

Seminar 4: US, Japan, and China Trilateral Trade Imbroglia: What is after the East Japan Great Earthquake?

Monday, September 12, 2011

3:00pm-5:00pm

Ambassador Room, The Embassy Row Hotel

Organized by the U.S.-Japan Research Institute

Welcome Remarks

Professor Katsuichi Uchida, *President, USJI/ Vice President, Waseda University*

Prof. Uchida gave a brief introduction to the U.S.-Japan Research Institute, a non-profit organization which was established by 5 prestigious Japanese Universities (Keio University, Kyoto University, Ritsumeikan University, The University of Tokyo, and Waseda University) to connect the United States and Japan through research on security, environmental, and economic issues. This seminar was part of a weeklong series of seminars part of USJI Week: Reconstruction after the Great East Japan Earthquake

Moderator's Remarks and Presentation

Dr. Kenji Nakatsuji, *Operating Advisor, USJI/Professor of International History, Graduate School of International Relations, Ritsumeikan University*

Dr. Nakatsuji laid out the context for the seminar's focus on the future of Japan's trade with China and the U.S. after the Great East Japan earthquake. Advanced economies are suffering from economic and political difficulties such as sovereign debt risks. Japan's hardship is compounded not only by the earthquake disaster, but also changing political leadership that results in little being done. Dr. Nakatsuji argued that in order to break from economic stagnation, countries such as Japan must incorporate the vitality of emerging Asian economic powers for their mutual benefit.

Presenters

Professor Susumu Yamagami, *Vice President, Ritsumeikan Asia Pacific University*

Prof. Yamagami shared his presentation on the history and prospects for trade and investment in the Asia-Pacific region, with a focus on APEC countries. Prof. Yamagami emphasized that the region has been a strong supporter of the global trade regime under GATT, and a history of regional and bilateral free trade agreements (FTAs) is a relatively new phenomenon in the region. In fact, in 1997 only 5 Asian economies among the top 30 economies did not conclude any preferential trade agreement.

However, some trade concerns in both Asia and the U.S. arose in the 1990's. Within East Asia, there were intensifying trade frictions and disputes and a stalemate of the GATT-UR (General Agreement on Tariffs and Trade Uruguay Round), coupled with increasing protectionism/regionalism in Europe and North America and a shift of FDI to the former Soviet Union and Mexico. From the U.S. perspective, there were concerns over the huge trade deficits with Asian countries and dissatisfaction with trading practices of the European Community and

Japan. And after the Cold War the major policy challenges were economic and domestic, making the U.S. more inward-looking.

With the slowdown or stalemate of global negotiations, traditionally the best trade agreements, **economies turned to “second best” options – regional and bilateral agreements.** Regional responses were to form APEC, or the Asia-Pacific Economic Cooperation, which included the U.S., and the idea to form the East Asia Economic Group was shelved due to U.S. opposition.

So what did APEC do for trade liberalization? Quite a bit, Prof. Yamagami explained. APEC economies exemplified the importance of a trade liberalization regime under APEC process, while collectively issued declarations to support GATT-UR negotiations, and shaped the Bogor Declaration regarding trade and investment liberalization so as to compliment the GATT regime.

The 1994 Bogor Declaration was a non-binding political commitment to implement trade and liberalization by 2020 for developing countries and 2010 for developed countries. The Bogor Declaration used various modalities: voluntary liberalization through action plans and peer review; early voluntary sector liberalization for “easy” sectors, or ones not sensitive to outside competition and/or not of national security interests. Japan could not cope with liberalizing marine and forest products, which led to a standstill in the process, and the U.S. voiced concerns over the extent of voluntary liberalization.

Regional cooperation under ASEAN +3, first convened in 1997, brought about increased regional collaboration to cope with the financial crisis. The Chiang Mai initiatives in 2000 accelerated cooperation in wide areas. In 2000, ASEAN proposed the East Asia Summit to explore an East Asia Free Trade and Investment Area.

The APEC Summit in 2005 saw a revitalization of the Bogor goals. The Summit noted that average tariffs had decreased from 16.9% to 5.5% between 1989 and 2005, and about 50% of the countries applied an average tariff of less than 5%. Also noted was the fact that APEC members had already concluded 53 FTA/EPAs. At the 2005 Summit, APEC Leaders decided that FTA/EPAs should be qualified and transparent, as well as compatible with other agreements to promote comprehensive liberalization to meet Bogor goals.

Looking Ahead: How to Reach Bogor Goals

Prof. Yamagami offered an overview for how APEC economies can work together to reach the Bogor goals. One way would be to **decrease effective tariff rates to 0% or almost 0% except for sensitive commodities.** While the 2010 deadline for developed countries already passed and there is concern about political commitment to the goals, there is hope that stems from a progressive initiative agreed upon by New Zealand, Chile, Singapore and Brunei. This initiative came to be known as the Trans-Pacific Partnership, or TPP. TPP establishes free trade without exception among member countries, and now negotiations also include the U.S., Malaysia, and Australia, and should conclude at the APEC Summit in Hawaii in November 2011. Once approved, **TPP will be the most critical modality for achieving the Bogor goals.**

Now APEC boasts numerous FTAs, including regional FTAs such as NAFTA and AFTA, bilateral FTA/EPAs between ASEAN countries and Japan, Korea and China, and a pending FTA

between the U.S. and Korea. A U.S.-Japan FTA may be feasible if they shelve the rice issue. And APEC economies are also exploring other regional and bilateral FTAs, like TPP and an East Asia FTA, that will continue to promote trade liberalization and investment.

After Prof. Yamagami concluded his very comprehensive presentation, Dr. Nakatsuji commented that TPP has a lot to do with APEC, as it is a meaningful result out of dialogue that will have implications for each major economy.

Dr. Hironori Sasada, *Associate Professor, Ritsumeikan University*

Dr. Sasada's presentation examined Japan's FTAs in the context of its domestic political landscape. Dr. Sasada first gave the context for Japan's trade policies: there is a worldwide trend toward free trade policies, including FTAs and bilateral agreements, to push toward global competitiveness and work around stalled negotiations in the WTO and APEC. This trend put pressure on Japan's government to catch up with Asia trade rivals, as the fast moves by rival countries toward free trade gave Japanese companies competitive disadvantages.

LDP and Trade

Japan's previously long-ruling party, the LDP, was reluctant to engage in FTA, including FTAs with agricultural counties and the Doha Round, even though Japanese companies were struggling to compete. Why? Dr. Sasada explained that it all had to do with the **LDP's key constituencies, which were the farmers in rural areas**. The LDP had to maintain trade protection for farmers, illustrated by a high average tariff rate of about 11%, and tight protectionist measures on products like rice, wheat, dairy, and sugar.

While the urban centers of Japan are more populated, **malapportionment** in Japan's political districting induces **overrepresentation of rural interests** (more seats allocated to rural areas than urban in the Diet), and thus LDP's reliance on rural votes. In addition, the agricultural policymaking process favors three particular interests, the so-called "**Iron Triangle**" of farmers, agricultural cooperative (Nokyo), and the LDP. Each of the actors within this "triangle" benefits from watching out for the others' interests. Small, non-competitive farmers rely heavily on government subsidies and Nokyo for provisions. Nokyo offers business assistance for farmers, and also acts as a political machine to mobilize votes and lobbying. Finally, the LDP follows a clientelistic approach to win the farmer's vote: a combination of trade protection, price support, subsidies, and infrastructure development.

DPJ and Trade

LDP was toppled from power in 2009 by the DPJ. The DPJ's campaign promises regarding trade were twofold: promote free trade by removing trade barriers and increasing market competition, and offer social security in the form of income support programs for farming households. The latter would shift from price support to income support, which is more beneficial for consumers (urbanites the DPJ would want to please), and is common practice among other OECD countries.

However, since the DPJ has been in power, Japan has only 2 new FTAs and isn't yet part of TPP negotiations or any other FTA negotiations with major trade partners. Why is this? To explain, Dr. Sasada went into the factors that affect Japan's trade policies. International factors are the

WTO framework and regional arrangements. Domestic factors are the electoral system, leadership (or lack thereof), and interest groups.

From Urban-Based to Catch-All: The DPJ's Transition

This led to Dr. Sasada's main argument: before the DPJ was in power, it was mainly appealing to urban voters, who tend to be more pro-trade. **But now that the DPJ is in power, it is not an urban-based party anymore – instead it is a “catch-all” party.** To illustrate his point, Dr. Sasada showed a graph which showed the number of Upper House representatives from urban and rural areas over time. At first the DPJ was clearly more urban and the LDP more rural, but over time the two have converged to the same number of rural and urban. The DPJ's urban members have decreased, suburban members have stayed about the same, and rural members have increased, while the LDP has experienced the opposite trend (with a few exceptions due to leaders' strength).

Reminding participants that urban members are generally more pro-FTA, and rural members are generally more anti-FTA, Dr. Sasada then illustrated the division within former PM Kan's cabinet. Five ministers, including Kan, were from urban or suburban districts, while four were from rural or suburban (suburban can go either way, but mostly they are anti-FTA). PM Noda's administration is also divided. **The cabinets of Kan and Noda show the increasing influence of rural-based MPs in the DPJ,** and this explains why the once pro-FTA DPJ is not moving forward on many FTAs. Finally, Dr. Sasada suggested that frictions within the DPJ between leadership and anti-mainstream factions such as Ozawa's children (who are predominantly from rural districts) also make pro-FTA policies less likely.

Dr. Sasada went on to stress that in a post-3/11 Japan, there are other factors that affect Japan's policies. The serious damage to the Tohoku region, a major agricultural region, has galvanized demand for agriculture protection. On the other hand, the industry hardships such as the appreciation of the Yen and electricity shortage creates more incentive for investment overseas, and thus increases demand for FTAs.

Discussant's Remarks

Dr. Mark S. Manger, Lecturer in International Political Economy, International Relations Department, London School of Economics

Dr. Manger offered a few of his comments and feedback based on the presenters' arguments.

In response to Prof. Yamagami: Dr. Manger described that he was struck by the parallel between APEC in the early 1990s and the current situation. Dr Manger suggested that APEC may have helped focus the minds of negotiators. At the same time, it was clear that the voluntary steps proposed in APEC back then were, in hindsight, likely to fail because they implied GATT/WTO commitments that would have been extended to e.g. the EU, who would have been able to free-ride on APEC efforts.

As for East Asia, Dr. Manger observed that East Asian countries had as many FTAs with countries outside the region as the number of FTAs with Asian countries.

Dr. Manger said that as trade policy's goal shifts to promote investment, standards, etc., businesses will benefit from the shift. But economies' should consider that a patchwork of

agreements will lead to different rules, including categories and subcategories for tariffs that are difficult for exporters and customs officials to process. One example would be initial TPP, where member countries agreed to no trade barriers, but now he fears that the **TPP is being watered down through negotiations.**

Prof. Yamagumi's response: Prof. Yamagumi agrees that the Bogor goals are very ambitious, and how the APEC economies will realize them are up to the group. Prof. Yamagumi explained that while the Bogor Declaration called for liberalization of trade by 2010 for developed countries, **many countries have been endeavoring to achieve the goal as exemplified in the TPP negotiation.** Already Japan is well on its way to reaching the goals since its import tariffs are very low for most goods. As far as a Japan-EU FTA, there is really no incentive there on the part of EU since tariffs aren't a problem; however, if the FTA also incorporated something else, like standards, then there would be more incentive. Prof. Yamagumi used this example to describe how incorporating more things in FTAs could help persuade developed countries accept terms. Once large economies like the US and EU accept terms, then all others normally accept as well, since they don't want to be blamed for blocking the global system. However, lately countries such as Brazil and India have exercised their muscle in trade negotiations, the most prominent being the Doha Round.

In response to Dr. Sasada: Dr. Manger recapped Dr. Sasada's argument that the DPJ was originally an "urban" party, but it has shifted to a more comprehensive party whose new constituencies make it hard to negotiate FTAs without angering a large part of their base. Dr. Manger observed that it seems that while the ruling party changed, and the rural constituencies still get some benefits, which seems to support Dr. Sasada's argument. Dr. Manger also commented on the lack of leadership of the DPJ, and how that must negatively affect trade policies.

Dr. Manger asked a few follow-up questions, after which Dr. Sasada replied:

- 1. How do we know that the trade policy malaise comes from politicians' efforts to claim rural votes and not entrenched bureaucrats?**
 - a. Dr. Sasada agreed that the bureaucrats do play a role in actively trying to sabotage efforts for FTAs. For instance, zoku politicians used LDP members to defend their interests, and now that these politicians are gone, bureaucrats could be replacing them.
- 2. How did the DPJ win over some of LDP's traditional supporters? What were platforms that caused some of LDP's constituencies to switch?**
 - a. Dr. Sasada explained that one draw for farmers to the DPJ was the income support program, which showed that the party would provide benefits and help protect businesses. While Dr. Sasada could not speculate on the program's implementation and effectiveness, it is clear these measures have not decreased farmers' opposition to FTAs. Dr. Sasada said that it seems that farmers want the best scenario from both parties: both price support and income support.
- 3. Regarding the Ozawa strategy, how many MPs are Ozawa followers? Is there potential for coalition to establish income transfers to rural households? That might help with FTAs.**
 - a. Dr. Sasada clarified about the origins of Ozawa's children. When the LDP was in

power, Ozawa specifically targeted rural districts that were historically dominated by the LDP. Therefore, most of Ozawa's children are now from rural districts.

4. The DPJ can't implement policies unless it shakes up the bureaucracy and increases inter-party discipline. Noda is a more moderate/central figure – what can we expect from him?

- a. Dr. Sasada said that it was hard to say what we can expect from Noda because some important cabinet members and important figures are still changing. But Dr. Sasada described a "Best Scenario" case, where Noda can achieve a cease-fire between the mainstream DPJ and Ozawa's children in order to implement basic policies, finish the income support system, and remove trade barriers. In the "Worst Scenario," Noda falls into the same trap as Kan, not being able to negotiate peace between the mainstream and Ozawa factions to get things done.

Question and Answer Session

After the presentations and discussion with Dr. Manger, Dr. Nakatsuji opened the floor for questions from the audience.

Question: We weren't able to talk about China today, but if we added China in the mix, would it make trade agreements more difficult? Would all 3 currencies depreciate?

Prof. Yamagumi answered first, saying that China is sticking to the idea of a regional focus as ASEAN+3, and not invite the US in; yet, China does acknowledge that the US is a very important trade partner. The perspective of Chinese leaders is to learn from Chinese history and therefore they understand it is necessary **to satisfy rural peasants**. As such, it would be difficult for them to accept and FTA with agriculture because it would hurt development in one of their priority areas. Nonetheless, China's neighbors will certainly find opportunities to link their growth with China's.

Dr. Sasada argued that it **depends on the actor**. Japanese industries welcome China's rise because it means more business opportunities for Japan. It also gives them a reason to call for a FTA. For anti-FTA actors (like farmers), they would argue that Japan is already open for China, since Japan already imports a lot of goods from China. Interestingly, Japanese rice farmers are not threatened by Chinese rice farmers, because Chinese rice is not really demanded by consumers in Japan. The U.S., however, does produce this rice, so that is why the rice issue would need to be shelved before Japan could agree to a US-Japan FTA.

Dr. Manger said that the main issue with China is not opening the market, but rather **enforcing rules and compliance with international trade law**. Dr Manger argued that the principal obstacle to a Japan-China trade agreement was such an enforcement problem. Experience in the past had shown that dispute resolution in bilateral agreements was ineffective because the members of such panels tended to vote along national lines. In comparison, the WTO was more effective, because it set rules for trade globally in a neutral fashion.

To conclude the seminar, Dr. Nakatsuji stressed that time is of essence for forward-looking trade policies with rising threats of a serious global recession. Therefore, trade policies should be a part of national debate and gain support to share the benefits of regional agreements and break political stagnation in both the U.S. and Japan.