Abenomics and Japan's Trade Policy in a New Era

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I. Introduction

Prime Minister Shinzo Abe of Japan must have been disappointed by an announcement by the new United States President Donald Trump declaring withdrawal of the US from the Trans-Pacific Partnership (TPP) Treaty on the his first day in office. Although President Trump’s announcement was expected given his negative view toward TPP, which was delivered persistently during his presidential campaign, Prime Minister Abe is still hopeful for the return of the US to TPP. TPP is a high level and comprehensive free trade agreement (FTA) involving 12 Asia-Pacific countries including Japan and the US, but not China.

A main reason behind Abe’s keen interest in TPP is its importance in his economic and political strategies. Abe introduced Abenomics (Abe economics), in order to recover the Japanese economy from a long recession. TPP is an important component of his growth strategy, one of three arrows forming Abenomics. For Abe, TPP is also an important foreign policy to strengthen Japan’s alliance with the United States. One of the important challenges for Abe, after returning to the prime minister-ship, was to rebuild a good relationship with the US, as the relationship worsened under the DPJ (Democratic Party of Japan) government. The importance of this goal increased as Japan’s relationship with China became more problematic.

In light of these developments, this paper examines Japan’s recent trade policy focusing on TPP and discusses alternative trade policies, now that the original TPP is not likely to be enacted. The remainder of the paper is structured as follows. Section II reviews Japan’s recent trade policy briefly, and Section III examines Japan’s policy on TPP from various perspectives with a focus on TPP’s expected role in Abenomics. Section IV discusses the potential directions of US trade policy under President Trump while section V makes suggestions on Japan’s trade policy after considering various possibilities in light of the emerging new trade environment. Section VI provides some concluding remarks.

II. Japan’s New Trade Policy: FTAs

Japan began to have an interest in free trade agreements (FTAs) in the late 1990s,
as Japan was approached by several countries including Mexico, Singapore, and Korea to have FTAs. Japan was not interested in FTAs at first because Japan thought discriminatory FTAs would undermine the multilateral trade system under the General Agreement on Tariffs and Trade (GATT) and later the World Trade Organization (WTO), which were built upon basic principle of non-discrimination and benefited Japan substantially. Japan changed its view toward FTAs, as an increasingly large number of countries enacted FTAs, resulting in discrimination against Japan. Faced with the difficulty in starting multilateral trade negotiation under the WTO, many countries became interested in FTAs, in order to expand their exports, and began to establish FTAs with like-minded countries.

Under the new trading environment, Japan became to consider FTAs a useful trade policy tool. Indeed, FTAs have become most important trade policy for many countries as multilateral trade negotiation under the WTO, or Doha Round, has been in a stalemate. Japan began to establish FTAs actively in early 2000s. As of the end of March 2017, Japan has 15 FTAs (14 bilateral FTAs and one regional FTA with the Association of Southeast Asian Nations (ASEAN)). Japan is involved with three mega-FTAs; TPP, Regional Comprehensive Economic Partnership (RCEP) involving 16 East Asian countries including Japan and China, Japan-European Union (EU) FTA. RCEP and Japan-EU FTA are under negotiation. As with many other FTAs, Japan’s FTAs are of comprehensive coverage including not only trade liberalization, but also investment liberalization, trade and investment facilitation, economic cooperation, and others. Because of their broad coverage beyond free trade, Japanese government uses the expression “Economic Partnership Agreement (EPA)” rather than FTA. Among FTAs Japan is involved with, TPP is most important because of its high quality and comprehensive coverage, and its political implications. We will come back to more detailed discussions on the contents of TPP in a later section.

III. TPP: The Most Important Trade Policy in Abenomics

Japan joined the TPP negotiation in July 2013 after 3 years and 4 months since the TPP negotiations began. Japanese leaders showed an interest much earlier but strong opposition mainly from the agriculture sector did not allow the Japanese government to enter the negotiation. The TPP negotiation reached a conclusion in October 5, 2015. The negotiations had to overcome a number of difficult issues. This section reviews the developments regarding Japan’s involvement in the negotiations and examines possible impacts of TPP on the Japanese economy.
III.1 Interest in the TPP Negotiation under DPJ Government

It was then Prime Minister Naoto Kan of the Democratic Party of Japan (DPJ) who expressed an interest in TPP formally for the first time for Japan in October 2010. Faced with long recession and lagging internationalization, Kan argued for the need to open the Japanese economy and society, in order to regain vitality and dynamism (Kantei, 2012). Indeed, he called for the need of “the third opening,” the first and second being the opening in the final stage of Edo Period leading to the Meiji Restoration and the opening in Showa Era after WWII, respectively. Kan appeared to have an interest in TPP as it may help restore Japan’s relation with the United States, which deteriorated during the previous Prime Minister Yukio Hatoyama of the DPJ, who called for the establishment of an East Asian community excluding the United States and complicated the issue concerning the relocation of the US base in Okinawa.

Kan realized that Japanese businesses had a strong interest in joining the TPP. Indeed, in the past Japanese businesses had argued for a Japan-US FTA, but the US did not show any interest in that idea. Japanese businesses were keen to have a free access to the huge US market by an FTA, particularly since Korea signed an FTA with the US in June 2007. However, the United States was not enthusiastic about pursuing an FTA due to frustration with the limited results of past attempts – e.g., the Japan-US Structural Impediments Initiative (SII) in early 1990s- to expand U.S. exports in the Japanese market (Kawai and Urata, 2012).

Despite his keen interest, Kan could not decide to join the TPP negotiations because of strong opposition, and he only made an announcement at the APEC meetings in Yokohama in November 2010 that his government would start collecting necessary information and engage in pre-negotiation consultations with TPP countries. There was no progress on the TPP front until Yoshihiko Noda of the DPJ became Prime Minister in September 2011, because the Kan government was occupied with the Eastern Japan Earthquake, which hit northeastern part of Japan on March 11, 2011, and its aftermath.

Prime Minister Noda decided to begin pre-negotiation consultation with the TPP negotiating countries in November 2011. However, he could not enter into pre-negotiation consultation because of the strong opposition within the DPJ. Main opposition came from the agriculture sector. In addition, medical service and insurance service sectors also opposed TPP.

The agriculture sector in Japan has been heavily protected by tariff and non-tariff measures as well as subsidies. Hence, it has been argued that liberalization of the agriculture sector resulting from the entry into TPP would seriously damage the

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2 The Korea-US FTA went into force in March 2012, after a long ratification period.
agriculture sector with reductions in production and employment. Indeed, the Ministry of Agriculture, Forestry and Fisheries estimated that removal of tariff protection on 19 major agricultural products, including rice and wheat, would reduce GDP by 1.6 percent and employment by 3.5 million workers (the estimate includes direct impacts on agriculture as well as indirect impacts on other sectors) (MAFF, 2010). Furthermore, tariff elimination of agriculture is estimated to reduce the food self-sufficiency ratio from 40% to 14%. These estimates may overestimate the real impacts since they rely on some unrealistic assumptions. For example, because imported agricultural products are assumed to be perfect substitute for domestic products, a large portion of domestic production is expected to be replaced by lower-priced imported agricultural goods.

Opposition by the medical services stems from the view that TPP would destroy Japan’s national health insurance system. TPP opponents argued it would undermine the national health insurance system by allowing the entry of foreign private hospitals and profit-seeking medical services that are partially covered by medical insurance. The opposition from the medical services sector dissipated after it became clear that the TPP negotiations did not address issues impacting the national health insurance system. Indeed, there were several similar cases including the inflow of unskilled foreign workers that were not part of the negotiations but caused anxiety among the labor unions. Indeed, it has been argued that the opposing agriculture sector tried to intensify the opposition by aligning itself with groups such as medical doctors and nurses, and labor unions which feared TPP’s impact.

III.2 Entering the TPP Negotiation by Abe Administration

Shinzo Abe of the Liberal Democratic Party (LDP) became Prime Minister for the second time in December 2012 after the LDP won the Lower House General Election.5 Abe was very interested in joining the TPP negotiations to enable Japan to participate in making the economic rules for Asia-Pacific, and to facilitate Japan’s economic recovery from a long recession and finding a path to economic growth. Indeed, Abe considers joining TPP as an important component of Abenomics which was formulated to recover the Japanese economy from the long recession and to regain competitiveness to achieve sustained economic growth in the future.

Abenomics is comprised of three parts (arrows), aggressive monetary policy (1st arrow), flexible fiscal policy (2nd arrow) and growth strategy (3rd arrow). The TPP and other free trade agreements (FTAs) are included in the growth strategy, which is intended

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5 Shinzo Abe resigned from the Prime Minister because of his health problem in September 2007 after serving the post for a year.
to deal with structural problems such as unproductive agriculture. Abenomics’ growth strategy was detailed in the document titled “Japan Reconstruction Strategy,” which was made public in June 2013 (Kantei, 2013). Japan Reconstruction Strategy consisted of three action plans, industry reconstruction plan, strategic market creation plan, and internationalization strategy. In the internationalization strategy, free trade agreements (FTAs) are given special importance for the Japanese economy/industry in expanding international business. Under this strategy, the share of trade covered by FTAs in total trade is targeted to increase to 80 percent by 70 percent from 17 (2013). Among various FTAs being negotiated by Japan, TPP is given special attention as it is envisaged to become a new rule framework in the Asia-Pacific region. The importance of TPP was repeatedly confirmed in Abenomics’ growth strategy. The 2016 Japan Reconstruction Strategy heralded the historical significance of signing the TPP agreement in February 2016 (Kantei, 2016).

Despite his very strong interest, Abe could not decide to join the negotiations right away, because there was very strong opposition from the LDP members. Indeed, the LDP made a pledge during the Lower House Election campaign to oppose joining the TPP negotiations, as long as “tariff elimination without exception” was a precondition. The LDP also included additional conditions for joining the TPP negotiations in their election campaign; rejection of numerical export target for manufactured products such as automobiles, defense of the national health insurance system, protection of food safety standards, rejection of the investor-state dispute settlement (ISDS) that damages sovereign right, and consideration of Japan’s special characteristics in negotiating government procurement, financial services and others.

Prime Minister Abe wanted to make sure that the US understands the LDP’s position toward Japan’s participation in TPP during their first meeting in February 2013. Abe felt reassured that elimination of tariffs on all the products was not a requirement for joining the TPP negotiations by referring to the joint-statement: “Recognizing that both countries have bilateral trade sensitivities, such as certain agricultural products for Japan and certain manufactured products for the United States, the two Governments confirm that, as the final outcome will be determined during the negotiations, it is not required to make a prior commitment to unilaterally eliminate all tariffs upon joining the TPP negotiations.”

Japan joined the TPP negotiations in July 2013, following the 90-day rule set by the US Congress. Japan and the US agreed to hold bilateral negotiations in parallel to the

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TPP negotiations to address the issues concerning non-tariff measures in nine areas including insurance, investment, competition policies and others. In addition, the two countries confirmed that they would continue to negotiate on issues related to distribution of automobiles and auto safety in Japan, while the US would maintain tariffs on imported automobiles from Japan and the tariffs would be eliminated gradually within the longest period permitted under TPP.

III.3 TPP Negotiation

TPP negotiations lasted for approximately 5 years and 6 months. The negotiations were complex and time consuming both due to the broad issue coverage and high level of liberalization, as well as the diversity among negotiating members with very different levels economic development. Developed counties such as the US, Japan, and Australia and developing countries such as Vietnam and Malaysia countries have different views on a number of issues such as market access in goods and services. Despite the difficult odds, TPP countries successfully reached a conclusion. One reason is strong political commitment of the leaders of the negotiating countries which was revealed by the intensity of the negotiations. Indeed, 19 formal negotiations and a series of additional meetings involving Chief Negotiators, Ministers, and Leaders. This section reviews the process of TPP negotiation with a focus on Japan.

For overall negotiations, the most difficult issues included market access in goods, particularly in agricultural products between Japan and the US, which will be discussed later, and intellectual property right, specifically the period of data protection for biologic drugs. The US argued for 12 years, reflecting the benefits of competitive pharmaceutical industry, while Australia, New Zealand and several other countries advocated for 5 years, representing the users of drugs. A final agreement was reached at 8 years as a compromise for both sides. Other issues that faced difficulty until the end of negotiation include state-owned enterprises, ISDS, and others. Let us turn to the difficult issue involving Japan and the US, that is, market access in agricultural products.

Among the five sacred agricultural products, beef and pork were the products that remained unsolved until the end of negotiation. Market access issues in other agricultural products such as rice, wheat, dairy products were resolved, as Japan provided special and preferential treatment for the imports from the US by increasing import quotas.

The US was in a disadvantageous situation vis-à-vis Australia concerning beef and pork exports to Japan, as Japan agreed to lower tariffs on beef and pork products from Australia under their bilateral FTA. The tariff rate on beef imports from Australia will

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9 Elms (2016a) provides a good account of the TPP negotiation.
decline from 38.5% (ad valorem equivalent of the specific tariff) to 19.5 % (frozen beef in 18 years) and 23.5% (chilled beef in 15 years). The US demanded a larger reduction in tariff rates on beef import. After an intense negotiation, Japan agreed to lower tariff to 9% after 16 years.

Turning to pork imports, the US demanded abolition of the gate-price system. Under the price system, the Japanese government sets a standard import price and collects a levy, which is equivalent to the difference between the standard import price and CIF import price, when CIF import price is lower than the standard import price. The gate-price system practically maintains the pork price in the Japanese market at least as high as the standard import price, making it a very effective protective system for the Japanese pork growers. The negotiation reached an agreement in that the gate-price system is maintained but the tariff rate would be reduced. It should be noted that special safeguard system was agreed to be introduced for both beef and pork imports, in order to moderate/avoid the negative impacts that may result from increased imports.

The compromises reflect Prime Minister Abe’s strong political commitment to the success of TPP. Indeed, the Abe Administration established the TPP Headquarters in the Cabinet Secretariat and assigned Toshiaki Amari a Minister in charge of the TPP negotiations. The TPP Policy Unit, which is staffed by approximately 100 officials, is composed of two teams, one is in charge of TPP negotiations and the other is to deal with domestic issues. Before the TPP, FTA negotiations were conducted by government officials from four ministers, Ministry of Foreign Affairs (MOFA), Ministry of Finance (MOF), Ministry of Economy, Trade, and Industry (METI), and Ministry of Agriculture, Forestry, and Fishery (MAFF). Although the chief negotiator was assigned from MOFA, a unified position of the Japanese government could not be established because different ministries have different opinions about the negotiations. The designation of a TPP Minister, who enjoys strong support from Prime Minister Abe, enabled the Japanese government to have a unified position in the TPP, so that it could overcome the fierce opposition from the agricultural sector.

III.4 TPP Agreement

TPP was aimed to be a model for 21st century agreement with comprehensive coverage and high level of liberalization. This section discusses notable features of TPP and examines if these objective were achieved.

Table 1 shows the contents of TPP agreement. It has 30 chapters and it contains a number of issues not covered by other FTAs. They include labor, environment, state-owned enterprises, regulatory coherence, transparency and anti-corruption. These issues
have been recognized as barriers to free and fair business activities, but they were difficult to incorporate in FTAs because of opposition from mainly developing countries. In the following we examine some of the important achievements by TPP.

Market Access

Achieving a free and open business environment was an important objective of TPP.\(^9\) Trade liberalization, or market access, was one of the most difficult issues in the TPP negotiation as was discussed earlier. Table 2 shows the current level of tariff protection for TPP12 countries and their commitments on market access in goods, or tariff reduction/elimination. The figures under the headings “Final Bound” and “MFN Applied” indicate the shares of products with zero tariff in total number of products (tariff lines) registered under the WTO. MFN Applied indicate the actual practice while Final Bound indicate formal pledges which cannot be increased. In other words, for Japan, concerning agricultural products, 36.5 percent of the tariff line products have zero tariff in practice, while this share may be reduced to 34.1 percent without violating its WTO commitment. All TPP12 members -except Japan- committed to eliminate tariffs on virtually all the products with or without transition period in TPP. Considering the limited commitment on tariff elimination under the World Trade Organization, the commitment made by the TPP members to realize an open market is remarkable.

The adoption of cumulative rules of origin rule in TPP facilitates the construction and use of production network/supply chains in the TPP member countries as intermediate goods/parts and components sourced in the TPP member countries are treated as TPP products and thus can be traded tariff-free.

The agreement on government procurement enables foreign suppliers to bid for central government procurement contracts in TPP member countries. These markets are open to the WTO members that are parties to the Government Procurement Agreement (GPA). Among the TPP members, only Japan, New Zealand, Singapore and the United States are GPA members. Hence, the TPP opened the government procurement market of the remaining eight countries, Australia, Brunei, Canada, Chile, Malaysia, Mexico, Peru, and Vietnam.

Services and Investment

TPP ensures national treatment to foreign service providers and foreign investors. In other words, foreign firms are not discriminated against vis-à-vis local firms in TPP member countries. However, sensitive areas such as the defense sector are excluded from

\(^9\) Cimino-Isaacs and Schott (2016) provides a useful assessment of TPP.
this treatment based on the negative list approach which allows for a more liberalizing outcome (by explicitly designating excluded sectors) than a positive list approach (where only opens sectors explicitly listed). It is noteworthy that TPP prohibits the application of a number of restrictions by the government on the behavior of foreign firms. They include the prohibition of performance requirement such as technology transfer requirement and restriction on transfer of funds.

Special treatment of state-owned enterprises (SOEs) that creates unfair competitive advantage is not permitted in TPP. This treatment of SOEs enables foreign firms to expand their business in Malaysia and Vietnam, where SOEs dominate in their respective markets. The agreement on intellectual property rights (IPRs) and the adoption of the investor-state dispute settlement (ISDS) aims to encourage FDI flows with protection of intellectual assets and enforcement of obligations on the part of host country governments.

This examination of TPP’s features indicates that the agreement – if enacted – is likely to result in an expansion of trade in goods and services and investment by Japanese firms, contributing to the recovery of the Japanese economy, as envisaged by Prime Minister Abe.

III.5 Impacts of TPP on Japanese Economy

Several studies have examined the possible impacts of TPP on the Japanese economy by using a general equilibrium model (CGE) model, which mimics the system and functioning of actual economic activities involving consumers, producers and government. Some simulation exercises assume tariffs on goods are eliminated, while others include other policy variables such as non-tariff measures and/or liberalization of trade in services and investment.

The Japanese government analyzed the possible impacts of TPP on the Japanese economy by using GTAP model that takes into account tariff reduction/elimination, trade facilitation, and elimination of non-tariff barriers, as well as a (TPP Office Cabinet Secretariat, 2015). The study showed that TPP would increase Japan’s GDP by 2.59% (13.6 trillion yen) and employment by 1.25% (795,000 workers). The impacts on agricultural sector is a decline in production by 130~210 billion yen. However, the simulation also assumed the following growth mechanism (scenario). First, tariff reduction/elimination, trade facilitation and elimination of non-tariff barriers would result in an expansion in trade, which in turn increases labor productivity. Second, an increase

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11 The most widely used CGE model is the GTAP (Global Trade Analysis Project) developed at Purdue University.
in labor productivity would result in an increase in wages, which in turn increase labor supply. Third, increase in wages and labor supply would result in an increase in income, which in turn would result in an increase in savings. An increase in savings would increase capital stock, which in turn expand production capacity. The cabinet office study justifies these assumptions by providing supportive evidence from previous studies. However, the realization of some of the assumptions may require domestic policy reform and it may take some time for the effects to be fully worked out. Indeed, the Cabinet Office’s simulation result of the impacts of tariff elimination alone showed 0.66 percent increase in GDP (Kantei, 2013).

Petri and Plummer (2016) conducted a similar simulation analysis and obtained a similar result. By applying a CGE model that incorporates heterogeneous firm behavior, which is one of the most remarkable recent developments in the area of theoretical and empirical economics, Petri and Plummer showed that Japan’s real income and exports would be higher by 2.5 and 23.2 percent, respectively, in 2030 with TPP, compared to the situation without TPP. Their model includes not only liberalization in goods trade but also liberalization in service trade and foreign direct investment. A novelty of their model is to introduce a mechanism under which increased competition resulting from liberalization improves productivity of the country by weeding out non-competitive firms. Indeed, this is the mechanism which yields the largest impact.

Other studies have shown somewhat lower figures for the impacts of TPP on the Japanese economy. They include Kawasaki (2014) and Gilbert et al (2016), which obtained the increase in real income by 1.6 percent and 0.31 percent, respectively. The Kawasaki study includes both reduction/elimination of tariff and non-tariff measures, while Gilbert et al only considers reduction/elimination in tariffs. One of the most important findings of Kawasaki is that a large contribution from FTAs to economic growth comes from the opening of its own market while the opening of FTA partners’ markets provides relatively small contribution. These observations indicate the importance of domestic policy reform.

The TPP was the most significant trade initiative for Prime Minister Abe to advance his economic strategy and cement relations with the United States. However, domestic politics in the United States upended these goals.

IV. A pivot in US trade policy?

The growing divisiveness in U.S. trade politics and the onset of a Trump administration embracing a swift departure towards an “America First” trade policy, will
have profound consequences for Japan and the rest of the world. The purpose of this section is to provide some background on the factors behind the emergence of the new trade environment—where the United States is no longer championing multilateral economic diplomacy and where the disruptive impact of protectionist policies looms larger. Towards this end, the discussion addresses some of the main factors contributing to the trade backlash in the American political debate and the main tenets of the Trump trade philosophy. The new American administration has already followed through on a major policy decision—withdrawal from the TPP, but there is greater ambiguity regarding the implementation of other campaign pledges on the trade front. Hence, Japan’s trade policy must factor in the deeper uncertainty regarding the future of the international trade regime.

The diminishing political support for trade liberalization in the United States is apparent from Congressional voting trends on trade bills. Prior to the NAFTA agreement, Congress had periodically reauthorized trade promotion authority and trade bills had secured bipartisan support. The North American Trade Agreement, the first US FTA to include a developing nation, generated a heated political battle and its ratification marked a watershed. Thereafter, the reauthorization of TPA became more uncertain (a TPA bill was defeated in 1998 and there were long stretches of time where the executive did not have delegation of trade negotiation authority), and the majorities needed to approve FTAs became slimmer, first as most Democrats withdrew their support, and later as some Republicans defected as well.

The reasons for trade skeptics to object to the deep integration agenda in the post-NAFTA period are varied, they range from concern over the loss of public interest regulations to protect the environment and consumers, the legal arbitration recourse made available to foreign investors, complaints about the lack of negotiation transparency, and worries about asymmetrical bargaining outcomes in North-South FTAs. But no issue has galvanized the U.S. political debate on trade as much as the distributional consequences of trade liberalization. In other words, the focal point of trade policy debates has centered on the impact of trade agreements on wages and employment. In fact, the U.S. public is more skeptical about the impact of trade on jobs than publics in other industrialized nations. A Pew cross-national survey shows that 50% of respondents in the United States believe that trade destroys jobs, whereas the average elsewhere is 19% (Stokes, 2015).

The notion that the American worker has been the casualty of globalization began to gain traction during the NAFTA period when opponents predicted major job losses due to unfair competition with cheap Mexican labor. The evidence proved otherwise. In the first years of NAFTA implementation, the U.S. unemployment rate decreased, and there
was a gain in manufacturing jobs. More recently, it has been China’s insertion into the world economy -as it gained WTO membership in 2001- that has animated skepticism on the merits of trade. Import competition from China had a significant impact on specific U.S. manufacturing sectors such as apparel and furniture, and overall Autor et al (2016) estimate that it was responsible for up to 20% of the 5.8 million jobs lost in manufacturing jobs from 1999 to 2011. But it is the other finding of the “China trade shock” which provides most insight in understanding the fraying consensus on trade: displaced workers have faced a much more difficult and prolonged transition than previously reckoned -with long spells of unemployment, wage losses, and the lack of opportunities in depressed communities. Moreover, of the social programs available to laid-off workers, trade adjustment assistance has played a marginal role (Autor et al, 2016).

The traditional case for trade –highlighting broad aggregate gains in economic welfare, while acknowledging concentrated costs- fails to resonate in a context of increased inequality, stagnation in middle class income, falling rates of labor market participation, and lessened geographical and social mobility. These adverse socio-economic trends have created fertile ground for scapegoating trade with the consequent misdiagnosis of the root problems and effective policy responses. The vast majority of manufacturing job losses (87%) were caused by technological change (e.g. automation), but both trade and technology have helped spur efficiency, innovation, and productivity (Hicks and Devaraj, 2015). Rather than attempting to block economic change, it would be more effective to address the growing skill deficits in the workforce and to encourage genuine labor mobility to enable workers to acquire new skills, enter new fields and occupations, and tap on the economic opportunity that comes with geographical mobility. This effort calls for a host of social and labor market policies such as wage insurance, retraining, expanded tax benefits for the working poor (in addition to other measures to tackle inequality such as taxation and access to affordable health care); but the United States has been a laggard in investing in active labor market policies.

Repairing the nation’s safety net did not headline the 2016 Presidential election. Instead, a critical view of the impact of trade agreements prevailed, with candidates from

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14 According to OECD data, the gini coefficient in the United States increased from 0.34 in 1985 to 0.389 in 2012. The rate of labor force participation among prime-aged males went down from 98% in 1954 to 88% in 2015 (Council of Economic Advisors, 2015). And due to growing inequality, absolute mobility has declined sharply in the United States: 90% of children born in 1940 were better off than their parents, but only 50% of those born in 1980 were better off (Chetty et al, 2016).

15 For a more detailed discussion of these challenges and their influence on trade politics, see Solís (2017).
both parties reneging on TPP. But it was Trump’s protectionist message – calling for renegotiation or exit from existing FTAs and threatening punitive tariffs on main trade partners such as China or Mexico, which gained most traction in the swath of Rust Belt states that hold a large share of Electoral College votes. As Hendrix (2016) shows, the electoral coalition that brought Trump to the presidency encompasses the battleground states with the lowest support of free trade, and which hold a disproportionate share of votes in the face of population decline.\footnote{The appeal of Trumpism cannot be reduced to its trade message. Other prominent issues for his base include immigration, cultural clashes on issues such as LGTB rights, and the appeal of an anti-establishment platform. Moreover, although trade bashing resonates strongly with his base, the views of the general public on trade are more benign. A 2016 Pew survey showed that 51\% of respondents had positive views of trade and 39\% negative (Stokes, 2016).}

The finding on the electoral traction of a protectionist platform is important because it lowers the prospects for a future correction course in the Trump administration towards the conventional parameters of postwar U.S. foreign policy, i.e., endorsing free trade as a source of economic prosperity and American influence abroad. In this case, electoral politics reinforce long-held nationalistic views on trade policy of the new President and his trade team. Listed below is a highlight of main threads in a Trump trade doctrine, as can be glanced from public speeches, position papers, media interviews, and social media commentary (tweets).

- **Trade is zero-sum and the United States is losing the race.** Inspired by mercantilism, international trade is understood as an all-out competition among nations, where one party’s gains come at the other’s expense (Alden, 2017). The losers (drained by import competition and the overseas relocation of industry) suffer de-industrialization and the extinction of job opportunities. Trump’s presidential inaugural address poignantly captured this worldview as he talked about the carnage suffered by American workers because of international trade and offshoring, and asserted that protection can lead to prosperity.\footnote{The inaugural address can be found here: \url{https://www.whitehouse.gov/inaugural-address}.}

- **Reducing/eliminating the trade deficit is the end goal of trade policy.** This objective emanates from the view that the trade deficit saps economic growth. Asserting that GDP expansion is driven by the growth in consumption, investment, government spending and net exports, Trump’s trade advisors
(Navarro and Ross, 2016) conclude that when a country imports more than it exports it lowers its economic growth.\textsuperscript{18} Hence, only trade agreements that reduce the trade deficit should be maintained/negotiated.

- **A shift in priorities/resources from governance to enforcement; from rules to results.** The American trade deficit reflects both flawed trade agreements and rampant cheating from U.S. trade partners. Hence, enforcement of trade disciplines will be pursued with renewed vigor to “identify all trade violations and to use every tool at the federal government’s disposal to end these abuses.”\textsuperscript{19} Signaling a return to a results-oriented trade policy, Trump’s trade advisors have also advocated for “automatic triggers” to reopen trade agreements if the bilateral trade deficit expands.\textsuperscript{20}

- **A preference for bilateral negotiations over multilateral deals.** The preference for one-on-one negotiations comes from the notion that bilateral talks enhance American bargaining advantage as the largest consumer market. It also underscores that rule-making is not at the heart of the trade strategy since multi-party deals are much better suited for dissemination of standards.

- **The renationalization of manufacturing is a desirable/achievable goal.** The promotion of domestic manufacturing is a central promise in Trump’s economic program. The goal is not only to revive industries in decline (such as coal and steel), but also to return to the homeland advanced manufacturing that currently operates across the global supply chain.\textsuperscript{21} Hints of a carrots/sticks approach include: corporate tax reform to significantly lower the statutory rate, large-scale deregulation, subsidies to maintain domestic factories (see Carrier) versus presidential tweets threatening border taxes against companies that invest in

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\textsuperscript{18} As Ikenson (2016) points out, the fundamental problems with this assertion are that it mistakes a national income identity with a growth equation, fails to consider that trade deficits reflect broad macroeconomic forces (negative savings), and that greater reliance on imports is correlated with higher growth rates and lower unemployment rates.

\textsuperscript{19} The White House, “Trade Deals that Work for all Americans”

\textsuperscript{20} “Meet Mr. ‘Death by China,’ Trump’s inside man on trade” The Washington Post, February 17, 2017.

\textsuperscript{21} “US trade chief seeks to reshore supply chain” Financial Times, January 31, 2017.
Mexico and export to the United States, and the possible adoption of a border adjustment tax that dis-incentivizes imports.\textsuperscript{22}

- **The comeback of unilateralism.** In Trump’s trade circles there is deep skepticism towards the value of the WTO to advance U.S. interests. During the presidential campaign, Trump alluded to the possible withdrawal from the multilateral trading body. Trump’s trade advisors have complained that the one-country one rule violates U.S. sovereignty because it gives equal weight to nations of disproportionate economic power (Navarro and Ross, 2016: 12). The first USTR trade policy report to Congress under the Trump administration admonishes that the U.S. may not abide by a negative finding from a WTO’s dispute settlement panel if it considers it runs counter to its sovereignty. And it goes on to emphasize the value of U.S trade laws including section 301 (permitting the unilateral imposition of sanctions on countries deemed to engage in unfair trading practices) to aggressively “encourage true market competition” (USTR, 2017: 4).

Importantly, the list above is as a composite of the Trump administration trade rhetoric, which is yet to be operationalized into policy. The extent to which these precepts infuse actual trade initiatives will hinge on a number of factors: the buy-in or pushback from Congress, the mobilization of the private sector, and the responses from trading partners (Dadush, 2017). But one major decision has already been implemented – withdrawal of TPP- which directly impinges on the core initiative of Abenomic’s trade policy.

V. Reassessing Japan’s trade choices for the future

The recalibration of Japan’s trade strategy must factor in significant trends in the new environment: the abdication of leadership in advocating multilateral trade frameworks from the new U.S. administration, the continued slowdown of international trade (with the added headwind of policy uncertainty), and the potential escalation of protectionism.\textsuperscript{23} This would mark a shift from the existing trend among G20 countries of

\textsuperscript{22} The border adjustment tax (BAT) currently under consideration did not originate from Trump’s trade team, it is an initiative championed by House Republicans. Because it runs counter the principle of national treatment (exports deduct labor costs, but not imports), if adopted it would likely be challenged at the WTO. See Cline (2017).

\textsuperscript{23} For a recent analysis of the deleterious effect of policy uncertainty on trade growth, see Constantinescu et al (2017)
relying on WTO-legal restrictive measures (e.g. anti-dumping) to the cascading effects of retaliation to a large country’s overtly discriminatory policies -such as punitive tariffs, extensive buy-national clauses, or border taxes imposed on companies to distort business investment decisions and penalize imports.

Japan’s best response in this difficult climate is to reinvigorate its multi-party trade negotiations advocating for high quality liberalization. One immediate step should be the successful conclusion of the Japan-EU FTA, which incorporates as well multiple WTO plus disciplines, represents almost 10% of Japanese trade, and it is estimated to generate income gains of 0.8% of GDP (Solís, 2017, Kawasaki, 2014). Negotiations have been challenging in areas such as automobiles, agriculture, and the opening of government procurement at the local level. Recent changes in European trade policy and politics have added new complications: the replacement of ISDS for an investment court system (which Japan has not incorporated in any of its FTAs), and the advisory opinion in the European Court that mixed competence trade agreements must be ratified by national and regional parliaments as well -which if fully implemented- would drastically increase the hurdles of ratification. Brexit obviously has created significant uncertainty on the future of the European project, but it also provides a powerful incentive for the Japan-EU FTA. Japanese investment had concentrated in the UK as a gateway to Europe, but the UK’s loss of preferential access to the European market in a hard Brexit scenario, creates a premium to hedge by securing such access through the Japan–EU trade deal.

A second vector in Japan’s relaunched trade policy should be to salvage the TPP project. The U.S. withdrawal from TPP means that Japan can no longer use this trade agreement to fulfill the geopolitical goals of deepening the U.S. alliance by overcoming divisive market access issues and jointly supplying governance to the Asia-Pacific region at a time of rising Chinese influence. It also means that preferential access to the U.S. market through TPP is off the table. But far from meaningless, a TPP minus one serves well Japan’s economic and geopolitical interests. A recent simulation study by Kawasaki (2017) shows that in a TPP 11, Japan’s income gains through tariff reduction go down (from 0.24 to 0.07% of GDP), but the largest payoff for Japan has always centered on reducing non-tariff gains, and in this area the reduction in benefits is much smaller (from 1.13 to 1.04% of GDP). Overall, the decrease in expected income gains from losing the U.S. market is not marked: from 1.37 to 1.11% of GDP. This result reflects two fundamental facts: 1) the terms of access to the American market (not just its overall size) is crucially important. The U.S. has low average MFN tariffs and in TPP it played hard core defense in areas of competitive interest for Japan (autos and trucks with liberalization pushed back decades). And 2) the competitiveness gains for Japan mostly derive from its
own domestic reforms tied to liberalization (e.g. services) and the adoption of behind-the-border rules (investment, IPR, etc.) that enhance the operation of its global supply chains.

Geopolitically, a relaunched TPP helps Japan position itself vis-à-vis the other great trading powers in the region: it prevents China from becoming the single focal point of integration and preserves an economic rulebook that helps deter Chinese mercantilist practices. But it also discourages a U.S. inward turn by raising the costs of American marginalization from mega trade deals while keeping open the option of a future US return to the TPP. For example, a study by the Council of Economic advisors (2016) found that in the absence of TPP, a modest outcome in RCEP would still disadvantage American firms in 35 industrial sectors with annual good exports of $5.3 billion dollars to Japan because of trade diversion effects. These disadvantages may help mobilize the American private sector and Congress to come back to TPP. Delivering a TPP 2.0 will require political will and creative diplomacy. It will likely involve one or more of the following steps: amending the ratification clause so that U.S. participation is no longer required to achieve a critical mass, engaging in surgical renegotiation to encourage developing Southeast Asian members to remain in TPP, and encouraging the admission of new members across the Asia-Pacific (Solís, 2017a, Urata, 2017).

Securing ambitious trade agreements in East Asia is also a high priority for Japan. The Regional Comprehensive Economic Partnership (RCEP) –comprising a third of world GDP- has the potential to deliver significant gains from trade liberalization. With 16 members from the Indo-Pacific region, RCEP differs from TPP in terms of membership, scope, and modalities of negotiation. Based on the principle of ASEAN centrality, RCEP aims to build from the network of ASEAN+1 FTAs to achieve further liberalization that is WTO consistent. But the launch of RCEP was also enabled by a fundamental understanding between China and Japan -which had been pushing different blueprints for region-wide integration- spurred by Japan’s interest in TPP (Solís and Katada, 2015). Reflecting the wide diversity in levels of development, RCEP embraces the notion of special and differential treatment, flexibility in implementation, and has a narrower scope (e.g. no provisions on government procurement, environment and labor, and SOEs).

A leadership deficit has resulted in protracted negotiations and has clouded the

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24 Vietnam and Malaysia have been more skeptical of a TPP without the United States because they made concessions in TPP that were deeply sensitive domestically (e.g. Vietnam on independent unions) in exchange for obtaining for the first time preferential access to the American market. Their willingness to remain in TPP may hinge on rebalancing the package of concessions, but the attendant risk of unraveling the agreement through a renegotiation should not be neglected.
prospects for ambitious outcomes. India has offered very conservative offers on tariff elimination, creating the prospects of a lowest common denominator effect. ASEAN has opted for a two-track process first caucusing amongst its members before discussing topics with the rest of RCEP members, which encumbers negotiations (Elms, 2016b). China did not play a leadership role in an ASEAN-centric initiative, opting instead to push for signature initiatives such as the AIIB and the One Belt, One Road (Ye, 2015). And Japan attached utmost priority to the TPP talks, as can be discerned from the creation of a TPP headquarters to pool elite bureaucrats with access to the Kantei, but no equivalent effort for RCEP talks. The uncertain fate of TPP and a potential American turn inward create an opportunity for RCEP members to reinvest in achieving a significant liberalization outcome. Japan and other like-minded countries like Australia, New Zealand, Singapore and possibly South Korea have an incentive to rebalance priorities and push for ambitious outcomes for an RCEP that could be the sole standard-bearer for the region. Their efforts could find a more receptive ASEAN as it seeks to attract investment at a time of rising protectionist threats to the global supply chain, as well as a more responsive China eager to deliver on RCEP to buttress its credentials as champion of economic multilateralism. A reinvigorated RCEP should also aim to establish clear accession protocols to expand its reach beyond the region and possibly include members of the Pacific Alliance which have recently expressed interest (Chile and Peru, for example).

Japan’s trade strategy for the new era must also fashion a response to a likely entreaty by the Trump administration to negotiate a bilateral FTA. Such a trade deal would offer a positive opportunity provided it builds on the standards of TPP and provides further opportunities for mutual liberalization on sensitive issues (e.g. agriculture for Japan and autos for the United States). At this time, however, a wait-and-see response is advisable until the Trump administration operationalizes its America First trade policy. Binding rules on currency manipulation, further tightening of rules of origin, one-sided demands for Japanese market opening without reciprocal concessions, and the adoption of automatic triggers to correct bilateral trade deficits would severely limit the benefits for Japan and could present insurmountable negotiation challenges. Under such scenario, Japan can still engage in productive bilateral dialogue on the broader economic complementarities with the United States (infrastructure and energy for example). In the

25 Ideally, South Korea could also champion a higher level of liberalization in the CJK FTA talks. However, as the country is gripped by a deep political crisis in the aftermath of President Park’s impeachment, it is unlikely to advocate a major push on trade liberalization in the region.
long term, Tokyo should deploy a trade strategy that creates an incentive structure for the United States to reengage in multilateral economic diplomacy by delivering on its own mega trade deals.

VI. Conclusions

The Abe administration has placed great importance on TPP and other FTAs as essential components of its growth strategy. Mega trade agreements, particularly TPP, were expected to contribute to a speedy recovery of the Japanese economy from a long recession by increasing exports and foreign direct investment by Japanese firms, and by improving productivity of the Japanese economy through structural reforms. This optimistic scenario on the role of TPP to spur economic recovery needs to be adjusted since the original TPP cannot be achieved with U.S. withdrawal.

Under a new trade environment, Japan should play a leading role in establishing other mega-FTAs including TPP minus US, RCEP, and Japan-EU FTA. In order to fulfil these objectives, Prime Minister Abe must display, as it did for the original TPP, strong political will. As for Japan’s policy toward the US, Japan should wait until the new US administration formulates its foreign economic policy. All along, it is important for the Japanese government to carry out necessary domestic policy reform since it yields the largest economic gains and provides the groundwork for Japan to successfully negotiate high quality FTAs.

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Table 1 Contents of TPP

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Source: TPP Agreement Text

Table 2. Tariff Elimination Rate under TPP (%)

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<th>TPP Commitments</th>
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<tr>
<td></td>
<td>Agricultural products</td>
<td>Manufactured products</td>
</tr>
<tr>
<td></td>
<td>Final bound</td>
<td>MPN applied</td>
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<tr>
<td>Australia</td>
<td>31.3</td>
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<tr>
<td>Brunei</td>
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<td>98.5</td>
</tr>
<tr>
<td>Canada</td>
<td>46.0</td>
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<tr>
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<tr>
<td>Viet Nam</td>
<td>8.7</td>
<td>15.5</td>
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Source: WTO Tariff Profiles, and Japanese Government, Cabinet Secretariat, TPP Section