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Trade Policy, Constituent Interests and Politics in US-Japan Economic Relations

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1. INTRODUCTION

A change in trade policy in a country changes the payoffs to export and import competing industries at home and abroad. These changes are likely to have political ramifications (Grossman and Helpman, 1994). There is a vast literature analyzing the economic consequences of trade policy changes.[1] This literature is as old as the academic study of economics itself. There is a much smaller but growing literature by economists studying the political impacts of trade policy changes. These two literatures studying the consequences of trade policy changes have empirical, as well as theoretical components.[2]

It is only within the past dozen years that economists have begun to use equity market data to analyze the consequences of trade policy changes (Hartigan et al., 1986). To date, virtually all this equity market literature has assessed only the impact on the home country of trade-policy changes. Almost no attempt has been made to use equity-market data to simultaneously assess the impact of policy changes on the welfare of trading partners.[3] Nor has this equity market literature attempted to evaluate the impact of trade

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[1] For a recent set of contributions, see Feenstra (1997).

[2] See, for example, the early survey by Leamer and Stern (1970).

[3] An exception may be Saxonhouse (1997).

negotiations.[4] This paper will attempt to work in both these neglected areas by assessing the impact on the value of selected equities in the United States and Japan of: (1) the enactment of the so-called "Super 301" legislation; (2) the inclusion of a significantly strengthened Dispute Settlement Mechanism in the final Uruguay Round Agreement; and (3) the Japan-U.S. Automobile Agreement of June 1995. In addition, the domestic political impact of operating in the post-Uruguay Round international economic environment will be examined by evaluating the results of the Japan-U.S. Automobile Agreement using evidence from the Iowa Presidential Stock Market (Forsythe et al., 1991).

2. THE EVENTS

a. Event 1 - The Super 301 Clause of the Omnibus Trade and Competitiveness Act of 1988

The Super 301 Clause of the Omnibus Trade and Competitiveness Act of 1988 changed existing trade law by requiring the United States Trade Representative (USTR) to identify countries that have a "consistent pattern of trade barriers and market distorting practices." Having identified these countries, the USTR is now required to enter into negotiations with them to remove all such practices within 15 to 19 months. Failing agreement, Section 301 cases begin. Any settlement reached must provide for the complete elimination of major barriers within three years. Super 301 also provides that while it is the USTR instead of the President who decides retaliatory measures, the President can block final retaliation by invoking national economic or security

[4] For many years, this has been the province of computable generated equilibrium modeling. See, for example, Brown et al. (1992).

considerations.[5] Previous trade legislation allowed, but did not require the USTR to initiate Section 301 cases. Nor did previous legislation require such a strict time table (Elliott and Richardson, 1997). Previous legislation also had a much narrower definition of unfair trade practices.[6]

Super 301, like the Omnibus Trade and Competitiveness Act itself, has a complicated legislative history. It arose, on the one hand, out of a desire to put the onus on trading partners to reduce the bilateral imbalances between them and the US. On the other hand, it built on a decade long effort to amend the Trade Act of 1974 to strengthen Section 301.[7]

In 1986, Richard Gephardt, then Majority Leader of the US House of Representatives, proposed that countries having chronic bilateral trade surpluses with the United States be required to lower them by 10% a year. This proposal was widely criticized. If the overall U.S. trade imbalance reflects insufficient domestic savings relative to domestic investment, requiring trading partners to reduce their bilateral surpluses, in the absence of any U.S. adjustments, will simply lead to the shifting of these bilateral surpluses from one U.S. trading partner to another (Saxonhouse, 1986).

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[5] The Super 301 Clause had a sunset provision of three years, but the process was restored during the Clinton Administration by executive order.

[6] Super 301 expands the definition of actionable unfair trade practices to include lack of market reciprocity, export targeting, toleration of cartels, diversion of exports and restrictions on technology transfer.

[7] For example, it is only since 1984 that the USTR has had the power to self-initiate Section 301 cases without a private-sector plaintiff. This authority was not provided for in the Trade Act of 1974.

The Gephardt Amendment (to the Trade Act of 1974) was effectively dead by the time the Ways and Means Committee of the U.S. House of Representatives finally debated it on November 10, 1987 (Lambsdorff, 1988). In its place, the Senate Finance Committee, in consultation with the Ways and Means Committee, crafted Super 301. By early January, 1988, all the major provisions that would be included in the legislation finally passed were already present (Brookes, 1988).

Ironically, even as Super 301 emerged from the Senate Finance Committee deliberations, Majority Leader Gephardt's presidential campaign was ending. This left Super 301 without an advocate among the major presidential candidates in 1988.[8] This changed in March, when Governor Dukakis, in advance of the Michigan primary, altered his previously stated position and announced he would support Super 301 (Brookes, 1988). With Dukakis having changed his position, Vice President Bush prevailed upon the Reagan White House to base their opposition to the Trade Bill reported out of Congress exclusively on the provision requiring 60 days notice for plant closings and major layoffs. No emphasis would be placed on concerns about the Super 301 provision.

The period between early May, when the new Trade Act was first sent to the President, and August 7th , when the White House finally agreed to a different version of the bill was characterized by intense lobbying. Following President Reagan's veto of the first version of the bill sent to him in late May, the House of Representatives voted to override. As expected, the effort to override failed in the Senate. In the weeks that

[8] When the Omnibus Trade and Competitiveness Act was finally passed by the Senate, Majority Leader Gephardt voted against it arguing in its final form it had strayed too far from his original conception. See Wechsler (1988).

followed, whether Congress and the White House could agree on a Trade Bill at all remained in doubt (Swoboda, 1988).

While, as the Bush campaign intended, the focus of debate on the Trade Act was primarily on the plant-closing provision, public discussion of Super 301 also continued. Senator Danforth (R., Mo.) argued, "The underlying theme of the bill is reciprocity… . The 'Super 301' provision of the bill provides us with a consistent means of addressing unfair trade practices." In contrast, Senator Evans (R., Wa.) complained, "Any time you shrink that [flexibility], I think you're acting in a way detrimental to American general interests and also, specifically you're probably going to end up harming America's most competitive industries because other nations will clearly retaliate against the only industry they can, and those are the ones which are penetrating their markets, which are our most successful industries."[9]

U.S. trading partners were also quick to denounce Super 301. Japan's Minister of International Trade and Industry, Hajime Tamura, went so far as to brand the provision "racist" (Harbrecht et al., 1988, p. 42). Otto Lambsdorff, the former German Minister of Economics, complained, "The Gephardt Amendment was designed to compel the surplus countries, among them the Federal Republic of Germany, to cut their trade surpluses with the U.S. by 10% a year, but the Senate proposal for … Super 301, which has been adopted in its place, is no less unpalatable to America's trading partners" (Lambsdorff, 1988).

On August 23, 1988, after prolonged negotiations between the White House and the congressional leadership, President Reagan finally signed the Omnibus Trade and Competitiveness Act of 1988 (Preeg, 1995, p. 78).

b. Event 2 - The World Trade Organization's Dispute Settlement Mechanism

It is widely agreed that the revised Dispute Settlement Mechanism (DSM) is the most important part of the new World Trade Organization (WTO). Indeed, many believe that the revised DSM is the most important result of the entire Uruguay Round (*Inside U.S. Trade*, 1993c, p. 6). Many also believe that but for the enactment of Super 301, a revised DSM would have been no more part of the Uruguay Round than it was part of the Tokyo Round (Preeg, 1995, p. 78).

The critical element of the revised DSM is the absence of single country veto power to block the formation of a dispute settlement panel or the adoption of panel findings. As the old GATT mechanism had evolved, veto power was held even by the accused party. Now panels go forward and panel findings get adopted unless the WTO Council decides otherwise by consensus (Jackson, 1994). This is the polar opposite of the older *modus operandi*. At the same time, under the revised DSM, an appellate review procedure is available upon request by one of the parties to the dispute, and a three-member appellate panel may uphold, modify or reverse the findings of the original dispute panel (Preeg, 1995, p. 208). Other important elements of the revised arrangements include a tightening of procedures to insure prompt findings by dispute panels and the provision for cross-retaliation. Unlike the old GATT mechanism, a violation in one product area can be countered by a sanction in some other product area (*Inside U.S. Trade*, 1993b).

U.S. government interest in a revised DSM is of very long standing. During the Tokyo Round, the United States pressed both for an end to the single-country veto and for expedited procedures, but the European Community firmly resisted (Jackson, 1992, p.

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[9] See *The Washington Post* (1988).

182). Interest on the part of all parties was revived around 1985 when GATT Member-States began to use the DSM to resolve a number of significant trade disputes. As Preeg (1995, p. 77) notes:

> "The surge in GATT dispute settlement was, in part, a reaction to the parallel growth in bilateral actions outside the GATT. It also reflected recognition by some countries, such as Japan, that unpopular decisions against vested political interests can be more palatable as part of an international adjudication process than as a result of bilateral political pressure."

This revived interest was such that when the Uruguay Round commenced, a separate negotiating group on the dispute settlement process was created (Jackson, 1992, p. 183).

Despite the existence of a separate negotiating group on the dispute settlement process since as early as 1986, relatively little progress was made on agreeing to revise procedures until as late as November 1993.[10] Had the Uruguay Round been successfully concluded as planned at the Brussels Ministerial in December 1990, it is most unlikely that the single country veto of a panel finding would have been removed as part of the dispute settlement process (Preeg, 1995, pp. 124-25).[11]

Hard bargaining on the final version of the revised DSM began only on November 1, 1993 when, in response to U.S. criticism that no significant progress had been made on

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[10] The mid-term Ministerial Review of the Uruguay Round held at Montreal in December 1988 did make clear that under the contemplated agreement the establishment of a panel would normally be the right of a disputing complainant. Consensus to go ahead would not be necessary (Jackson, 1992, p. 183).

[11] The draft agreement put forward by Arthur Dunkel a year later in December 1991 contains a proposed DSM that includes the provision that panel findings will be automatically adopted unless an appeals body or all Members acting unanimously decides otherwise (Jackson, 1992, p. 183). At the time they were proposed the provisions of the Dunkel Draft were not accepted.

this issue, GATT Director-General Peter Sutherland called on delegations to send higher-level representatives to the negotiations (Bergsman, p. 7). In the six weeks that followed until final agreement was reached on December 12, 1997, bargaining was as much about the scope of the revised Dispute Settlement Mechanism as about its procedures. As bargaining proceeded, the Clinton Administration, under pressure from groups such as the Semiconductor Industry Association, seemed increasingly uncomfortable with the traditional U.S. position advocating a rigorous dispute settlement process (*Inside U.S. Trade*, 1993d, p. 51). For example, the Clinton Administration during this period came to argue against giving dispute settlement panels the right to accept so-called non-violation cases (Bergsman, 1993, p. 6).

The Clinton Administration also proposed, against the opposition of all its major trading partners, that dispute settlement panels be limited to insuring that decisions by domestic authorities involve reasonable interpretations of trade rules. A reasonable interpretation need not be an interpretation most preferred by the dispute settlement panel. The Clinton Administration's proposal would have limited the ability of dispute settlement panels to overturn interpretations of fact arguing that "reasonable minds could differ as to the significance to be attached to certain facts" (Bergsman, 1993, p. 1).

On many issues that were resolved during the final weeks of the Uruguay Round negotiations, U.S. proposals prevailed as, for example, on research subsidies. Despite heavy pressure, however, the Clinton Administration's proposed changes to the draft text on the DSM made no headway and were not incorporated at all in the final agreement (*Inside U.S. Trade*, 1993a, p. 5).

The increasing recognition that the Clinton Administration had made no headway in its efforts to change the Uruguay Round dispute settlement text led industry groups in Washington in the week just prior to the conclusion of the Uruguay Round to charge that: "The threat of unilateral action to protect U.S. interests has been repealed without changing a word of U.S. law" (*Inside U.S. Trade*, 1993a, p. 5). The most vocal critics of the new dispute settlement rules were among the private sector groups advocating aggressive trade policies against Japan. They pointed out that the United States would be restrained in its ability to enforce the results of the Framework Agreement that the Administration wanted to negotiate with Japan, particularly if it sought to address anti-competitive practices (Jackson, 1993a). European Union (EU) Chief Negotiator Hugo Paeman seemed to back this up arguing, "Section 301 will not be possible under the WTO as long as there are multilateral rules to settle disputes" (*Inside U.S. Trade*, 1993a, p. 6).

At the conclusion of the Uruguay Round, Japan's views on the revised Dispute Settlement Mechanism and Section 301 were summarized by its Chief Negotiator Nobutoshi Akao (*Inside U.S. Trade*, 1993c, P. 7):

> "The American government has been saying [the revised Dispute Settlement Mechanism] strengthens Section 301. But it's difficult … to say how it is going to work. Perhaps … if they first take the case to the WTO and … if they lose they forget about it; if they win then they can use the strengthened dispute settlement mechanism with Section 301 … There is no reason for us to complain because retaliation would be based on a result of the dispute settlement procedure.
>
> What we have been afraid of in the past is that, without going through the GATT process, the US has invoked Section 301 and threatened us to concede. But the merit for our side is that once the WTO goes into effect, all countries, instead of resorting to unilateral action, have to go through the dispute settlement mechanism.

> … Under the new system, there is no reason for us not to negotiate on bilateral trade issues. If the US request is a reasonable one, then we should try to settle it bilaterally. At the same time, sometimes US requests are very unreasonable. For such unreasonable requests, we don't have to listen to the US, and we shouldn't worry about a threat by the US. If [the US takes] unilateral action in a case where we have more reason than the US, then we can go to the dispute settlement procedure. In the past, with the lack of that kind of multilateral system, we had to often compromise and sometimes accept something which from the multilateral viewpoint is not necessarily desirable. We have been major victims of Section 301 and Super 301."

c. Event 3 - The Japan - U.S. Automobile Agreement of June 1995

The first major Japan-U.S. trade dispute to test the new law came to a head in the Spring of 1995 when the Japanese government refused to agree to measures that would have had Japanese automobile manufacturers issue new foreign parts purchasing plans whose fulfillment would be monitored by both the Japanese and US governments (Alden, 1995, p. 1). In retaliation, on May 16, USTR Kantor announced that the United States, operating under Section 301 of the 1988 Trade Act, would impose tariffs of 100 percent ad valorem on thirteen Japanese-made luxury cars, valued at $5.9 billion at the entry prices prevailing in 1994. It was intended that a final sanctions list would be published on June 28th (*Inside U.S. Trade*, 1995b, p. 1). At the same time that Kantor was announcing sanctions under Section 301, he also confirmed that the United States would launch a broad challenge to Japanese practices in autos and auto parts under Article XXIII of the WTO (*Inside U.S. Trade*,1995c, p.15). Despite filing this case, Kantor insisted that the US sanctions were in accordance with its obligations under the WTO, because the practices targeted were not covered by the WTO (*Inside U.S. Trade*, 1995b, p. 2).

Chief Negotiator Akao's prediction proved correct. Rather than caving in to U.S. pressure, Japan challenged the U.S. sanctions by filing its own case at the WTO, insisting it

would not continue bilateral negotiations. The Japanese case at the WTO charged the United States with violating Articles I and II. These provisions require countries to offer MFN treatment to imports from all WTO members and not raise duties above those bound in their schedules of tariff concessions. Japan also argued that the announced sanctions were inconsistent with Article XXIII of the WTO Dispute Settlement Understanding which "prohibits any Contracting Party from making a unilateral determination on remedial measures" (*Inside U.S. Trade*, 1995b, p. 2).

The EU took Japan's part in this dispute proclaiming that "this is not the way to solve trade disputes. … These [sanctions], if implemented, would be contrary to U.S. obligations under the World Trade Organization." The EU said it would continue to urge both sides to resolve their differences through the recently strengthened multilateral dispute settlement procedures (*Inside U.S. Trade*, 1995a, p. 3).

Echoing the EU's attack on the Clinton Administration's trade policy, Speaker of the House Gingrich also denounced the decision to impose sanctions on Japanese luxury cars without first bringing a complaint to the WTO (Bergsman, 1995, p. 1). Even Alan Wolff, a lawyer representing the Semiconductor Industry Association, who had argued strenuously in Geneva, in December 1993, in favor of limiting the scope of the DSM, predicted that Japan's case against the U.S. decision to impose sanctions under Section 301 would be a "slam dunk" victory for Japan (*Inside U.S. Trade*, 1995d, p. 1).

Other than an agreement to resume negotiations under WTO auspices on June 22nd, little was accomplished in the four weeks following the announcement of sanctions (*Inside U.S. Trade*, 1995d, p. 1). On June 15th, Japanese government officials met with members of Congress and congressional staff and indicated that Japan's automobile manufacturers

would be willing to take a leadership role in resolving the bilateral dispute. While the automobile manufacturers were not willing to announce purchasing plans for auto parts, they were prepared to announce specific plans for increased automobile production in the United States and indicated that, in principle, increased localization of production should lead to increased purchases of local U.S.-made auto parts over time. Since the plans for increased U.S. transplant production had already been released, this was a concession that was easy for the Japanese automobile manufacturers to make. Neither they nor the Japanese government, however, were willing to permit government monitoring of the implementation of these plans (*Inside U.S. Trade*, 1995f, p. 21).

During the week following the congressional meetings and the resumption of negotiations on June 22nd, the USTR continued to insist that the Japanese automobile companies' purchase plans must include numerical targets either for the overall value of parts purchases, or for an increase in local content. The Japanese government continued just as strongly to reject this approach (*Inside U.S. Trade*, 1995g, p. 23). The agreement that was finally announced the morning of June 28th just before sanctions were due to go into effect, embodied most of the principles that had been outlined by Japanese government officials to congressional members and staff two weeks before. The Japanese automobile companies would only announce transplant production plans, but no plans for parts purchases or local content. At the same time no mechanism for monitoring the fulfillment of even these limited plans was agreed upon. To make any monitoring more difficult, each of the major Japanese automobile companies announced transplant production plans of different duration and time periods making the aggregation of results impossible.

USTR Kantor at his joint press conference with MITI Minister Hashimoto was permitted to announce an estimate of the increase in Japanese foreign auto parts purchases under the agreement. Minister Hashimoto immediately announced, however, at the same joint press conference that USTR Kantor's estimates were his own and were not shared by Hashimoto himself or by the Japanese government and were not part of the agreement. Given the variation in the dates of the individual company plans, Minister Hashimoto claimed to be surprised that USTR Kantor felt the plans could be combined in a meaningful way (*Inside U.S. Trade*, 1995h, p. 17).

3. EVALUATION

The impact of each of the three events just discussed will be evaluated by examining its impact on the market evaluation of the equity of selected publicly-traded U.S. and Japanese firms. Such an approach assumes that in Japan, as in the United States, unbiased assessments of the effects of publicly released information are systematically incorporated into the value of publicly traded equities. A list of the Japanese and American firms whose equity valuation will be studied is presented in Table 1. In general, these are firms, for

TABLE 1

A. Japanese and American Firms Included in the Super 301 and Dispute Settlement Mechanism Event Studies

Hitachi	Chrysler
Honda	Federal Mogul
Matsushita Electric Industrial	Ford
Mitsubishi Electric	General Electric
Nippon Denso	General Motors
Nissan	Intel
NEC	Motorola
Oki Electric	National Semiconductor

Toyota	Texas Instruments

B. Japanese and American Firms Included in
Japan-US Automobile Agreement Event Study

Aisin Seiki	Chrysler
Koito Mfg.	Exide
Honda	Federal Mogul
Nippon Denso	Ford
Nissan	General Motors
Toyota	Trinova

whom it is expected the event would have a large impact. It is expected that the enactment of Super 301 would affect the valuation of Japan's firms negatively. The reverse should be true for the valuation of American firms. If it is correct to say that the revised Dispute Settlement Mechanism greatly curtailed the use of Section 301, then the second event should have a positive impact on the valuation of Japanese firms. The impact of this event on the valuation of the American firms in this study can be expected to be more ambiguous. Curtailing Section 301 should have a negative effect, but over the time period being examined this effect may well be swamped by other positive benefits that may flow to these firms from the enactment of the Uruguay Round. Finally, if the conventional view of the 1995 Japan-US Automobile Agreement is correct, there should be no impact at all on the valuation of the Japanese and American automobile and automobile parts companies in the sample being used here.

If an event is to have an impact on equity valuation, it must generate changes significantly above or significantly below those that would have been predicted given the firm's normal relationship with the market. If stock market returns follow a multivariate normal distribution, the following well-known equation holds:

(1) $R_{iw} - R_{fw} = a_i + b_i (R_{mw} - R_{fw}) + v_{iw}$

where R_{iw} ≡ continuously compounded rate of return for security *i* in period *w;* R_{mw} ≡ continuously compounded rate of return for the market portfolio, in period *w*; R_{fw} continuously compounded risk-free rate of return; $b_i \equiv cov(R_{iw*}, R_{mw*})/var(R_{mw*}) \equiv$ the systematic risk of security *i*; $R_{iw*} \equiv R_{iw} - R_{fw}$; $R_{mw*} = R_{mw} - R_{fw}$; $a_i \equiv$ firm-specific constant; $v_{iw} \equiv$ normally distributed random error term that is uncorrelated with R_{mw} and has zero mean and constant variance.

Equation (1) is estimated for each of the three events using the firms listed in Table 1. This estimation takes place for the first event using weekly returns for the 78 weeks prior to November 10, 1987 and up until 26 weeks before this date and for 26 weeks up until 78 weeks after the agreement between Congress and the White House was concluded. Likewise, equation (1) is estimated for the second event using weekly returns for the 78 weeks prior to November 1, 1993 and up until 26 weeks before this date and for 26 weeks up until 78 weeks after the Uruguay Round Agreement was announced in Geneva. Finally, equation (1) is estimated using weekly returns for the 78 weeks prior to April 28th, 1995 when the first news reports on possible sanctions began to appear in press up until 26 weeks before this date and for 26 weeks until 78 weeks after the Auto Agreement was announced by USTR Kantor and Minister Hashimoto. The parameters estimated from equation (1) are used to compute excess returns for each equity for the period when new information about each of the events, respectively, is thought to reach the equity markets.

$$2) \qquad G_{iw} = (R_{iw} - R_{fw}) - \hat{a}_i - \hat{b}_i(R_{mw} - R_{fw}) \qquad e_1 \le w \le e_2$$

where $\hat{a}_i$ and $\hat{b}_i$ are taken from the estimation of equation (1).

Just calculating excess returns for an arbitrary period (e_1, e_2) preceding the announcement of the projects ignores the gradual leakage of information that is so characteristic of both legislative and diplomatic processes in both the United States and Japan (Halloran, 1969). Even newspaper reports on rumors about new negotiating positions for parties to a dispute may lag substantially the capitalization of such information by the equity markets. Unfortunately, if e_1 is set very far away from e_2 to allow for gradual information leakage, the test to check for statistically significant excess returns will have very low power (Morse, 1984; Brown and Warner, 1980). Alternatively, assume that the gradual leakage of information influences securities prices in the S-shaped pattern of the cumulative normal distribution (Ellison and Mullin, 1995)

$$(3)\quad E(G_{iw} / Y_w) = g\{\Phi(\frac{w-\mu}{\eta}) - \Phi(\frac{w-1-\mu}{\eta})\} \quad , e_1 \le w \le e_2$$

$$= \quad g\{1-\Phi(\frac{w-\mu}{\eta})\}, \quad w = e_2$$

$$= 0 \qquad\qquad , w < e_1 \text{ and } \quad e_2 > w$$

where $g \equiv$ reaction parameter; $\Phi \equiv$ normal cumulative distribution function with μ and η as first and second moments; $e_2 \equiv$ time of the announcement of the agreement.

In order to avoid arbitrary decisions as to when the events first influenced equity prices, g, μ, and η are estimated using observations beginning 26 weeks before the first rumors about the character of the final agreement for each event appeared in the press up until the final official announcement of an agreement. g, μ, and η are estimated separately for each of the events and separately for each national sample of firms. It is also assumed

that while e_2 is the same, e_1 will vary in accordance with when rumors first appear in Japanese and English language publications.

The results of the estimation are presented in Table 2. These results highlight the rather different reactions of Japanese and American equity prices to information about the three different events being studied here. Japanese equity values have a sharply negative reaction to the passage of the 1988 Trade Act with its inclusion of the Super 301 clause. At the same time, and as expected, the successful conclusion of the Uruguay Round with the

TABLE 2

The Impact of Super 301, the Revised Dispute Settlement Mechanism and the Japan-United States Automobile Agreement on Selected Equity Prices

a. Super 301

	Japan	USA
g	-0.0471	0.0087
	(0.0183)	(0.0160)
μ	36.5	34.1
	(2.8)	(3.6)
η	3.11	2.63
	(1.90)	(1.74)

b. The Revised Dispute Settlement Mechanism

	Japan	USA
g	0.0997	0.0285
	(0.0304)	(0.0196)
μ	29.2	30.8
	(3.7)	(2.4)

η	2.50	3.38
	(1.39)	(1.95)

c. The Japan-United States Automobile Agreement

	Japan	USA
g	0.0524	0.0188
	(0.0375)	(0.0216)
μ	24.4	25.2
	(1.6)	(2.5)
η	2.4	1.8
	(1.3)	(0.9)

Note: Standard errors are in parentheses. μ and η are calibrated in weeks.

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revision of the dispute settlement process has a sharply positive effect on Japanese equity values. In contrast, American equity values have a positive reaction both to the passage of the 1988 Trade Act and to the inclusion of the revised Dispute Settlement Mechanism in the new WTO. Neither of these reactions, however, is statistically significant. Nor is there a statistically significant reaction by either Japanese or American equity markets to the conclusion of the Japan-United States Auto Agreement in June 1995.

μ and η, the first two moments of the cumulative normal distribution function φ, characterize the path of the impact of information from the event. μ indicates the point in the distribution where new information about the projects has its maximum impact. η helps

characterize how quickly such information diffuses to the equity markets. Unlike the reaction parameter g in at least two of the events, μ and η are statistically significant for both the Japanese and American samples. Not surprisingly, given the resources devoted to

monitoring each of these three events by political and economic elites in Japan and the United States, there is no statistically significant difference in the speed with which information about these events diffuses to the equity markets in each country.[12] What is most interesting is how early the equity markets in both Japan and the United States appear to have reached the conclusion that whatever auto agreement might be reached would be of little consequence. This conclusion appeared to have been quite widespread even before sanctions were formally announced.

4. POLITICAL INTERPRETATION

Unlike the first two events, equity market evidence suggests the Japan-United States Auto Agreement had no impact on major automobile industry participants on either side of the Pacific. There are a number of possible interpretations for this finding. First, the agreement even as contemplated as early as February 1994 was never of a scale that could have had substantial impact on the earnings of any of the companies whose equity values are being studied here. Second, it is also possible that the functional form being used in this study to characterize the impact of information on equity values is too limiting.

If neither of these factors is responsible for the findings here, and if it was obvious very early to all concerned that nothing of economic importance would result from an agreement, why is it that the Clinton Administration pursued this case with such vigor and at such cost to amicable relations not only with Japan, but with many other U.S. trading partners? In this connection, Figure 1 is most instructive. Evidence from the Iowa

[12] Contrast this with the asymmetric monitoring found in Saxonhouse (1997).

Presidential Stock Market appears to indicate quite strongly, and in contrast to much press commentary, that President Clinton drew considerable political benefit from pursuing this agreement. The prices of Clinton futures rose sharply in late June when discussions of the Japan-United States Auto Agreement dominated the news media.[13] Whatever the economic consequences of these negotiations, the Presidential Stock Market indicated that this Agreement would be highly favorable to President Clinton's re-election prospects.

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[13] Holders of Clinton futures were to receive $1 per future in the event President Clinton won re-election in 1996.

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