gunter Rexrodt, Minister of Economic Affairs in Germany, suggested that setting numerical targets could be counterproductive and could encourage other countries to take similar action (*ITR*, 2/23/94: 284-5)

All five major Japanese automakers did agree to increase purchases of auto parts globally and announced their individual plans at the end of March. Most of the announcements, however,

fell far short of U.S. objectives and included only relatively modest increases in purchases of U.S.- made products. Many of the increases were already necessary for Japanese firms to fit into increasing local content provisions of the North American Free Trade Agreement (NAFTA).

Talks Resume

The limited market opening promised in the plans increased the sense of loss for the Americans. The Framework talks were at a standstill. Domestic political pressures from Congress were rising. Voluntary purchasing plans from Japanese companies would not result in significant market penetration. U.S. officials were willing to take riskier steps to resolve the dispute, including stronger demands for indicators.

The response of the Americans to deadlock in the negotiations also increased the perceptions of loss for Japan. U.S. officials were not renouncing the use of quantitative indicators, but were increasingly strident about their demands for such criteria. Worse, some officials suggested that such an approach could become routine in the future in other sectors. Japan's modest steps to resolve the dispute had failed. As a result, Japanese negotiators also began using an increasingly aggressive value claiming strategy. Trade officials who were normally quite circumspect in public statements began using stronger language to complain about American practices and tactics.

Working-level talks on autos and auto parts resumed in early June 1994 with both sides seeking the same goals outlined at the start of the Framework talks in 1992. In particular the U.S. continued to demand quantitative and qualitative indicators for measuring progress.

These indicators could include the number of foreign automakers and Japanese dealerships carrying foreign vehicles alongside Japanese cars or foreign vehicle sales. The Japanese side suggested a focus on the number of foreign maker research and development facilities in Japan, price competitiveness of foreign vehicles or the number of right-hand steering wheel models.

Second Deadline Passes

The 30 September 1994 deadline came and went for auto and auto parts negotiations. While agreements were announced in insurance and government procurement issues discussed under the Framework talks, no progress was reported in autos. American firms argued that their losses were continuing to mount. They still remained substantially shut out of the marketplace and even potentially favorable conditions for an agreement (in the form of a bundled set of negotiations) had not resolved the dispute. U.S. officials, in a position of rising losses, took another risky step. The U.S. initiated a trade investigation of Japan under Section 301 into aftermarket auto parts. The use of the 301 mechanism gave the United States one year to resolve the issue through negotiations before sanctions would be imposed. The Japanese aftermarket included parts installed on autos after the initial sale such as roof racks as well as parts needed for repair. Kantor suggested that the aftermarket sector was chosen because “we felt it necessary to take a limited and targeted action aimed at clearly identifiable barriers to market access at this time”(ITR, 10/5/94: 1524).

The specific problem cited by Kantor was a Japanese requirement that certified auto parts be included on a “critical parts list” before they could be installed by certified auto mechanics.

But foreign suppliers had a very difficult time being placed on the list, because the critical parts list was not published anywhere.

Japan's value claiming strategy continued to harden in the wake of the Section 301 announcement. Not only was Japan at risk from the use of objective indicators, but it was now also at risk of sanctions if negotiations remained deadlocked. In early 1995, MITI Vice Minister Sozaburo Okamatsu announced that the resumption of talks could take place once four Japanese demands were met: that the two sides limit discussions to items which were "within government reach" or influence; that numerical targets not be used; that the Japanese government would not intervene in voluntary plans for parts purchase increases announced by auto manufacturers in Japan; and that Japan would not negotiate under the threat of Section 301 retaliation.

The United States informed Japan that government officials would directly approach the Japanese auto industry to request increasing purchases of U.S.-made auto parts. The first visit took place in the wake of information suggesting that the auto and auto parts deficit with Japan had soared to a record high level—estimated at \$36.1 billion in 1994 or nearly 59 percent of the overall trade deficit with Japan (*ITR*, 1/11/95: 47).

Meanwhile, both sides became locked into an increasingly value claiming strategy. Even the Japanese negotiators, rarely known for issuing harsh public statements or blaming the United States for failure, were routinely castigating the U.S. position and American demands. With each successive failure of negotiations, both sides emerged with recriminating comments.

Jeffrey Garten, chief U.S. negotiator for the talks, emphasized that there had been no shift in American requests. “Our approach”, he said, “remains totally results-oriented and the means is less important to us than at the end of the day the spirit of the framework is satisfied, which is that there will be significant or substantial increases in the purchase of parts” (*ITR*, 2/1/95: 214). JAMA responded, “Whatever the words, the issue is clear. The U.S. government demands non-market devices and other interference in the marketplace to assure increased sales of U.S. auto parts to Japanese companies” (*ITR*, 2/1/95: 214).

Ninety six members of Congress pressed President Clinton to move the deadline forward to March 31st. The Clinton Administration, responding to increasing pressure, apparently reached a decision within the Cabinet to move up the deadline in the 301 case, although such a decision was never publicly announced (*ITR*, 3/8/95: 450).¹²

Next Round of Discussions

Negotiators held the first working group meetings in over four months on 15-17 February 1995, but these too were unproductive. U.S. negotiators announced the two sides continued to have a “wide gulf” between their positions. On 17 March, Hashimoto sent a letter to Kantor, warning him that the use of 301 sanctions against Japan would be met by a complaint by Japan to the WTO. American officials understood that the Japanese government was preparing to issue a report that singled out the United States as the largest violator of trade rules. Turning the U.S.-Japan negotiations over to the WTO for a ruling was a high-stakes decision. If the WTO were to rule against the Americans, it might deal a fatal blow to the fledgling WTO and its dispute resolution mechanisms. Support for the WTO in Congress

¹² A decision was apparently made during a cabinet meeting on March 2 and was supported by most of the members of the cabinet and industry officials.

was not high. There was a fear that the U.S. could choose to ignore an unfavorable ruling, effectively withdrawing the United States from the WTO.

Although U.S. officials expressed confidence in their position in the auto talks, it was entirely possible that the WTO would issue a ruling against the United States. If the U.S. chose to ignore a negative ruling, it would have, at a single stroke, seriously harmed seven years of complex international negotiations in the Uruguay Round of General Agreement on Tariffs and Trade (GATT) that had brought the WTO into being. Such a decision would have delivered a serious setback to the continuing movement to global free trade of goods and services since other states could follow the U.S. lead in this regard and turn increasingly to unilateral or bilateral approaches to trade issues rather than multilateral ones.

Although Japanese companies had indicated an unwillingness to consider extension of voluntary purchase plans, a continuing high rise of the yen (*endaka*) was forcing some companies to reconsider this position. The rising yen not only damaged auto exports from Japan that lost price competitiveness, but also encouraged cheaper imports.

Given the lack of progress in U.S.-Japan talks over autos, Jeffrey Garten announced a new U.S. plan to garner multilateral support for the U.S. position in prying open the closed Japanese markets. He said, “We want to balance the bilateral approach with a multilateral approach . . . To the extent that we can get a consensus, pressure will be more effective” (*ITR*, 4/5/95: 608). At the same time, U.S. officials admitted that the “benchmark date” of 31st March for resolution of the issue was not going to be met. Garten and USTR’s General Counsel Ira Shapiro announced that they had come to realise that no significant progress

would be made before that date, but agreed that a new level of intensity had given them encouragement that an end could be reached (*ITR*, 4/5/95: 609).

Third Deadline Passes

In mid-April 1995, two new days of talks at the vice ministerial level also ended in no agreement. “We have a long way to go,” said Garten, “Wide gaps remain in each of the areas of negotiation” (*ITR*, 4/19/95: 680). One area of contention was the issue of deregulation. Shapiro indicated that the U.S. was interested in developing a comprehensive plan without being led on a “forced march through thousands of regulations” on a point-by-point basis. Although the Japanese maintained that most of the regulations were necessary for safety purposes, Shapiro disagreed. “It is simply not the case”, he said, “that these elaborate, unnecessary, byzantine regulations serve the interest of safety—not all of them—and they do constitute a serious market barrier. So we are starting from fundamentally serious [mis]perceptions” (*ITR*, 4/19/95: 680).

The pressures on the American side to achieve resolution continued to increase. On 18th April, a wide range of industry leaders gathered to urge the Clinton Administration to continue to press Japan. Businesses represented were not just auto executives, but also aluminum producers, electronics industries and the auto workers union. “For the first time in over 15 years of high-level government efforts to open Japan’s markets, we have a united administration, industry, labor, and congressional front”, said Alfred Gaspar, President of the Automotive Parts and Accessories Union (*ITR*, 4/19/95: 681).

President Clinton held a prime-time news conference on the same day in which he suggested that the U.S. and Japan should not risk a trade war, but he did note that the U.S. had been “very patient” on this subject for “a very long time” (*ITR*, 4/26/95: 724). One of the top trade officials noted, “We’ve put ourselves pretty far out on this one, and there is no backing away now. We came to the conclusion that either we draw the line here, or throw in the towel on Japan” (Sanger, 1995).

By this point in the dispute, both sides had become so publicly entrenched in their respective negotiating positions that neither side left room for movement. Both sides continued to trade accusations of intransigence against the other. Repeated negotiations that ended in failure only increased the sense of loss for both sides. The U.S. and Japan were caught in a “spiral model” of increasingly harsh demands and risky tactics.

MITI’s Hashimoto told the Japanese House of Representatives that Japan could not “make an easy compromise” on auto talks because that would lead the United States to demand similar measures from Europe and the rest of Asia (*ITR*, 4/26/95: 722). MITI was reportedly preparing a list of counter-sanctions to be applied to the United States, should the U.S. move ahead with 301 sanctions. Within Japan, the strong U.S. position was seen as President Clinton’s political ploy to shore up support among labor unions and middle-class voters concerned over the possibility of losing more jobs to Japan.

The whole U.S. strategy was lambasted by Japan in the MITI report, *1995 Report on the WTO Consistency of Trade Policies by Major Trading Partners*. The report suggested that the U.S. direct approach to industry was not problematic as long as the U.S. was merely appealing to Japanese companies. But, if such an appeal contained “de facto coercion”

through the use of threats or pressure on Japanese companies, it would deprive them of their right to make voluntary purchasing decisions. The report alleged that such activities could amount to local content requirements, and would have the same effect as import restrictions. It would constitute “interference by a foreign government in the administration of domestic affairs”, and amount to “exertion of authority on foreign soil” without the permission of Japan. Such measures would violate not only GATT Article III, Section 4, but GATT Article XI prohibiting quantitative import restrictions, the Safeguards Agreement and the Treaty of Friendship, Commerce and Navigation between the United States and Japan.

A renewed round of negotiations in early May 1995 also ended with no agreement. USTR Kantor met with MITI’s Hashimoto for six hours on 3rd May in an attempt to break the deadlock. After the meeting, additional rumours suggested that the U.S. was preparing to announce sanctions. The President said that if the negotiations failed, the U.S. would counter with a “strong response” (Cooper, 1995). Mickey Kantor placed blame solely at the feet of the Japanese. “The Japanese government adopted a rigid ideological stance that appeared bent on failure, while we attempted to seek practical solutions to real problems,” he said. “Frankly, the Japanese government will take just about any position except opening their markets” (*ITR*, 5/10/95: 839).

Hashimoto was no less harsh in his criticism of the United States. “The demand by the U.S. [for voluntary plans] is nothing more than de facto numerical targets and would lead to managed trade. If the U.S. stops demanding voluntary plans, we feel there is ample room for an agreement” (*ITR*, 5/10/95: 840). The Japanese government proposed making a joint announcement which would cover important basic principles, including: the promotion of globalisation of business activities; enhanced industrial cooperation, including joint R&D;

efforts to ensure that transplant firms become good corporate citizens; and a commitment to engage in business activities tailored to the host market. The United States did not accept this announcement and the statement was never released.

Movement Towards U.S. Sanctions

Now in a position of strong losses and with both sides locked into a spiral of increasingly aggressive value claiming, the U.S. upped the stakes again by appealing to the WTO. On 10th May, American negotiators sent a letter to Renato Ruggiero, Director General of the WTO, informing him of U.S. intentions to file a claim with the dispute settlement mechanism of the WTO against Japan to challenge the continuing discrimination against the United States products in the market for automobiles and automotive parts in Japan. Kantor reported that the USTR was preparing the case for official filing within 45 days.

Congress supported the administration's position. On 9 May, the Senate had approved a resolution by a vote of 88-8 to support the decision to use trade sanctions under 301 if Japan refused to open its market. In President Clinton's weekly radio address on 14 May, he said:

[W]e've been hitting that brick wall long enough. I am determined to open Japan's auto market. That's why I've asked my administration to draw up a list of potential sanctions to impose against Japanese imports. We are prepared to act. And we will act soon if we must (Meisler, 1995).

Section 301 Used

Commerce Secretary Ronald Brown admitted that when the U.S. had asked its own lawyers to decide on whether U.S. actions under Section 301 would be consistent with WTO rules, the administration had received "mixed" advice (*ITR*, 5/31/95: 918). Nonetheless, on 16th May, the United States formally announced a list of items eligible for sanctions if an

agreement could not be reached by 28th June. The list included up to 100 percent tariffs valued at \$5.9 billion on 13 models of Japanese luxury cars.¹³ These models accounted for only 12.5 percent of Japanese autos sold in the United States, but were 22.7 percent of the \$26 billion in Japanese sales.¹⁴

The publication of this sanctions list was a very risky approach. The proposed sanctions were the largest and most developed list of sanctions ever drawn up against the Japanese in a Section 301 case. The stakes were high. If Japan failed to back down, the United States would be forced to impose significant tariffs. The United States also ran the serious risk that Japan would also follow through with their own threat of substantial countersanctions against American products.

The Clinton Administration was clearly hoping that the threat of sanctions would lead to softening of the Japanese position—not a completely unrealistic perspective, given the past experiences of U.S.-Japan trade conflicts—and that the whole conflict would be short-lived so that support for sanctions would not erode before an agreement could be reached. Senior administration officials were privately predicting that sanctions would never go into effect,

¹³ Luxury automobiles were chosen for sanctions because there were alternative non-Japanese sources of supply for these items (unlike VCRs or laptop computers, for example) and because there was a strong feeling among administration officials that the Japanese auto manufacturers were more receptive to policy shifts than the Japanese government indicated. Imposing heavy penalties on these items, it was hoped, would lead to more conciliatory policies. See Bob Davis and Helene Cooper, “Hefty Tariffs on Japanese Cars Planned by U.S. in Escalation of Trade Fight,” *Wall Street Journal*, May 9, 1995, p. A6.

¹⁴ The list included all five of Toyota’s Lexus models, three Infiniti models from Nissan, two Acura models of Honda, two models of Mazda and one from Mitsubishi. The Clinton administration had considered placing minivans on the sanctions list as well, but removed this items out of a concern of backlash by consumers. Helene Cooper and Bob Davis, “U.S. Targets 13 Car Models from Japan for Big Tariffs,” *Wall Street Journal*, May 16, 1995, p. A2. The cars included on the list were all produced in Japan, making minimal use of American parts, and all were priced above \$25,000 so they were largely out of reach of the middle-class electorate. Andrew Pollack, “Japan Plans Appeal to New Trade Group,” *New York Times*, May 17, 1995, p. D4.

because the imminent and specific nature of the threat would provide the necessary leverage to reach a settlement.

Japan's response was an immediate request for a hearing before the WTO. MITI Minister Hashimoto said, "This announced action [by the United States of imposing 100 percent tariffs] is clearly inconsistent with the rules of the WTO and we think it's very regrettable".¹⁵ The failure to reach agreement, he said, was related to American insistence on "two types of numerical targets" including both renewal and expansion of "voluntary" business purchasing plans and commitments on the future number of dealers offering foreign brands.¹⁶ MITI suggested that the cost of imposing sanctions on luxury autos would be \$243 million in reduced American exports of parts and components to Japan.

By 26 June, Japanese automakers were privately forecasting changes in business plans and forecasts that would result in additional American production. Honda said it would increase production at North American transplant firms from 610,000 vehicles to 720,000 by 1997 in addition to building a new engine plant to increase output by 50 percent by 1998. Toyota announced plans to boost production at its Georgetown, Ky., plant to 790,000 units in 1996, up from 581,000 in 1994.¹⁷

On 26 June, Kantor and Hashimoto agreed to meet in Geneva to see if any last-minute breakthroughs could be accomplished. The first day of meetings ended in no agreement.

¹⁵ Remarks by Ryutaro Hashimoto, May 16, 1995, as released by MITI.

¹⁶ Such an action, Hashimoto said, represented an American attempt to impose "de facto numerical targets under the threat of unilateral sanctions, which is nothing but government intervention in private business activities, and poses a serious challenge to the free trade system." See "Remarks by Ryutaro Hashimoto," May 16, 1995, MITI.

¹⁷ The sticking point continued to be Japanese refusal to put the plans into writing. Helene Cooper, "U.S., Japan Trade Officials Agree to a Meeting Today," *Wall Street Journal*, June 26, 1995, p. A2.

Kantor suggested that sanctions would still be preferable to “going for one more cosmetic agreement with Japan”. He said:

I worry a lot about the reaction in Japan and in America if we signed something which is not concrete. If people think these agreements are not meaningful, we’ll hurt the relationship with Japan, and in Japan and the U.S. everyone will lose confidence. I think it is more responsible to go for a real, verifiable agreement, even if it is painful in the short term.

Hashimoto responded that reaching an accord would “be more difficult than climbing the northern face of Mount Eiger” (Sanger, 06/27/95).

Agreement at Last

Finally, on the very eve of U.S. sanctions, an agreement was reached between the United States and Japan over autos and auto parts on 28 June 1995.¹⁸ The final joint announcement was made by Kantor and Hashimoto in which they discussed four guiding principles for the private sector: globalisation, localisation, industrial cooperation and transparency. The announcement included expressions of appreciation to Japanese auto makers for announcing and carrying out plans to increase auto parts purchases in 1991, 1992 and 1994 and stated that both sides would welcome any further plans.

Both sides, however, recognised that the announcement of increased purchases by Japanese auto makers were not to be viewed as commitments, nor were they “subject to the trade remedy laws of either country”. The two ministers were also pleased to note the stated willingness of U.S. firms to expand their presence in the Japanese market while offering

¹⁸ Agreement was reached so quickly that neither side was able to publish even an abridged version of the text within the week and the USTR did not release the final copy until August 15, 1995. See “Announcement on U.S.- Japan Auto Trade Agreement by Japanese Trade Minister Ryutaro Hashimoto and USTR Mickey Kantor,” June 29, 1995, as reported in *ITR*, 7/5/95, p. 1165.

competitive products, prices and service. In addition to discussing private sector efforts, the two ministers announced the conclusion of the Framework talks on autos and auto parts, including various governmental “measures” to be taken by both sides.

The Japanese government was able to announce victory in holding firm against U.S. requests for numerical targets (even while urging Japanese automakers to release detailed business plans for continued expansion of auto production in the United States) and the U.S. declared a victory by holding firm on its insistence on using numerical targets (even though the numbers released in the final document were not agreed upon by the Japanese government).¹⁹

Immediate assessment of the deal was mixed. From an American perspective, if the Japanese side lived up to its agreement and business forecasts, it could result in substantial new sales opportunities for the United States. On the other hand, since the agreement contained no enforcement mechanisms, it was equally possible that the agreement could result in no additional business (Cooper and Reitman, 1995). The Clinton Administration appeared to believe that if the U.S. intentions were clearly stated in writing, the Japanese government and business would feel obligated to live up to the agreement.

But the final deal certainly did not represent the kind of sweeping change in the Japanese system that the administration officials had been discussing for more than two years.²⁰ Even in Japan, euphoria was mixed with concern that the final agreement would only lead to larger problems in the future. The headline of *Mainichi Shimbun* read, “Unintelligible Ending” and

¹⁹ In fact, subsequent reports trumpeted the inclusion of “17 objective criteria” for judging the agreement.

²⁰ U.S. trade officials admitted to a great deal of unease about the possibility of extracting even greater concessions, had an agreement not be announced and sanctions gone into effect. “These are questions we’ll be asking ourselves for a long time,” said one U.S. official. David Sanger, “At the End, U.S. Blunted its Big Stick,” *New York Times*, June 30, 1995, p. D4.

the *Yomiuri Shimbun* suggested in an editorial that differences in interpretation could become “a source of future friction between the two countries” (Pollack, 1995).

THE KOREAN CASE: INTRODUCTION

At the same time the American dispute with Japan over autos and auto parts was reaching a climax, U.S. negotiators were also engaged in discussions with the South Korean government over the same sector. When Kim Young Sam became president of South Korea in 1992, he announced that “globalization” would be a prominent component of his administration (*Economist*, 1995). This new stance was in stark contrast to previous governments in South Korea who were often unwilling to discuss market liberalization measures. Beginning in mid 1994, U.S. and Korean officials began a series of low-level meetings to discuss market access issues for automobile imports from the United States.

American market penetration for autos was miniscule. U.S. firms exported approximately 1,900 cars to South Korea in 1994, while South Korean firms exported 206,000 cars to the United States. Nearly 1.4 million autos were sold annually in Korea (Maggs, 9/20/95). American negotiators claimed that the U.S. share of the market was 0.2 percent. The Koreans claimed a 0.6 percent share.²¹ “We’ve had an argument with the Koreans about what fraction of one percent of the market we have, but it’s kind of ridiculous if you think about it”, said Andrew Card, President of the AAMA (Maggs, 9/20/95).

The Big Three firms alleged that the primary restrictions to increased penetration of the market were Korean regulations, high taxes against cars with larger engines, harassment of

²¹ An official at the Korean embassy claimed that, calculated in terms of value, imports constituted 3.4 percent of the Korean market, since imported cars tended to be more expensive than domestic autos. Paul Blustein, “U.S., South Korea to Hold Auto Trade Talks,” *Washington Post*, September 19, 1995, p. E1.

Korean consumers who purchased American autos (including tax audits), restrictions on advertising, and financing and leasing restrictions.

Although the domestic market for autos in Korea was smaller than the market for finished autos in Japan, American firms stood to reap significant benefits from greater market access. Parts makers would likewise gain from market liberalisation, especially since Korean auto manufacturers were dramatically increasing exports of Korean autos and domestic parts makers were struggling to keep up with the growing demand.

In this environment, U.S. officials may have been expected to turn to the same negotiating strategies and tactics used in the Japanese case. Officials could have chosen the same aggressively value claiming strategy over this dispute in the same sector with similar types of market access barriers. They may have opted for the same set of threats as well, including Section 301 and recourse to the WTO. Instead, U.S. officials opted for a different type of negotiating strategy—one closer to value creating than strict value claiming. Although they used Section 301 twice in resolving the dispute, officials refrained from publishing sanctions lists and did not turn to the WTO. The two sides never approached the brink of a large-scale trade war.

1995 Agreement

American firms were substantially shut out of the Korean auto and parts markets through the early 1990s, although Korea took several modest steps under the leadership of Kim Young Sam to liberalise. Although American firms continued to sell extremely small quantities of cars in Korea, the government appeared to be taking steps to resolve the most obvious

barriers to imports. U.S. and Korean negotiators had not been engaged in lengthy negotiations over the auto sector. Unlike Japan, U.S. officials had not come under intense political pressure over cars in Korea. In short, the perception of domain for industry and government negotiators appears to have been one of loss, but loss located close to the status quo. Firms were still not experiencing great success in exporting to Korea but the situation appeared to be slowly improving. Bilateral talks in 1994 remained at lower levels of the government.

As the U.S.-Japan auto discussions became more heated, however, industry and government officials began to pay greater attention to the apparently closed nature of the Korean market. Jeffrey Garten, U.S. Commerce Undersecretary for International Trade, said that the Japan negotiations were necessary to stop other nations like South Korea from following Tokyo's trade policies (Murayama, 1995). South Korean officials admitted feeling some concern.²² In a ceremony marking the 25 August 1995 signing of the U.S.-Japan auto accord, Andrew Card of the AAMA said, "The U.S.-Japan negotiations should serve as a signal to other nations" (Bluestein, 1995). Industry leaders repeatedly mentioned South Korean barriers to U.S. trade officials at the ceremony.

The deadline for Super 301 announcements followed at the end of September. Super 301 legislation had just been reinstated. Although the Super 301 provision in U.S. trade law had been rarely used, the Clinton administration had come into office vowing to use this regulation more vigorously.²³ Super 301 is a highly risky threat. The original legislation was

²² Choi Min-ku of the Ministry of Trade, Industry and Energy, said he thought Korea had taken sufficient measures to avoid a bruising battle with the Americans. Paul Shin, "Seoul Worries About Fallout from U.S.-Japan Auto War," *Associated Press*, June 2, 1995.

²³ The Super 301 law was passed in the 1988 Omnibus Trade Act. In the following year, the U.S. named four states to the list. Although South Korea was widely expected to be among the states singled out because South

aimed at countries with pervasive trade barriers, especially Japan. Rather than negotiate over each item or sector separately, under Super 301 USTR was empowered to name whole countries for unfair trade practices. If the offending state failed to substantially liberalise trade, the legislation authorised broad economic sanctions.

Heading into the final days of the negotiations before the Super 301 announcement, talks were at a stalemate.²⁴ The South Korean cabinet reportedly met twice specifically to discuss the auto negotiations (*Journal of Commerce*, 1995). Finally, on 28 September 1995, just hours before the deadline, the two sides reached an agreement.

In the memorandum of understanding, South Korea pledged to reduce taxes on medium and large sized cars, which was expected to lower the cost of a vehicle with a large engine by 15 percent. Korea also promised fewer inspection and certification procedures for imported autos and agreed to allow expanded advertising campaigns for U.S. firms. The agreement also promised to end the routine tax audits of Korean consumers who purchased imported cars. Korean officials promised to send all car buyers a flyer that explained that purchasing an imported automobile was not “unpatriotic”. The overall trade pact was widely praised as being tougher, more concrete and more verifiable than the agreement reached with Japan.

As a result of the agreement, no states were named to the Super 301 list in 1995. USTR Mickey Kantor hailed the agreement as a significant step forward, but said that he reserved

Korean practices had received the largest number of complaints of unfair market access restrictions, intense negotiations with South Korea in the months leading up to the announcement helped Korea avoid being named to the list. The following year, USTR named the completion of the GATT Uruguay Round negotiations as the most important element of Super 301. After that, the law was not used again under the Bush administration. See Bayard and Elliott, 1994: 141-186, and Destler.

²⁴ One source of disagreement was a greater reduction in tariffs. “U.S.-South Korean Auto Talks Fail to Reach Agreement,” *Yonhap News Agency*, September 23, 1995, and “U.S., South Korea Hit Auto Trade Impasse,” *Journal of Commerce*, September 22, 1995, p. A3. Amy Borrus, Keith Naughton, and Laxmi Nakarmi, “Now Detroit’s Heavy Artillery is Trained on Seoul,” *Business Week*, September 25, 1995.

the right to file a complaint with the WTO if the pact did not result in more imports to South Korea. He suggested a date of 1 June 1996, for monitoring compliance and imposing additional sanctions if the agreement was not carried out.

By the end of 1995, South Korea car manufacturers had exported more than one million vehicles, up 40 percent from 1994. South Korean firms commanded five percent of the global market share and were poised to become the fifth largest automobile producer.²⁵ Korean automakers, in fact, were building so many plants that they were projected to have an excess capacity of five million units beyond the domestic market.²⁶

Verification of the Agreement

Acting USTR Charlene Barshefsky promised a review of the auto pact during a July 1996 conference with her South Korean counterpart. The share of imports on the Korean market had risen, but only from 0.44 percent to 0.55 percent (Maggs, 6/4/95 and Crutsinger, 6/3/96). U.S. automakers expressed concern that South Korea had decided to reclassify sport utility vehicles as passenger cars—making them subject to local taxes. Another point of contention was the continuation of an 8 percent tariff for all imports (compared to a U.S. tariff of 2.5 percent). In spite of these concerns, however, the U.S. government declared that South Korea was in general compliance with the agreement and declined to file a WTO case against the Koreans or engage in renewed negotiations over autos.

²⁵ “Korean Autos Barrel into Global Markets,” *Nihon Keizai Shimbun*, November 20, 1995. Hyundai, the industry leader, had expanded sales from North America to 152 countries. The rise of the yen had weakened the price competitiveness of Japanese cars in favor of Korean autos overseas.

²⁶ The rapid expansion of Korean exports had some American and European car makers concerned. Paul Eisenstein, “South Korean Auto Industry Expands Rapidly,” *The Washington Times*, November 24, 1995.

Although sales of imported autos remained small, American firms had greater success breaking into the auto parts market. With four domestic auto makers (and a fifth gearing up to start) that relied heavily on outside suppliers for parts churning out as many as six million cars per year, Korean manufacturers needed parts suppliers. Growth in the Korean parts market, therefore, held considerably more promise for American firms than the Japanese parts market.

Movement Towards Sanctions

In November 1996, however, imports began rising rapidly and the South Korean trade deficit soared to a record \$20 billion.²⁷ Government officials resumed the practice of auditing the tax records of those consumers who purchased imported autos. Korean auto manufacturers entered a prolonged slump in early 1997. Three weeks of labor strikes in December had caused significant disruption through the country, especially in the automotive sector. The two largest manufacturers saw profits plunge in 1996 and the Korean government refused to help the industry (*AFP*, 4/24/97).

Renewed discrimination against imports and barely rising sales contributed to a stronger perception of losses for American firms. U.S. negotiators asked several times for working-level meetings to amend the 1995 memorandum of understanding, but Korean officials rejected the requests (*Automotive News*, 1997).

²⁷ “South Korea’s Auto Industry Hit by Strike Over Labor Law,” *New York Times*, December 27, 1996. The U.S.-Korean trade balance showed a \$4.32 billion trade surplus with Korea from January-May 1996. “U.S. Pushes South Korea for Open Markets,” *United Press International*, June 26, 1996.

In July 1997, American and European auto manufacturers made a joint trip to Seoul. For the first time, both sides presented a unified message: the Korean market remained closed to imports and Korean firms were building up excess capacity both at home and abroad. Two new complaints by both groups were the imposition of a new Korean regulation on noise levels and a “subway bond”. The noise level regulations did not establish any testing procedures so foreign firms could ensure compliance. The subway bond tax applied to vehicles sold in Seoul and Pusan, the largest domestic markets. It totaled \$3,350 for imported minivans, but only \$437 for domestic minivans.²⁸

U.S. and Korean officials met in a second working-level set of bilateral talks in August. American officials privately expressed disappointment at the talks. By September, the Clinton administration was quietly warning Korea that it might again be subject to placement on the Super 301 violations list for failure to fully liberalise the Korean auto market. A dozen senators sent a letter to President Clinton that demanded that Korea be cited under Super 301 (Maggs, 9/23/97). The Big Three U.S. automakers wrote a letter to President Clinton expressing growing frustration with Korea’s failure to honor market opening commitments (AFP, 9/11/97). The letters arrived in the midst of renewed interest in trade legislation in Congress and growing concern about the failure of some states to fully implement market access agreements—especially Japan and Korea in autos and auto parts. The AAMA also filed paperwork directly with the USTR asking that South Korea’s trade practices be investigated.

²⁸ Differential tax rates for foreign and domestic products are prohibited by the WTO. Korean officials argued that imported minivans were equipped with gasoline engines, not diesel engines like Korean vans, so the two products were not comparable and therefore not subject to different tax rates based on origin alone. “Korea Trip Ends in Stalemate,” *Automotive News*, July 21, 1997, p. 4.

In this environment of greater political pressure and continued economic problems for U.S. exporters, U.S. officials prepared to take a riskier step to resolve the dispute. Negotiators held one more scheduled round of bargaining, but indicated that they were preparing to move forward with a Super 301 citation. Even with a possible Super 301 case in the background, U.S. trade officials remained low-key about the dispute. Officials did not use the harsh, accusatory language that characterised the Japanese case. Public pronouncements of any kind were limited.

In a third set of meetings, American officials continued to request that tariffs for imported passenger cars be lowered from eight percent to 2.5 percent and tax policies that resulted in progressively higher taxes on larger engine sizes be revised.²⁹ Korean officials resisted attempts to discuss legal revisions to tariffs since these laws had to be approved by parliament first.

With another 301 citation pending, Korean officials also prepared to take riskier steps. As the deadline for the announcement of Super 301 approached, the Korean government suggested that, if Korea were placed on a Super 301 list, it would take the United States before the WTO (Maggs, 10/2/97). USTR Charlene Barshefsky identified South Korea's barriers to auto imports as a "priority foreign country practice" on 2 October 1997. "Korea was not prepared to undertake the reforms that are necessary for real opening of their auto market," she said, choosing to place only Korea on the list (Crutsinger, 10/2/97). USTR cited tariffs and taxes unfairly aimed at imports, costly auto standards and certification procedures, restrictions on auto financing and a "climate of bias" against imported vehicles. American

²⁹ The Big Three sold mostly large cars in Korea. U.S. manufacturers argued that smaller cars were not profitable to import. Korean officials said progressive taxes were necessary for energy savings, environmental protection, balanced taxation and an efficient use of roads.

officials expressed hope that bilateral negotiations would be successful under the 301 timeframe of one year.

The Korean government met to coordinate its position for future bilateral talks. The Korean position shifted quickly away from harsh public statements and officials repeatedly spoke of the need for compromise and rapid resolution of the dispute. The group agreed to not offer any additional concessions beyond those already on the table, but did pledge to streamline and improve the regulatory framework, to seek out other bilateral and multilateral partners, facilitate contact between foreign car importers and key government agencies, and organise a joint task force team.

The American side, likewise, spoke of hopes for a diplomatic solution to the dispute. Donald Phillips, Assistant USTR for Industry, told Korean officials during a trip to Seoul that, “we were in essence initiating for process and that its objective was to seek to resolve our differences in this way in a manner that would be to the advantage of both countries and to avoid any trade friction” (*Asia Pulse*, 10/17/97).

Korean Economic Crisis and Super 301

In the last months of 1997, South Korea’s economy was swept by the contagion of the economic crisis that first struck in Thailand. Seven of Korea’s *chaebol* (conglomerates) collapsed or went bankrupt by November. Banks admitted holding a minimum of \$52 billion in bad debts. Hyundai Motor promised at least 5,000 layoffs—a significant number for a country with “lifetime” employment guarantees (Clifford, 1997). Korea was forced to turn to the International Monetary Fund (IMF), the Asian Development Bank, the World Bank, the

European Union, the United States and Japanese governments for a \$55 billion bailout by early December. Some American industry leaders, including auto executives, argued that Korea should not receive U.S. taxpayer funds in the form of an IMF bailout if Korea was not willing to take the necessary steps to liberalise its markets (Zitner, 1997).

Although U.S. industries such as autos and steel were unsuccessful in attaching market opening conditions on the bailout financing, the scale of the economic crisis and falling value of the Korean won forced a restructuring of the Korean economy. Korean auto manufacturers began to consolidate and slashed their output. U.S. exports fell sharply, from 10,315 in 1996 to just 8,600 in 1997 (Abruzzese, 1998). From January-July 1998, Chrysler and Ford sold a combined 321 cars in South Korea.³⁰

With 301 sanctions looming over autos, South Korea and the U.S. struck a new deal intended to open the Korean market further to imports on October 21, 1998. Agreement was reached after a week of non-stop negotiations—in fact, the deadline for the imposition of sanctions was moved from 19 October to 21 October to allow more time to reach an agreement. If agreement were not forthcoming, the sanctions list would have included higher tariffs on Korean products exported to the United States. The new plan called for a reduction in tariff levels, decreased taxes, elimination of the government's influence over bank loans to South Korean auto manufacturers, steps to improve the public's perception of foreign autos, expanded foreign financing options and the inclusion of minivans and sport utility vehicles into the agreement (Wright, 1998).

³⁰ GM did not export vehicles to South Korea. In 1997, Chrysler and Ford sold 4,496 autos. Kenneth Cole, "Big 3, South Korea Settle Trade Issue," *The Detroit News*, October 22, 1998, p. B1.

U.S. government officials claimed that the agreement resolved the fundamental concerns, and terminated the 301 case. American manufacturers acknowledged, however, that the agreement was not likely to lead to significant U.S. sales, given the economic downturn in Korea. “Certainly, though, the potential is greater than 321 cars”, said Richard Fisher, the deputy U.S. official who headed the talks (Cole, 1998).

CONCLUSIONS

At the end of repeated rounds of negotiations with the Japanese and Koreans over automobiles, U.S. trade officials could point to three major agreements designed to increase market access for American firms. The U.S. and Japan had gone to the brink of a trade war in 1995 before signing an agreement as both sides adopted aggressively value claiming strategies, backed by the strongest domestic and international trade threats available. The U.S. also threatened Korea with Super 301 over autos in 1995 and 1997, although negotiations were actually conducted without the strong value claiming strategies that characterised the Japanese case.

Various interest groups had made compelling arguments to the Clinton Administration for vigorous action in autos and auto parts. Within this window, however, negotiators had significant latitude in determining the final course of bargaining. In the end, negotiators choose a value claiming strategy with Japan and something closer to value creating with Korea.

This choice is puzzling, since a hardline stance was equally appropriate in both cases—the support for such a strategy, backed by threats, was strong. As the case history indicates,

business leaders repeatedly urged Clinton to stand firm on demands for clear indicators in any final agreement. Since the Korean market for autos was even more closed than Japan's, it suggests that there should have been greater support among industry groups for aggressive actions by government negotiators. Nevertheless, with Korea, negotiators did not use the same strategy that characterised the Japanese discussions.

Japanese and South Korean negotiators faced similar constraints and opportunities from their own domestic constituents. For example, Japanese negotiators had to contend with a shifting internal structure in Japan over the period of the auto dispute. In 1993, the Liberal Democratic Party lost its stranglehold on the Japanese political system. Over the course of the auto and auto parts discussions, four different government configurations came and went in Japan. The Americans viewed this instability as both an opportunity (since the Japanese were less likely to present a united front) and as an unfortunate bit of timing that should be overlooked (Japan was unwilling to negotiate over these access issues even without political turmoil and the U.S. team was tired of waiting for the "right moment"). By the time the U.S. imposed sanctions, the head of Japan's Ministry of Trade and Industry (MITI), Ryutaro Hashimoto, was making a move for the Prime Ministership. A stance of toughness towards the Americans who were portrayed as bullies resonated well within Japan and allowed Hashimoto to separate himself from the field of candidates for office.

An explanation focused solely on shifting internal structures in the target state, however, is indeterminate. A similar problem might have foundered the second round of Korean negotiations. The United States opened a Section 301 case against Korea in October 1997. Within weeks, South Korea was caught up in the financial crisis that rocked many economies. The weakness of the Korean economy dramatically altered the economic landscape.

Negotiations to expand American exports were less urgent than before, given the strength of the U.S. dollar vis-à-vis the Korean won. Korean consumers were not going to purchase more American automobiles, even if the market were suddenly thrown completely open, since American cars were priced prohibitively high. It is at least possible to imagine, in this landscape, that the Korean government could have chosen to hold firm against American demands. After all, the government had a long history of exhorting its citizens to practice frugality and refrain from purchasing imported products. In a time of economic crisis, it would have been easy to revert to the same pattern.³¹ Instead of responding as the Japanese to changing domestic political conditions by holding firm against U.S. demands, the Korean government chose to accommodate U.S. demands for change.

In short, while an examination of factors at the domestic level in the U.S. and target states can reveal important information about the timing and intensity of the dispute, it does not explain why the United States was ultimately unable to enshrine their most cherished goals in an agreement with Japan or why the Koreans made substantial changes to accommodate American demands.

Domestic industry groups, I argue, provided the framing used by negotiators in each dispute. The United States began the dispute with Japan in 1993 with a position of moderate, but increasing, losses. Once U.S. officials announced their intention to include quantitative indicators in any final agreement in autos, Japan began to move into a position of losses as well. When modest changes in Japanese policy and practices failed to convince the

³¹ The United States charged that the Korean government did resort to an anti-import campaign as the economic situation deteriorated. The Koreans argued forcefully that the campaign was not run by or even sanctioned by the government, but was instead a private citizen response to economic hardship and a desire to support Korean businesses. The truth is probably somewhere in-between. The Korean government did not, however, take the same active steps to discourage imports it had taken in the past.

Americans to drop their demands for indicators, Japanese officials moved into stronger positions of loss. With both sides now facing ever stronger losses (the situation tomorrow would be worse than the situation today), both sides began using an aggressive value claiming strategy and taking increasingly risky steps to resolve the dispute. These risky approaches included threats of significant sanctions and counter-sanctions and plans to approach the new WTO over this high-stakes dispute. Caught in a prospect theory spiral, both sides were unable to compromise.

In the end, facing the most serious trade war ever between the two sides, trade officials patched together a weak agreement designed to satisfy the minimum requirements and drop the 301 case. The final agreement failed to enshrine meaningful quantitative indicators and included only modest market opening plans. As implemented, the agreement also failed to increase market penetration for American firms.

This outcome makes sense only with a focus on the role of losses in driving U.S. and Japanese negotiators to take increasingly aggressive approaches to bargaining. The tactics chosen by both sides led to greater losses and renewed desire to recoup losses through risky maneuvers. With negotiations in a rapidly escalating downward spiral, officials could either start a trade war or accept an agreement cloaked with vague promises of future behaviour. Officials chose the agreement over war.

The Korean negotiations, by contrast, never got caught up in a spiral of increasingly risky actions by both sides. Market penetration for American autos was tiny, but had always been miniscule. In addition, the Korean government had promised changes that could result in greater sales in the future. The United States, therefore, entered negotiations with only

modest losses. Changes demanded by the United States did not create a powerful sense of loss for Korea either. In this environment, with both sides facing losses close to the status quo, both sides selected bargaining strategies closer to value creating. Negotiations were largely held off the record. Both sides appeared flexible and willing to create a package of changes that more closely suited the requirements of each.

Even after the announcement of 301 actions in 1997, harsh public statements were limited to the first week. After that, Korean officials vowed to seek a diplomatic solution that would avoid the use of American sanctions. Of course, the collapse of the Korean economy played a critical role as well. The Korean government could hardly approach the United States for support with a huge bailout program while simultaneously acting aggressively over autos. But even in the absence of the crisis, it is likely that Korean negotiators would have refrained from using value claiming tactics. The changes requested by the United States would likely not have moved Korea into a position of strong losses.

Value claiming strategies backed by threats usually result in only temporary agreements. This situation characterises the U.S.-Japan negotiations from 1993-1995. In fact, the agreement did not hold: not only did American firms fail to increase market penetration after 1995, but the Big Three actually experienced fewer sales than at the outset. The United States could point to clear data in annual reviews illustrating the lack of progress in expanding foreign sales in autos and auto parts. Other parties in the reviews, the Europeans, Australians and Canadians, concurred. Yet the United States made only weak attempts to restart negotiations. Officials never renewed Section 301 trade threats and declined to move the dispute to the WTO.

Expected utility theorists would point to the same potential benefits from a breakthrough and argue that negotiations should continue until market access increased, even if the costs of pursuing the dispute continued to rise.³² For prospect theorists, negotiators should have been operating in a domain of losses—certainly by the end of the decade as the agreement was about to expire in 2000. The economic situation, represented in both declining U.S. sales and a rising proportion of the U.S. trade deficit tied up in autos, actually represented strong losses. In this environment, negotiators should be willing to take risky approaches.

In the Korean case, although market opening has been modest (at best), the agreements suggest the potential for broader liberalisation in the future. The complete economic collapse in Korea by 1998 makes it difficult to accurately judge the outcome of this case. If the economy had not gone into a tailspin, it is possible that the implementation of the agreement would have resulted in significantly increased market access. In this environment, and with the economy slowly recovering, U.S. industry and trade officials may have elected to wait and see before moving forward with a possible renewed round of negotiations. The most recent reports from USTR have been a bit more strident in discussing continued Korean barriers to trade.³³ It is likely that the issue will resurface in the near term.

Finally, a broader focus on negotiating strategies reveals an important question. If the longest lasting agreements reached with value creating strategies, why don't officials always use this approach? I believe that the answer to this question lies in the importance of losses. In an environment of loss, negotiators are predisposed to take risky approaches to resolve the

³² To a point, of course. But because the potential benefits from liberalization in Japan's auto market were substantial, officials could incur significant costs and still realize gains in the end.

³³ See the *National Trade Estimates of Foreign Trade Barriers*. This document, required by Congress, is published annually with input from 13 different U.S. government agencies about the types of market access barriers faced by American firms in specific states.

conflict. Value creating strategies do not contain risky tactics. Hence, when negotiators find themselves in a position of loss (a likely situation in most bilateral market access disputes), they are prepared to reach for value claiming strategies and tactics with greater risks. Such an approach had the potential for generating significant gains. Recall that the most risky tactics are those with all-or-nothing outcomes. If you “win” with a risky tactic, you can “win” overall and rapidly reset the status quo in your favour.

The nature of market access disputes drives policymakers to take exactly the opposite approach. Rather than operate under value creating strategies with limited threats, negotiators frequently are driven by perceptions of large and mounting losses to take harsh, value claiming strategies and issue public threats. This approach is likely to backfire, resulting in deadlock, temporary agreements that must be renegotiated at a later date, or cosmetic fixes that fail to properly address the root causes of the disagreement.

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