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JAPAN TRADE RELATIONS AND IDEAL FREE TRADE PARTNERS: WHY THE UNITED STATES SHOULD PURSUE ITS NEXT FREE TRADE AGREEMENT WITH JAPAN, NOT LATIN AMERICA

JAMES MICHAEL LAWRENCE II

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INTRODUCTION: RECENT TRENDS IN U.S. TRADE POLICY

Throughout the Cold War era the United States guided the international system. Only the former Soviet Union challenged its military superiority, and until the 1970s no state challenged its economic supremacy. However, the large problems of the 1970s — the energy crisis, the Vietnam War, the beginning of a pattern of negative trade accounts and budget deficits, the decline of the dollar,[1] the second en-

1. In 1973, the Bretton-Woods system of fixed exchange rates broke down. The

ergy crisis, the inflation crisis, and the Iran-hostage crisis — began to chip away at both the image and substance of its mightiness.[2] Although it is still the international system's most powerful actor, it is no longer a hegemon, and this reality greatly concerns and frustrates it.[3]

With the onset of the 1980s and the presidency of Ronald Reagan, the United States sought to reinvigorate itself. To counter the Soviet threat, it marshalled a military build-up.[4] To counter its relative economic decline, it borrowed heavily, turned toward protectionism, and began a bilateral and (increasingly) unilateral approach to trade relations with other states.[5]

Bretton-Woods agreement, established in 1944 as the basis of international finance, required its contracting parties to fix their exchange rates around a par value — 35 U.S. dollars equalled one ounce of gold. During the late 1960s and early 70s, however, U.S. economic policy became inconsistent with the goal of maintaining a fixed exchange rate at the predetermined par value. Consequently, the dollar became significantly overvalued — *i.e.*, the supply of dollars greatly exceeded the private demand for dollars. By 1973, the signatories to Bretton-Woods were unable to sustain the exchange market intervention necessary to prop-up the dollar and maintain the par value of their currencies. Thereafter, exchange rates were allowed to float freely. *See* Timothy J. Schmidt, *The Rise of U.S. Exports to East Asia and Latin America*, 79 ECONOMIC REVIEW 67, 68 (1994).

2. In general, one can attribute the relative U.S. economic decline as a consequence of imperial over-stretch. Also, the defense-oriented national policies of the Cold War (like the 1958 National Defense Act) encouraged the most able U.S. researchers, scientists, and technicians to produce military technology. In Japan, the emphasis on production mobilized its most able into industries producing for the civilian sector. *See* Martin E. Weinstein, *The Impact of Trade Problems on U.S.-Japan Security Cooperation*, in THOMAS D. MASON & ABDUL M. TURAY, U.S.-JAPAN TRADE FRICTION 88 (1991); *see also* PAUL KENNEDY, THE RISE AND FALL OF THE GREAT POWERS: ECONOMIC CHANGE AND MILITARY CONFLICT FROM 1500 TO 2000 (1987).

3. This deterioration is partly shown in the dollar's decline vis-à-vis the Japanese yen (and the German mark) during the last decade. In 1985, the dollar traded for approximately 250 yen. In the summer of 1995, it traded for less than 100, hitting an all time low of 79.85 during the week of 16 April 1995.

4. In the long-run, this build-up worsened U.S. competitiveness, for "the spendthrift[sic] policy of the Reagan Administration encouraged, if not caused, a sharp fall in household savings and an equally sharp rise in federal deficits, 'bankrupting' the national economy." CHAE-JIN LEE & HIDEO SATO, U.S.-JAPAN PARTNERSHIP IN CONFLICT MANAGEMENT: THE CASE OF KOREA at 148 (1993) (quoting DAVID CALLEO, THE BANKRUPTING OF AMERICA (1991)).

5. *See* ROGER BENJAMIN & LOREN YAGER, FAIRNESS: THE SCYLA AND CHARYBDIS OF U.S.-JAPAN RELATIONS (1993). The U.S. turn toward protectionism is a result of its relative decline in the world economy. This phenomenon parallels Britain's turn toward protectionism in the early twentieth century. Bhagwati has labeled such phenomena the "diminished giant syndrome." JAGDISH BHAGWATI, POLITICAL ECONOMY AND INTERNATIONAL ECONOMICS 48 (1991) [hereinafter BHAGWATI 1991A].

The U.S. shift away from concentrating on the multilateral negotiating process signaled its dissatisfaction with the General Agreement on Tariffs and Trade (GATT). This dissatisfaction, which persists today, stemmed from the belief that the GATT had failed to result in a level playing field.[6] It produced, many in the U.S. Congress complained, a system in which U.S. firms faced increasingly stronger foreign competitors domestically, while facing protected competitors abroad.

The U.S. frustration with the GATT regime found a target in Japan. Japan replaced the United States as the world's largest creditor nation; meanwhile, the United States rapidly became the world's largest debtor nation. Whereas the United States used to run current-account surplusses vis-à-vis the rest of the world, now it ran high and persistent current account deficits, and a significant portion of these deficits were with Japan.[7] Overall, the U.S. economy was in relative decline, while Japan's was ascending.[8] Consequently, much of the U.S. frustration with decline found a scapegoat in Japan's success. This remains the case today, despite agreement among most economists that U.S. deficits are due overwhelmingly to macroeconomic imbalances and that there is little trade policy can do to correct them.[9]

In recent years the United States has used aggressive unilateralism[10] to pressure Japan[11] (and others) on trade issues. The main tool of

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6. U.S. dissatisfaction also stemmed from a fundamental fact about the U.S. economy. Between 1950 and 1962, when U.S. hegemony was at a peak, the United States depended on trade for only 9% of GDP. During the period 1984-1992, it depended on trade for 20% of GDP. By comparison, most other industrial economies have had percentages above 40% since the 1960s. BENJAMIN & YAGER, *supra* note 5, at 99. These countries are used to such dependence; the United States is not.

7. A majority of the U.S. trade deficit with Japan stems from auto and auto part imports.

8. U.S. real growth rates declined from a high of 3.8% (with a corresponding growth rate of 3.3% in output per hour) in the 1950-1962 period to 2.2% (with a corresponding growth rate of 1.0% in output per hour) in the 1984 -1992 period. BENJAMIN & YAGER, *supra* note 5, at 99.

9. *See* PACIFIC DYNAMISM AND THE INTERNATIONAL ECONOMIC SYSTEM (C. Fred Bergsten & Marcus Noland eds., 1993); PAUL KRUGMAN, TRADE WITH JAPAN: HAS THE DOOR OPENED WIDER? (1991); Makoto Kuroda, *Strengthening Japan-U.S. Cooperation and the Concept of Japan-U.S. Free Trade Arrangements*, in FREE TRADE AREAS AND U.S. TRADE POLICY 121 (Jeffrey J. Schott, ed., 1989). There is little that can be done in the short-run about these imbalances — such as differences in savings and investment rates. Furthermore, some economists argue that these imbalances are bound to occur periodically and will eventually self-rectify.

10. Aggressive unilateralism has been defined as "any bilateral trade negotiation in which unilateral demands for liberalization are backed by threats of retaliation."

this approach has been the enhanced version of Section 301[12] of the 1974 Trade Act,[13] particularly as augmented by Super 301 which came into effect with the passage of the Omnibus Trade and Competitiveness Act of 1988.[14]

While pursuing aggressive unilateralism with states like Japan, U.S. trade policy focused on negotiating free trade agreements (FTAs). In April 1985, the United States established an FTA with Israel to eliminate all tariffs on bilateral trade within ten years.[15] Following this success the United States negotiated an FTA with Canada which took effect in 1989.[16] The conclusion of these two agreements signaled a reversal of past U.S. opposition to the agreements and further reflected

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THOMAS O. BAYARD & KIMBERLY A. ELLIOT, RECIPROCITY AND RETALIATION IN U.S. TRADE POLICY at 19 (1994). Bhagwati argues that unilateralism refers to three different issues: one, seeking unilateral trade concessions from others; two, refusing to submit to the same dispute resolution processes in determining one's trade rights that one uses against others; and three, defining unfair trade practices through unilateral specification rather than by treaties. BHAGWATI 1991A, *supra* note 5, at 51-52.

11. The use of pressure tactics (like Section 301) has been dominant in the U.S.-Japan relationship, so much so that the Japanese language created a new word for foreign pressure — gaiatsu. The term also reflects the realities of the Japanese political system. Japan's democracy is built on a painstakingly slow consensus building approach to change, and gaiatsu seems to be a necessary catalyst in its public decision-making. *See* Yoichi Funabashi, *Introduction* to JAPAN'S INTERNATIONAL AGENDA 1, 8 (Yoichi Funabashi ed., 1994).

12. Section 301 of the 1974 Trade Act focuses on the policies and practices of other countries. Since its creation the European Union has by far been its most frequent target, and agricultural disputes have dominated these cases. BAYARD & ELLIOT, *supra* note 10, at 26.

13. Some of the changes in U.S. trade policy discussed in this section can be traced back to the 1974 Trade Act itself.

14. Pub. L. No. 100-418, 102 Stat. 1107 (1988) (codified in scattered sections of 35 U.S.C.) Special 301, which focuses on intellectual property rights, accompanied Super 301. *Id.*

15. Although many view this FTA as a result of historic U.S. strategic interests in Israel, this FTA eliminated the discrimination against U.S. exports caused by preferences awarded to Western European nations under the 1975 European Community-Israel FTA, and the United States has not attempted to link this FTA to strategic foreign policy objectives like the European Union has. *See* Howard F. Rosen, *The U.S.-Israel Free Trade Agreement: How Well Is It Working and What Have We Learned?*, in FREE TRADE AREAS AND U.S. TRADE POLICY, *supra* note 9, at 97-119.

16. In the CUSFTA (negotiations began in May 1986) the parties contracted to eliminate all tariffs on bilateral trade within ten years. It also created innovations in dispute resolution and pioneered new approaches to liberalization in services and investment. *See* Jeffrey J. Schott, *More Free Trade Areas?*, in FREE TRADE AREAS AND U.S. TRADE POLICY 1, *supra* note 9, at 6.

its dissatisfaction with the GATT regime.[17]

The shift of U.S. trade policy toward FTAs accompanied the faltering Uruguay Round of GATT, the 1992 Single European Act and negotiation of the Maastricht Treaty creating the European Union, and the expectation of E.U. enlargement. In this context, the United States, upon invitation by Mexico, decided to pursue a U.S.-Mexico FTA.[18] After extensive debate in its cabinet, Canada opted to join the negotiations, and the three parties pursued the negotiation of the North American Free Trade Agreement (NAFTA).[19] Undoubtedly, the United States perceived the NAFTA as a counterweight to the tremendous market access bargaining power being assembled by the European Union.[20]

The notion of an FTA with all of Latin America accompanied the idea of a U.S.-Mexico FTA. Shortly after the announcement of FTA negotiations between the United States and Mexico, President Bush unveiled the Enterprise for the Americas Initiative (EAI).[21] This raised the prospect of a Western Hemispheric FTA (WHFTA), and it implicitly committed the United States to the negotiation of FTAs with Latin American countries.

In sum, aggressive unilateralism and FTAs, not multilateralism, are now the cornerstones of U.S. trade policy.[22] Although economic or-

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17. There have been two waves of FTA formation. During the first wave (1960s), the United States was largely antagonistic toward regional bloc formation. The only exception to this was the case of Western Europe. The United States viewed its regional moves as a positive step in the direction of European peace. However, during the second wave (1980s through present day) the United States has been the prime actor in FTA formation.

18. The decision to pursue an FTA was announced by Presidents Bush and Salinas on June 11, 1990. Mexico viewed an FTA as a way to place a "drop-lock" on its domestic reforms and attract foreign direct investment. It was definitely successful in doing the latter: Foreign direct investment in Mexico increased 50% between 1990 and 1991. Scott Stollman, A Regional Approach to Free Trade, paper presented at a seminar on international trade law at Florida State University, Tallahassee, Fla. (Apr. 18, 1995, on file with author).

19. 19 U.S.C.S. §§ 3301-3473 (Law. Co-op Supp. 1995).

20. *See* FREDERICK M. ABOTT, LAW & POLICY OF REGIONAL INTEGRATION: THE NAFTA AND WESTERN HEMISPHERIC INTEGRATION IN THE WORLD TRADE ORGANIZATION SYSTEM 129-37 (1995).

21. The EAI announcement, made 27 June 1990, relieved many Latin American officials' fear about trade diversion as a result of a Mexican-U.S. FTA. This may have been President Bush's intention. *Id.*

22. *See* Schott, *supra* note 16. Bhagwati agrees. He states that "[t]he evidence of a fundamental change in trade policy is the new interest in regional arrangements and the departure from the accepted way of 'doing business' under the [GATT] by asserting that demands can be made for unilateral trade concessions by others and enforced

thodoxy has long considered them second-best solutions, FTAs are not necessarily negative and neither is aggressive unilateralism.[23] However, these policies are negative if they are intended to institutionalize purely preferential treatment to the exclusion of third parties rather than to further global trade liberalization and global welfare maximization. Unfortunately, the purpose of U.S. trade policy appears to be the negative aspects of aggressive unilateralism and FTAs. The growing influence of the protectionist lobby in the United States and the Clinton Administration's emphasis on managed trade lend credence to this perception.[24] In a world where the salience of military power is declining and global power is measured more and more in economic terms, the United States seeks to halt its decline legislatively. To increase the competitiveness of U.S. industries, U.S. trade policy demands that Japan agree to fulfill sectoral market access targets while simultaneously seeking to blunt inexorable competition from East Asia[25] by gaining preferential access to Latin American markets through a WHFTA.

This study posits that pursuing a WHFTA and aggressive unilateralism with Japan are not the best trade policies for the United States (or the world trading system). The United States is wise to en-

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by threats of retaliation." BHAGWATI 1991A, *supra* note 5, at 35. However, to be sure, favor for the multilateral approach is still strong. The U.S. expenditure of effort on completing the Uruguay Round of GATT demonstrates that it remains a pillar of U.S. trade policy, albeit one accompanied by aggressive unilateralism and FTAs.

23. This study criticizes the U.S. purpose in using aggressive unilateralism. The views of critics like Bhagwati deserve mention. Bhagwati argues that "[e]ven if one makes the implausible assumption that Section 301 will be used only for 'altruistic' reasons . . ., the notion that the United States should serve as a benign dictator, laying down its own definition of a desirable trading regime instead of making . . progress by persuasion and mutual concession, is hard to accept." JAGDISH BHAGWATI, THE WORLD TRADING SYSTEM AT RISK at 56 (1991) [hereinafter BHAGWATI 1991B]. Bhagwati makes a strong case. Although the argument that aggressive unilateralism can be used positively is valid in theory, in reality the United States has not often used aggressive unilateralism in such a manner. The reasons are clear. Opening markets for all countries is unlikely to satisfy those domestic groups which demand action in the first place; their objective is not to open markets in general, but to secure market access for themselves, and they judge market access by their degree of success in those markets. *Id.* at 52-56. Thus, the U.S. argument that its pressure only aims to get "a foot in the door" through which all states can access Japan's markets is not persuasive.

24. *See* BENJAMIN & YAGER, *supra* note 5, at 38; PATRICK LOW, TRADING FREE: THE GATT AND U.S. TRADE POLICY (1993); B. Mulroney, Trade Outlook: Globalization or Regionalization (15 Oct. 1989) (published lecture on file with The Institute for Southeast Asian Studies, Singapore).

25. For the purposes of this article, East Asia includes Japan, China, North and South Korea, Taiwan, Hong Kong, Singapore, the Philippines, Indonesia, Malaysia, Vietnam, Laos, Thailand, Cambodia, and Brunei.

courage Latin American regional cooperation and improvement, but Latin America as a whole does not fit the criteria of an ideal free trade partner and few Latin American countries have liberalized sufficiently to expect that a WHFTA will be long-lasting. The potential benefit to the Unites States of a WHFTA, therefore, is questionable. Since forming a WHFTA encourages the digression of the world trade order into one of competing blocs, it is unwise for the United States to focus its policy in this direction.

The United States should focus its efforts to build an institutionalized and cooperative relationship with Japan, its most important trade partner and a state vital to U.S. efforts to maintain a stable security environment in East Asia. Japan fits the criteria of an ideal free trade partner very well. Rather than engaging in quarrelsome debates over market access targets and threatening to impose Section 301 sanctions, a threat which, by its mere assertion, further deteriorates U.S.-Japan relations and revives images of the ugly American, the United States ought to pursue building a cooperative framework with Japan through an FTA. Such an agreement would fundamentally alter U.S.-Japan relations by institutionalizing the means for the two countries to cooperate and lead the world in economic policy matters. It would fill the trust gap and, by doing so, make easier the task of establishing a more vibrant security alliance. Also, whereas U.S. influence over Japan is currently declining, a Japan-United States FTA (JUSFTA) would enshrine its influence, providing the United States a far greater amount of leverage with Japan in the future than it would otherwise possess.

The sections below add to the rationale and substance of the arguments above. Section one begins by introducing the reader to the economics of FTAs and the reasons behind their implementation; it also discusses the prospects for the current regionalism to be open and the issue of trade diversion. From there section two develops a two-tier free trade partner model, with the first tier focused on trade indicators and the second tier on readiness factors — including states' level of democracy.

Section three quantitatively and qualitatively demonstrates that Japan, but not Latin America, fits the ideal free trade partner model. This finding indicates that hemispheric free trade would not be the panacean windfall U.S. trade policy makers may desire it to be. It also strongly suggests that the dynamic trade creation benefits of pursuing true liberalization in the U.S.-Japan trade relationship would be quite large given the two economies' existing levels of interdependence, competitiveness, and wealth. For this reason the study argues that, rather than expend its limited resources on a small-gain game such as a WHFTA, the United States should focus its cooperative efforts foremost toward Japan. In support of this position the study holds that non-traditional access barriers are both the explanation as to why the United States and Japan do not already have an FTA and the reason their relationship needs one.

Section 4 then critiques some of the problems with the current U.S. trade policy toward Japan and explains why, rather than pursuing managed trade deals and threatening Section 301 sanctions, the negotiation of a Japan-United States Free Trade Agreement (JUSFTA) would be a better approach to mitigating U.S.-Japan trade tensions. An in-depth discussion of the 1995 U.S.-Japan auto and auto parts dispute helps illustrate the correctness of this argument.

Finally, section five proposes the JUSFTA framework. It discusses possible Japanese and U.S. motivation in JUSFTA negotiations, pinpoints likely JUSFTA objectives, and recommends the key JUSFTA components needed to achieve those objections: One, a consultative mechanism with two necessary sub-components — Structural Impediment Talks aimed at encouraging the amelioration of external imbalances and Working Groups aimed at harmonization of regulatory and industry standards; two, a dispute resolution mechanism that is self-executing (thus allowing private parties, not just the two governments, to bring suit), speedy (capable of rendering decisions within one year), and pro-active (authorized to appoint new working groups to iron out problems which the originally-negotiated JUSFTA rules do not address); and three, a G2 for increased macroeconomic policy coordination.

The article concludes that, even though its pursuit would be immense in terms of time, effort, and difficulty, the JUSFTA would necessitate cooperation, better resolve trade disputes, and encourage true long-term liberalization and trust in the U.S.-Japan relationship. In addition to de-politicizing trade disputes which are bound to occur between such competitive trade partners, it would bring much welcomed relief to the security side of the alliance. It would begin realizing the once much talked about "global partnership" between the two countries, and, having established the means of cooperation in its most vital trade relationship, it would provide the platform from which the United States could launch a new round of multilateral GATT trade negotiations aimed at harmonization of standards and competition policies, as well as furthering progress on trade in services and intellectual property rights. Overall, a JUSFTA would be a giant leap toward establishing free trade throughout the world, and it would burnish the tarnished image of U.S. leadership in international economic affairs.

Section 1: Free Trade Agreements, Regionalism, and Trade Creation/Trade Diversion

Scholars currently debate the idea of free trade agreements with vigor. Among economists a key issue is that most FTAs appear to be regionally focused, implying that they are closed to non-regional states. This selective approach to trade liberalization is commonly referred to as regionalism. To be sure, the strength of any trend toward regionalism and its possible effects on the world trading system are major questions still largely unanswered, but there has been great concern that trade is unnecessarily becoming regionalized at the expense of global welfare. In other words, there is concern that trade is being diverted from efficient producers to less efficient producers due to the preferential treatment which FTA members grant each other. Some of the factors that lead to these concerns over trade diversion and regionalism are discussed below. First, however, this section clarifies more precisely the substance of FTAs.

1.1 FTAs

FTAs are a way to help manage and establish bilateral, minilateral, or multilateral trade relations. They can be an effective and expeditious means of achieving trade liberalization between trading partners. Primarily they eliminate border barriers to trade between countries — *e.g.*, quotas and tariffs. They are not customs unions, however, for each member maintains its own tariff policies when trading with non-members.

FTA members receive preferential treatment.[26] To ensure protection of these preferences, FTAs erect rules of origin which prevent third parties from shipping through a lower-tariff member to a higher-tariff member. Thus, GATT's fundamental principal of most favored nation (MFN) treatment does not apply to the concessions FTA members grant each other.[27] FTAs are nevertheless GATT compatible if they meet the requirements of Article XXIV, namely, the liberalization of substantially allbarriers affecting trade in goods between member countries.[28]

FTAs can be open to third party accession. However, since new members "dilute the value of preferences received by existing FTA

26. When market access comes at the expense of non-members it is called trade diversion (*see* section 1.3).

27. Article XXIV of the GATT gives FTAs exemption from the MFN treatment requirement.

28. Schott, *supra* note 16, at 15.

members, there are few examples of open-ended FTAs."[29] Indeed, any FTA involving the United States is difficult to open, for the 1988 Trade Act prohibits the accession of any third party to a U.S. FTA without new congressional approval.[30]

1.1.1 Non-Traditional FTAs

FTAs can be a wide variety of arrangements geared toward improving trade relations. They do not necessarily have to involve the liberalization of substantially all barriers to trade. The agenda in negotiating an FTA can be targeted to specific issues in a trade relationship; in other words, an FTA can be tailor-made. As such, some non-traditional FTAs might have only selective liberalization and therefore might lie outside of GATT.[31] Such selective liberalization agreements might be product- or sector-specific; however, they can be used as building blocks to larger agreements.

Even though some non-traditional FTAs might lie outside of GATT, they might be conducive to a global free trade system. FTAs are as much about rules, procedures and governance as they are about trade barriers, and non-traditional FTAs can emphasize these aspects.[32] For instance, they can establish special administrative bodies capable of facilitating the parties' relationship, or they may establish significant

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29. *Id.* This suggests a problem for the pursuit of a WHFTA. It is in the Latin American countries' collective interest to pursue NAFTA accession simultaneously, for then their collective size would force the NAFTA members to concede more preferences than they would if countries negotiated on an individual basis. Acquiring such bargaining strength, however, requires that the Latin American countries integrate among themselves first — or at the least come to an agreement over what concessions they want from the NAFTA members. They could best do this through integrating their existing regional agreements. They show few signs of doing this, however, and the NAFTA members are moving in the direction of single country accession. Since NAFTA has already invited Chile to join, it appears that the Latin American countries will have to accede individually or through their existing regional blocks. If this turns out to be the case, one can imagine that as more and more countries accede to NAFTA, more and more of the Latin American NAFTA members will become opposed to new applicants. Again, they do not want to further dilute the preferences they have received — *i.e.*, preferential access to the NAFTA market — and they do not wish to dilute any of the new foreign direct investment which NAFTA membership has brought them.

30. *Id.*

31. Such FTAs, to comply with GATT, would need to obtain a waiver under Article XXV:5. The United States did this for the U.S.-Canada Auto Pact. *Id.* at 14.

32. Beth V. Yarbrough & Robert M. Yarbrough, *Regionalism and Layered Governance: The Choice of Trade Institutions*, 48 JOURNAL OF INTERNATIONAL AFFAIRS 95, 114 (1994).

consultative and dispute resolution mechanisms between the parties.[33]

1.2 Regionalism

Most FTAs formed today are regionally focused. Although the Israel-U.S. FTA is a notable exception, the fact of regional FTAs has caused observers to fear that the world trading system is degenerating into three regional trading blocks anchored by the United States, Germany, and Japan. This fear stems from the possibility of regional FTAs intensifying and proliferating — the so-called domino effect.

The fear of a domino effect in regionalism may be somewhat overstated. East Asia, including Japan, is committed to multilateralism. Its unprecedented growth in the post-World War II system has been trade-based. It wishes to consolidate GATT, not usurp it, for it has been the greatest beneficiary of the GATT system.[34]

On the other hand, the fear of a domino effect in regionalism may be justifiable. "A danger with regionalism is that, depending on its formulation and implementation, it can serve as a self-fulfilling prophecy: [A] . . . bloc which is conceived as a defense [or insurance] against the fragmentation of the world economy is likely to contribute to such fragmentation."[35] Thus, there is a danger in the U.S. proposal to form a WHFTA.

The possibility of a WHFTA has worried the rest of the world, especially East Asia, the world's fastest growing region. Although East Asia must realize that NAFTA's current form is not seriously threatening (since Mexico and Canada traded heavily with the United States prior to NAFTA), Malaysia was sufficiently concerned with the enlargement of NAFTA on a solely geographical basis to propse an East Asian Economic Group (EAEG). The EAEG idea — rejected initially but still alive[36] — shows a real danger in a WHFTA. It encourages a

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33. *Id.* at 11. A consultative framework agreement involves creating guidelines and rules which establish the proper environment in which to conduct negotiations and consultations. A dispute resolution agreement regulates how partners should solve disputes and may entail binational panels which issue binding judgments on cases brought before them. *Id.* at 14.

34. *See* Soogil Young, *East Asia as a Regional Force for Globalism*, in REGIONAL INTEGRATION AND THE GLOBAL TRADING SYSTEM 126 (Kym Anderson & Richard Blackhurst eds., 1993).

35. *Id.* at 127.

36. At least one expert believes that "in nongovernmental circles, including in Japan, the idea remains alive, and there appears to be a growing number of proponents." Hadi Soesastro, *Implications of the Post-Cold War Politico-Security Environment for the Pacific Economy*, in PACIFIC DYNAMISM AND THE INTERNATIONAL ECONOMIC SYSTEM 365, *supra* note 9, at 379.

narrow, geographically defined Asian regionalism[37] which is wholly against U.S. interests considering the fact that East Asia is the fastest growing and largest U.S. regional trade partner.[38] Although East Asia might not desire a regional bloc, the question of how best to function in a world trade system increasingly driven by two large and expanding blocs — *i.e.*, the European Union plus the NAFTA (or a WHFTA) — might necessitate a regional answer.

Domino effect or not, regionalism is not necessarily bad for the world economy. A regional approach to trade might allow a greater degree of harmonization of standards among states than is readily achieved through the multilateral process. The reason is clear: There are fewer parties to the negotiating process. Membership in GATT has grown from the original 23 states to 120 today. Indeed, the intensive and difficult task of negotiating the Uruguay Round of GATT compares negatively to the more easily achieved NAFTA. This experience causes some game-theorists to speculate that "if one envisions a two-step process, then the bloc approach might well be the best strategy for liberalizing global trade."[39] In other words, if regionalism proceeded upon current paths, then three blocs would emerge, and then these three blocs, as compared to 120 countries, could negotiate to reach global free trade. This might be a quicker process than multilateralism.

A second scenario is also possible. An important fact to remember is that the Uruguay Round of GATT reduced tariff barriers from approximately 6.3% to 3.9%.[40] Hence the agenda in future trade negotiations will include less discussion about tariffs and more about non-tariff barriers (like the particularly difficult issue of harmonization of national standards). Although these issues might be more readily

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37. Despite the inherent leadership problems for East Asia in forming such a collective bloc without the United States, it is best for U.S. actions to discourage rather than encourage such ideas.

38. East Asia is the United States' most vibrant and promising trading partner, and East Asian wealth is growing far faster than Latin America's or any of the industrialized nations. Throughout the rest of the 1990s East Asia is expected to grow 7.6% annually — a rate 2.5 times the expected growth rates of the OECD states and well beyond what anyone predicts for Latin America. Schmidt, *supra* note 1, at 74; *see also* GARY C. HUFBAUER & JEFFREY J. SCHOTT, WESTERN HEMISPHERIC ECONOMIC INTEGRATION (1994). The late Commerce Secretary Ron Brown remarked that "these [East Asian] nations are the fastest growing markets for U.S. goods, and if we are to expand the share of world markets claimed by [U.S.] companies and workers, it will occur in these countries." *Quoted in* Schmidt, *supra*, note 1, at 74.

39. Heemin S. Kim & Dale L. Smith, Blocs or Rounds? A Formal Analysis of Two Competing Approaches to Trade Liberalization at i (1994) (unpublished manuscript on file with author).

40. *Id.*

solved through regionalism due to cultural familiarities among the actors within a region, there is the distinct possibility that the new blocs will develop unbridgeable trade philosophies and laws. Thus, while the world's standards are currently converging due to the multilateral process, a regional focus might cause them to diverge and create three equally powerful and perhaps uncompromising blocs.[41] Also, if three blocs were to emerge, it is more likely that instead of negotiating to achieve global free trade, they would accept free but managed trade between the blocs.

A key question concerning regionalism, then, is whether or not it is open. Open regionalism means that the FTA is open to any state, anywhere, which is willing to live by the FTA's rules.[42] Closed regionalism means that the FTA is only open to those states which lie in the defined region. An important determinate of the type of regionalism may be the motivation behind the FTA formation — *e.g.*, whether the reasons behind it are more defensive, offensive, or integrationist in composition; whether it is formed to allow industries to function as international cartels; or whether it is formed to allow countries with similar trade preferences to exert monopsony power over the rest of the world.

Two arguments — labeled here as the "coercion" and "insurance" hypotheses — about the motivation behind today's regionalism imply that it is closed.[43] The thesis of the "coercion" hypothesis is that the

41. There may be yet another danger in regionalism:

> The worse the behavior of the [European Union] and the [United States] in the context of the multilateral system, the more probable will appear the collapse of that system, and the more valuable will be the association [of small countries] with the [European Union] or the [United States]. Either [the European Union or the United States], therefore, by threatening the multilateral system, may generate signals that it can interpret as applause for itself and its policies. It is far from evident that [such a] position is stable.

Brian Hindley & Patrick A. Messerlin, *Guarantees of Market Access and Regionalism*, in REGIONAL INTEGRATION AND THE GLOBAL TRADING SYSTEM 358, *supra* note 34, at 382 (1993). In other words, regionalism may be a vicious cycle spiraling the international system into one of three antagonistic powers with smaller countries forced to line up behind one of the three. Such a system may be unstable; most system theorists agree that the most unstable international system is one led by three powerful and competing actors.

42. In other words, states like the United States and Japan could be a part of both an East Asian-dominated FTA and a Latin American-dominated FTA. So could Chile, or the Czech Republic, South Africa, and India.

43. A third argument about why countries are currently pursuing FTAs can be labeled as the drop-lock hypothesis. It argues that countries wish to secure their domestic policy reforms by committing to those reforms in international agreements like FTAs. This was partly the case for Mexico, but it is far from clear that this is the case

large countries wish to use regional FTAs to enhance their bargaining power in bilateral or multilateral trade negotiations and force reluctant trade partners to make extra concessions. The thesis of the "insurance" hypothesis is that small countries desire insurance against future large country protectionism;[44] they want to maintain their market access.[45] Small countries also desire insurance to safeguard against the possibility of a global trade war.[46] Meanwhile, large countries desire insurance against competition. They want to secure dominance in the small country market by gaining market access beyond what GATT provides and what other large countries are afforded. If the coercion and insurance hypotheses are correct, then today's regionalism is not geared toward openness.

Both the coercion and insurance hypotheses describe at least part of the motivation of the United States and of Latin America in pursuing a WHFTA. First, the United States, seeking to blunt fierce manufacturing competition from East Asia (particularly Hong Kong, South Korea, Singapore, Taiwan and Japan), desires to ensure preferential access to Latin American markets through a WHFTA. A WHFTA will allow U.S. manufacturers to take better advantage of Latin American factor endowments — land and unskilled labor — than its Asian competitors. Also, a WHFTA will provide the U.S. an edge in selling to Latin America goods from industries in which East Asia and the United States compete head on — electronics, mechanical machinery, high-technology goods, and financial services. Whereas Latin American countries currently are heavily involved with Japan as well as the United States, after a WHFTA they will tend to deal more exclusively with the U.S. Second, a WHFTA will create a bloc countering the

for countries like Chile, where already implemented reforms have the support of the citizenry. *See*, REGIONAL INTEGRATION AND THE GLOBAL TRADING SYSTEM, *supra* note 34.

44. A large country for a particular good is any country that can affect the world price for that good through a change in production or trade barriers. The United States is almost always a large country, but countries like South Korea and Singapore are also large countries for certain goods.

45. About small countries seeking insurance with the United States, Schott writes: "This is clearly a response to the perceived growth in 'process protectionism' in the United States, abetted by their strong trade dependence . . . The interest of candidate countries lie in attaining an exemption from, or discriminatory preferences pursuant to, the application of U.S. trade laws." Schott, *supra* note 16, at 29.

46. *See* CARLO PERRONI & JOHN WHALLEY, THE NEW REGIONALISM: TRADE LIBERALIZATION OR INSURANCE? (National Bureau of Economic Research Working Paper Series No. 4626, 1994).

E.U. in new rounds of multilateral negotiations.[47] In circumstances where the Americas and the E.U. are in agreement, they will effectively force others — *i.e.*, East Asia — to acquiesce to their wishes.

For Latin America, a WHFTA provides insurance against new U.S. calls for protectionism against developing economies. More importantly for Latin America, however, a WHFTA will bring newfound economic wealth. The first source of this new wealth will be foreign direct investment (FDI).[48] A WHFTA will legitimize Latin America's economic policy reforms and foster a perception of stability, both of which are necessary to increase its access to FDI. Just as important, a WHFTA will provide Latin America permanent and preferential access to the NAFTA markets, the most important of which is the U.S. market. This will encourage multinationals with needs like low-wage labor and less regulation — especially safety and environmental regulations — either to relocate to Latin America or to create new factories there so that they may enjoy these advantages coupled with cheaper access to the U.S. market.

In the area of trade, Latin American industries from which the United States already buys — in other words, industries in which Latin America has a comparative advantage, *e.g.*, coffee, fruit, iron ore, and petroleum — will continue such exports, but after the formation of a WHFTA, because of the preferential treatment Latin America gives NAFTA members, the United States might begin to buy more from industries it would otherwise not — in other words, industries in which Latin America does not have a comparative advantage. Also, in industries — like the textile and apparel industry — where Latin America is competitive with others — *e.g.*, East Asia — the United States would likely begin to buy more from Latin America. Like the increase in FDI, this new trade would be a boon to Latin America, but would come at the expense of other economies. This overall effect is called trade diversion.

1.3 Trade Creation/Trade Diversion

FTAs represent "both a policy of protection (against non-mem-

47. However, the fact that NAFTA does not have a common external tariff (and therefore a WHFTA may also lack the coordinated central institutions for speaking with one voice in trade) weakens NAFTA as a coercive tool.

48. FDI provides the capital through which a country can expand its manufacturing base and import technology and human capital. This has been critical in the development of East Asian states like Singapore and Malaysia.

bers) and a move toward free trade (with members)."[49] As such, when an FTA is formed there are two conflicting effects. Jacob Viner labeled these contradictory pressures as trade diversion and trade creation in his 1950 classic, *The Customs Union Issue*. Trade diversion occurs when an FTA, because of the preferential treatment given to members, causes low-cost imports from a non-member to be replaced by higher-cost imports from a member.

Thus, "a trade-diverting FTA expands trade between partners at the expense of trade between the union and the rest of the world."[50] By contrast, "a trade-creating FTA does not reduce trade between the union and the rest of the world, and it expands trade between partners."[51] This distinction allows an analysis of the efficacy of an FTA for the maximization of the global economic welfare.[52] A trade-diverting FTA worsens the world's allocation of resources by shifting production away from comparative advantage. It also reduces the welfare of non-members because their resources are used less efficiently than before trade was diverted. Likewise, a trade-creating FTA improves the world's allocation of resources.

However, this is a simplification of the effects of an FTA. This framework focuses only on the static effects of an FTA, and it is widely held that the dynamic effects are potentially much greater for trade creation.[53] Dynamic effects may lead to improved efficiency even if the static effects are predominantly trade diverting. One such dynamic ef-

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49. BETH YARBROUGH & ROBERT M. YARBROUGH, THE WORLD ECONOMY: TRADE AND FINANCE 427 (1994).

50. JAIME DE MELO & ARVIND PANAGARIYA, THE NEW REGIONALISM IN TRADE POLICY 3 (World Bank, 1992).

51. *Id.*

52. Srinivasan and his co-authors, however, suggest that trade creation and trade diversion are "inappropriate for measuring the welfare effects of [an FTA]". They point out that the drop in prices of goods for the importing country may offset any losses in tariff revenue. This implies that from the point of view of individual countries, "the induced changes in the pattern of trade are not reliable predictors of the welfare consequences of [an FTA]." T. N. Srinivasan *et al.*, *Measuring the Effects of Regionalism on Trade and Welfare*, in REGIONAL INTEGRATION AND THE GLOBAL TRADING SYSTEM, *supra* note 34, at 55. Even if this were the case, the concern over trade creation and trade diversion is a global one. It is a concern over what happens to world welfare, not just domestic welfare. And this concern over world welfare is a legal concern, pursuant to Article XXIV of the GATT.

53. According to Yarbrough & Yarbrough, the analysis of static effects "focuses on a single time period and on the reallocation of resources caused by elimination of barriers to intra-group trade." *See* YARBROUGH & YARBROUGH, *supra* note 49, at 429. The analysis of dynamic effects focuses on how this removal of trade barriers causes member economies to evolve over time.

fect is the creation of economies of scale. Economies of scale are a key reason for establishing FTAs, and the larger the trade partners are, the larger the possibility that economies of scale will result. (Some other dynamic effects include increased competition and stimulus to investment.)[54]

This discussion begs a few questions: Why does trade creation and trade diversion matter for a potential FTA member? Should a country like the United States even be concerned about whether or not an FTA it pursues creates more trade than it diverts? After all, as long as it creates more trade for the United States, is it not necessarily in the U.S.'s interests?

First, all GATT members contemplating an FTA should be concerned about trade diversion — in other words, the possible welfare effect on the rest of the world. One, their commitment to the fundamental GATT principal that all GATT members are granted MFN should give them pause in pursuing an FTA, which by its creation grants members preferential treatment. Two, they should have concern because a trade-diverting FTA may taint the trade atmosphere for further multilateral cooperation and perhaps undermine the GATT. Nonmembers, fearing the negative consequences of the FTA, might seek to join or create a competing FTA, making the expansion and proliferation of FTAs more likely.

Even if a country cares not what effect its participation in an FTA will have on the world trading system, it should nonetheless care about potential trade diversion. Not all FTAs are in a country's interests.[55] Why?

It is possible that by forming an FTA a country will lose more welfare than it will gain. Such a welfare loss might ensue if the country integrated with inefficient producers — *i.e.*, high-cost producers. If integration resulted in trade diversion (*i.e.*, imports from low-cost producers being replaced, due to the preferential treatment FTA members grant one other, by imports from higher-cost producers), then it is pos-

54. *See* CHARLES P. KINDLEBERGER, INTERNATIONAL ECONOMICS (1968). In regards to the dynamic effects, there is a general bias that an FTA will be trade creating, for, as Meade noted, "it represents a reduction in trade barriers which will lead in all cases to some primary expansion of trade, and on this expansion of trade there will almost always be some important gain." JAMES E. MEADE, THE THEORY OF CUSTOMS UNION 107 (1955). This general bias cannot be adopted for the static effects of an FTA, however, and in general, one may start with a predisposition that an FTA will almost always result in some static trade diversion. *See* Michael G. Plummer & Pearl I. Iboshi, *Economic Implications of NAFTA for ASEAN Members*, 11 ASEAN ECONOMIC BULLETIN 158-75 (1994).

55. *See generally* Schott, *supra* note 16.

sible that the country's loss in tariff revenue could outweigh its gains through free trade. Although some of its tariff revenue would be transferred to consumers in the form of lower prices, some of it would become a deadweight loss, for it will no longer collect any tariff revenue from the low-cost producer. This ambiguity can be avoided by integrating with the low-cost producer. In such a case, all of the previous tariff revenue would be transferred to consumers in the form of lower prices; there would be no deadweight loss. Thus, the net effect would be absolute trade creation.

Section 2: An Ideal Free Trade Partner Model

The last section observed that the most important issue in regionalism and FTA formation is whether overall world trade will become more or less liberal as a consequence. It noted that this involves determining the extent of trade creation and trade diversion caused by the FTA and that the extent of trade creation and trade diversion is important not only for the world's welfare and the continuance of an open world trade system, but also for the welfare of the integrating country. It explained that one of the best ways to minimize trade diversion and to maximize trade creation is for the country to integrate with low-cost producers. These low-cost producers are its most ideal free trade partners.

However, there is more to an ideal free trade partner than being a low-cost producer. Suppose that a country creates an FTA in the sector of fresh fish with the low-cost producer of fresh fish, but that fresh fish constitutes an insignificant portion of the country's overall imports; then the FTA in fresh fish would be essentially meaningless to the integrating countries. What other factors, then, are important? In other words, what factors, if present in a potential free trade partner, will lead to the least trade diversion and the most trade creation?

The analysis below outlines an ideal free trade partner model which helps answer these questions. The primary tier of this model outlines those ideal trade characteristics of a potential partner which favor trade creation over trade diversion. However, it should be noted that this is a static model which can generally indicate if an FTA will lead to static trade creation but can only imply what the dynamic effects of an FTA might be. The second tier of this model focuses on how ready a potential partner is to enter an FTA. It examines macroeconomic, social, and political factors which favor the success of an FTA in the long run. These factors, however, do not indicate what the trade effects of an FTA might be; they indicate readiness. This ideal free trade partner model, then, should be used in the following manner: First, the primary tier should be used to examine potential partners' trade characteristics; second, if and only if a country fits the trade criteria for an ideal free trade partner, then the second tier should be used to indicate the potential partner's readiness. In the next section, this methodology will be used to examine to what extent Latin America and Japan are ideal free trade partners for the United States.

2.1 The First Tier

Determining ex ante the static, not to mention the dynamic, effects of an FTA in a Viner-type analysis is empirically quite difficult. There is an alternative way to estimate the trade diverting potential of an FTA, however, which is not as empirically cumbersome yet indicates the general desirability of a trade partner for an FTA. As mentioned above, this method involves examining some of the potential partner's trade characteristics. Again, however, these characteristics only imply what the dynamic effects of an FTA might be.

2.1.1 Trade Characteristics

Upon examining the literature, one finds some degree of agreement over the desirable characteristics in a potential free trade partner which minimize the trade diverting potential of an FTA.[56] The sum of the agreement is the following:

Trade creation is likely:

- If the countries negotiating the FTA are already significant trading partners.[57] In such a situation, an FTA will only reinforce the potential partner's existing relationship and pattern of comparative advantage. The experience of the European Community is illustrative in this regard. A prime reason for the greater success of the European Community than the European Free Trade Association is the greater amount of pre-union trade that existed between European Community members.[58]

- If each partner is the "principal supplier to the other of the products which it exports to the other and if each is the principal mar-

56. *See* ALI M. EL-AGRAA, INTERNATIONAL ECONOMIC INTEGRATION (1982); MIROSLAV JOVANOVIC, INTERNATIONAL ECONOMIC INTEGRATION (1992); MEADE, *supra* note 54; DOMINICK SALVATORE, INTERNATIONAL ECONOMICS (4th Ed. 1993); JACOB VINER, THE CUSTOMS UNION ISSUE (1950).

57. SALVATORE, *supra* note 56, at 233-45; MEADE, *supra* note 54, at 107.

58. SALVATORE, *supra* note 56, at 233-45.

ket for the other of the products which it imports from the other."[59] This indicates that the potential partners are the lowest-cost producers of the goods which they import from each other. As discussed in section 1, forming an FTA with the low-cost producer favors trade creation.

- If the partners' economies are actually competitive or similar rather than complimentary or dissimilar.[60] Under these circumstances members will continue to import external goods in which no member has a comparative advantage. These conditions also indicate that there are greater possibilities for specialization in production. Consider two countries, both with a comparative advantage in autos and auto parts, but with one especially suited to produce automobiles and the other especially able to manufacture auto parts. The auto parts producer has by protection manufactured some high-cost autos, while the automobile manufacturer has by protection produced some high-cost auto parts. Under such conditions, both countries are producing autos and auto parts. After forming an FTA, and thus eliminating barriers, one will eventually concentrate more fully on creating autos and the other will concentrate on auto parts.

- If the partners' combined proportion of the world's wealth is great.[61] This will both improve the likelihood of economies of scale and increase the scope for dynamic trade expansion within the area. In the extreme, an FTA between all of the world could not result in any trade diversion. It follows, then, that the greater the degree of the world's production, consumption, and trade — *i.e.*, the greater degree of the world's wealth — the less likely is trade diversion.

These four trade characteristics favor trade creation over trade diversion. Each could also indicate the FTA's potential for dynamic trade creation, although the third and fourth characteristics are perhaps the

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59. MEADE, *supra* note 54, at 108-09; *see also* SALVATORE, *supra* note 56, at 233-45.

60. *Id.*

61. *Id. See also* HUFBAUER & SCHOTT, *supra* note 38. Trade creation is also likely if the pre-FTA trade barriers between partners are significant; if after the FTA is formed the average level of external tariffs of members is low; and if the parties' trade consists of goods with high supply and demand elasticities. *See* note 55. Because of the difficulty of obtaining information, these other characteristics are not examined.

more important indicators of this potential. The first and second characteristics suggest that the potential partners are good export platforms to one another, and, since an FTA would only improve this, they suggest that the FTA might attract FDI. However, hey are not strong indicators of the important FDI dynamic effect. The third characteristic implies that competition will increase. Firms will compete based on their comparitive advantages, on macroeconomic factors such as savings and investment rates, and on their ability to innovate; they will not compete on the basis of how much protection their government affords them. The fourth characteristic implies that economies of scale, which are usually hindered by trade barriers, are more likely to result from the enlarged market — thus greater dynamic effects will result.

Overall, it is important to remember that these assertions are generalizations. There may undoubtedly be conceivable circumstances in which each one of the characteristics may not prove to be universally valid. Still, these characteristics are suggestive of the possible welfare effects of an FTA, and they will be employed in the next section to analyze Latin America and Japan as potential free trade partners for the United States.

2.2 The Second Tier

As mentioned above, the second tier of this model focuses on how ready a potential partner is to enter an FTA. It examines macroeconomic, social, and political factors which favor the success of an FTA. Again, these factors do not indicate what the trade effects of an FTA might be; they indicate readiness. Still, readiness is an important issue. Perhaps a country looks ideal from a strictly trade viewpoint, but its macroeconomy is unstable, or its social conditions are poor, or it has a non-democratic government. If such were the case, then the potential partner would not be as ideal. The discussion below reveals why.

2.2.1 Macroeconomic and Social Readiness Indicators

Macroeconomic and social conditions affect the pattern of free trade. An economy which is typified by such things as "volatile and high inflation" or "wildly fluctuating exchange rates" is incompatible as a partner in "any sustained program of international economic liberalization."[62] Nothing may help sustain open trade policies more than a

62. *See* HUFBAUER & SCHOTT, *supra* note 38, at 72.

stable macroeconomic environment.[63]

A hypothetical example illustrates the importance of macroeconomic and social conditions for an FTA. Suppose that large income disparities between potential partners exist. Low income in one country implies low wages and poor social conditions and economic infrastructure in that country. Upon integration with the wealthier and thus more industrialized country, the wage and infrastructure differences might lead to very dramatic contractions and expansions of industries in both countries. Such conditions would be destabilizing. Also, the large disparity in social conditions — *e.g.*, minimum wage, education, health and safety, and environmental standards — may require harmonization to avoid "social dumping."[64] This means either the poorer partner will have to introduce expensive changes to its society, or the wealthier partner will have to make unwise reductions in its standards. Given the bargaining power and typically greater degree of independence of the wealthier country, the former is more likely. In sum, great differences in social conditions and income implies that the FTA may involve dramatic and, perhaps, overwhelming change.[65] Macroeconomic and social criteria, then, are quite important for the potential success of an FTA and should be examined after the trade characteristics of the candidate country.

Which macroeconomic indicators should be examined? The history of attempts at FTAs suggests some important guideposts for ascribing a candidate country's readiness. Hufbauer and Schott outline some of these factors, and part of their analytical framework is borrowed in this study.[66] Some of the factors they consider include real effective exchange rate stability, price stability, and reliance on trade taxes. They also include some qualitative assessment of the extent of market-oriented policies. This study adds a qualitative assessment of social conditions. Significant disparities between these factors suggest that an FTA may, at the least, be simply undesirable and, at the most, wholly counterproductive.

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63. DANI RODRIK, THE RUSH TO FREE TRADE IN THE DEVELOPING WORLD: WHY SO LATE? WHY NOW? WILL IT LAST? at 39 (National Bureau of Economic Research Working Paper Series No. 3947, 1992). *See also* MICHAEL MICHAELY ET AL., LIBERALIZING FOREIGN TRADE: LESSONS OF EXPERIENCE IN THE DEVELOPING WORLD (1991).

64. Interview with Frank Garcia, Assistant Professor of International Business & Trade Law, Florida State University, in Tallahassee, Fla. (May 1, 1995).

65. *See* HUFBAUER AND SCHOTT, *supra* note 38, at 64; *see also* RICHARD S. BELOUS & JONATHAN LEMCO, NAFTA AS A MODEL OF DEVELOPMENT: THE BENEFITS AND COSTS OF MERGING HIGH AND LOW WAGE AREAS (1993).

66. *See* HUFBAUER AND SCHOTT, *supra* note 38, at 72-77.

PRICE STABILITY AND CURRENCY STABILITY: Inflation matters. History shows that a pattern of high inflation correlates with a pattern of highly variable inflation. High variable inflation rates wrench and twist the economy and can, by causing drastic changes in the real effective exchange rate, lead to mania and depression in trade. Such circumstances are negative for FTAs and increase trade friction.[67]

RELIANCE ON TRADE TAXES: A high reliance on trade taxes reduces the likelihood that a country will be willing to forego this revenue. Even if it did desire to do so, trade liberalization in such a case would lead to macroeconomic instability which negatively affects trade. It will also require a large change in the state's tax structure; consequently, the most affected tax-payers might attempt to undermine the FTA. Such conditions do not favor the success of an FTA.

EXTENT OF MARKET-ORIENTED POLICIES: If an economy is not market-oriented, then an FTA is probably meaningless. As Hufbauer and Schott point out, with significant portions of an economy in state control "free trade is at best a nuisance," for "state enterprises or highly regulated firms [do not] wish to respond to market signals, and their first line of defense is to block those signals by undermining trade agreements."[68]

SOCIAL CONDITIONS: Poor social conditions suggest that a country has poor labor, health, and environmental standards. If a country has poor social conditions and wants to integrate with a country with significantly higher standards, then it will probably have to improve its standards. Otherwise, since it does not have to pay the same relative minimum wage or live up to the same safety, environmental, and health standards, its costs will be cheaper. This implies that it will have an unfair competitive advantage which might become a future source of tension in the FTA.

Like the trade characteristics outlined in the previous sub-section, these macroeconomic and social factors will be examined in the next section to test Latin America and Japan as potential free trade partners.

2.2.2 Level of Democracy

The abundance of literature on the economics of FTAs contrasts sharply with the amount of information available on the requisite political factors for a successful FTA. There is almost no information on this subject. There is much new and interesting work currently being

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67. *Id.*
68. *Id.* at 76.

conducted on regime type and methods of conflict resolution, however, and these theories, some of which focus on war,[69] offer some insights into the importance of regime type for cooperative efforts like an FTA.[70] By adapting some of their principals, this section seeks to contribute to an understanding of liberal democracy as a necessary condition for a successful FTA.[71]

Before discussing regime type, it is important to make an assumption clear. In many senses, the economics of FTAs might be an afterthought in their formation. There are two aspects to this perception that FTAs are politics-based. First, the reasons for which FTAs are negotiated are usually political. Europe serves as the supreme example of this. After World War II, France viewed economic union as the best way to prevent its considerable history of hostilities with Germany from erupting again into another world war. The coercion and the insurance hypotheses (discussed above) about the underlying causes of FTA formation point to the fundamental role of politics as well. Second, and most important, the implementation and regulation of FTAs — referred to collectively as the execution of FTAs — is political. It is this second aspect of execution which is of the most concern.[72]

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69. A major theory regarding war and democracies is called the Democratic Peace theory. Maoz and Russett argue, with quite robust empirical proof, that democracies almost never, and by some criteria never, fight each other. They develop both a normative and structural argument to explain why this is the case. The normative argument is discussed below. *See* Zeev Maoz & Bruce Russett, *Normative and Structural Causes of Democratic Peace*, 1946-1986, 87 AMERICAN POLITICAL SCIENCE REVIEW 624-38 (1993).

70. Also, a commitment to democratic norms is a prerequisite for E.U. membership. It is a "democratic club," so to speak.

71. Russett uses an eleven-point scale (0-10) to rate a state's level of democracy. *See* Maoz & Russett, *supra* note 69. This scale is based on the aggregation of five measurements formulated by Ted R. Gurr: the competitiveness of political participation, regulation of political participation, competitiveness of executive recruitment, openness of executive recruitment, and constraints on the chief executive. *See e.g.*, Keith Jaggers and Ted R. Gurr, *Tracking Democracy's Third Wave with the Polity III Data*, 32 JOURNAL OF PEACE RESEARCH 469 (1995). Countries which score above a five are labeled as democratic (a reasonable degree of competitiveness of political participation, etc.), whereas countries which score below a five are labeled as nondemocratic.

72. *See* Daniel S. Sullivan, *Effective International Dispute Settlement and the Necessary Condition of a Liberal Democracy*, 81 GEO. L. J. 2369, 2396-412 (1993). The negotiating process is also wholly political. Negotiators take into account interest group and business lobbies; these groups may even be their prime concern. Also, negotiators try to wean more concessions from the other parties than they themselves concede. *See* GENE GROSSMAN & ELHANAN HELPMAN, THE POLITICS OF FREE TRADE AGREEMENTS (National Bureau of Economic Research Working Paper Series No.

FTAs, as discussed above in the first section, are as much about rules, procedures and governance as they are about trade barriers. By forming an FTA parties agree to a set of rules governing their trade relationship, and adherence to these rules is regulated by some form of dispute resolution mechanism (DRM). In the most effective type of FTA, the DRM has what Sullivan calls a "sovereignty-impinging nature."[73] This means that they have the jurisdiction and mandate to make rulings on matters heretofore regulated only by state courts. More specifically, this means that the DRM allows a tribunal or panel "to rule upon (and in some cases strike down) the legality of a state's laws, as well as the validity of a state's application of its own laws if those laws violate the [FTA]."[74] The most effective FTAs also have the requirement of effective compliance.[75] This means that the decisions which arise from the dispute resolution process are necessarily complied with by the parties involved.

As a consequence of this need for effective compliance and some infringement upon sovereignty, the parties involved need to be democratic.[76] According to Sullivan, an examination of DRMs found in the European Union (European Court of Justice), the European Convention on Human Rights (European Court of Human Rights), and the CUSFTA (the AD/CVD binational panel process), on the one hand, and of the International Court of Justice, the Iran-U.S. Claims Tribunal, and the DRM of the Organization of American States human rights system (the Inter-American Court of Human Rights), on the other hand, reveals that there is strong evidence of the correlation between effective DRMs and liberal democracies.[77] This evidence provides the foundation for the argument that effective DRMs, and therefore effective FTAs, will occur only between liberal democracies.[78] Why?[79]

4597, 1993). This political aspect, however, is political in a different sense, in that it is a contest over economic interests.

73. *See* Sullivan, *supra* note 72, at 2370.

74. *Id.*

75. *Id.*

76. *See* note 70 for a discussion of how to rate a state as democratic or non-democratic.

77. *See* Sullivan *supra* note 72, at 2370.

78. *Id.*

79. A counter-factual argument discussed by Sullivan bears emphasizing here. If instead of democracy one explains the success of the CUSFTA, the European Court of Justice, and the European Court of Human Rights as having to do with cultural, geographic, and economic ties, then why are there no institutions with effective dispute resolution mechanisms in regions like Southeast Asia, Africa, and the Middle East?

The Democratic Peace (DP) theory developed by Maoz and Russett,[80] although meant to address why democracies almost never fight one another, provides insight into why FTAs with effective DRMs are best formed between democracies. The first assumption of the normative model of the DP theory posits that "states, to the extent possible, externalize the norms of behavior that are developed within and characterize their domestic political processes and institutions."[81] This assumption suggests that the norms of domestic political behavior will be expressed in international conduct. Thus, when two democracies confront one another they apply democratic norms to their interaction. Democratic political norms emphasize adherence to transparent rules and solving disputes through compromise. Such practices generally translate into mutual respect, trust, and accommodation among conflicting democracies and imply that parties will abide by the rules of their agreements — *e.g.*, FTAs. This is not the case with non-democracies. Rather than adherence to common rules, non-democratic political norms emphasize coercion and zero-sum conflict resolution. Such practices generally translate into an atmosphere of fear and distrust within and outside the government and imply that parties will more likely reneg on their agreements — *e.g.*, FTAs.[82]

The second assumption of the normative model of DP theory suggests that "the anarchic nature of international politics implies that a clash between democratic and nondemocratic norms is dominated by the latter, rather than by the former."[83] This assumption means that, because democratic norms are more easily exploited than non-democratic ones, "democracies are more likely to shift norms when confronted by a non-democratic rival than is the non-democratic rival to shift to democratic forms of international conduct."[84] A crucial aspect of this assumption is that democratic states are also likely to assume non-democratic political norms when confronting democratic states perceived to be unstable. Maoz and Russett state that "uncertainty about the commitment to democratic norms by a state with which one has a conflict of interest may lead to perceptions and expectations that it will practice these norms imperfectly."[85] Therefore, if a democracy enters an FTA with what it perceives to be an unstable democracy,

Only the lack of democracy in these regions effectively explains why. *Id.*

80. *See supra* note 69.

81. Maoz & Russett, *supra* note 69, at 625.

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

then it is more likely to defect from the rules of that FTA and not to accept judgments made by the DRM.[86]

In sum, if a democratic state is to subjugate itself to the rulings of a DRM in an FTA, then the parties involved must be stable democracies. If both parties are not stable democracies, then the more democratic state is more likely to ignore the rules of the FTA or the rulings of the DRM. In other words, it will not effectively execute the FTA. This is not to say that a stable democracy will not do the same with other stable democracies; rather, the extension of democratic political norms — with their emphasis on mutual respect and trust — to like parties will discourage such a defection, for "dependence on democratic norms tip rational cost-benefit calculations toward further support of these norms."[87]

Like the trade characteristics and macroeconomic factors outlined above, a state's level of democracy will be examined in the next section to test Latin America and Japan as ideal free trade partners for the United States.

The analysis above outlined an ideal free trade partner model. The primary tier of the model examined those trade characteristics which favor, in a static sense, trade creation over trade diversion; in judging the possible dynamic effects of an FTA, however, the model is not as illustrative. The model also focused on some non-trade characteristics which favor the success of an FTA in the long run. These macroeconomic, social, and political factors, however, do not indicate what the trade diversion effects of an FTA might be, and therefore are necessarily part of a secondary level of analysis. This model is used in the next section to examine to what extent Latin America and Japan are ideal free trade partners.

Section 3: Japan Versus Latin America

President Bush presented the EAI as the starting point for the negotiation of a WHFTA. Ever since, the focus for the next U.S. FTA has been on Latin America. At the time of this writing, the United States, Mexico and Canada appear ready to negotiate NAFTA accession for Chile. Indeed, many expect these negotiations to go smoothly

86. There is a question as to how unstable a democracy would need to be before it would be perceived as unstable. Where such "cut-off" points lie is an area for further research in democratic peace theory. A possible answer lies in JAMES L. RAY, DEMOCRACY AND INTERNATIONAL CONFLICT: AN EVALUATION OF THE DEMOCRATIC PEACE PROPOSITION 212 (1995).

87. Maoz & Russett, *supra* note 69, at 625.

and for Chile to be the first partner accepted in the formation of a WHFTA. While this is the direction of current U.S. trade policy, some fundamental questions about this policy should be asked. Is Latin America, on the whole, an ideal free trade partner? Are any of the countries within it even ready for an FTA with the NAFTA members? If not, then who is? The significant trade relationship the United States has with Japan (as well as the European Union) indicates that it might be an ideal partner.[88] How, then, do Japan and Latin America compare?

Using the ideal free trade partner model presented in the last section, these important questions are answered below. Before beginning, however, a note regarding methodology is warranted. Comparing Latin America to Japan involves a different level of analysis; Japan is a state, while Latin America is not. Nevertheless it is useful to compare the two. Aggregate trade figures can be compiled for Latin America. Therefore there is no problem in comparing the two actors on the first tier trade characteristics of the ideal free trade partner model. The second tier readiness factors are more difficult to aggregate, but by using a scale to rate performance in individual countries, a Latin American average can be computed. This permits Latin America to be artificially yet legitimately examined as a single actor. The same can be said for Latin America's sub-regional groupings like the Mercosur, the Andean Group, and the CACM; and their patterns and volumes of trade are selectively compared to Japan's. Their performance on the readiness factors are also compared to Japan's. On the individual country level, since Chile appears to be on the verge of NAFTA accession, particular attention is paid to its readiness factors; however, other countries are only selectively compared to Japan. This three-step approach — comparing Latin America to Japan on trade characteristics and readiness factors, comparing the sub-regional groupings to Japan selectively on trade characteristics and consistently on readiness factors, and comparing Chile to Japan selectively on trade characteristics and consistently on readiness factors — is employed below.[89]

88. The European Union is, when compared to Asia and Latin America, the most auspicious area for the United State's future economic success. *See* Clayton Yeuter & Warren H. Maruyama, *A NAFTA for Europe*, WALL ST. J., May 19, 1995, at A14. *See also* N.Y. TIMES, *passim* May, 1995.

89. For reasons of space and the availability of data, not all Latin American countries (*e.g.* Belize, Panama) nor associations (such as CARICOM) are examined in this study.

3.1 The First Tier — Comparison of Trade Characteristics

To review, the characteristics are: one, the significance of the trading partner; two, whether the partner is a principal market and a principal supplier; three, the competitiveness of the economies; and four, the wealth of the partner.

3.1.1 Trade Characteristic 1 — Trading Partner Significance

By comparison, how significant are Latin America and Japan as U.S. trade partners? To answer this question, it is necessary to show the extent of U.S. trade with Japan and Latin America in both dollar terms and as a percentage share of U.S. exports and imports. Table 1 presents the dollar amount of U.S. exports and imports to these areas in 1992. Table 2 presents the percentage share for these areas in the same year.

From the numbers, Japan is clearly a more significant trading partner than Latin America. Japan is 1.4 times a better customer for U.S. exports, and it is 2.9 times a better provider of U.S. imports. Thus if the United States liberalized trade in goods with all twenty countries included in Latin America's figures, it still would not be liberalizing more than it trades with Japan. If compared at a level below Latin America, Japan is 4.3 times a better customer than the Andean Group (the best sub-regional grouping customer and provider), and it is 7.0 times better the provider. Also, Japan is 8.3 times a better customer than Brazil (the best country customer), and 11.5 times a better provider than Venezuela (the best country provider). In comparison with Chile, Japan is 19.4 times a better customer and 61.2 times the better provider.

These findings show how much more significant U.S.-Japan trade relationship is than the U.S.-Latin America trade relationship in terms of dollar amounts. They suggest, therefore, that an FTA between the United States and Japan will lead primarily (if not exclusively) to trade creation. The reason is simple: an FTA will only reinforce the two countries' existing relationship and pattern of comparative advantage. Meanwhile, the relative insignificance of Latin America as a U.S. trading partner suggests that an FTA with it will lead to some modest degree of trade diversion.

3.1.2 Trade Characteristic 2 — Principal Market and Principal Supplier

As previously stated, trade creation is likely if each partner is the "principal supplier to the other of the products which it exports to the other and if each is the principal market for the other of the products which it imports from the other."[90] To examine this characteristic fully requires an examination of the top exports for Japan, Latin America, and the United States, as well as an examination of the destination of these top exports. Unfortunately, the information on the destination of Japan's and Latin America's top exports was not available to this study. For this reason, the principal market characteristic discussed by Meade is not fully answered here.

As a substitute, this study examines only the top U.S. exports. There is a caveat here as well. The only data on the destination of particular U.S. exports available to this study came from the U.S. Department of Commerce's National Trade Data Bank. It, however, only breaks down U.S. exports into entire industries — such as cereals, represented by a two-digit harmonization code — or specific products — like frozen King Crabs, represented by a ten digit harmonization code.[91] This study compares the industries rather than the specific products. Even at this level of analysis, however, there is still a further caveat. To reveal the principal market characteristic requires analysis of all the countries to which the top U.S. industries export. Only then can it be established which country is a principal market. Instead of performing such an in-depth analysis, however, this study assumes a cut-off point — any country which imports at least 10% of the goods exported by the top U.S. industries for exports is a principal market.

With the above constrictions and guidelines in mind, this study analyzes whether Japan and Latin America are principal markets for U.S. industry exports. Tables 3 and 4 show the principal market characteristic for Japan and Latin America. Table 3 lists the top nine U.S. industries for exports in 1991. Each of these industries had exports worth over $10 billion in 1991. The cut-off point of $10 billion works rather well; there are no industries with exports in the $9 to $10 billion range.

Using 1991 as the year of comparison, Table 4 reveals for which industries Japan and Latin America were principal markets between 1988 and 1991.[92] Japan is a principal market for four top U.S. industries, while Latin America is a principal market for only one. If the 10% cut-off point is relaxed to 7.5%, then Japan is a principal market

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90. MEADE, *supra* note 54, at 108-09.

91. The NTDB also has three-digit, five-digit, and seven-digit harmonization codes. The export and import by country tables, however, do not have this data.

92. (avg. of gds. (1988-91) exported to L.A. (Japan) for top 9 U.S. industries for exports x 100)/(avg. of gds. (1988-91) exported from world for top 9 U.S. industries for exports).

for seven of the nine industries, and Latin America is a principal market for four. This shows that Japan, despite its supposedly "closed" economy, is a significantly more important market for top U.S. export industries than is Latin America, despite the latter's geographic proximity.

Tables 5 and 6 show the principal supplier characteristics for Japan and Latin America. Table 5 lists the top eleven U.S. industries for imports in 1991. Four industries normally divided — the apparel knit and crochet industry, the apparel non-knit industry, the iron and steel industry, and the articles of iron and steel industry — are consolidated into two — the apparel articles and accessories industry, and the iron and steel and articles thereof — for the purposes of this study. Each of the top industries had exports worth over $7 billion in 1991. Using 1991 as the year of comparison, Table 6 shows for which industries Japan and Latin America were principal suppliers between 1988 and 1991.[93] Japan is a principal supplier for seven industries, while Latin America is a principal supplier for only two. If the 10% cut-off point is relaxed to 7.5%, then Latin America becomes a principal supplier for three industries and Japan remains at seven. This shows that, despite its geographic distance, Japan is a significantly more important supplier for top U.S. import industries than Latin America.

A comparison of Tables 4 and 6 further shows the importance of Japan as a U.S. trade partner. Japan is both a principal market and supplier for both the organic chemicals and optic, photo etc. industries. If the cut-off point is relaxed to 7.5%, then this number increases to four, adding both the nuclear reactor industry and the electronic machinery industry. Meanwhile, Latin America is both a principal market and supplier for only the mineral fuel industry. Even if the cut-off point is relaxed to 7.5%, there is no change. This strongly suggests that the United States and Japan have a significantly more mutually beneficial trade relationship than the United States and Latin America. It also implies that Japan is a low-cost producer of the goods which U.S. consumers buy the most of, while Latin America is a higher-cost producer of these goods. The implications of this finding, as illuminated in the previous section, are that if the United States integrated with Latin America in these goods, then trade diversion might take place. Consequently, the United States would suffer some loss in the form of government tariff revenue, thus increasing the likelihood that the FTA will

93. (avg. of gds. (1988-91) imported from L.A. (Japan) for top 11 U.S. industries for imports x 100)/(avg. of gds. (1988-91) imported from world for top 11 U.S. industries for imports).

reduce both the welfare of the U.S. and world. However, if the United States integrated with Japan in these goods, then there would be no associated deadweight loss, and the U.S. economy, along with the world's, would enjoy a larger expansion of welfare.

3.1.3 Trade Characteristic 3 — Competitiveness of the Economies

A good way to determine if two economies are competitive is to compare their revealed comparative advantage indices.[94] This involves calculating the ratio of a country's share in world exports of a particular good to the country's share in total world exports. The United Nations' International Trade Statistics Yearbook houses a complete listing of every country's exports for a given year. It divides these exports into two-digit, three-digit, and five-digit standard international trade classification (SITC) codes. Because of the intermediate nature of this measure, this study compared exports with a three-digit SITC code.[95] Tables 10, 13, and 16 show the revealed comparative advantage measure for the top ten (three-digit SITC code) U.S., Japanese, and Latin American export goods respectively.

First, this study analyzed whether the Japanese and Latin American economies are competitive with the U.S. economy. Table 7 shows the approximate share of world exports for Japan, Latin America, and the United States for the years 1988-1991. Table 8 analyzes the top ten U.S. export goods for the 1988-1991 period. Table 9 calculates the average country share of the top ten U.S. export goods between 1988-1991. Tables 10a and 10b show the revealed comparative advantage indices for these export goods. An index less than one means that a country does not have a revealed comparative advantage in the good measured.[96] Also, the highlighted sections in Tables 10a and 10b show in which goods the countries have a very similar revealed comparative advantage and in which they are therefore competitive. A very similar

94. *See* BELA BALASA, JAPAN IN THE WORLD ECONOMY (1988); C. FRED BERGSTEN & MARCUS NOLAND, RECONCILABLE DIFFERENCES: U.S.-JAPAN ECONOMIC CONFLICT (1993).

95. The two-digit SITC code is like the two-digit NTDB codes used to examine the principal supplier (market) characteristic in the last sub-section; it is broad. But this study seeks a more illustrative picture of what goods each economy actually imports than that provided by the two-digit SITC code. Meanwhile, the five-digit SITC code is too specific. Therefore this study chooses the three-digit SITC code to provide a more descriptive idea of which goods the economy produces best, while not being so specific that the data compiled reflects too little of the economy as a whole.

96. These are the goods for which the bullet in the table is to the left of the dotted line.

revealed comparative advantage means that the indices are within 0.75 points of each other and are both on the same side of the comparative advantage line. The highlighted sections of the same two tables further demonstrate in which food groups the countries have a very dissimilar revealed comparative advantage and in which they are therefore not competitive. A very dissimilar revealed comparative advantage means that the indices are at least 0.75 points apart and on opposite sides of the comparative advantage line.

Table 10a reveals that the United States and Japan are competitive in six of the top U.S. exports, while Latin America is only competitive in three. Also, of the goods in which Japan is not very similar to the United States, both Japan and the United States have a comparative advantage in two. Therefore, while the two economies may not be very similar in these goods, they are somewhat comparable. Meanwhile, Latin America has a comparative advantage in none of the goods in which it is dissimilar to the United States. Table 10b reveals that Japan is greatly dissimilar to the United States in only two of the ten goods examined, while Latin America is greatly dissimilar in seven. Overall, these findings strongly suggest that, at least for the goods which the United States exports the most, Latin America's economy is very dissimilar to the U.S. economy, whereas Japan's economy is very similar to that of the U.S.

Next, this study analyzed the revealed comparative advantage measure for Latin America's top ten export goods. Table 11 shows Latin America's top ten export commodities. Table 12 calculates the average (for years 1988-1991) country share for these Latin American exports. Tables 13a and 13b show the revealed comparative advantage index for the top Latin American exports.

Table 13a reveals that the United States, like Japan, is only similar to Latin America in one of its top exports — base metal ores. However, neither the United States nor Latin America has a comparative advantage in this good. Still, the United States does have a comparative advantage in three of Latin America's top ten exports. In these goods the United States is at least somewhat similar to Latin America, and the lesser degree of similarity stems only from Latin America's extreme competitiveness in these goods. Meanwhile, Table 13b shows that the United States is very dissimilar to Latin America in six of its top ten exports and that the comparative advantage differences between the two economies in these goods are quite large. These findings, when combined with the findings of Tables 10a and 10b discussed above, not only suggest but show that, in their most important exports, the United States and Latin America are not competitive. In other words, the two economies are very dissimilar, and if they were integrated, then one might expect trade diversion to ensue. Even if trade diversion did not occur, the integration of the two economies would not enhance their possibilities for specialization in production. In other words, integration would not provide much in the way of increased efficiency. What, then, from an economic point of view, would be the point of integrating the two economies through an FTA rather than through the multilateral process?

Finally, this study analyzes the revealed comparative advantage measure for Japan's top ten export goods. Table 14 examines the top Japanese export goods for the 1988-1991 period, and Table 15 calculates the average country share of these top Japanese exports for the same years. Tables 16a and 16b show the revealed comparative advantage indices of the three economies for these export goods. While Table 16b shows that the United States is only dissimilar in three of Japan's top ten export goods, Table 16a reveals both that the United States is very similar to Japan in five of Japan's top export goods and that the United States has a comparative advantage in two more of Japan's top export goods. Furthermore, a comparison of Tables 10a and 16a shows that six of these top ten Japanese export goods are also top ten U.S. export goods. This makes clear the striking degree of similarity in the two economies' industrial composition. These findings imply that if the two economies integrated, then the possibilities for further specialization in production would be great. Also, there would be little possibility of trade diversion, for the two economies would continue to import goods in which neither has a comparative advantage.

3.1.4 Trade Characteristic 4 — Proportion of the World's Wealth

Like characteristic one, this characteristic is easily examined. Table 17 reports the gross domestic product (GDP), the real GDP per capita in purchase power parity dollars ($PPP), and the share of world GDP in 1992. The Japan-U.S. share of world wealth is a staggering 41.6%. With a 12.2% greater share of the world's wealth, Japan's is approximately 4.3 times wealthier than Latin America. It is 6.0 times wealthier than the Mercosur grouping (the wealthiest sub-grouping) and is 10.2 times wealthier than Brazil (the wealthiest country). In comparison to Chile — the next likely U.S. free trade partner — it is 88.9 times wealthier! When one considers the fact that, on average, individual Japanese are $15,039 wealthier than Latin Americans in general, $11,270 wealthier than Venezuelans (the richest of the Latin Americans), and $12,330 wealthier than Chileans, it becomes apparent that Japan and Latin America, just like the United States and Latin America, have very different purchasing powers. Indeed, while U.S. integration with Latin America would increase the size of the market to which U.S. firms have free access by approximately 14.3%, integration with Japan would increase it by over 62%.[97] Thus while integration with Latin America would increase the possibilities for economies of scale for industries like high-technology manufacturing, integration with Japan would travel much farther towards this goal. Overall, the sheer size of the Japanese economy makes the scope for trade creation through integration far greater than that possible through integration with Latin America.

3.1.5 Summary of the First Tier — Trade Characteristics Analysis

Overall, the foregoing analysis of the U.S., Japanese, and Latin American volumes and patterns of trade suggests three unmistakeable things. First, it is likely that a modest degree of static trade diversion would result from U.S. integration with Latin America. Second, it is likely that substantial trade creation and almost no significant trade diversion will result from U.S. integration with Japan. Third, the likely scope of dynamic trade creation in the case of U.S.-Latin American integration would be far less than the likely scope of dynamic trade creation which would result from U.S.-Japanese integration. There are reasons why this is so.

Japan is a low-cost producer in most of the industries from which the U.S. imports the most, therefore the United States would suffer little deadweight loss due to integration. The net effect for the U.S. economy from integration with Japan would be undeniable trade creation. Moreover, this trade creation is likely to be substantial because both economies are very competitive and similar, and the integration of such economies leads to a greater degree of specialization in production. In other words, because of their similarities, eventually the two economies would be much more likely to become increasingly interdependent, and thus merge into one inclusive whole, rather than remaining as two distinctive economies. This would be similar in a case of integration between two complimentary economies. Such integration can only improve world welfare, and especially the welfare of the two countries. The only concern for the rest of the world would be that the two merging economies would be so strong as to hold monopoly power over the rest of the world in their top exports. Lastly, since the two economies combined represent over 40% of the world's wealth, integration would greatly improve the likelihood of economies of scale, and

97. These percentages do not take into account the access U.S. firms already enjoy in Canada, Israel, and Mexico.

thus dynamic trade creation.

None of the above observations can be made about Latin America. It is not a low-cost producer of top U.S. imports, and therefore integration with it may lead to a deadweight loss for the United States and to trade diversion for the rest of the world. Its economy is not similar to the U.S. economy and therefore, the possibilities for specialization in production would be minimal. And even though integration with Latin America would increase the size of the market to which U.S. firms have free access, it is unlikely that this increase would lead to economies of scale. Thus dynamic trade creation would be more likely if the U.S. integrated with Japan than if the U.S. integrated with Latin America.[98]

3.2 The Second Tier — Comparison of Readiness Factors and Levels of Democracy

Recall that the second tier of this ideal free trade partner model is to be employed if and only if the potential partner fits the ideal trade characteristics. Strong performance on the readiness indicators, absent a similar performance on the trade characteristics, is not a justification for an FTA. The trade characteristics are primary. Therefore, since under this model's first tier analysis Latin America is not ideal, it should not be examined further. However, despite this observation, the United States is in actuality pursuing a WHFTA. Therefore, it is worthwhile for the purposes of this study to include Latin America nevertheless. The reader should keep in mind, however, that this is not in keeping with the model's prescribed methodology and that, based on the trade characteristics, Japan is an ideal free trade partner, whereas Latin America is not.

Even if Latin America were ideal in terms of the four trade characteristics analyzed in the last section, would it be ready for an FTA with the United States? The analysis below answers these questions by examining the macroeconomic, social, and political readiness factors outlined in the previous section.

To review, the six readiness factors are price stability, real effec-

98. However, even though pre-trade tariff barriers in certain Japanese and Latin American industries are high, in general Latin American tariff barriers are more significant than Japanese ones. There will be a larger degree of static trade creation than generally suggested by the model used. Contrarily, Japanese non-tariff barriers, in general, are more significant than Latin American ones. This would hinder a traditional FTA with Japan from realizing its potential dynamic gains. This point will be returned to later in this section.

tive exchange rates, reliance on trade taxes, the extent of market-oriented policies, social conditions, and the level of democracy (freedom). This study scores the readiness factors on an 11 point scale (10 to 0), with 10 being the best possible score. It calculates the overall regional and sub-regional scores by adding the individual country scores together and dividing by the number of countries. This scale method allowed for an average score on readiness factors to be given.

3.2.1 Readiness Factor 1 — Price Stability

To measure the degree of price stability, this study examined the four year period 1990-1993 and averaged the percent change in consumer prices over the previous year. This study awarded average inflation rates between 0-2.5% a 10, between 2.5-5% a 9, between 5-10% an 8, between 10-20% a 7, between 20-35% a 6, between 35-50% a 5, between 50-75% a 4, between 75-100% a 3, between 100-150% a 2, between 150-200% a 1, and above 200% a 0.[99]

Table 18 reports the findings on price stability for 1990-1993. With only an average of 2.4% inflation, Japan scored a 10. By comparison, Latin America scored a 4.13; this would place it somewhere between a 50-75% inflation rate. Even if some of the worst offenders (Argentina, Brazil, Ecuador, Peru, and Nicaragua) are deleted, the average for Latin America improves only to a 6.1. The CACM (the most price-stable grouping) scored a 5.4 — 35-50%. Bolivia (the most price-stable Latin American country) averaged 14.8% inflation, and Chile averaged 19.0%; both scored sevens. These findings suggest that, in general, Latin America's prices are unstable. Such a condition disfavors investment and expansion of trade. Rates much above 20% "call into question sustained progress on trade and capital liberalization."[100] Latin America as a whole needs to achieve a greater degree of price stabilization before the United States should consider a WHFTA. Even at a less than hemispheric level, only Bolivia, Chile, Costa Rica, El Salvador and Honduras have achieved average inflation rates of less than the suggested 20% cut-off point, and none of them has achieved average rates less than 10%.

99. This scale is based on HUFBAUER & SCHOTT, *supra* note 38, at 70. They employed a 5 to 0 scale and awarded scores on the following basis: inflation rates less than 5% received a 5, between 5-20% a 4, 20-50% a 3, 50-100% a 2, 100-200% a 1, and greater than 200% a 0.

100. *Id.* at 73.

3.2.2 Readiness Factor 2 — Currency Stability

To measure the degree of currency stability, this study calculated the standard deviation in exchange rates over the period 1990-1992. It awarded standard deviations between 0-3% a 10, between 3-6% a 9, between 6-9% an 8, between 9-12% a 7, 12-15% a 6, 15-18% a 5, 18-21% a 4, 21-24% a 3, 24-27% a 2, 27-30% a 1, and more than 30% a 0.[101]

Table 19 reports the findings on currency stability for the years 1990-1992. The lowest standard deviation belonged to Bolivia at 0.4; it scored a ten. Chile had a deviation of 3.3. Japan had a deviation of 4.6; both countries received a 9. The Andean Group (the best grouping) also scored a 9.4. Latin America scored an 8.3. Overall, currencies in Latin America appear to be stable and comparable in this sense to Japan. Based on these findings, none of the Latin American countries examined here should be eliminated from FTA contention for having unstable currencies.

3.2.3 Readiness Factor 3 — Reliance on Trade Taxes

To measure a state's reliance on trade taxes, this study computed an average for the period 1986-1991 of each state's percentage of government revenue derived from taxes on international trade and transactions. It gave a 10 to countries with averages less than 2.5%, a 9 between 2.5-5%, an 8 between 5-7.5%, a 7 between 7.5-10%, a 6 between 10-12.5%, a 5 between 12.5-15%, a 4 between 15-17.5%, a 3 between 17.5-20%, a 2 between 20-22.5%, a 1 between 22.5-25%, and a 0 for anything higher than 25%.[102]

Table 20 reports the findings on trade tax reliance for the years 1986-1991. With an average of 1.35%, Japan performed the best. Brazil was not far behind with a 2.17% average. It is the only Latin American country with an average less than 10%. Both countries scored a 10. Chile averaged 10.06% and received a 6. The Mercosur (the best grouping) scored a 6.25. Overall, however, Latin America scored a 4.07. This places it somewhere in the 15-17.5% range, and this is precisely the range at which Hufbauer and Schott argue govern-

101. *Id.* at 71. In Hufbauer & Schott's 5 to 0 scale they awarded real exchange rate fluctuations of less than 10% a 5, between 10-30% a 3, and greater than 30% a 0.

102. *Id.* In their 5 to 0 scale, Hufbauer & Schott awarded countries which derived less than 5% of revenue from trade taxes a 5, between 5-10% a 4, 10-15% a 3, 15-20% a 2, 20-25% a 1, and greater than 25% a 0.

ments will begin to strongly resist the phasing-out of these revenues.[103]

3.2.4 Readiness Factor 4 — Extent of Market-Oriented Policies

This factor seeks to measure the extent to which countries have privatized and deregulated. Of course, measuring this requires a more qualitative approach than experienced with the first three readiness factors. To score performance in their study, Hufbauer and Schott divided Latin America into three groupings: countries with operational privatization programs and deregulation received a 4 or 5 (8 to 10 here);[104] countries with plans to privatize and deregulate received a 2 or 3 (4 to 6 here); those without plans scored a 0 or 1 (2 to 0 here). This study duplicated the results of their findings, but converted their 0 to 5 scale to the 0 to 10 scale used here.

Table 21 reports the scores for the extent of market-oriented policies in 1994. Japan received a 9 while Latin America on the whole received a 6. Chile (the best country) scored high with a 10. Mercosur (the best grouping) received a 7. The fact that Chile scored so high and is the first candidate in line for NAFTA accession suggests that this factor might have a high degree of salience for U.S. strategists. It may be noted that Chile also scored high in currency stability, but the other countries scored high in that category as well.

3.2.5 Readiness Factor 5 — Social Conditions

Like the market-oriented policies factor, Hufbauer and Schott discuss social conditions as particularly relevant to a state's readiness for economic integration.[105] However, they do not attempt to score this factor quantitatively. This study does. It uses a recognized method of measuring social conditions: life expectancy.[106] It awarded life expec-

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103. *Id.*

104. *Id.* This study assumes that Hufbauer & Schott gave countries which do not need privatization programs due to existing low levels of state ownership a score of 5 (translated as a 10 here).

105. *Id.*

106. *See* Adrian Karatnycky, *Democracies on the Rise, Democracies at Risk*, 26 FREEDOM REVIEW 5 (1995). A higher life expectancy rate, foremost, indicates a higher standard of health care in a nation. One's health, however, is also dependent on social factors like environmental conditions, work conditions, and the general harshness of life. For instance, at the turn of the century, life expectancy in the United States at birth was 32.5 years for males and 35.0 years for females. By 1970 those rates had increased to 68.0 for males and 75.6 for females. Although advances in medicine surely contributed greatly to this increase, it would be disingenuous to ignore the importance of the improved social conditions in the United States as a factor.

tancies over 77.5 years a 10, between 75-77.5 a 9, between 72.5-75 an 8, between 70-72.5 a 7, between 67.5-70 a 6, between 65-67.5 a 5, between 62.5-65 a 4, between 60-62.5 a 3, between 57.5-60 a 2, 55-57.5 a 1, and below 55 a 0.

Table 21 also reports the scores for social conditions in 1994. Japan had the highest life expectancy with 78.6 years and scored a 10. Costa Rica (the highest Latin American country) scored a 9 with a life expectancy of 76 years. Chile scored a 7 with a life expectancy of 71.9 years. Mercosur (the best grouping) scored a 6.0. Latin America scored a 5.6. This corresponds to the 65-67.5 range. If the worst offenders are dropped — below 65: Bolivia, Guatemala, and Peru — the average improves by a half point, becoming a more respectable but still low 6.1.

In as much as a low life expectancy rate can be said to indicate poor social conditions — *e.g.*, poor environmental and labor standards — most of Latin America's performance suggests that its accession to NAFTA may run into opposition in the U.S. Congress. Indeed, anti-NAFTA activists from labor and environmental groups have already vowed to press for more labor and environmental protection in any new trade pact, and they believe that the Clinton Administration is not stressing the need for environmental and labor safeguards enough in its current discussions with Chile.[107]

3.2.6 Readiness Factor 6 — Levels of Democracy

How does one judge a state's democracy? Any such assessment is inherently qualitative. Still, this does not mean that it is inaccurate. Political scientists widely recognize the accurateness of the measurement of a state's freedom published annually by Freedom House. Although this measurement of freedom does not rate governments per se, it does rate the rights and freedoms individuals have in each country. According to Freedom House, "[it] does not score countries and territories based on governmental intentions or constitutions but on real world situations caused by governmental and non-governmental factors."[108] Therefore this paper utilizes Freedom House figures when appropriate.[109] However, because Freedom House uses a scale from 1 to

107. *See* Asra Q. Nomani, *NAFTA Shafta*, WALL ST. J., June 27, 1995, at A1.

108. J. E. Ryan, *Survey Methodology*, 26 FREEDOM REVIEW 10, 19.

109. Freedom House uses two checklists to measure freedom. Its political rights checklist includes eleven questions (two of which are discretionary) such as: "Is the head of state and/or head of government or other chief authority elected through free and fair elections;" "[D]o cultural, ethnic, religious and other minority groups have reasonable self-determination, self-government, autonomy or participation through informal consensus in the decision-making process?" Its civil liberties checklist includes

7, with 1 being the highest score, this study converted their scale to a 10 to 1 scale. In so doing, this author has essentially inverted the Freedom House scale. A 1 became a 7, a 2 became a 6, etc. This number was multiplied by the ratio of 10 to 7 (or 1.428. . .). Therefore, a score of 1 on the Freedom House scale received a 10, a 1.5 a 9.3, a 2.0 an 8.6, a 2.5 a 7.9, a 3.0 a 7.1, a 3.5 a 6.4, a 4.0 a 5.7, a 4.5 a 5, a 5.0 a 4.3, and so on.

Table 22 reports the scores for freedom in 1994. Costa Rica scored the highest with 9.3, followed by Japan and Chile with a score of 8.6. Mercosur (the best grouping) scored a 7.5, while Latin America received a 7.19. This means that the state of democracy in Latin America is fair to good, and suggested that Latin America might be sufficiently liberal with which to enter into an FTA. However, certain countries like Colombia, Guatemala, Nicaragua, Paraguay and Peru should probably be avoided either due to low scores, significant daunting changes in political rights or civil liberties, or general decreasing trends in freedom.

3.2.7 Overall Scores

Table 23 compiles the overall scores for the readiness factors and level of freedom. Japan received the highest score with a 9.43. Latin America received a 5.88. The difference of 3.55 points is quite significant. Overall, Latin America is not as ready for economic integration as is Japan.

At the sub-regional grouping level, the findings are similar; no grouping can confidently claim readiness. The CACM, with an overall score of 5.1, is the least ready. It has a dismal score of 1.2 on trade tax reliance and only a 3.6 score for the extent of market-oriented policies. The Andean Group and Mercosur are about equal with overall scores of 6.11 and 6.04 respectively. Both scored very poorly on price stability and fair to poor on trade tax reliance and social conditions. These group findings suggest that if NAFTA wishes to expand into a WHFTA, it might be necessary to do so on an individual, country-by-country basis. Nonetheless, the Andean Group is not as unprepared as its score suggests. Without Peru, its score increases from a 6.11 to a 6.89. Indeed, of its members, every country except Peru — that is, Bolivia, Colombia, Ecuador, and Venezuela — can claim some degree of readiness. The only other countries that can do so are Costa Rica and

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thirteen questions such as: "Is there open public discussion and private discussion?;" "[A]re there free trade unions and peasant organizations or equivalents, and is there effective collective bargaining?" *Id.*, at 11.

Chile. Among the Latin American countries which are ready, Chile is the most prepared with an overall score of 7.93. Based on these figures it makes sense, then, for the first new member in NAFTA (en route to the WHFTA) to be this state. However, Japan proved to be the most ready, scoring an impressive 9.43.

3.3 Conclusion of Japan versus Latin America

The comparison of Latin America and Japan demonstrates two things. From the point of view of the ideal free trade partner model employed here, Japan is an ideal free trade partner for the United States; Latin America is not. It is doubtful, then, that hemispheric free trade would be the panacean windfall U.S. trade policy-makers may desire it to be.[110] The analysis in this section strongly suggests that the trade creation benefits of pursuing true liberalization in the U.S.-Japan trade relationship would be quite large given the two economies' existing levels of interdependence, competitiveness, and wealth.

The ideal free trade partner model developed here does not employ a measurement of degrees of cultural similarity. Such similarities make a successful FTA with Latin America more likely than with Japan. Still, the presence of cultural affinities alone is not a sufficient reason to pursue economic integration outside of the multilateral framework. Cultural affinities, whether they stem from a common sense of history, a common sense of religion, or a common sense of values, are arguments for greater cultural cooperation (such as student-exchange programs), but not for a special economic relationship (such as an FTA).

This study's analysis also does not take into account differences in market structure which, it can be asserted, may not only prohibit an FTA from realizing dynamic trade creation, but may also make the realization of an FTA on any grounds less likely. Despite this fact, the presence of such differences should not disqualify an FTA approach. Indeed, although they make an FTA more difficult to negotiate, their presence in a significant trade relationship — *i.e.*, one that meets the ideal trade characteristics — as non-tariff barriers makes the negotiation of an FTA aimed at ameliorating such differences all the more valuable. Also, their presence as non-tariff barriers in a significant trade relationship justifies establishing a special institutional relationship within GATT.

The U.S.-Japan trade relationship is just such a relationship. Non-traditional access barriers, which are ubiquitous in both economies,

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110. *See* Thomas F. McLarty III, *The Americas: Hemispheric Free Trade Is Still a National Priority*, WALL ST. J., May 26, 1995, at A11.

dominate the two countries' trade disputes and might prohibit the realization of the dynamic trade gains FTAs are aimed at capturing. One could argue that this makes Japan a less ideal free trade partner. On the contrary, however, this study holds that these non-traditional access barriers are both the explanation as to why the United States and Japan do not already have an FTA and the reason that their relationship needs one.

The United States and Japan should fundamentally adjust their relationship through a JUSFTA. U.S.-Japan disputes have often taken the form of a Section 301 complaint, holding that Japan's markets are closed, accompanied by a unilateral demand that Japan agree to market-access targets. Recently, such a complaint over auto trade brought the two countries to the brink of a trade war (discussed more fully in section 4). *Time* magazine recently published an article on the event entitled the "Launch of an Economic Cold War."[111] Written before the two sides agreed to a plan (outlined in section 4), it stated that "if a showdown is averted in this spat, another would come soon, and then another, until one shakes to the core the political relations between the two economic superpowers."[112]

Instead of focusing the expertise of its limited number of trade negotiators and analysts on a small gain like a WHFTA, the United States should use its limited resources more efficiently by pursuing a JUSFTA. Diverting its experts' attention away from the underlying causes of U.S.-Japan trade imbalances will do nothing to solve one of its most politically charged economic issues. Moreover, continuing to ignore the core problems which have been weakening the U.S.-Japan alliance over the past two decades only insures that these problems will continue the alliance's deterioration. For a nation which wishes to maintain its current level of influence in world affairs into the twenty-first century, allowing its most important economic relationship to remain unattended is not wise policy. The United States should maintain its power by repairing, fortifying, and building upon its most important economic relationship, not by building a new one to counter it.

The next section looks more closely at some of the problems in the U.S.-Japan relationship and argues that the political issues separating the United States and Japan need solving through an FTA approach. Section five then provides a sketch of a JUSFTA.

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111. *See* George J. Church, *Launch of an Economic Cold War*, TIME, July 3, 1995, at 30-31.

112. *Id.*, at 30.

Section 4: Japan-U.S. Trade Relations: The Need for a New Approach

The comparison of Japan and Latin America in the last section raised some questions about a WHFTA. Since hemispheric integration probably would not provide much in the way of increased economic efficiency, there appears to be no justification for linking Latin America and the United States through an FTA. In contrast, the Japan-U.S. pattern and volume of trade should encourage integration because the two countries have much trade creation to gain from an FTA.

U.S. trade policy makers would be well-advised to consider this view. Instead of focusing their attention on Latin America, they should focus their cooperative efforts where they are needed most. They should recognize that Japan, not Latin America, is the direction in which the United States should be focusing its institution-building desires. The U.S.-Japan relationship is deteriorating, and if an economic war begins, then no one can predict or control how detrimental it will be. By creating a JUSFTA, however, the United States and Japan can avoid the threat of economic war altogether. They can move past the point of political posturing and accept the reality of their situation: they need each other both economically and militarily, and if they are to avoid a split, they need to begin a serious attempt at mending their straining ties.

The section that follows discusses the problems in the U.S.-Japan relationship which are so negative that in the minds of some they warrant threats of trade wars. The problems in the approach of the U.S. that aggravate these underlying problems are also discussed below.

4.1 U.S.-Japan Distrust

Japan is a vital U.S. trade partner and competitor. The United States benefits enormously from its trade with Japan and from the prosperity its trade helps engender. It gains from Japan investing, building factories, and purchasing government bonds in the United States.[113]

The United States gains from trade with other vital partners including Canada, the European Union, and Mexico. U.S. trade relations with this group are largely cooperative, however. The U.S. has separate agreements with Canada, the CUSFTA, and with Mexico and Canada,

113. *See* CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE, RETHINKING JAPAN POLICY: A REPORT OF THE U.S.-JAPAN STUDY GROUP (1993) [hereinafter CARNEGIE].

the NAFTA. With the European Union, although it has yet to institutionalize its trade relationship, it has a significant relationship through NATO and has shared the stewardship of the international economic system throughout most of the Cold War.[114] Although the transatlantic cooperation may at times be stressed, especially since the end of the Cold War and the onset of the war in the former Yugoslavia, the appointment of a European to head the new World Trade Organization demonstrates the underlying fact of cooperation.[115]

The term "cooperation" greatly fails to describe the reality of the relationship shared with Japan. Although U.S. policy-makers and politicians discuss the importance of the U.S.-Japan relationship and use the slogan that the two have a "global partnership" in economic, political, and strategic affairs, their rhetoric is devoid of real content.[116] The U.S.-Japan partnership does not seem to exist.

What best describes the U.S.-Japan relationship is unfriendliness and distrust. In 1993 the *New York Times* reported that polls conducted jointly by it, CBS News, and Tokyo Broadcasting between July 1985 and June 1993 found 64% of Japanese characterized U.S.-Japan relations as unfriendly; 45% of Americans believed that Japan competes unfairly; and 85% of the Japanese thought that the United States was unjustly blaming Japan for its economic difficulties.[117] These results show why some observers believe that if the two economies were not so interdependent, and if Japan did not depend on the United States for its security, the two states might have parted ways some time ago.[118]

Some of the U.S. hostility toward Japan reflects its frustration with relatively poor economic performance in the 1980s and the result-

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114. This co-stewardship is symbolized by the fact that a European is usually chosen as head of the International Monetary Fund, while an American is usually chosen as head of the World Bank.

115. Admittedly, the two are very competitive, and the United States only accepted the European candidate after its candidate, former President Salinas of Mexico, withdrew his name from competition because of the economic troubles in Mexico and the arrest of his brother in connection with the murder of a prominent Mexican official.

116. *See* Morton I. Abramowitz, *Foreword* to CARNEGIE i, *supra* note 113 at viii; ROBERT M. KIMMITT, U.S.-JAPAN: DEFINING OUR GLOBAL PARTNERSHIP (U.S. Department of State, 1989); W. ALLEN WALLIS, U.S. AND JAPAN: PARTNERS IN GLOBAL ECONOMIC LEADERSHIP (U.S. Department of State, 1988).

117. David E. Sanger, *64% of Japanese Say U.S. Relations Are Unfriendly*, N.Y. TIMES, July 16, 1993, at A1.

118. *See* FRANCIS FUKUYAMA & KONG DAN OH, THE U.S.-JAPAN SECURITY RELATIONSHIP AFTER THE COLD WAR (1993); *see also* Kuroda, *supra* note 9.

ing tendency to look for foreign scapegoats.[119] Some of the U.S. dissatisfaction with Japan can also be characterized as ethnocentrism.[120] Critics state that Japan is unable to play by the rules; that Japan's traders are predatory and hence need to be restrained;[121] and that rules-oriented trade is not possible with Japan.[122] The same cultural bias leads many officials to argue that Japan is an abnormal state in that it operates a fundamentally different type of capitalism.[123]

4.2 Japan is Different

The notion that Japan is somehow different and closed is an issue which dominates U.S.-Japan disputes.[124] Politicians and, for lack of a better term, "Japan-bashers" believe that the differences are fundamental. That is, Japan will continue to maintain "opaque protection" of its markets, while the United States will keep its "relatively transparent openness;"[125] that Japan cannot successfully be approached through the traditional processes; and that therefore the United States should pursue results-oriented policies.[126]

To be sure, there are significant differences between the two economies due to their different styles of financial markets, labor-management relations, industrial policy, and corporate governance, but the notion that Japan's different style of capitalism makes it impossible to do business there has not yet been supported econometrically.[127] Addition-

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119. BERGSTEN & NOLAND, *supra* note 94, at 4.

120. BHAGWATI 1991B, *supra* note 23, at 24 (1991).

121. *Id.*, at 27-28.

122. Meanwhile, the reverse implication is that U.S. firms are benign and fair. *Id.* at 28.

123. *Id.* at 32.

124. The most cited evidence of Japan's un-openness is its low propensity to import. CARNEGIE, *supra* note 113, at 26. Some studies, however, demonstrate that Japan's level of imports is normal given its triangular trade. Gary Saxonhouse, *The Micro- and Macro-Economics of Foreign Sales to Japan*, in TRADE POLICIES IN THE 1980s 259 (William Cline ed., 1983); Edward Leamer, *Measure of Openness*, in TRADE POLICY ISSUES AND EMPIRICAL ANALYSIS 147 (Robert E. Baldwin ed., 1988). Still, the issue of openness persists. Unfortunately, the perception of un-openness leads to the reality of un-openness, for the perception discourages attempts at penetration by U.S. firms.

125. BERGSTEN & NOLAND, *supra* note 94, at 8.

126. *Id.* at 7.

127. *Id.* Structural non-tariff barriers do exist in Japan. This is indisputable. They include product liability, competition policy, FDI restrictions, and rules on intellectual property rights. *Id.* at 72. How significant these barriers are, however, is controversial. Another structural barrier is the Japanese keiretsu. Japanese industry is highly concentrated, and it is often concentrated through keiretsu. Keiretsu are networks of firms

ally, the U.S. rhetoric concerning the trade deficit with Japan is not well-rooted in empirical studies.[128] Also, the varying styles are neither set nor immutable. In fact, the two styles appear to be converging, a process which will likely "accelerate with the increasing internationalization of both economies."[129] This convergence is occurring for two reasons. First, U.S. economic weaknesses require reform and emulation of foreign models like Japan's.[130] Second, Japan's consumers want an increased standard of living and a less hostile relationship with the United States.[131]

The differing styles of capitalism are not the most serious problems in the U.S.-Japan relationship. The most fundamental issues are the U.S. budget deficit and Japan's global current account surplusses. Despite claims to the contrary by policy-makers and trade negotiators, these macro-imbalances are the underlying cause of the U.S. trade deficit with Japan.[132] The reasons for this are well known: the U.S. budget deficit crowds out saving and investment; the United States must rely on foreign savings to finance its debt and investment needs; much of this financing comes from Japan, which saves twice as much as the United States;[133] and these realities are a consequence of the emphasis on consumption in the United States and the emphasis on saving and investment in Japan.[134]

Still, even in the absence of these problems, the U.S.-Japan relationship would not be problem-free. For one, trade tensions are an inherent problem for any significant trade relationship. Two, the competi-

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with financial, managerial, and product market interlinkages. They are largely exclusionary, but they are probably also efficiency-enhancing. *Id.* at 74. Bergsten and Noland distinguish three roles of the keiretsu. The first role is as the financial links which allow for longer time horizons, thus allowing a focus on market share. The second is as the vertical integration of producers and suppliers which allows for increased information exchange. The third is as the distribution links. (The distribution links are not efficiency-enhancing.) *Id.* at 75.

128. BHAGWATI 1991A, *supra* note 5, at 67.

129. BERGSTEN & NOLAND, *supra* note 94, at 11.

130. Some methods worth adopting are long-term rather than short term investing, patient profit-seeking, emphasis on long-term market-share, and just-in-time inventory practices (which has already been borrowed). *Id.* at 12.

131. *Id.*; *See also* Funabashi, *supra* note 11 at 20.

132. *See* BERGSTEN & NOLAND, *supra* note 94; Stephen D. Cohen, *United States-Japan Trade Policies*, 37 PROCEEDINGS OF THE ACADEMY OF POLITICAL SCIENCE 122-36 (1990); CARNEGIE, *supra* note 113, at 21, 25-29; Takatoshi Ito, *U.S.-Japan Macroeconomic Policy Coordination*, in JAPAN'S INTERNATIONAL AGENDA 81, *supra* note 11; and Kuroda, *supra* note 9.

133. BERGSTEN & NOLAND, *supra* note 94, at 36.

134. *See* KRUGMAN, *supra* note 9.

tiveness and similarity of the U.S. and Japanese economies (shown in the last section) almost ensure conflict.[135] For this reason, when searching for solutions, the microeconomic dimension of the relationship must be considered alongside the macroeconomic one.

4.3 Managed Trade

It is the microeconomic issue (or sectoral issue) which has the most salience in the U.S. political debate, and U.S. trade policy has responded by seeking managed trade with Japan. The managed trade approach is characterized by the use of Section 301 to obtain market access agreements. Fundamentally, managed trade agreements set numerical targets for market share — *e.g.*, 20% of Japan's market for semiconductors guaranteed to U.S. firms — that a government is legally bound to fulfill. In other words, instead of allowing market conditions to decide how much trade is conducted, managed trade requires the politically agreed market shares to be the basis of how much trade takes place. The Clinton Administration professes (as did the Bush Administration before it) that such market access agreements open markets and counter the trade deficit. However, as Schott states, "[t]rade negotiations — and other trade policy measures, whether pursued unilaterally, bilaterally, or multilaterally — can do little to correct the U.S. trade deficit."[136]

The Clinton Administration currently pursues managed trade with Japan.[137] Managed trade comes in two main forms: voluntary export restraints (VERs) and voluntary import expansions (VIEs).[138] Two examples, the 1981 Auto Agreement (VER) and 1986 Semiconductor Agreement (VIE), illustrate why these policies are negative.

135. *See* BERGSTEN & NOLAND, *supra* note 94. The two economies compete head-on in industries like financial services, autos, and high-technology manufacturing. *Id.* at 1.

136. Schott, *supra* note 16, at 53.

137. The Clinton Administration prefers to label its trade policy as "cautious activism." *Free Trade Policy or Protectionism? Clinton Aids Prefer "Cautious Activism,"* BNA INTERNATIONAL TRADE REPORTER, Dec. 9, 1992, at 2113. Former Clinton Treasury Secretary Altman rationalizes U.S. policy this way: "The United States is not seeking targets. The issues are goals and measurability. In any particular sector, the U.S. aim is to negotiate a series of long-term goals and objective standards against which progress can be judged." Roger C. Altman, *Why Pressure Tokyo?*, 73 FOREIGN AFFAIRS 2, 4 (1994). Altman's rhetoric is not convincing. He and other decision-makers can characterize U.S. policy in any manner they wish, but they cannot change the underlying fact that managed trade is what they describe.

138. They are voluntary only in the sense that other nations agree to them. Such agreement only comes after threats of U.S. sanctions.

Concern over autos mounted in the 1970s and led to the 1981 Auto Agreement. By 1979, when the second oil crisis hit, fuel efficient Japanese autos had captured 25% of the U.S. market. In turn, the Big Three U.S. auto-makers pursued an unprecedented lobbying effort to gain protection. Congress responded with threats of limiting auto imports. Under enormous pressure, Japan reluctantly agreed to limit their auto exports to the United States.[139]

The 1981 Auto Agreement had five results. One, it increased auto prices significantly. Two, it forced Japan's auto firms to establish a cartel to limit exports. Three, Japan's factories established firms in the United States to avoid the restrictions. Four, Japan's firms shifted production from low-end to top-end autos, thus earning higher profits and increasing the deficit in autos. Five, the agreement spurred debate between the United States and Japan.[140]

Another source of continuing debate has been the 1986 Semiconductor Agreement. The United States negotiated this agreement to counter this industry's $2.5 billion deficit with Japan. The agreement had set floor prices for Japanese semiconductor exports to the United States, and promised U.S. companies a 20% share in Japan's market.[141]

The 1986 Semiconductor Agreement had five outcomes. It capped U.S. firms' share of the Japanese market at 20%. Prices for semiconductor chips increased to many times their previous level, but virtually all of the firms at the time were from Japan. The agreement had a net effect of transferring wealth from U.S. consumers to Japanese producers. Japan failed to fulfill the target, and the United States imposed sanctions.[142]

Managed trade agreements like the 1986 Semiconductor Agreement should be viewed with skepticism for five reasons more fully discussed below. They necessarily force the foreign government to become more involved in its firms' affairs. They use political power rather than economic competitiveness as the determinate of trade outcomes. They require attention to details that are not easily resolved. They are likely to be captured politically. They encourage bickering rather than cooperation in the countries' relationship.[143]

First. Managed trade necessarily increases a foreign government's involvement in its economy. This sort of trade forces bureaucrats to

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139. BENJAMIN & YAGER, *supra* note 5, at 33.
140. *Id.*
141. *Id.* at 34.
142. *Id.*
143. *Id.* at xvii.

decide which exporting firms can export and how much they can export to the United States.[144] When numbers instead of rules guide trade, a state must increase regulation to produce the politically set market shares. In turn, this fact encourages firms to collude or create cartels where before there were none. In Japan, cartel formation only strengthens the iron triangle of Japanese politics.[145]

Second. In pursuing managed trade policies, the United States uses its political power rather than its economic competitiveness to succeed in the global marketplace. Such behavior is "inconsistent with the very principals on which the [United States] has itself provided leadership in shaping the world trading system over half a century."[146] Such behavior "amounts to a denial of free business activities and of the system of free trade"[147] and is a move away from existing fairness rules.[148] This behavior also encourages others to behave in the same manner — beggar thy neighbor — and therefore places the world trading system at risk.[149] Overall, the use of political power moves trade away from a rule-based system to one resembling the anarchic international system of power politics.[150]

Third. Understandably managed trade requires attention by governments to details that are not easily resolved. How does a government count the goods produced by joint companies? What percentage of the product defines its origin? Are domestically produced but foreign owned goods foreign or domestic? How does the government guarantee the percentage of a market? Does it buy the goods and then force its people to buy them? For how long does the government guarantee access? What is a fair amount of access? From these questions one can tell that managed trade policies "grossly exaggerate [t]he ability of governments to control the outcome of complex economic forces."[151]

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144. In the case of autos from Japan, Honda, a firm with no government involvement before the agreement, was forced to politicize its management.

145. *See* Heizo Takenaka, *Japan's International Agenda: Structural Adjustments*, in JAPAN'S INTERNATIONAL AGENDA 164, *supra* note 11. Three groups, labeled collectively as the iron triangle, dominate politics in Japan: politicized business sectors, their representatives in the Diet, and the bureaucrats who oversee industry. "These groups seek to maintain a symmetry of power and to protect their vested interests." *Id.* at 182.

146. Jagdish Bhagwati, *Samurais No More*, 73 FOREIGN AFFAIRS 7, 7-8 (1994).

147. Kuroda, *supra* note 9, at 127.

148. BENJAMIN & YAGER, *supra* note 5, at xvii.

149. *See* BHAGWATI 1991B, *supra* note 23.

150. It is arguable that the "beggar-thy-neighbor" policies of the 1930s symbolized such a trade environment.

151. CARNEGIE, *supra* note 113, at 31.

Therefore enforcement of managed trade agreements is problematic. In addition, there is no "sufficiently unambiguous and plausible way" in which a fair share for the United States in Japan's market can be calculated.[152]

Fourth. Managed trade is likely to be captured politically. It is a "Pandora's box" which causes every exporting company to call for the application of targets in their sector, and "given the realities of the [U.S.] political process, [these pleas are] difficult to resist."[153] In such an environment, U.S. policy cannot set priorities; it just responds to the wheel that squeaks the loudest.[154] Each problem appears to be handled on a case-by-case basis in response to the level of political clout of the complaining industries or firms. Such an approach to trade policy is costly, inefficient, and never-ending.[155] Furthermore, such an approach cannot be expected to change the fundamentals of the economic relationship, and there is no reason to believe that resolving today's problem will prevent another issue from being raised tomorrow. In fact, the opposite is true, since handling a complaint today makes it likely that another issue will be brought forward tomorrow.[156]

Fifth. Pursuing managed trade damages the U.S.-Japan relationship. U.S.-Japan trade negotiations, like the ones begun under the auspices of the 1993 Framework Agreement, continually stall on the issue of numeric targets. The United States indicates that it wants some type of numeric target or market share and Japan refuses. Also, whereas Japan would like the talks to be reciprocal, the United States insists that they are not, and it stresses its right to use Section 301 sanctions with respect to any negotiations. This is inflammatory to the Japanese and only emboldens their opposition to U.S. demands, whatever they are and whatever they become. After all, Japan is a global economic superpower that can effectively defend its interests. It "no longer needs to defer to the dictates of the United States."[157] Its cooperation "must now be sought and won . . . on most key issues."[158] The United States should recognize this reality and change its approach. As it stands now, however, the best that can result from the U.S. insistence on managed trade and the use of Section 301 and the Japanese refusal to use nu-

152. BHAGWATI 1991A, *supra* note 5, at 68.

153. CARNEGIE, *supra* note 113, at 29.

154. BERGSTEN & NOLAND, *supra* note 94, at 202.

155. *See* Penny Turner, *The Feasibility of a U.S.-Japan Free Trade Agreement*, 26 TEX. INT'L L. J. 275-313 (1991).

156. BENJAMIN & YAGER, *supra* note 5, at xvii.

157. *Id.* at 299.

158. BERGSTEN & NOLAND, *supra* note 94, at 235.

merical targets is "a continuation of the contentious discussions" which can only lead to an overall deterioration in U.S.-Japan relations.[159]

4.4 The Auto and Auto Parts Dispute

A very recent example, the auto and auto parts discussions (arguments), shows how deleterious this fundamental disagreement over the approach could be. These talks began in July 1993 under the Framework Agreement, and three months later then-U.S. Trade Representative Mickey Kantor launched an investigation of Japan for possible trade barrier violations under Section 301. The talks were generally cantankerous. The U.S. position, as stated by USTR Kantor, was "it's time that Japan plays by the same rules the rest of us do."[160] Japan's position was that it would not accept another managed trade deal like the 1986 Semiconductor Agreement; it got burned then, and it did not want to repeat the same mistake.

The United States had three complaints. The main point was the auto-parts market. The United States argued that the Japanese auto-parts market was effectively closed because of Japan's "genuine parts" certification rules. These rules caused garages to buy parts from certified Japanese auto-dealers, who in turn are tied exclusively to the Japanese auto-makers through age-old contractual relationships. There was truth in the U.S. argument; this process did bias the auto-parts market in favor of local producers. This practice, however, did not break any established rules on trade. But if it was an impediment, then the United States should have tried to negotiate its removal without political posturing, or it should have taken whatever legal case it might have had to the WTO; it should not have threatened sanctions like a bully.

Unlike the first complaint, the others were no less than ridiculous. The second U.S. complaint was that Japan's auto-makers buy too many parts under long-standing arrangements with Japanese suppliers. Japanese auto-makers typically find sources through their existing supplier networks — this was and still is true — and the structure of their contractual relationship is such that assemblers will only change suppliers in response to large cost differences. There is nothing wrong with this practice. These same types of arrangements would not be illegal under U.S. anti-trust laws.[161] Furthermore, this practice makes sense, since it alleviates uncertainty, and U.S. auto-makers have begun to imi-

159. BENJAMIN & YAGER, *supra* note 5, at 40.

160. Interview with Mickey Kantor, former United States Trade Representative, on This Week with David Brinkley (ABC television broadcast, May 28, 1995).

161. *Putting a Stop to Trade*, THE ECONOMIST, May 27, 1995, at 18.

tate it.

The last U.S. complaint was that Japan bought too few cars from the United States. The United States argued that the Japanese auto-makers' intimate relationships with suppliers and dealers closed Japan to competition. Meanwhile, somewhat hypocritically, the U.S. auto-makers clung (and still cling) to the status quo in Europe, where regulations permit auto-makers to operate vast, exclusive dealership networks virtually free of competition.[162] Even if this intimate relationship did not exist, however, the Big Three will not sell many U.S.-made cars unless they put the steering wheel on the right side. Currently, there are only two U.S.-made cars offered in Japan with right-hand drive (the norm in Japan) — Chrysler's Jeep Cherokee and Ford's Mazda-based Probe.[163] General Motors does not sell even one U.S.-made car in Japan with right-hand drive. No wonder the Big Three only have a 0.5% share of the Japanese auto-market. "It's not easy driving a car with the steering wheel on the 'wrong' side."[164]

The Big Three's failure contrasts with European automakers' success in Japan. The success of Adam Opel AG,[165] Bayerische Motoren Werke AG and Volkswagen AG show the realities of operating in Japan: though very expensive to enter, the Japanese car market can be cracked by those who make a genuine commitment to do so. In fact, BMW and VW have successfully courted Japanese dealerships to sell their cars, which undermines the argument that Japanese dealers are closed to foreign cars.[166]

The United States cannot expect Japanese consumers to buy U.S. cars when the Big Three have made almost no effort to sell them, and it makes little sense for the United States to complain, and almost impose sanctions, over this issue or any of the others. Indeed, it is not unreasonable to argue that the "only reason Japan is an issue is because the Big Three want [domestic protection]. They're not serious about building cars for the Japanese market. If they were, you would see them building in Japan just like they do in Europe."[167] Incidentally,

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162. *Big Three Tactics Diverge in Japan and Europe*, THE WALL ST. J., May 19, 1995, at A2, C3.

163. Interview with Peter Brown, Reporter for AUTOMOTIVE NEWS, on Talk of the Nation (National Public Radio broadcast, May 11, 1995); *Dear Mickey*, THE ECONOMIST, June 17, 1995, at 73.

164. *Dear Mickey*, *supra* note 163, at 73.

165. Adam Opel AG is a European auto-maker owned by GM.

166. *See* Valerie Reitman, *Sales of Auto Imports Are Rising in Japan*, THE WALL ST. J., May 19, 1995, at A2.

167. Walter Huizenga, President of the American International Auto Dealers Association, *quoted in* Reitman, *supra* note 166.

the U.S. has never even considered threatening sanctions over another apparently closed market, that of Great Britain's — another country where people drive on the left side of the road. The Big Three's share of that market is only 0.6%.[168]

There lies the real point. Japan has a comparative advantage in auto-production superior to that of the United States. Japanese autos are reliable, fuel-efficient, and attractive — something U.S.-made cars only recently have become. As *The Economist* points out, "[o]ut of the 59 different models on sale in [the United States] . . . every single one has a steering wheel where Americans expect it."[169] Clearly, until Americans (none of whom have ever been forced to buy a Japanese car) stop buying so many cars, or until Japanese auto-makers move most of their production facilities to places like Australia, East Asia, and South America, the U.S. trade deficit, the majority of which is from autos and auto parts, will remain high. The trade deal which the United States and Japan recently reached will not change this basic fact.

4.4.1 Trade War Barely Averted

Despite the inherent problems in the U.S. stance, the trade dispute "came closer to outright economic warfare than its predecessors."[170] In May, after negotiations broke down over the issue of numerical targets, USTR Kantor announced the U.S. plan to impose sanctions[171] on thir-

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168. *See Big Three Tactics*, *supra* note 162.

169. *Id.*

170. Helene Cooper and Valerie Reitman, *Averting a Trade War: U.S. and Japan Reach Agreement on Autos*, THE WALL ST. J., June 29, 1995, at A6.

171. For its part, the United States stated that after it levied sanctions it would also file a complaint against Japan with the WTO. The proposed use of Section 301 sanctions while making an appeal seems inconsistent and contradictory, however.

> Had the [United States] moved resolutely and early to gather facts, file a case and see it through, it would have demonstrated to the U.S. public and other nations that trade disputes can be settled by reason. Applying sanctions after a victory is considered lawful activity; applying sanctions first is considered bullying.

Bob Davis, *U.S.-Japan "Trade War" Is Really Just a Brawl*, THE WALL ST. J., May 15, 1995, at A1. This is the course of action the United States should have taken if it had a legitimate case. Instead, even though there was no compelling national interest to do so, the United States planned to violate the new dispute settlement rules without ever giving them a chance to serve their purpose. And even if it did file its supposedly "massive" case against Japan (probably under the Article 23 "nullification and impairment" provision), observers noted that it did not plan to see the case through; "rather, filing [was] a tactical move to deflect attention from unilateral [U.S.] sanctions against the Japanese." *Id.*

teen Japanese luxury cars worth $5.9 billion.[172] In response, Japan's top negotiator said that Kantor "is scarier than my wife when I come home drunk."[173]

Both sides painted themselves into a corner through the use of tit-for-tat strategies; the United States would not back away from its demands, while Japan stated that it would not offer any new "voluntary plans" for increasing purchases of U.S. auto parts beyond what Japanese car makers had already detailed.[174] The sanctions deadline of 12:00 a.m., June 29, 1995,[175] was literally a few hours away when the two sides finally agreed to cease their quarreling.

Box 1: The 1995 Auto-Trade Pact

1• Japanese auto-makers volunteered their business forecasts, and the United States makes the following projections:
- Japanese vehicle production in the United States will increase 25%
- US-based Japanese auto-makers will purchase $6.75 billion more parts from US firms by 1998.
- Japanese-based car makers will purchase $2 billion more parts US firms.
- Japan does not guarantee these results.

2• Japan will send a letter to Japanese dealers confirming their right to sell foreign cars.
- The US auto-makers estimate they will contract more than 200 more Japanese dealers in 1996 and 1,000 by year 2000.
- Japfan does not guarantee these results.

3• Japan will ease "genuine parts" certification requirements by reducing the number of parts labeled as :critical," which requires them to be handled by designated garages.

Source: THE WALL STREET JOURNAL, June 29, 1995, A6.

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172. Not all involved in the U.S. auto and auto parts industry favored sanctions. An ITT Automotive spokesman commented frankly that "this is an issue we wish didn't exist." Robert Simison & Neal Templin, *More Sales of Components in Japan May Generate Few Jobs in America*, THE WALL ST. J., May 18, 1995, at A2. The reason for ITT's opposition, as well as the opposition of others like Dana Corporation, was that they have been aggressively expanding into Asia and already have a substantial degree of business in Japan. A trade war would have benefited neither of these companies, for it would likely result in a backlash and taint the relationships they have been working so hard to gain and solidify.

173. Hashimoto, *quoted in* Simison & Templin, *supra* note 172, at A6.

174. *U.S.-Japan to Resume Trade Talks on Market for Automobiles, Auto Parts*, BNA INTERNATIONAL TRADE DAILY, March 24, 1995.

175. After the deadline's announcement, top Japanese trade official Hashimoto called that "a made-in-the-U.S. deadline." *Quoted in* Valerie Reitman, *Silent Negotiators*, THE WALL ST. J., June 27, 1995, at A12. Meanwhile, the Big Three issued jubilant statements because they could regain lost ground in the luxury car market. However, it would more likely have been a big pay day for the European luxury automakers. Another outcome would have been certain as well. History shows that whenever new restrictions are imposed on a market, prices for the goods in that market go up. U.S. consumers would have had to pay more for a luxury car.

The United States held firm on needing quantifiable targets of production and of a rise in the number of foreign-car dealers in Japan, but the United States put forward the projections itself and the Japanese did not commit to them. Evidently, this was enough for both sides to claim victory and a deal was signed.[176]

4.4.2. What Did the Auto-Trade Pact Achieve?

What did the deal really achieve? The answer is very little. Japanese auto-makers have been considering increasing production in the United States for quite some time due to the continued rise of the yen. Their announced moves probably do not differ much from what they have been considering all along. The U.S.-based Japanese auto-makers forecasted in early 1995 increased purchases of U.S. auto parts. It is unclear that they have made concessions to the United States by increasing the size of their forecasted purchase plans. Furthermore, Japan does not in any way guarantee that Japanese auto-makers will meet their forecasts.

The significant portion of the agreement is the progress on Japan's "genuine parts" certification practices. This will help liberalize that industry. But the Japanese have shown a willingness to compromise on this issue all along.[177]

The United States could have achieved the same outcome, and probably an even better outcome, by focusing on the "genuine parts" issue all along without the threat of sanctions and the rhetoric of a U.S. Marshall coming to clean-up Dodge City. This approach, after all, was and will remain Japan's main point of contention. They refuse to manage trade. To be sure they may have conceded somewhat on this point by allowing Japanese auto-makers to volunteer their business forecasts, but Japanese bureaucrats set forth no numbers. The numbers used are merely U.S. estimates of what they expect Japanese firms will do, and these numbers are not guaranteed by Japan. Clearly, on this

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176. *See* Simison & Templin, *supra* note 172. The deal that aborted the planned trade war owes less to the U.S. or Japanese trade negotiators than to two American businessmen, Walter Huizenga and Kjell Bergh. On their own accord, these men used back-channel connections to arrange meetings with Honda, Mitsubishi, Nissan, and Toyota representatives. They got beyond the rhetoric and almost single-handily brokered a deal. However, the distrust between Japanese and U.S. officials nearly ruined their efforts. The two sides were agreed on the basic issue but polarized on how to convert this understanding into a trade agreement. *Id.*

177. *See* Bob Davis *et al.*, *Getting Serious*, THE WALL ST. J., May 17, 1995, at A1.

issue, the Japanese won.[178]

In reality, neither the United States nor Japan came out of the experience as winners. Even if the United States claims victory, the spoils of that victory in terms of increased exports and jobs do not appear to be very large. With the world's best auto-maker, Toyota, doubling its North American production, along with increases by other Japanese auto-makers, the Japanese will likely take more market share in the United States, possibly leading to more calls by the Big Three for protection. This is the unending cycle of managed trade. Meanwhile, the parts-makers who will benefit the most are those who already, because of serious efforts at penetrating the Japanese market, do significant business in Japan — *e.g.*, Dana Corporation and ITT Automotive. And their new business will not lead to many more U.S. jobs. Dana and ITT both stated that they would respond to any new business in Japan by building more factories there and in East Asia, not in the United States.[179]

4.4.3. What Did the U.S. Approach Risk?

Was all this worth a possible trade war? If sanctions were imposed, then Japan might have retaliated; although it has never retaliated against the United States before, there was the increasing possibility that it might do so. It warned in March 1994 that it would retaliate against any GATT-illegal U.S. actions,[180] and in June 1995 it published a list of possible products which could suffer sanctions. If it did retaliate, then the bickering over the Big Three auto-maker's access to the Japanese market would have become a trade war, and the most likely causalities would have been the WTO, APEC,[181] and U.S. economic leadership[182] in the post-Cold War era, not to mention the thousands of former businesses and employees serving the Japanese luxury car industry in the United States. In such an event, Japanese auto-makers could have responded by sourcing even fewer auto parts from U.S. firms than they currently do. Much worse, "Japanese investors . . . could [have] hurt the [United States] by withdrawing funds

178. One U.S. negotiator conceded, "They won that point." Simison & Templin, *supra* note 178, at A1.

179. Davis, *supra* note 171, at A6.

180. BAYARD & ELLIOT, *supra* note 10, at 321.

181. Diplomats from East Asian countries say privately that continued use of Section 301, especially Super 301, will undermine APEC and make it harder to launch serious negotiations for an FTA in the region. *Id.* at 322.

182. U.S. leadership has probably been undermined despite the trade war not taking place.

from key U.S. markets."[183] According to a Christian Science Monitor Radio report, Japanese investors sold $6.5 billion more assets than they bought in the United States during 1994, and so far in 1995 have withdrawn $10 billion. This flight would only be exasperated if a trade war had worsened Japan's banking crisis.

Even if Japan did not retaliate against U.S. imposed sanctions, it would have taken the issue to the WTO for resolution. The United States would probably have lost a confrontation in the WTO. Again, most other states view Section 301 as GATT-illegal, and the East Asian states are exceptionally hostile to its use because they view themselves as its targets. And although the E.U. privately rode the fence on the issue of U.S. aggressive unilateralism with Japan because they realized that they could piggy-back on any "successful" U.S. efforts, they publicly scolded the United States that the use of sanctions without WTO approval "is not the way to solve trade disputes."[184]

A loss for the United States in the WTO would have been potentially catastrophic for its sense of leadership and power and its commitment to the world trade order. Also, it is not unimaginable, given the difficult vote over ratifying the WTO in the U.S. Congress, Senator Dole's reservations over the sovereignty infringing nature of the WTO's DRM, the protectionist stance of Senator Helms (the Chair of the Senate's Committee for Foreign Relations), and the lurking U.S. Presidential race, that such a ruling would have been captured politically in an argument in favor of U.S. protectionism. In fact, Dole commented on President Clinton's U.S. policy this way: "It's strong medicine. It's going to have to be strong until we're permitted access to their markets."[185] One can just imagine the political jockeying taking place on who could be "tougher" on trade in the 1996 Presidential primaries.

An even worse case scenario than the United States losing in a WTO ruling would have been if it refused to comply with the WTO's ruling. Given the growing conservatism in U.S. politics and the past U.S. record of compliance with GATT dispute settlement rulings against it,[186] it is quite possible that the United States would have re-

183. BERGSTEN & NOLAND, *supra* note 94, at 230.

184. Simison & Templin, *supra* note 172 at A10. The E.U. also despises Section 301. In fact, because of U.S.-E.U. agricultural disputes, the E.U. is targeted by Section 301 actions the most. BAYARD & ELLIOT, *supra* note 10, at 57.

185. Simison & Templin, *supra* note 172 at A10.

186. The U.S. responded negatively to 50% (9 of 18) of the valid complaints brought against it during the 1980s. In four cases, it refused to take remedial action. In five cases, it imposed sanctions illegally and would not remove them until the victim had acceded to U.S. demands. The U.S. also habitually delayed taking remedial action

acted negatively to a WTO ruling against it. This would surely have crippled if not destroyed the infant organization the United States had struggled for so long to create.

To be sure, the U.S. insistence on its right to impose sanctions unilaterally without WTO approval has already weakened the WTO's credibility as the governing body of world trade. The new system's success depends on the willingness of powers like the United States to accept, uphold, and enforce its rules and principals. "Going-it-alone turns the WTO into a joke and invites others to disregard it."[187] In all, the U.S. policy of choosing which rules of the WTO to obey and when encourages others to do the same. And "at a time when Asian powers are gaining on the [United States] in strength, that's shortsighted."[188] Already the U.S. use of restrictive "dumping rules" is copied abroad. About this fact Schott says, "[T]he United States is creating monsters."[189] There may come the day when the surging powers of Asia can collectively treat the United States with such disregard, and then it will only have itself to blame. This is the broader picture that U.S. trade policy-makers, by pursuing confrontational managed trade agreements through Section 301 threats, refuse to see.

4.5 Section 301

Flirting with a trade war via Section 301, and especially its Super 301 component, is not the best approach for U.S. trade policy in its desire to change Japan. Although the immensity and leverage of the U.S. market makes Section 301 a powerful trade tool, it is at odds with the rules-based multilateral trade system. Most states argue that it is GATT-illegal. This matters, for as Bhagwati states:

> Prima facie, honoring a treaty commitment is to reaffirm one's respect for orderly procedures and the rule of law in dealing with other nation-states . . . . There is also the problem that means affect ends. Is it not likely that a declared willingness to break GATT commitments, and even actual breach thereof, may spread cynicism toward such commitments by others rather than adherence to them in the future?[190]

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within the Super 301 deadlines it expected others to meet. BAYARD & ELLIOT, *supra* note 10, at 251.

187. *See Big Three Tactics*, *supra* note 162, at A1.

188. *Id.* at A8.

189. *Id.* (quoting Jeffrey J. Schott).

190. BHAGWATI 1991B, *supra* note 23, at 55.

Almost every other member of GATT views Section 301 negatively. Japan characterizes it as the "nuclear weapon" of trade policy.[191] The reasons for the general distaste for Section 301 are clear:

> [Its] detailed procedures are structured as a series of public investigations and decisions which make them appear to be "trade crimes" trials. . . . Section 301 proceedings . . . are a totally one-sided affair in which the United States plays both prosecutor and judge, . . . the defendants are tried in absentia, and . . . [the U.S.] Congress has ordained certain guilty verdicts in advance, particularly with regard to Japan.[192]

Section 301 relies on unilateral interpretations of trade practices, and implicit within it is the belief that the United States is more correct and less protectionist in its policies and practices than the targeted county — *e.g.*, Japan. Consequently, Section 301 marks a significant departure from the key GATT principal that trade rights are defined by and available to all GATT members. Overall, its use is a step away from a rules-based trading system.

There are more beneficial ways to approach trade policy than the Section 301 tool. A recent study by Lee and Roland-Holst analyzing the prospective impact of alternative trade polices like the use of Section 301 to open Japan found that the welfare gains to the United States from bilateral liberalization would be far greater than those obtainable by imposing unilateral sanctions — almost nine times as large.[193] Likewise, Bayard and Elliot conducted a thorough study of Section 301 cases to analyze its effectiveness as a trade tool. They found that a reasonable estimate of the trade gains from successful Section 301 cases might be only $4 to $5 billion, or 1% of annual exports, whereas the liberalization from the Uruguay agreements is an estimated $30 to $40 billion, or 8% to 10% of annual U.S. exports.[194] With this finding in mind, Bayard and Elliot state, "Given its relatively modest impact on U.S. exports, it would be a Pyrrhic victory if Section 301 and other U.S. trade threats undermined the global trading system that has contributed so importantly to global welfare since 1947."[195]

191. Michael Mastanduno, *Setting Market Access Priorities: The Use of Super 301 in U.S. Trade With Japan*, 14 THE WORLD ECONOMY 729, 730 (1992).

192. Robert E. Hudec, *quoted in* LOW, *supra* note 24, at 94.

193. *See* BERGSTEN & NOLAND, *supra* note 94 at 96-97.

194. BAYARD & ELLIOT, *supra* note 10, at 57, 334; *see also* JEFFREY J. SCHOTT, THE URUGUAY ROUND: AN ASSESSMENT (1994).

195. BAYARD & ELLIOT, *supra* note 10, at 334.

In their study, Bayard and Elliot find that U.S. pressure through Section 301 works best when: (1) there is a vulnerable target; (2) the barriers negotiated are transparent; (3) its use is GATT-consistent; and (4) a politically effective constituency in the target country also favors liberalization.[196] This was not the case in the auto-trade dispute.

Bayard and Elliot specifically criticize the use of Super 301.[197] Super 301 requires the U.S. Trade Representative to identify certain individual countries and practices as trade liberalizing priorities.[198] After the liberalizing priorities are established, the United States threatens to impose retaliatory sanctions if the trade practice deemed as unreasonable is not removed within the mandated time frame.[199] On the whole, Bayard and Elliot find that Super 301 is "unnecessarily inflammatory . . . and potentially counterproductive."[200] U.S. trading partners associate it with the worse excesses of aggressive unilateralism — that is, the labeling of target countries as unfair traders (even though their practices do not violate existing international trade agreements). Thus, it further erodes U.S. leadership and credibility in any future trade negotiations. Also, while fear of retaliation may "squeeze out marginal concessions," even vulnerable states will only engage in substantial liberalization when they believe it is in their interests to do so."[201] Bayard and Elliot add that "while systemic and structural barriers are a legitimate problem for U.S. exporters in some cases, . . . labeling [these countries] as unfair traders is not an effective solution."[202]

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196. *Id.* at 320.

197. *See id.* at 55, 76, 313, 317.

198. Super 301 initially singled out three nations, but observers believe that the United States named India and Brazil alongside Japan only to prevent from isolating the latter. *See* JAGDISH BHAGWATI & HUGH T. PATRICK, AGGRESSIVE UNILATERALISM: AMERICA'S 301 TRADE POLICY AND THE WORLD TRADING SYSTEM (1990). In fact, Senator John Danforth stated that "while Super 301 was designed to be aimed at more than Japan, it was not aimed at anything less than Japan." *Quoted in* Senate Committee on Finance, Oversight of the Trade Act of 1988, 100th Congress, 1st Sess. 14 (Comm. Print 1989). Super 301 originally authorized the USTR to pinpoint trade liberalizing priorities only for the years 1989 and 1990, but President Clinton renewed its authority by executive order on March 3, 1994. Exec. Order No. 12,901, 3 C.F.R. 10721(1994).

199. In addition to viewing Section 301 as a tool in forcing unilateral concessions, the United States considered it as a bargaining tool for the then-current Uruguay Round negotiations of GATT. Interview with Frank Garcia, Assistant Professor of International Business & Trade Law, Florida State University, in Tallahassee, Fla. (May 1, 1995).

200. BAYARD & ELLIOT, *supra* note 10, at 313.

201. *Id.* at 316.

202. *Id.* at 321.

Overall, Bayard and Elliot find that the use of "Super 301 is undesirable because the potentially significant — and unnecessary — costs outweigh the limited benefits."[203]

What policy is desirable then? In concluding their study, Bayard and Elliot observe that the work for U.S. trade policy which remains after the Uruguay Round involves ill-defined, non-tariff barriers which are less amenable to a process like Section 301. They state, "The more systemic the barrier, the greater will be the number of groups that must cooperate in eliminating it."[204] They point out that "broad based changes in the mental attitudes of low-level bureaucrats, consumers, and the society at large are needed as a part of an effective solution to structural problems." They explain that trade agreements — like the 1995 Auto-Trade Pact, one might suggest — which "are not accompanied by a corresponding change in mentality are meaningless."[205] They go on to say that ameliorating the differences between Japan and the United States requires "a profound understanding of the reasons for the differences, how they impede trade, and how they can be changed without undermining legitimate economic objectives or social preferences."[206] The next section outlines such a broad-based, cooperative, and fundamentally different approach, built around a Japan-U.S. FTA, that would lead to such a new mentality and understanding in the Japan-U.S. relationship.

Section 5: Improving The U.S.-Japan Relationship: A Japan-U.S. FTA

> The Cold War partnership between our countries is outdated. We need a new partnership based on a longer vision and above all based on mutual respect and responsibility.
>
> — *President Clinton to Prime Minister Miyazawa, 16 April 1993*[207]

> What issues and challenges will dominate the next century are unclear, but two things are certain: economics will be at the center of international affairs, and the [U.S.]-Japan partnership will play a key role in determining the course of global events.

203. *Id.* at 317.
204. *Id.* at 336.
205. *Id.* at 316.
206. *Id.* at 342.
207. *Quoted in* CARNEGIE, *supra* note 113, at 1.

> The Clinton Administration is committed to charting a new course of relations with Japan that builds on these emerging realities.
>
> — *Former Secretary of the Treasury Roger C. Altman*[208]

> If we keep our objectives in mind, we will realize that the way in which we have tried to relieve the frictions has often been in conflict with what should be our goal.
>
> — *Economist Robert Z. Lawrence*[209]

> Given that economic competition will, and should, continue between the two countries, we need to cease this nickel-and-diming approach that we have fallen into and find a more collaborative, broader and longer range method of resolving our individual trade differences. . . . One idea worth looking at is the concept of a free trade agreement between the [United States] and Japan.
>
> — *Former U.S. Ambassador to Japan Mike Mansfield*[210]

There exist many clichés about the U.S.-Japan relationship, but most everyone recognizes as truth the mantra that it is the most important bilateral trade relationship in the world.[211] Why, then, is better care not taken of it? No one can sufficiently answer this question. For this reason, almost every study of the relationship calls for a new collaboration. They argue that the United States and Japan need to formulate practical ways to address jointly the current problems, like the North Korea nuclear issue, and future ones, like the emergence of China as a superpower. Studies argue that the United States and Japan need to address their trade problems jointly in a less charged atmosphere. Although President Clinton has professed the need for such a "partnership," his administration's actions move U.S. policy in the opposite direction. It is time to stop this negative trend.

The U.S.-Japan relationship must be viewed with an eye toward its broader context. It is a vital relationship not only in economic terms, but also in political and strategic terms, and the costs would be enor-

208. *Quoted in* Schott, *supra* note 16, at 6.
209. Robert Z. Lawrence, *comment* to Kuroda, *supra* note 9, at 131.
210. *Quoted in* Kuroda, *supra* note 9, at 122.
211. Abramowitz, *supra* note 116, at xvii.

mous if the two states were to go separate ways. Such a possibility is not far from the minds of many Japanese, especially with their new-found economic superpower status. According to Kuroda, "there is a growing mood that [Japan] should take a path of separation and go it alone."[212] This gives all the more reason for the United States to move in a fundamentally different and more conciliatory direction. To do that this study recommends that the United States abandon the use of Section 301 and pursue a non-traditional FTA with Japan (JUSFTA) which includes a consultative mechanism, a dispute resolution mechanism, and a macroeconomic coordination mechanism in the form of a G2.[213]

5.1 JUSFTA

To resolve its disputes, the United States needs to restructure its relationship with Japan substantially. It needs to examine the underlying problems as a whole rather than responding to individual problems piecemeal, for the ad hoc managed trade approach only treats symptoms rather than causes. Overall, it needs a substantially better forum for the seemingly endless arguments and counter-arguments over product-specific and industry-specific disputes which have not improved but worsened U.S.-Japan relations. Without such a forum, the United States and Japan will neither mitigate trade tensions nor correct trade imbalances. Such a forum could be found in a U.S.-Japan FTA.

A JUSFTA is not a new idea. In 1987 former ambassador to Ja-

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212. Makoto Kuroda *quoted in MITI-Appointed Private Study Group Warns U.S.-Japan FTA Would Harm Multilateralism*, BNA INTERNATIONAL TRADE REPORTER, June 21, 1989.

213. This G2 could be expanded to include the core European Union states once monetary union occurs amongst them. On another note, the United States should also pursue an expanded role for Japan in international affairs. Quite legitimately, observers characterize Japan as a "free rider" in security, economic, and political arrangements. BERGSTEN & NOLAND, *supra* note 94, at 201. Much of Japan's lack of responsibility stems from its lack of offensively capable armed forces and East Asia's fear of any Japanese moves to substantially rearm itself; from its political system needing gaiatsu to act on major international and domestic issues; and from its Cold War big brother-little brother relationship with the United States. The big brother-little brother mentality, however, is outdated and understandably sparks Japanese resentment. CARNEGIE, *supra* note 113, at 4. This is all the more reason for the United States to make Japan a full partner in the international system. A vital step would be to bring Japan into the United Nation's Security Council. Even if it did this, however, (and geo-politics weigh very much against this occurrence) some argue that "Japan cannot develop an effective international role until there is a significant measure of domestic political change." Funabashi, *supra* note 11, at 25.

pan Mike Mansfield stated that "an FTA could be helpful in defining the economic goals of [the U.S.-Japan] relationship. It is better to face up to the whole policy issue rather than submit to nickel and diming on every single issue."[214] In January 1988 Professor Milton Friedman and ten other economists placed a full page ad in the Washington Post urging the United States and Japan to establish an FTA as a means of easing trade disputes. In the same year then Secretary of Commerce C. William Verity stated that "an honest and two-way examination of the issues of free trade would underline both for [the United States] and Japan the responsibilities [they] bear to each other."[215] In 1989 Schott wrote that "an FTA could contribute to the improved management of bilateral trade relations by creating new rights and obligations that perforce require new consultative and dispute resolution mechanisms to supervise the operation of the agreements and enforce the parties' rights and obligations."[216] In 1990 Peters stated that "the ability of a [U.S.]-Japan FTA to remedy the numerous problems in the trade relationship is significant . . . and its potential scope can be assessed only through the commencement of serious preliminary negotiations."[217] And in 1991 Turner argued that "an FTA with Japan would . . . force the two nations to take a closer look at the macroeconomic factors . . . which [are] the primary cause of the current trade imbalance."[218] Overall, these observers agree that an FTA is an efficient avenue for pursuing a new comprehensive collaboration.

There are a number of notable precursors to a JUSFTA. Recent examples include the Market-Oriented Sector Specific (MOSS) talks, the Structural Impediments Initiative (SII) talks, and the 1993 Framework Agreement.[219] These mechanisms, however, have only been halfway approaches to the problem. They have not been comprehensive enough nor have they been truly reciprocal. They all have started with the assumption that Japan's markets, as symbolized by Japan's low propensity to import, are closed; that Japan is to blame for the U.S. trade deficit; and that therefore Japan must change.[220]

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214. *See* Schott, *supra* note 16 at 32.

215. C. William Verity, Remarks Before the Council on Foreign Relations, U.S. Dept. of Commerce News, June 8, 1988.

216. Schott, *supra* note 16, at 52.

217. Mary Peters, *Free Trade Area Agreements as the Economic and Legal Solution to Bilateral Trade Relationships: The Case of Japan*, 28 COLUM. J. OF TRANSNAT'L L. 499, 529-30 (1990).

218. *See* BENJAMIN & YAGER, *supra* note 5, at 296.

219. *See* Schott, *supra* note 16 for a fuller discussion.

220. Although the SII talks had a more reciprocal tone, the United States did not enact any of the recommendations given by Japan.

An FTA would involve a fundamentally different approach than these precursors. Unlike negotiations characterized by Section 301 proceedings, these negotiations would necessarily be more consultative, not dictatorial, with both sides open to critical concessions.[221] Also, Schott makes clear that by entering into FTA negotiations the United States and Japan would establish

> a stake in [the FTA's] success, since once the negotiating process begins, it is hard to go back to the status quo ante. Expectations get built into the process, and if results are not achieved, there is a risk that the backlash could worsen relations. Thus, by focusing attention on the overall bilateral relationship, the successful conclusion of an FTA takes on importance for many reasons beyond the economic ones.[222]

Such a concentration of attention and political stake will help the United States and Japan realize their much talked about global partnership. In addition, the FTA approach, as opposed to precedents like the SII talks, would result in a binding agreement. Overall, the negotiation of an FTA with Japan would force the United States to prioritize its trade concerns. The United States would have to identify systematically government policies and private practices which are barriers. It could then push for true market liberalization in Japan. It is this true liberalization which "provides the greatest trade benefits in almost all cases of impeded market access. . . . The payoffs . . . are likely to be much greater than any 'managed trade' deal."[223]

5.1.1 Japan's Motivation in Negotiating a JUSFTA

Accepting the arguments above, why might Japan negotiate an FTA with the United States? There are four prime reasons.

ONE. Japan may wish to avoid any trade diversion that might take place if the United States begins to form a WHFTA. Japan has been particularly vocal in expressing concern that NAFTA is protectionist and trade diverting. In 1993 Former Prime Minister Miyazawa even

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221. Let there be no illusions; the United States would have to make concessions of its own. The largest concession it could make would be a standstill commitment on U.S. barriers; it could also agree to eliminate the 25% tariff on small trucks, which, ridiculously enough, came into existence as a result of a trade war with Europe over chickens. Its other obvious barriers, which come mostly through managed trade agreements already negotiated, could be phased out over time.

222. Schott, *supra* note 16, at 11.

223. BERGSTEN & NOLAND, *supra* note 94, at 197.

imagined that NAFTA could turn America into a "fortress" against foreign goods.[224] Since Japan is heavily involved in Chile's economy, such concern will surely be voiced louder if Chile accedes to the NAFTA.[225]

Two. Japan may wish to keep trade issues from hurting the U.S.-Japan security relationship. Its relationship with the United States remains the key to its stability and psychological sense of security.[226] It very much needs the U.S. presence in East Asia to safeguard the region's security and continued prosperity.[227] Clearly, if its trade relationship with the United States deteriorates to the point that the United States no longer wishes to guarantee its protection, then it would have to rebuild its armed forces substantially, and currently no state in East Asia welcomes this.[228]

THREE. Japan may wish to have insurance against future U.S. protectionism. The first and largest concession it would likely seek from the United States would be a standstill commitment on U.S. barriers. Also, Japan may view an FTA as the only means in which it may ever get the United States to agree to phase out the existing managed trade agreements. Lastly, after an FTA was formed, Japan would no longer have to worry about the threat of Section 301 sanctions; its place in the U.S. economy would be secure.

FOUR. Japan may view an FTA as a politically viable way to instill domestic reforms like deregulation.[229] Japan has a heavily regu-

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224. Richard Steinberg, *Antidotes to Regionalism: Responses to Trade Diversion Effects of the North American Free Trade Agreement*, 29 STAN. J. OF INT'L L. 315, 318 (1993). This phrase comes from observers who have characterized the European Union as creating a "fortress" Europe.

225. As mentioned earlier, NAFTA accession to include Chile looked almost certain at the time of this writing.

226. CARNEGIE, *supra* note 113, at 7.

227. *Id.*

228. *See* MASON & TURAY, *supra* note 2; FUKUYAMA & OH, *supra* note 118.

229. An excellent example of Japan's over-regulation is cellular phones, an industry pioneered in Japan but then regulated so heavily that the United States and Europe soon dominated. According to THE WALL ST. J.:

> a year ago the government finally permitted people to buy cellular phones instead of just renting them. Phone prices have dropped by more than half, and even to zero, as companies woo subscribers with cut-rate sets. . . Sales are exploding. From last April through this January, consumers snapped up 1.6 million cellular phones, almost four times the number of new rentals the entire previous year.

David P. Hamilton, *et al.*, *Tied in Knots Japan's Big Problem: Freeing its Economy from Over-Regulation*, THE WALL ST. J., April 25, 1995, at A1.

lated economy.[230] This fact reflects the strength of the iron triangle in Japanese politics. Bureaucrats simply want to protect the Japanese industries which support them. Consequently, Japan's regulation and tax laws hinder its imports and suppress its consumption, and its cartels force high prices. Economists in Japan recognize that change needs to come, however.[231] They find that Japan's real income could increase by 20% to 40% if domestic prices dropped to international levels.[232] To be sure, due to its sluggish growth[233] and high yen over the past few years, changes like deregulation have begun to occur.[234] But Japan's efforts have been largely piecemeal, and in general it has not shown the political will to trim down its bureaucratic regulation — despite its citizens wishes and despite the wealth deregulation could bring.[235] In this context, the Japanese consumers welcome gaiatsu like the SII talks.[236] Such forums help "buttress the shortcomings of patterned pluralism,"[237] and they are desirable as more permanent institutions dealing with trade disputes.[238] For Japan, such an institution may be a JUSFTA.

5.1.2 The United States' Motivation in Negotiating a JUSFTA

Why might the United States want to negotiate an FTA with Japan? There are four prime reasons.

ONE. The United States may wish to avoid an economic Cold War. The U.S.-Japan relationship is in trouble. Although the two countries just avoided a trade war over autos and auto parts, more and more firms in the United States are pressuring the USTR's office for action

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230. "Although the economy is highly advanced, it is still run, in many ways, like a developing one." *Id.* at A13.

231. *See* Takenaka, *supra* note 145; *see also* Kazumasa Iwata, *Rule Maker of World Trade: Japan's Trade Strategy and the World Trading System*, in JAPAN'S INTERNATIONAL AGENDA 111, *supra* note 11.

232. Takenaka, *supra* note 145, at 168.

233. Japan's growth over the last few years has been below 1%, and in 1994 it was negative. Hamilton, *supra* note 229, at A13.

234. One MITI official states, "We must deregulate or die." *Quoted in id.* at A13.

235. *See id.*

236. Takenaka reports that "demands [which] were asserted in the SII context found wide support among Japanese citizens due to their recognition that external pressure offers an effective means for surmounting patterned pluralism." *See supra* note 145, at 183.

237. *Id.* Patterned pluralism in this context means that market mechanisms function in some but not other sectors. Also, managed trade has the opposite effect because of its demand for preferential treatment.

238. *See* Iwata, *supra* note 231

on their behalf, and, as of this writing, the USTR is currently considering sanctions over Federal Express's access to Japanese airports and over Kodak's claims that Fuji competes unfairly in the Japanese film market. However valid these cases might be — and it should be added that even though their cases appear to be on surer ground than the Big Three auto-maker's complaints, their validity has yet to be fully accepted by academics or the media — they show how ubiquitous are the problems in the U.S.-Japan relationship. The case of Kodak highlights Benjamin's and Young's hypothesis that whenever an industry experiences a trend of deficits with Japan they will appeal to the USTR for action.

What will happen if the USTR does file a Section 301 suit? It is doubtful that the next U.S. threat will be tempered before sanctions go into effect. Clyde Prestowitz, President of the Economic Strategy Institute, stated prior to the last deal that "if there is maybe one more 'standard' deal, it will be the last one."[239] Japan has grown more adamant about not acquiescing to U.S. demands. If its current trend of refusing continues on the path that observers like Prestowitz believe it will, then Japan will refuse to change its policies, and President Clinton and the USTR, instead of losing face by backing down, may decide to continue the contest and "drop the bomb on them."[240] A full-blown economic war could follow. Therefore if the U.S. wants to prevent another "Big Scare" from developing into a "Big Bang," then it might want to take an approach like the JUSFTA outlined later in this section.

Two. The United Sates, like Japan, may wish to keep trade issues from hurting the U.S.-Japan security relationship. Again, the U.S. security relationship with Japan has been "the foundation of East Asia's stability and prosperity."[241] Pentagon officials, like the Assistant Secretary for International Security Joseph Nye, recognize that "[this relationship's] fraying, as the 50th anniversary this summer of the bombing of Hiroshima and Nagasaki should remind both parties, could have perilous consequences."[242] Indeed, a report labeled as the "Nye Initiative" underlines the need for cooperation if the United States is to handle the danger of a nuclear-armed North Korea and a recalcitrant China.[243] Such cooperation will not take place if, through a trade war,

239. *Quoted in* Church, *supra* note 111, at 30.

240. On the telephone with General Motor's CEO John F. Smith Jr., Kantor was quoted as exclaiming, "We're going to drop the bomb on them!" *Id.* at 30.

241. *Is Japan Normal?*, THE ECONOMIST, June 24, 1995, at 25-26.

242. *Id.* at 25.

243. *Id.*

the economic side of the relationship cripples the security side.

THREE. The United States may wish to focus all of its pressure on Japan in one concentrated approach to its problems within an environment conducive to change. It was mentioned in the last sub-section that Japanese consumers have the most to gain from Japanese deregulation. Bayard and Elliot argue that if the United States were to advertise relentlessly a thoroughly researched, well-constructed case on how Japanese barriers negatively affect the Japanese standard of living, then Japanese consumers might mobilize to effect change.[244] These observers agree that the United States will not solve its trade problems with Japan, problems which are emboldened by the Japanese iron-triangle of politics, without gaiatsu focused on persuading the Japanese consumer of the wisdom in the U.S. position. Unfortunately, every new debilitating quarrel over managed trade just encourages the Japanese consumer's belief that the United States is using its muscle to gain special privileges and not to further the cause of a free market in Japan.[245]

FOUR. The United States may wish to pursue a JUSFTA in order to promote global free trade. Strategically speaking, if the United States negotiated the JUSFTA sketched later in this section, it would eliminate the possibility of the world trading order digressing into one of three trading blocs. It would have bridged the chasm separating Japan from the similar market structures of Europe and North America. The dynamic trade effects of such an accomplishment can not be understated; they would likely be tremendous. Also, if the United States wished to continue a regional trade policy in the Asian-Pacific region, it would have removed one of its largest stumbling blocks in such a pursuit; without Japanese cooperation, however, an APEC FTA is almost certainly not going to unfold.

The possibilities appear endless. The United States could incorporate Japan in its WHFTA pursuit. It might even be able to link a WHFTA and APEC. Even better, having established the means for cooperation in its most vital trade relationship, it could launch a new round of multilateral GATT trade negotiations aimed at harmonization of standards and competition policies and at furthering progress on trade in services issues. Overall, President Clinton's words regarding the recent auto trade pact would aptly describe the situation: "This breakthrough is a major step toward free trade throughout the world."[246] That's exactly what a JUSFTA would be.

244. *See* BAYARD & ELLIOT, *supra* note 10.

245. Such a concentrated approach could also relieve the USTR's office from responding to future calls for managed trade.

246. *Clinton's Phoney Peace*, THE ECONOMIST, July 1, 1995, at 13.

5.1.3 Objectives of a JUSFTA

There would be five objectives for the negotiations of a JUSFTA to meet:

- Creating a consultative mechanism.
- Facilitating structural changes.
- Creating working groups to promote harmonization of standards and competition policies, as well as to oversee particular sectors.
- Establishing an effective DRM.
- Establishing a G2 for macroeconomic coordination.

The JUSFTA would be a non-traditional FTA because it would emphasize the consultative mechanism, the DRM, and the G2 but would not necessarily be geared toward eliminating all traditional barriers to trade. Although the elimination of all barriers is desirable, the tariffs between the United States and Japan are already quite low and are really secondary issues when compared to structural differences.

5.1.4 Consultative Mechanism

A consultative mechanism establishes the proper environment in which to conduct trade negotiations by creating guidelines and rules. It can involve establishing working groups which provide an arena for ongoing studies on harmonization, and it can require regular and frequent meetings to take place between both parties' officials at the cabinet and sub-cabinet levels. Frequent meetings among these persons would allow for a virtually continuous dialogue on bilateral relations and the full range of regional and global developments. Such a dialogue is essential to making Japan a true partner.

5.1.4.1 Structural Impediments Talks

Overall, the amelioration of both the U.S. and Japanese external imbalances can only occur if the United States encourages private savings and reduces the cost of capital investment — through structural adjustments like reducing its federal budget deficit — and Japan bolsters domestic demand — through structural adjustments like deregulation. Other positive steps for Japan would be: revamping its distribution system, enforcing its competition laws, reforming its product liability and regulatory standards, and changing its land use policies. Other positive steps for the United States would be: developing its human capital better by reforming and devoting more resources to its educational system, deregulating its banking industry, and revising its restrictive export policies on high-technology goods.

5.1.4.2 Working Groups

A JUSFTA should establish several working groups to coordinate efforts to harmonize regulatory standards. Two groups would be critical. One would work on issues in trade and competition law. The other would work "to facilitate the process by which the [two countries] make compatible their standards-related measures."[247] Other important groups to establish would be ones working on financial services, telecommunications, defense and civilian technology, agriculture, and auto trade. These groups should include consumer advocates, government representatives, interest groups, and academic trade law experts. They should work to create the rules by which Japan and the United States will conduct their relationship. Both superpowers should agree to implement to the largest extent possible these groups recommendations. In this sense, they would function like the independent minded U.S. military base-closing committee.

5.1.5 Dispute Resolution Mechanism

A DRM is vital to helping the U.S.-Japan relationship. More than any other measure, it would make rules, not politics the determinate of trade dispute outcomes. It would provide a more efficient, less biased forum in which the United States and Japan could resolve their trade disputes. It would also keep trade disputes from becoming politicized.

The DRM should allow private parties in both U.S. and Japanese courts to bring suit on the basis of the JUSFTA treaty, and it should have two divisions: a general dispute resolution mechanism and an antidumping/countervailing duty (AD/CVD) DRM. This parallels the structure of the CUSFTA and NAFTA DRMs. [248]

The primary division would be the general DRM. This would establish a Free Trade Commission composed of cabinet-level representatives from both countries. It would resolve disputes involving discrepancies in the interpretation or application of the JUSFTA. Disputes would first require consultation. If this fails to resolve the issue, then arbitration panels or expert panels would be the next step. Arbitration panels would make recommendations on how to solve the dispute while expert panels would issue binding rulings. Therefore the latter would be the forum for settlement of intractable disputes.[249]

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247. Abott, *supra* note 20, at 98.

248. *Id.* at 100-02.

249. *See* Note, *Old Wine, New Skins: NAFTA and the Evolution of International Trade Dispute Resolutions*, 15 MICH. J. OF INT'L L. 255 (1993).

The second division would be the AD/CVD DRM. According to Rosa, "the importance of an effective AD/CVD dispute resolution system . . . can hardly be overemphasized," for AD/CVD actions are usually viewed by the recipient as protectionist rather than as a "legitimate exercise of regulatory power."[250] The CUSFTA AD/CVD DRM has resulted in an "increased perception of fairness and impartiality in administration of unfair trade laws."[251] The success of CUSFTA's DRM suggests that it should be replicated in a JUSFTA.

Overall, the dispute resolution process should be speedy and capable of rendering judgments in less than a year. It should also have the ability to appoint working groups to iron-out problems which the rules of the JUSFTA do not address. In this sense, it would be part of the law-making process and not just the adjudicator of established rules. Likewise, if the United States and Japan decided to implement the JUSFTA DRM before any major commitments had been made, the DRM could be provisional until it had specific commitments to oversee. In any case, the JUSFTA DRM would move U.S.-Japan disputes away from the political arena to one dominated by rules.

5.1.6 G2

> The time has clearly come to install new systemic arrangements . . . to avoid future repetitions of [the trade imbalance cycles] with their extremely damaging economic and political consequences.[252]

Again, the underlying problems in the trade relationship do not lie in trade polices and restrictions, but rather in the discordant macroeconomic environment. Many economists ascribe much of the growth in the U.S. trade deficit with Japan in the 1980s to an overvalued dollar in relation to the yen. They also cite the high savings and investment rate in Japan relative to the United States.[253] As such, the macroeconomic goals in the relationship should be fiscal contraction in the United States and fiscal expansion in Japan. Also, "a sustained real exchange rate realignment . . . would have a significant impact on trade flows."[254] Cline computes that every 1% rise (fall) in the real

250. *Id.* at 271.
251. *Id.* at 272, n.117 (citation omitted).
252. BERGSTEN & NOLAND, *supra* note 94, at 203.
253. *Id.* at 36.
254. *Id.* at 55.

value of the yen against the dollar eventually produces a decrease (increase) of approximately one billion dollars in the bilateral deficit.[255] Therefore both countries need to pay closer attention to macroeconomic coordination. They should pursue systemic cooperation in a G2 for macroeconomic policy coordination. Although accomplishment of this goal would be even more technically and politically difficult than the other components of the JUFSTA, an attempt should be made nonetheless. If it were accomplished, then the United States and Japan would finally be installing the means to manage their bilateral relationship and the world economy as a whole.

CONCLUSION

While this prospect of NAFTA accession and of a WHFTA has many scholars and policy-makers excited, few have asked or answered a critical question — is Latin America an ideal free trade partner? This study shows why it is not.

It made sense for the United States to enter an FTA with Canada and Mexico because they are significant trading partners. However, Latin America is not; its volume and pattern of trade with the United States is small and dissimilar. This means that by integrating with Latin America the United States can expect to gain little in terms of economies of scale; it can also expect to divert trade away from a much more vital trading region for the United States, East Asia.[256] East Asia, not Latin America, is the region that the United States should integrate with if it wishes to pursue a regional trade policy. It is the region with which the U.S. livelihood and sense of well-being are increasingly bound.[257] Why, then, is the United States pursuing a WHFTA?

The introduction of this study argued that the United States move toward regionalism is part of a general trend in U.S. protectionism. When first proposed, the United States wished to protect its industries from the inexorable competition East Asia masses by gaining preferential market access in Latin America. It also wished to use the idea of a WHFTA to gain concessions from other trading powers, most notably Japan.

Japan is a major stumbling bloc for the United States in pursuing regional integration with East Asia. Clearly, if the United States

255. *See* William Cline, How Undervalued is the Yen? (Paper available from the Institute for International Economics, Washington, DC) (1993).

256. *See* Plummer & Iboshi, *supra* note 54.

257. CARNEGIE, *supra* note 113, at vii.

wishes to secure its broad interests in East Asia and form a significant Asian-Pacific bloc, one with more vigor than APEC, it must resolve its differences with Japan. The United States should seriously seek such a rapprochement through a JUSFTA, rather than through Section 301 and managed trade deals which have shown little evidence of helping U.S. competitiveness and risk far more in terms of lost U.S. credibility and leadership — not to mention the effects on the world trading system — than they promise to deliver in terms of jobs and wealth.[258]

Japan, unlike Latin America, is an ideal free trade partner for the United States. In fact, the United States has an unprecedented degree of interdependence with Japan. For this reason, the United States should view it as a vital friend, not just the nation with which it has its largest bilateral trade deficit.[259] It should view it "as an indispensable partner in the management of the global economy to which [its] well-being is deeply and inextricably tied."[260] Furthermore, it should view it as the preeminent economic power in the international system today, one whose cooperation "must now be sought and won," not dictated.[261] Such a dictatorial approach to U.S.-Japan relations is outdated and only worsens U.S.-Japan relations.

The United States should realize that the means it has employed to solve U.S.-Japan trade problems has had exactly the opposite effect. There is little doubt that the U.S.-Japan relationship is more deeply troubled now than ever before. Each state's peoples are now more than ever willing to sever the relationship. Such a mood should alarm U.S. and Japanese decision-makers. The recent trade brawl over autos and auto parts should also sound an alarm. Although it did not become a trade war, it easily could have. This near miss should motivate them to undertake a new approach.

The size and power of the U.S.-Japan relationship indicates that their current behavior will greatly influence the conduct of international trade for years to come. If their relations continue to deteriorate to the point of severing, the world trading order could suffer a similar fate. A new collaborative framework is the only path that will fill the "trust gap" and allow the two nations to guide the international system in a positive direction.[262]

The condition of the U.S.-Japan relationship could be compared to that of France and Germany after World War II. Both countries need

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258. BENJAMIN & YAGER, *supra* note 5, at 41.
259. CARNEGIE, *supra* note 113, at 5.
260. *Id.*
261. BERGSTEN & NOLAND, *supra* note 94, at 235.
262. For a similar argument see Kuroda, *supra* note 9.

each other but have a history of quarreling. As Germany's and France's age-old bickering exploded into World War I and eventually led to World War II, the United States' and Japan's bickering has threatened to begin an economic Cold War. To be sure, the 1995 Auto-Trade Pact avoided that catastrophe this time, but it does nothing about avoiding future problems. A JUSFTA will. The United States and Japan should not wait to damage each other economically before they finally decide to institutionalize the means to their cooperation.

A JUSFTA is the solution to U.S.-Japan relations.[263] It would allow a cooperative forum in which both countries could solve their differences without political posturing. Through a consultative mechanism — with regular cabinet and sub-cabinet meetings, with binding negotiations pinpointing needed structural changes, and with working groups studying and overseeing harmonization of standards and competitions laws — the two countries can solve their differences. Through an effective dispute resolution mechanism, the two countries can limit the effect of any new dispute by using rules and not political judgment to determine unfair competition. Through a G2 for macroeconomic coordination, the two countries can finally begin to realize the potential of their relationship.

These types of institutional links with Japan involve some new thinking about national sovereignty. Those who fret that with such links foreigners will hold too much influence in determining U.S. domestic affairs ignore the fact that "economic interdependence long ago destroyed much of the autonomy of most nations."[264] They should face reality. The United States is no longer a hegemon and is increasingly dependent on the outside world. As Bergsten and Noland argue:

> it is clearly more constructive to discuss key national differences openly, with an eye toward reducing them, than to ignore them; their propensity to trigger real economic problems, and therefore disputes between the [United States and Japan], is too

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263. As mentioned above, a JUSFTA would also eliminate the possibility of the world trade order digressing into a system of three powerful blocs. A bridge between the United States and the European Union would do the same. However, the U.S.-E.U. relationship is not in any danger of severance; the U.S.-Japan relationship is, and therefore it should take priority. Also, a U.S.-E.U. FTA will likely be viewed by Japan and East Asia as a bloc formed against them, thus encouraging them to form a bloc of their own. Because of the closeness of the E.U. and the United States, however, it is doubtful that the E.U. would view a JUSFTA in such manner. Hence, if a E.U.-U.S. FTA is "in the cards," so to speak, then it should be negotiated only after or simultaneously to JUSFTA negotiations.

264. BERGSTEN & NOLAND, *supra* note 94, at 212.

> great. [Institutional links] must be a part of any comprehensive new strategy to deal effectively with U.S.-Japan economic relations.[265]

Furthermore, whereas U.S. influence over Japan currently wanes considerably, the institutional links envisioned in the JUSFTA proposed here would enshrine U.S. influence, providing it with a far greater amount of leverage with Japan in the future than it would otherwise have.

In summary, the United States can no longer dominate the world economy, nor can it dictate policies to Japan. And in absence of a security blanket like that necessitated by the Cold War, economic conflict will be the norm in world alliance politics. This increased instability and volatility makes cooperation in the U.S.-Japan relationship more worthwhile than ever before. A JUSFTA, although immense in terms of time, effort, and difficulty, would necessitate cooperation, resolve disputes, and encourage true long-term liberalization and trust in the U.S.-Japan relationship. It would also finally begin realizing the much talked about "global partnership" between the two countries. Lastly, it would be a giant step toward global free trade, and it would re-inspire faith in U.S. leadership of the international economic system. A JUSFTA is exactly what the U.S.-Japan relationship, as well as the rest of the world, needs.

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265. *Id.*

Table 1: US Exports and Imports by Country/Region, 1992 (in $ billions)

	Exports	Imports
World	447.366	552.599
Japan	47.764	99.481
Latin America[a]	33.574	33.937
Chile	2.455	1.627
Mercosur	9.608	9.834
Argentina	3.222	1.370
Brazil	5.740	8.145
Paraguay	0.415	0.038
Uruguay	0.231	0.281
Andean Group	10.943	14.129
Bolivia	0.222	0.166
Colombia	3.282	3.064
Ecuador	0.999	1.482
Peru	1.002	0.781
Venezuela	5.438	8.636
CACM	4.293	4.056
Costa Rica	1.348	1.542
El Salvador	0.741	0.409
Guatemala	1.208	1.182
Honduras	0.808	0.851
Nicaragua	0.188	0.072

a. Including Panama, Dominican Republic, Jamaica, and Trinidad and Tobago also.
Source: International Monetary Fund, *Direction of Trade Statistics Yearbook* 1994.

Table 2: Good Customers and Good Providers — Approximate Shares for US Imports and Exports, 1992

	Good Customer	Good Provider
Japan	10.677	18.002
Latin America[a]	7.505	6.141
Chile	0.549	0.294
Mercosur	2.148	1.780
Argentina	0.720	0.340
Brazil	1.283	1.474
Paraguay	0.093	0.007
Uruguay	0.052	0.051
Andean Group	2.446	2.557
Bolivia	0.050	0.030
Colombia	0.734	0.554
Ecuador	0.223	0.268
Peru	0.224	0.141
Venezuela	1.216	1.563
CACM	0.960	0.734
Costa Rica	0.301	0.280
El Salvador	0.166	0.074
Guatemala	0.270	0.214
Honduras	0.181	0.154
Nicaragua	0.042	0.013

a. Including Panama, Dominican Republic, Jamaica, and Trinidad and Tobago also.
Source: Table 1

Table 3: Top US Industries for Exports, 1991 (in $ millions)

NTDB #[a]	Industry	Export Amt.
10	Cereals	10,104.454
27	Mineral Fuel, Oil Etc; Bitumin Substitute; Mineral Wax	12,054.878
29	Organic Chemicals	12,212.840
39	Plastics and Articles thereof	12,619.773
84	Nuclear Reactors, Boilers, Machinery Etc; Parts thereof	75,401.198
85	Electric Machinery Etc.; Sound Equipment; TV Equipment	43,617.936
87	Vehicles, except Railway or Tramway, and Parts	33,709.501
88	Aircraft, Spacecraft, and Parts thereof	34,691.439
90	Optic, Photo Etc, Medic or Surgical Instruments	18,816.624

a. National Trade Data Bank two-digit harmonization code.
Source: US Department of Commerce, *National Trade Data Bank*, "Exports - Commodity by Country"

Table 4: Principal Market — Ratio of Industries' Goods Exported to Japan and Latin America to Industries' Goods Exported to the World, 1988-1991 averages (in percentages)

Industry	Japan	Latin America[a]
10 Cereals	18.8	7.8
27 Mineral Fuel, Oil Etc; Bitumin Substitute; Min. Wax	12.5	12.3
29 Organic Chemicals	12.0	9.2
39 Plastics and Articles thereof	7.0	8.6
84 Nuclear Reactors, Boilers, Machinery Etc; Pts thereof	8.5	6.9
85 Electric Machinery Etc.; Sound Equipment; TV Equip	8.2	5.0
87 Vehicles, except Railway or Tramway, and Parts	4.0	3.5
88 Aircraft, Spacecraft, and Parts thereof	9.7	4.8
90 Optic, Photo Etc, Medic or Surgical Instruments	13.4	5.0

a. Including the Bahamas, Barbados, Belize, Dominican Republic, Guyana, Haiti, Jamaica, Surinam, and Trinidad and Tobago also. The darker shaded areas indicate that it is has a 10% or higher share of US exports, while the lighter shaded areas indicate that it has at least above a 7.5% share.
Source: US Department of Commerce, *National Trade Data Bank*, "Exports - Commodity by Country"

Table 5: Top US Industries for Imports, 1991 (in $ millions)

NTDB #	Industry	Import Amount
27	Mineral Fuel, Oil Etc; Bitumin Substitute; Mineral Wax	54,177.820
29	Organic Chemicals	8,721.644
39	Plastics and Articles thereof	7,006.711
48	Paper and Paper Board and Articles	8,069.919
61-62	Apparel Articles and Accessories, Etc	23,583.166
71	Nat Etc Pearls, Precious Stones Etc, Coin	12,207.443
72-73	Iron And Steel; Articles of Iron and Steel	13,559.993
84	Nuclear Reactors, Boilers, Machinery Etc; Parts thereof	65,060.987
85	Electric machinery Etc; Sound Equip; TV Equipment; Parts	59,561.966
87	Vehicles, except Railway and Tramway, and Parts Etc	73,763.648
90	Optic, Photo Etc, Medic or Surgical Instruments Etc	14,121.129

Source: US Department of Commerce, *National Trade Data Bank*, "Exports - Commodity by Country"

Table 6: Principal Supplier — Ratio of Industries' Goods Imported from Japan and Latin America to industries' Goods Imported from the World, 1999-1991 averages (in percentages)

Industry	Japan	Latin America[a]
27 Mineral Fuel, Oil Etc; Bitumin Sub; Mineral Wax	0.2	18.5
29 Organic Chemicals	13.3	7.1
39 Plastics and Articles thereof	13.2	2.3
48 Paper and Paperboard and Articles	2.7	0.8
61-62 Apparel Articles and Accessories, Etc	0.7	13.0
71 Nat Etc Pearls, Precious Stones Etc, Coin	1.5	7.5
72-73 Iron and Steel; Articles of Iron and Steel	20.6	7.1
84 Nuclear Reactors, Boilers, Machinery Etc; Pts thereof	29.8	1.4
85 Electric machinery Etc; Sound Equip; TV Equip; Parts	33.2	1.0
87 Vehicles, except Railway and Tramway, and Parts Etc	40.0	0.9
90 Optic, Photo Etc, Medic or Surgical Instruments Etc	40.0	1.4

a. Including the Bahamas, Barbados, Belize, Dominican Republic, Guyana, Haiti, Jamaica, Surinam, and Trinidad and Tobago also. The darker shaded areas indicate that it is has a 10% or higher share of US imports, while the lighter shaded areas indicate that it has at least above a 7.5% share.
Source: US Department of Commerce, *National Trade Data Bank*, "Exports - Commodity by Country"

Table 7: Approximate Share of Total World Exports, 1988-1991

	1988	1989	1990	1991	Average
United States	11.4	12.1	11.6	12.4	11.9
Japan	9.4	9.2	8.5	9.3	9.1
Latin America	2.6	2.7	2.6	....	2.6

Source: United Nations, *International Trade Statistics Yearbook* 1991.

Table 8: Top US Exports to the World, 1988-1991 (averages in $ millions)

3 Digit SITC[a]	Commodity	Export Amount
583	Polymerization Products, Etc	5,149.056
713	Internal Combustion Piston Engines	5,488.865
714	Engines and Motors Nes	7,394.384
752	Automatic Data Processing Equipment	14,446.255
759	Office, ADP Machine Parts, Accessories	11,620.187
764	Telecommunications Equipment, Parts, Acc Nes	7,680.574
776	Transistors, Valves, Etc	12,982.872
778	Electrical Machinery Nes	4,853.089
784	Motor Vehicle Parts, Accessories Nes	13,685.774
792	Aircraft, Etc	27,598.908

a. Standard International Trade Classification, revision 2.
Source: United Nations, *International Trade Statistics Yearbook* 1991.

Table 9: Approximate Share of World Exports for Top US Exports, 1988-1991 averages

	United States	Japan	Latin America
Polymerization Products, Etc	11.0	5.7	2.0
Internal Combustion Piston Engines	16.0	18.5	2.9
Engines and Motors Nes	36.3	4.8	0.3
Automatic Data Processing Equip	21.5	18.1	2.8
Office, ADP Machine Pts, Acc	24.7	17.8	0.2
Telecom Equip, Pts, Acc Nes	13.8	28.4	0.3
Transistors, Valves, Etc	20.9	22.1	0.2
Electrical Machinery Nes	13.4	19.9	0.6
Motor Vehicle Parts, Acc Nes	17.6	13.7	1.1
Aircraft, Etc	46.6	0.7	1.0

Source: United Nations, *International Trade Statistics Yearbook* 1991.

Table 10a: Similar Revealed Comparative Advantage Index for Top US Exports, 1988-1991

	Index	0 | | 1 | | 2 | | 3 |
Polymerization Prods Etc		
United States	**0.92**	
Japan	**0.63**	
LatinAmerica	**0.77**	
Intrnl Combst Pisnt Engs		
United States	**1.34**	
Japan	**2.03**	
LatinAmerica	**1.12**	
Engines and Motors Nes		
United States	3.05	
Japan	0.53	
LatinAmerica	0.12	
Auto Data Proc Equip		
United States	**1.81**	
Japan	**1.99**	
LatinAmerica	**1.08**	
Office, ADP Mch Pts		
United States	**2.08**	
Japan	**1.96**	
LatinAmerica	0.08	
Telecom Eqp Pts Acc		
United States	1.16	
Japan	3.12	
LatinAmerica	0.12	
Transistors, Valves Etc		
United States	**1.76**	
Japan	**2.43**	
LatinAmerica	0.08	
Eletrical Machinery		
United States	1.13	
Japan	2.19	
LatinAmerica	0.23	
Motor Veh Pts Acc Nes		
United States	**1.48**	
Japan	**1.51**	
LatinAmerica	0.42	
Aircraft Etc		
United States	3.92	
Japan	0.08	
LatinAmerica	0.38	

Dots on the right side of the dashed line indicate the country has a revealed comparative advantage in that commodity.
The shaded areas indicate that the countries have a very similar revealed comparative advantage and therefore are competitive with each other in the particular good.
Source: Tables 7, 8, and 9.

Table 10b: Dissimilar Revealed Comparative Advantage Index for Top US Exports, 1988-1991

	Index	0 | | 1 | | 2 | | 3 |
Polymerization Prods Etc		
United States	0.92	
Japan	0.63	
LatinAmerica	0.77	
Intrnl Combst Pisnt Engs		
United States	1.34	
Japan	2.03	
LatinAmerica	1.12	
Engines and Motors Nes		
United States	3.05	
Japan	0.53	
LatinAmerica	0.12	
Auto Data Proc Equip		
United States	1.81	
Japan	1.99	
LatinAmerica	1.08	
Office, ADP Mch Pts		
United States	2.08	
Japan	1.96	
LatinAmerica	0.08	
Telecom Eqp Pts Acc		
United States	1.16	
Japan	3.12	
LatinAmerica	0.12	
Transistors, Valves Etc		
United States	1.76	
Japan	2.43	
LatinAmerica	0.08	
Eletrical Machinery		
United States	1.13	
Japan	2.19	
LatinAmerica	0.23	
Motor Veh Pts Acc Nes		
United States	1.48	
Japan	1.51	
LatinAmerica	0.42	
Aircraft Etc		
United States	3.92	
Japan	0.08	
LatinAmerica	0.38	

Dots on the right side of the dashed line indicate the country has a revealed comparative advantage in that commodity.
The shaded areas indicate that the countries have a very dissimilar revealed comparative advantage and therefore are not competitive with the US in the particular good.
Source: Tables 7, 8, and 9.

Table 11: Top Latin American Export Commodities to the World, 1988-1991 (averages in $ millions)

3 Digit SITC	Commodity	Export Amount
011	Meat, Fresh, Chilled, Frozen	1,519.599
057 & 058	Fruit, Nuts, Fresh, Dried, Preserved, Prepared	4,261.736
071	Coffee and Substitutes	4,686.215
081	Feeding Stuff for Animals	4,241.072
222	Seeds for Soft Fixed Oils	1,807.624
281	Iron Ore, Concentrates	2,785.945
287	Base Metal Ores, Concentrates Nes	1,916.236
333 & 334	Crude Petroleum & Petroleum Products, Refined	17,405.342
682	Copper Exc, Cement Copper	3,664.606
684	Aluminum	2,143.896

a. Standard International Trade Classification, revision 2.
Source: United Nations, *International Trade Statistics Yearbook* 1991.

Table 12: Approximate Share of World Exports for Top Latin American Exports, 1988-1991 averages

	United States	Japan	Latin America
Meat, Fresh, Chilled, Frozen	10.5	0.0	5.
Fruit, Nuts, Fresh, Dried, Preserved, Prepared	12.3	0.0	16.0
Coffee and Substitutes	2.1	0.0	47.6
Feeding Stuff for Animals	19.6	0.0	26.3
Seeds for Soft Fixed Oils	44.0	0.0	18.1
Iron Ore, Concentrates	2.1	0.0	34.1
Base Metal Ores, Concentrates Nes	0.9	0.0	1.3
Crude Petroleum & Petroleum Products, Refined	1.6	0.3	6.6
Copper Exc, Cement Copper	4.8	5.3	16.8
Aluminum	9.1	0.0	7.2

Source: United Nations, *International Trade Statistics Yearbook* 1991.

Table 13a: Similar Revealed Comparative Advantage Index for Top Latin American Exports, 1988-1991

	Index
Meat	
United States	0.88
Japan	0.00
Latin America	2.15
Fruits, Nuts	
United States	1.03
Japan	0.00
Latin America	6.15
Coffee and Substitutes	
United States	0.18
Japan	0.00
Latin America	18.32
Animal Feeding Stuff	
United States	1.65
Japan	0.00
Latin America	10.10
Seeds for Soft Fixed Oils	
United States	3.69
Japan	0.00
Latin America	6.96
Iron Ore, Concentrates	
United States	0.18
Japan	0.00
Latin America	13.12
Base Metal Ores	
United States	0.01
Japan	0.00
Latin America	0.48
Crude, Refined Petrol	
United States	0.14
Japan	0.03
Latin America	2.53
Copper Exc	
United States	0.40
Japan	0.58
Latin America	6.45
Aluminum	
United States	0.76
Japan	0.00
Latin America	2.76

Dots on the right side of the dashed line indicate the country has a revealed comparative advantage in that commodity.
The shaded areas indicate that the countries have a very similar revealed comparative advantage and therefore are competitive with each other in the particular good.
Source: Tables 7, 11, and 12.

Table 13b: Dissimilar Revealed Comparative Advantage Index for Top Latin American Exports, 1988-1991

	Index	0 | 1 | 2 | 3
Meat		
United States	0.88	
Japan	0.00	
LatinAmerica	2.15	
Fruits, Nuts		
United States	1.03	
Japan	0.00	
LatinAmerica	6.15	→
Coffee and Substitutes		
United States	0.18	
Japan	0.00	
LatinAmerica	18.32	→
Animal Feeding Stuff		
United States	1.65	
Japan	0.00	
LatinAmerica	10.10	→
Seeds for Soft Fixed Oils		
United States	3.69	
Japan	0.00	
LatinAmerica	6.96	→
Iron Ore, Concentrates		
United States	0.18	
Japan	0.00	
LatinAmerica	13.12	→
Base Metal Ores		
United States	0.01	
Japan	0.00	
LatinAmerica	0.48	
Crude, Refined Petrol		
United States	0.14	
Japan	0.03	
LatinAmerica	2.53	
Copper Exc		
United States	0.40	
Japan	0.58	
LatinAmerica	6.45	→
Aluminum		
United States	0.76	
Japan	0.00	
LatinAmerica	2.76	

Dots on the right side of the dashed line indicate the country has a revealed comparative advantage in that commodity.
The shaded areas indicate that the countries have a very dissimilar revealed comparative advantage and therefore are not competitive with Latin America in the particular good.
Source: Tables 7, 11, and 12.

Table 14: Top Japanese Export Commodities to the World, 1988-1991 (averages in $ millions)

3 Digit SITC	Commodity	Export Amount
713	Internal Combustion Piston Engines	6,334.063
749	Nonelectronic Machine Parts, Accessories Nes	5,025.745
752	Automatic Data Processing Equipment	12,059.497
759	Office, ADP Machine Parts, Accessories	8,467.736
763	Sound Recorders, Phonographs	7,027.027
764	Telecommunications Equipment, Parts, Accessories Nes	15,686.899
772	Switchgear Etc, Parts Nes	5,475.522
776	Transistors, Valves, Etc	13,664.405
778	Electrical Machinery Nes	7,189.040
781	Passenger Motor Vehicles Excluding Buses	40,884.013

a. Standard International Trade Classification, revision 2.
Source: United Nations, *International Trade Statistics Yearbook* 1991.

Table 15: Approximate Country Share of World Exports for Top Japanese Export Commodities, 1988-1991 averages

	United States	Japan	Latin America
Internal Combustion Piston Engines	16.0	18.5	2.0
Nonelectronic Machine Parts, Accessories Nes	8.4	14.8	0.7
Automatic Data Processing Equipment	21.5	18.1	2.8
Office, ADP Machine Parts, Accessories	24.7	17.8	0.2
Sound Recorders, Phonographs	3.4	44.3	0.0
Telecommunications Equipment, Parts, Accessories	13.8	28.4	0.3
Switchgear Etc, Parts Nes	14.4	16.4	1.0
Transistors, Valves, Etc	20.9	22.1	0.2
Electrical Machinery Nes	13.4	19.9	0.6
Passenger Motor Vehicles Excluding Buses	6.7	26.1	0.4

Source: United Nations, *International Trade Statistics Yearbook* 1991.

Table 16a: Similar Revealed Comparative Advantage Index for Top Japanese Exports, 1988-1991

	Index
Intrnl Combst Pisnt Engs	
United States	1.34
Japan	2.03
LatinAmerica	1.12
Nonelec Mch Pts Acc	
United States	0.71
Japan	1.62
LatinAmerica	0.27
Auto Data Proc Equip	
United States	1.81
Japan	1.99
LatinAmerica	1.08
Office, ADP Mch Pts	
United States	2.08
Japan	1.96
LatinAmerica	0.08
Sound Recorders, Phono	
United States	0.28
Japan	4.87
LatinAmerica	0.01
Telecom Eqp Pts Acc	
United States	1.16
Japan	3.12
LatinAmerica	0.12
Switchgear Etc Pts Nes	
United States	1.21
Japan	1.80
LatinAmerica	0.38
Transistors, Valves Etc	
United States	1.76
Japan	2.43
LatinAmerica	0.08
Electrical Machinery	
United States	1.13
Japan	2.19
LatinAmerica	0.23
Pass Motor Veh exc Bus	
United States	0.57
Japan	2.87
LatinAmerica	0.15

Dots on the right side of the dashed line indicate the country has a revealed comparative advantage in that commodity.
The shaded areas indicate that the countries have a very similar revealed comparative advantage and therefore are competitive with each other in the particular good.
Source: Tables 7, 14, and 15.

Table 16b: Dissimilar Revealed Comparative Advantage Index for Top Japanese Exports, 1988-1991

	Index	0 | 1 | 2 | 3 |
Intrnl Combst Pistn Engs		
United States	1.34	
Japan	2.03	
LatinAmerica	1.12	
Nonelec Mch Pts Acc		
United States	**0.71**	
Japan	1.62	
LatinAmerica	**0.27**	
Auto Data Proc Equip		
United States	1.81	
Japan	1.99	
LatinAmerica	1.08	
Office, ADP Mch Pts		
United States	2.08	
Japan	1.96	
LatinAmerica	**0.08**	
Sound Recorders, Phono		
United States	**0.28**	
Japan	4.87	→
LatinAmerica	**0.01**	
Telecom Eqp Pts Acc		
United States	1.16	
Japan	3.12	
LatinAmerica	**0.12**	
Switchgear Etc Pts Nes		
United States	1.21	
Japan		
LatinAmerica	**0.38**	
Transistors, Valves Etc		
United States	1.76	
Japan	2.43	
LatinAmerica	**0.08**	
Electrical Machinery		
United States	1.13	
Japan	2.19	
LatinAmerica	**0.23**	
Pass Motor Veh exc Bus		
United States	**0.57**	
Japan	2.87	
LatinAmerica	**0.15**	

Dots on the right side of the dashed line indicate the country has a revealed comparative advantage in that commodity.
The shaded areas indicate that the countries have a very dissimilar revealed comparative advantage and therefore are not competitive with Japan in the particular good.
Source: Tables 7, 14, and 15.

Table 17: Gross Domestic Product, 1992 (in $ billions), Real GDP per Capita ($PPP), and Share of World GDP, 1992 (in percentages)

	GDP	per capita GDP	World Share
World	23,060.560	-	100.000
United States	5,920.199	22,130	25.672
Japan	3,670.979	19,390	15.919
Latin America[a]	848.488	4,351	3.680
Chile	41.203	7,060	0.179
Mercosur	607.035	5,113	2.632
Argentina	228.779	5,120	0.992
Brazil	360.405	5,240	1.563
Paraguay	6.446	3,420	0.028
Uruguay	11.405	6,670	0.049
Andean Group	149.771	4,220	0.649
Bolivia	5.270	2,170	0.023
Colombia	48.583	5,460	0.211
Ecuador	12.681	4,140	0.055
Peru	22.100	3,110	0.096
Venezuela	61.137	8,120	0.027
CACM	28.067	2,952	0.122
Costa Rica	6.530	5,100	0.028
El Salvador	6.443	2,110	0.028
Guatemala	10.434	3,180	0.045
Honduras	2.813	1,820	0.012
Nicaragua	1.847	2,550	0.008

a. Including Panama, Dominican Republic, Jamaica, and Trinidad and Tobago also.
The shaded area represents the best performer (outside of the United States) on this characteristic.
Sources: The World Bank, *World Development Report 1994*, and Freedom House, *Freedom Review*, 26.1 (1995).

Table 18: Price Stability — Consumer Prices, 1990-1993 (percent change over previous year)

	1990	1991	1992	1993	4 year average	Stability Score
Japan	3.1	3.3	1.7	1.3	2.4	10.0
Latin America	-	-	-	-	-	4.13
Chile	26.0	21.8	15.4	12.7	19.0	7.0
Mercosur	-	-	-	-	-	2.25
Argentina	2,314.0	171.7	24.9	10.6	630.3	0.0
Brazil	2,937.8	440.9	1,008.7	2,148.4	1634.0	0.0
Paraguay	38.2	28.3	15.1	18.3	25.0	6.0
Uruguay	112.5	102.0	68.5	54.1	84.3	3.0
Andean Group	-	-	-	-	-	3.8
Bolivia	17.1	21.4	12.1	8.5	14.8	7.0
Colombia	29.1	30.4	27.0	22.6	27.3	6.0
Ecuador	48.5	48.7	54.6	45.0	196.8	1.0
Peru	7,481.7	409.5	73.5	48.6	2,003.3	0.0
Venezuela	40.8	34.2	31.4	38.1	36.1	5.0
CACM	-	-	-	-	-	5.4
Costa Rica	19.0	28.7	21.8	9.8	19.8	7.0
El Salvador	24.0	14.4	11.2	18.6	17.1	7.0
Guatemala	41.2	33.2	10.0	11.8	24.1	6.0
Honduras	23.3	34.0	8.8	10.7	19.2	7.0
Nicaragua	7,485.2	2,742.2	20.3	-	3,415.9	0.0

The shaded areas represent those countries which have an acceptable performance on this factor.
Source: International Monetary Fund, *International Financial Statistics Yearbook 1994*

Table 19: Real Effective Exchange Rates Stability, 1990-1992

	Standard Deviation	Currency Stability Score
Japan	4.6	9.0
Latin America	-	8.3
Chile	3.3	9.0
Mercosur	-	7.25
Argentina	11.5	7.0
Brazil	14.6	6.0
Paraguay	5.3	9.0
Uruguay	9.5	7.0
Andean Group	-	9.4
Bolivia	0.4	10.0
Colombia	3.6	9.0
Ecuador	1.5	10.0
Peru	4.7	9.0
Venezuela	3.0	9.0
CACM	-	7.8
Costa Rica	3.6	9.0
El Salvador	3.8	9.0
Guatemala	15.9	5.0
Honduras	2.5	10.0
Nicaragua	12.1	6.0

Sources: International Monetary Fund, *International Financial Statistics Yearbook 1994*, and Hufbauer and Schott 1994.

Table 20: Tax Revenue from International Trade and Transactions, 1986-1991 (percentages of government revenue)

	1986	1987	1988	1989	1990	1991	Average	Score
Japan	1.34	1.35	1.40	1.32	1.33	-	1.35[a]	10.0
Latin America	-	-	-	-	-	-	-	4.07
Chile	8.78	9.87	9.70	10.21	11.60	10.22	10.06	6.0
Mercosur	-	-	-	-	-	-	-	6.25
Argentina	12.03	10.27	11.40	25.45	*21.90*	*7.60*	14.78	5.0
Brazil	2.29	1.64	3.38	2.29	1.52	1.88	2.17	10.0
Paraguay	11.31	10.94	11.74	21.34	20.10	*16.70*	15.36	4.0
Uruguay	13.62	11.97	10.42	9.88	9.78	8.18	10.16	6.0
Andean Group	-	-	-	-	-	-	-	4.8
Bolivia	12.55	15.44	10.40	9.32	7.31	5.95	10.16	6.0
Colombia	19.24	18.86	19.39	17.79	*16.10*	*12.20*	17.26	4.0
Ecuador	21.97	19.58	18.44	15.50	14.34	*14.00*	17.31	4.0
Peru	20.76	21.54	14.39	18.32	10.89	9.72	15.94	4.0
Venezuela	23.41	11.58	12.54	*7.50*	5.60	*7.75*	11.40	6.0
CACM	-	-	-	-	-	-	-	1.2
Costa Rica	21.06	23.01	34.20	32.27	22.95	19.65	25.52	0.0
El Salvador	41.32	26.13	21.13	16.82	21.77	20.55	24.62	1.0
Guatemala	37.07	39.89	37.18	33.78	*34.30*	*28.10*	35.07	0.0
Honduras	*34.30*	*33.40*	*28.70*	*28.70*	*26.20*	-	30.26[a]	0.0
Nicaragua	7.04	*7.10*	16.87	9.37	17.57	*18.60*	12.76	5.0

a. Simple average for 1986-1990.
The shaded areas represent those countries which have an acceptable performance on this factor.
Sources: Non-Italicized data — International Monetary Fund, *Government Finance Statistics Yearbook* 1993. Italicized data — Hufbauer and Schott 1994.

Table 21: Extent of Market Oriented Policies, 1994; Social Conditions, 1994

	Market Policies Score	Life Expectancy	Social Conditions Score
Japan	9.0[a]	78.6	10.0
Latin America	6.0	-	5.6
Chile	10.0	71.9	7.0
Mercosur	7.0	-	6.0
Argentina	10.0	71.1	7.0
Brazil	6.0	65.8	5.0
Paraguay	6.0	67.2	5.0
Uruguay	6.0	72.4	7.0
Andean Group	6.8	-	5.0
Bolivia	8.0	60.5	3.0
Colombia	8.0	69.0	6.0
Ecuador	6.0	66.2	5.0
Peru	4.0	63.6	4.0
Venezuela	8.0	70.1	7.0
CACM	3.6	-	5.6
Costa Rica	6.0	76.0	9.0
El Salvador	4.0	65.2	5.0
Guatemala	2.0	64.0	4.0
Honduras	4.0	65.2	5.0
Nicaragua	2.0	65.4	5.0

a. This study derived this number from Bergsten and Norman 1993b. It gave Japan a 9.0 due to the extent of Japan's over-regulation of the economy.
The shaded areas represent those countries which have an acceptable performance on this factor.
Source: Taken from Hufbauer and Schott 1994, 102.

Table 22: Political Conditions, 1994

	Political Rights	Civil Liberties	Freedom Rating	Overall Rating
Japan	8.6	8.6	free↑	8.6
Latin America			-	7.19
Chile	8.6	8.6	free	8.6
Mercosur	-	-	-	7.5
Argentina	8.6	7.1	free	7.9
Brazil	↑8.6	5.7	partly free	7.1
Paraguay	↓5.7	7.1	partly free	6.4
Uruguay	8.6	8.6	free	8.6
Andean Group	-	-	-	6.86
Bolivia	8.6	7.1	free	7.9
Colombia	7.1↓	5.7	partly free	6.4
Ecuador	8.6↓	7.1	free↓	7.9
Peru	4.3	5.7↑	partly free	5.0
Venezuela	7.1	7.1	partly free↓	7.1
CACM	-	-	-	6.98
Costa Rica	10.0	8.6	free	9.3
El Salvador	7.1	7.1	partly free↑	7.1
Guatemala	5.7	4.3	partly free↓	5.0
Honduras	7.1	7.1	partly free	7.1
Nicaragua	5.7	4.3	partly free	6.4

Scale: 10 very free to 0 not free.
The shaded areas represent those countries which have an acceptable performance on this factor.
↓↑ up or down indicates a significant change in Political Rights or Civil Liberties since the last survey.
↓↑ up or down indicate a general trend in freedom.
Source: Freedom House, *Freedom Review*, January-February 1995.

Table 23: Performance Scores on Readiness Factors

	Price Stability	Currency Stability	Market Policies	Trade Tax Reliance	Social Conditions	Stable Democracy	Avg.
Japan	10.0	9.0	9.0	10.0	10.0	8.6	9.43
Latin America	4.13	8.3	6.0	4.07	5.6	7.19	5.88
Chile	7.0	9.0	10.0	6.0	7.0	8.6	7.93
Mercosur	2.25	7.25	7.0	6.25	6.0	7.5	6.04
Argentina	0.0	7.0	10.0	5.0	7.0	7.9	6.15
Brazil	0.0	6.0	6.0	10.0	5.0	7.1	5.68
Paraguay	6.0	9.0	6.0	4.0	5.0	6.4	6.07
Uruguay	3.0	7.0	6.0	6.0	7.0	8.6	4.60
Andean Group	3.8	9.4	6.8	4.8	5.0	6.86	6.11
Bolivia	7.0	10.0	8.0	6.0	3.0	7.9	6.98
Colombia	6.0	9.0	8.0	4.0	6.0	6.4	6.57
Ecuador	1.0	10.0	6.0	4.0	5.0	7.9	6.98
Peru	0.0	9.0	4.0	4.0	4.0	5.0	4.33
Venezuela	5.0	9.0	8.0	6.0	7.0	7.1	7.02
CACM	5.4	7.8	3.6	1.2	5.6	6.98	5.10
Costa Rica	7.0	9.0	6.0	0.0	9.0	9.3	6.72
El Salvador	7.0	9.0	4.0	1.0	5.0	7.1	5.52
Guatemala	6.0	5.0	2.0	0.0	4.0	5.0	3.67
Honduras	7.0	10.0	4.0	0.0	5.0	7.1	5.52
Nicaragua	0.0	6.0	2.0	5.0	5.0	6.4	4.07

The shaded areas represent those countries which have an acceptable overall performance (above a 6.5) on the readiness factors.
Source: Tables 18-22.