REINVENTING THE TRADING NATION: Japan, the United States, and the future of Asia-Pacific trade

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EDITOR’S NOTE

This piece was originally written as an epilogue to the Japanese translation of the author’s 2017 book Dilemmas of a Trading Nation: Japan and the United States in the Evolving Asia-Pacific Order, published in Tokyo by Nikkei Publishing in October 2019. The author’s purpose in writing the epilogue was to assess the trade policy developments in the Asia-Pacific of the past two years, a time when Japan and the United States have sharply reoriented their paths as trading nations. It has been further updated to reflect recent developments.

EXECUTIVE SUMMARY

The international trading system is in turmoil. When the author’s Dilemmas of a Trading Nation was first published in August 2017, the United States and Japan were on the cusp of redefining their path as trading nations. The momentous change was best crystallized in the American decision to withdraw from the Trans-Pacific Partnership (TPP) and the Japanese resolve to salvage the trade deal against all odds. Precedents were broken in that the United States had never withdrawn from a signed trade agreement, and Japan had never displayed trade leadership of this caliber. The trade world has not looked at the United States and Japan the same way ever since.

Two plus years on, this transformation is in full display. Under President Trump’s “America First” mantra, the United States has set out to fundamentally restructure bilateral trading relations with its closest partners and allies, jolt the World Trade Organization (WTO), and compel China to restructure its economic model to level the playing field. There is no higher priority in the “America First” trade strategy than to curb Chinese market distorting policies and cajole structural reforms from China. Because of the tactics chosen, however, this has largely been an “America alone” quest.

Japan’s choices over the past two years could not have been more different. In salvaging the TPP, Japan and the other 10 original members ensured the survival of the most ambitious rulebook structuring trade and investment relations in Asia-Pacific. Japan has
brokered not one, but two mega trade agreements, concluding an economic partnership agreement with the European Union that covers one third of the world’s GDP. With its higher level of ambition, Tokyo has been in the forefront of international governance for the digital economy, and has worked with like-minded countries to upgrade trade and investment rules and reform the WTO.

In the span of few years, Japan and the United States have sharply reoriented their trade strategies as they navigate the dilemmas of a trading nation in their quest to ink trade agreements that can reconcile the goals of economic competitiveness, social legitimacy, and political viability. In the recent past, these two countries have twice met at the negotiation table— and the outcomes of each negotiation have been dramatically different. In the original TPP project, the United States and Japan were ready to forge a regional trade architecture; in the mini trade deal they settled for the minimum necessary to avoid friction in bilateral relations.

However, the broader horizons of coordinated economic statecraft for Japan and the United States still beckon. These two nations have an abiding interest in working as partners to improve international economic governance through the dissemination of digital economy standards, the supply of high-quality infrastructure finance in the developing world, and the codification of rules that alleviate the distortions of state capitalism in the trading system. Equally pressing and consequential is for the allies to work towards achieving a high-quality comprehensive bilateral trade agreement and engineer an American return to the regional economic architecture.

INTRODUCTION

The international trading system is in turmoil. When the author’s *Dilemmas of a Trading Nation* was first published in August 2017, the United States and Japan were on the cusp of redefining their path as trading nations. The momentous change was best crystallized in the American decision to withdraw from the Trans-Pacific Partnership (TPP) and the Japanese resolve to salvage the trade deal against all odds. Precedents were broken in that the United States had never withdrawn from a signed trade agreement, and Japan had never displayed trade leadership of this caliber. The trade world has not looked at the United States and Japan the same way ever since.

Two plus years on, this transformation is in full display. Under President Trump’s “America First” mantra, the United States has set out to fundamentally restructure bilateral trading relations with its closest partners and allies, jolt the World Trade Organization (WTO), and compel China to restructure its economic model to level the playing field. American trade policy has suffered from a domestic viability problem, essentially undercut by the lack of investment in workforce development and policies that support social resilience to economic change. But the arrival of Donald Trump to the White House brought about a more drastic reorientation, questioning core tenets of postwar American trade leadership.

The fixation with the trade balance and the demands to impose export restraints on others are reminiscent of American managed trade practices of the 1980s. They were not effective then in eliminating trade deficits, and they are even less compelling today given the extensive globalization of production through regional production networks. But the current shift is more profound, resting on President Trump’s deeply-held convictions: his willingness to dismiss multilateralism, his understanding of trade
as zero-sum competition where one of the parties always loses, and his belief that protectionism offers a pathway to prosperity. No one has captured the essence of Trump’s trade doctrine better than the president himself in a tweet on December 4, 2018: “I am a tariff man. When people or countries come in to raid the great wealth of our Nation, I want them to pay for the privilege of doing so. It will always be the best way to max out our economic power. We are right now taking $billions in Tariffs. MAKE AMERICA GREAT AGAIN.”

Japan’s choices over the past two years could not have been more different. In salvaging the TPP, Japan and the other 10 original members (Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam) ensured the survival of the most ambitious rulebook structuring trade and investment relations in the Asia-Pacific. Japan has brokered not one, but two mega trade agreements, concluding an economic partnership agreement with the European Union that covers one third of the world’s GDP. Both mega trade deals have entered into force, dramatically increasing the reach of Japan’s preferential trade network. Nevertheless, solving the challenges of Japan’s most important trading relationships with China and the United States is an ongoing effort clouded with uncertainty.

China’s recommitment to its state capitalism model, the unilateral turn in U.S. economic diplomacy, and the intensification of U.S.-China high tech economic rivalry could deal a fatal blow to an already fragile multilateral trading system. Japan’s prosperity continues to hinge on an open economic order and at this time of systemic crisis, Japan responded with multilateral solutions; pushing for an ambitious outcome in the Regional Comprehensive Economic Partnership (RCEP) negotiations, working with the EU and the United States on new rules to tackle market distortion from (China’s) state intervention in the economy, and pressing for global standards on free data flows essential to the digital economy during its G-20 chairmanship. And yet, Japan’s mettle as champion of rules-based trade liberalization has been most sorely tested in the bilateral trade talks with the United States launched in April 2019. Because both countries have moved on in starkly different directions since they last met at the negotiation table; these negotiations were anything but a repeat of the original TPP talks.1

“AMERICA FIRST” TRADE POLICY

President Trump has promised to leave no major U.S. trading relationship untouched. He has complained of unfair treatment by the WTO, touting instead the advantages of negotiating one-on-one deals with major players — China, Japan, the EU, and a post-Brexit U.K. And he has reopened existing trade agreements to align them with the goals of his “America First” trade program. The revision of the South Korea-U.S. trade agreement (KORUS FTA) was a more limited undertaking, since the U.S. sought changes that would not warrant congressional approval. The main revisions were to double the number of U.S. cars qualifying for expedited verification in South Korea (even though the current quota is not filled) and to push back on the deadline to eliminate U.S. truck tariffs by another 20 years, till 2041. As part of the negotiations, South Korea accepted a quota to cut its exports of steel to the United States in order to see the lifting of U.S. tariffs on metals (more on this below).
In contrast, the redo of the North American Free Trade Agreement (NAFTA) was more ambitious and carried greater risks. In remaking NAFTA, the Trump administration aimed to craft a new template for trade agreements — with the goal of reducing bilateral trade deficits front and center — that could be applied in subsequent trade talks. If negotiations went sour, however, the reopening of NAFTA carried the potential of disrupting trade and investment relations with Canada and Mexico, the first and second destinations for U.S. exports. Such upheaval would be felt acutely in the economic sectors and communities that are highly dependent on regional trade and integrated production chains. Negotiators did succeed in drafting a successor agreement to NAFTA — the U.S.-Mexico-Canada trade agreement (USMCA) — and its pending ratification by Congress has become a major test for the political viability of Trump’s trade policy. As U.S. Trade Representative (USTR) Robert Lighthizer put it in congressional testimony: “There is no trade program in the United States if we don’t pass the USMCA.”

Given the high stakes, the renegotiation of NAFTA was full of drama. It was carried out under the shadow of a potential U.S. pullout from the agreement. Press reports noted that at least twice President Trump came close to invoking the exit clause of the existing trade agreement. At the outset of the talks, the United States adopted maximalist proposals that seemed to leave little room for a viable compromise for Mexico and Canada, insisting on a sunset clause to phase out the USMCA after five years if the three governments chose not to renew it, and demanding that autos benefiting from duty-free treatment incorporate 50% U.S. content. At times, it was unclear if the trilateral partnership would be preserved. Mexico and the United States reached an understanding first, generating a scramble for Canada to finish the negotiations on time and remain in the revamped agreement.

The United States eventually compromised (settling for a joint review towards renewal by year six and working with regional — not national — content rules) and the USMCA remained a tripartite agreement. On the positive side, the USMCA preserves the vast majority of the North American duty-free zone and modernizes the 25-year-old NAFTA rules by incorporating the provisions of the original TPP in areas such as intellectual property and e-commerce. At U.S. insistence, the USMCA adopts two new rules that will be of great import in future U.S. trade negotiations. The first is a currency manipulation clause in the body of the text with enforceable provisions on the reporting and transparency requirements, but which recognizes the legitimate role of monetary policy for domestic purposes. The second is a surprise rule on non-market economy FTAs whereby it is mandatory to notify the other USMCA parties of intention to negotiate with a non-market economy (i.e. China) and to provide the full text of a negotiated deal prior to ratification. Moreover, the clause stipulates that the future inking of a trade agreement with a non-market economy may be grounds to be dropped from the USMCA.

Provisions on automobile export quotas and a dramatic tightening of rules of origin on car manufacturing are undoubtedly the USMCA’s lowlights. Canada and Mexico signed side letters providing “generous” export quotas (at 2.4 million vehicles per year above current export levels) that would kick in if the 25% national security tariff materializes. Separately, Mexico secured a lower quota of 1.6 million vehicles to enter duty free if the United States were to increase its most favored nation (MFN) tariff on automobiles, provided the vehicles meet the original NAFTA rules of origin. An unusual and concerning pattern was thus inaugurated in the USMCA talks: one party using a free trade agreement to advertise possible intent to raise tariffs, and the other members taking out an insurance policy against such an eventuality. With the objective of concentrating car
production and job creation in the United States, the Americans pushed for and obtained an increase in regional content levels from 62.5% to 75%, with sourcing requirements for steel and core components such as engines, and, for the first time ever, stipulating that 40% of the value of the vehicle must be generated by workers earning an average wage of $16 per hour. The tighter rules of origin on automobiles are an instance where the United States triumphed at the negotiation table but lost in competitiveness. An IMF study recently estimated that the more stringent requirements on autos will result in a $700 million welfare loss for the region, with the United States suffering the largest losses due to higher prices of imported cars and auto parts from Mexico and Canada.³

The ratification prospects for the USMCA are clouded in uncertainty. Even though USTR Lighthizer courted the support of Democrats and the labor movement by securing commitments such as an overhaul of Mexico’s labor regime, these groups have still demanded further revisions to the agreement and stronger guarantees on enforcement. Precious months in the ratification campaign were lost when the USTR took a year to remove “national security” tariffs on steel and aluminum on Canada and Mexico (originally imposed in the spring of 2018 and affecting many other nations as well), despite the fact that influential Republicans in Congress and the Canadian and Mexican governments had indicated USMCA ratification was contingent on their revocation.

These “national security” tariffs have emerged as a major tool of the Trump administration to protect specific sectors or to gain leverage in bringing reluctant parties to the negotiation table. Rarely used in the past, Section 232 of the 1962 U.S. Trade Act grants the executive the power to raise tariffs on imports deemed to harm national security. President Trump seized on this wide discretionary power to impose a 25% tariff on $10.2 billion of steel imports and a 10% tariff on $7.7 billion of aluminum imports. Although the Department of Defense had deemed steel supply sufficient to meet the demands of defense equipment manufacture, the Department of Commerce used the dubious argument of imports hampering steel capacity utilization to recommend tariffs.⁴ This was in essence an economic, not national security, argument.

Ironically, the 232 metal tariffs targeted mostly allied nations (Chinese steel imports had already decreased due to anti-dumping and countervailing duties) with Japan taking the first hit. The Japanese government chose not to retaliate, confident that it could gain exemptions for specialty Japanese steel products and desiring not to disrupt relations with the United States. The reaction of other allies and countries subsequently targeted was different and swift: retaliation (e.g. Canada raised tariffs on $12.8 billion of U.S. imports, and the EU on $3.3 billion) and challenges to the U.S. measure at the WTO.

Far greater disruption would ensue if President Trump were to make good on his threat to impose a 25% tariff on $208 billion dollars of auto vehicle imports. On May 2019, President Trump issued an executive decree endorsing the conclusion of the Commerce Department’s 232 investigation that imports from foreign-owned companies undermine the research and development capabilities of domestic firms and impair national security by hindering the development of technologies essential to U.S. military superiority. The President imposed a tight six-month deadline for negotiations with Japan and with the EU to achieve results in order to avoid auto tariffs.⁵ The argument that imported cars impair U.S. national security is even more dubious than the steel case, but the potential economic harm is far more significant. It would also deal a fatal blow to any coordinated effort between the United States and its closest allies and partners to compel China to change its market-distorting policies.
Sino-American relations have entered a new age, one increasingly defined by strategic competition. The unfulfilled expectation that China’s insertion into the world economy would eventually usher a market economy and a plural political system has fractured the bipartisan support for engagement. China’s military buildup, its growing authoritarian tilt, and the use of economic clout for political influence in Asia and beyond, has triggered a raging debate in Washington on new terms of interaction with China. A new consensus has yet to emerge on what China’s strategic intentions are, and the optimal American strategy and tactics to deal with the China challenge. But economic relations are increasingly viewed with a strategic competitive slant. When *Dilemmas of a Trading Nation* was first published, the debate over the “China trade shock” (loss of factory jobs due to China’s emergence as an export powerhouse) had figured prominently in the presidential election that delivered Donald Trump to the White House. Since then, a new focal point has gained greater saliency: China’s quest for high tech supremacy with the state playing an even more dominant role in the industries of the future, as laid out in the 2015 “Made in China 2025” blueprint.

There is no higher priority in the “America First” trade strategy than to curb Chinese market distorting policies and cajole structural reforms from China to level the playing field. Because of the tactics chosen, however, this has largely been an “America alone” quest. The opening salvo in the U.S.-China trade war was the imposition of 25% tariffs on $50 billion of goods shipped from China during the summer of 2018. This action followed the findings of a U.S. Section 301 investigation (whereby the U.S. reserves the right to punish what it deems are discriminatory foreign barriers to trade) into Chinese unfair intellectual property and technology practices. A rapid tit-for-tat tariff escalation ensued with an additional 10% tariff imposed by the United States on $200 billion of Chinese imports and by China on $60 billion of American goods in September 2018. Early casualties of the tariff war included American farmers and global supply chains.6

In late 2018, the United States and China decided to pull back from the brink of an all-out tariff war and try instead for a negotiated outcome. As talks progressed, the contours of a potential deal appeared to include large-scale Chinese purchases of U.S. goods to appease President Trump’s concern with the trade deficit, and some commitments from China in areas like intellectual property (IP) protection, disciplines on state subsidies, and elimination of the practice of forced technology transfer. By the spring of 2019, however, negotiations had broken down and positions have since hardened. The American side complained that China backpedaled from incorporating agreed-upon reforms into Chinese law; the Chinese side denied any backtracking and insisted that the lifting of U.S. tariffs was required in order to strike a deal.

The prospects for achieving a comprehensive trade agreement that both the United States and China can live with are dim.
share of their bilateral trade, they tried once again for a truce of sorts. On October 11, 2019, President Trump announced a “Phase One” trade deal whereby China agreed to very large purchases of U.S. farms products (in the range of $40-50 billion dollars), and to make some improvements on IP protection and financial services liberalization, in exchange for the United States to postpone a tariff increase scheduled to kick in a few days later.

A preliminary understanding is a far cry from a completed negotiation. The Chinese government has already stated that further negotiations are needed and that the planned December tariffs must be suspended as well. Even if the United States and China succeed in drafting a mini-trade deal by mid-November, they will have merely punted the ball on their most critical goals: for the United States, abating industrial subsidies, disciplining state-owned enterprises, comprehensive IP protection, and an enforcement mechanism; and for China the roll-back of tariffs and relief from a series of restrictions that threaten the viability of China’s tech giants.

Indeed, the tech war could very well be the most decisive front in this era of U.S.-China strategic competition. The Trump administration has adopted more restrictive screening procedures for investments in critical technology and infrastructure sectors – and is in the process of tightening export controls for emerging and foundational technologies. Both steps were undertaken with the thinly-disguised intention of curbing Chinese access to core American technologies. The Chinese telecom company Huawei has become the lightning rod in this broader contest. The U.S. government sharply raised the stakes with its decision in May 2019 of placing Huawei on the entity list, thereby mandating that all sales of U.S. technology products to the company must be licensed. This move was accompanied by an executive order banning American companies from purchasing telecom equipment deemed to harm national security. An additional 28 Chinese tech companies were blacklisted in September, this time for human rights violations in Xinjiang. The American government has also sought to exclude Huawei from participating in the 5G networks of allies and partners citing cyber security risks. The American persuasion campaign has had mixed results. As Adam Segal points out, while the security risks are real, the United States would be more effective in enlisting support from other countries if it could “offer them alternatives that can compete in price and efficiency.”

Economic rivalry between the United States and China has system-wide repercussions, both concerning the fate of the multilateral system and the health of the global economy. On the former, recent actions by the two largest economies in the world have added strain to WTO operations, complicating chances of much-needed reform and increasing the risk of irrelevancy for the multilateral body. China’s rampant use of industrial subsidies and its refusal to graduate from developing country status with its accompanying special and differential treatment are major stressors on the system and undermine chances of meaningful WTO reform. The United States’ decision to block nominations for the WTO appellate body by citing judicial overreach and its position that it will not accept WTO review of its national security tariffs has brought the WTO dispute settlement system to a crisis point.

In addition, the uncertainty created by the deterioration in U.S.-China relations has become a major headwind for global growth. The newly appointed IMF chief, Kristalina Georgieva, put the expected economic damage in perspective when she noted that the costs of the trade war — $700 billion dollars by 2020 — are equivalent to the size of
the Swiss economy. As tariffs have gone up, trade flows have suffered — so much so, that the WTO’s forecast for global trade growth in 2019 at 1.2% is the lowest since the onset of the global financial crisis.\(^{11}\) While in the past, the United States had been a force in abating protectionism, the speed at which the United States has undone decades of liberalization is breathtaking. In 2018 alone, the U.S. trade weighted tariff rate more than doubled from 1.5% to 3.4%, and at its current level of 4.2%, it is the highest among G-7 countries.\(^{12}\) Under the Trump administration, America has become a nation of tariffs.

**FIGHTING THE FIGHT FOR A RULES-BASED ECONOMIC ORDER: JAPAN’S QUEST FOR NEW ROLE**

Japan’s new calling has been in the making for years. *Dilemmas of a Trading Nation* tracked the confluence of economic and political changes that enabled Japan’s trade leadership to emerge: political and administrative reforms that empowered the prime minister to overrule recalcitrant ministries and vested interests, the transformation of Japan’s political economy away from mercantilism toward greater integration into the world economy through global supply chains that called for deep trade agreements, and the consolidation of a control tower in Shinzo Abe’s *Kantei* (prime minister’s office) with the return of political stability. And so, Japan surprised many with its ability to finally join the TPP negotiations, to negotiate with a unified voice, and to partner with the United States in advocating an ambitious rules-agenda in the mega trade agreement. When the United States pulled out of the TPP, many trade experts expected Japan’s proactive stance to fade away too, letting the TPP wilt when confronted with America’s absence. *Dilemmas of a Trading Nation* first went to press with a markedly different prognosis: that Japan should and could give TPP a new lease on life cementing its new role as a leader of free trade. The eventful past couple of years have proven this to be possible.

Japan’s motives for joining the big leagues of trade diplomacy reflect both longer-term trends and an abrupt geopolitical shift. Japan has become more closely intertwined with the world economy, both as corporate Japan weaved complex production networks in Asia and elsewhere, and as persistent population decline accentuates the importance of external demand to Japan’s prosperity. The investment-trade nexus at the core of global supply chains prompted a new phase for Japan’s economic diplomacy: rule-making on behind-the-border disciplines to update a WTO rulebook that has laid largely dormant for a quarter century. Stagnation in negotiations has long plagued the WTO, but a more immediate crisis point threatens to hamper its ability to adjudicate disputes among nations. By the end of 2019, the appellate body will cease to operate if no new appointments are made. The inability to enforce rules would greatly impair the WTO system. The systemic crisis of the postwar trading system — exacerbated by the stresses from China’s interventionist industrial policies and the U.S. disengagement from multilateralism — has compelled Japan to step up to defend the rules-based economic order. A more proactive economic diplomacy also helps Japan avoid a future Asia where China alone sets the terms of the economic integration while creating opportunities to re-anchor the United States to the regional architecture.

These hefty considerations likely weighed on Prime Minister Abe’s decision in the spring of 2017 to, after some initial hesitation, take the lead in working with the other ten remaining nations to resuscitate the TPP. As the largest remaining economy in the trade deal, Japan’s push was essential to give this undertaking a fighting chance. But it was a challenging mission because many countries had agreed to the TPP’s
ambitious standards in exchange for preferential access to the large U.S. market. The rescue operation worked for three main reasons. One, the TPP-11 countries agreed to keep market access commitments intact (reopening tariff talks would have unraveled the agreement). Two, at Japan’s insistence and with an eye to a potential U.S. return, amendments to the TPP rules were minimal. Twenty-two provisions were suspended (mostly on IP rules in areas like biologics and copyright extension that only the Americans had championed in the original talks), and the scope of the investor-state dispute settlement mechanism was narrowed (to exclude investment agreements and authorizations). But no whole chapter was excised, leaving the TPP rulebook virtually intact. Third, ratification conditions were eased, requiring only that six members conclude their domestic procedures for the agreement to begin taking effect. In March 2018, the eleven members signed a newly baptized Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), which entered into force on December 30 of that year.

The economic footprint of the CPTPP is certainly smaller than the original twelve-member grouping at 13.5% of the world’s GDP. Nevertheless, the effects of the new mega trade agreement were felt wide and far. For one, producers in the CPTPP have quickly taken advantage of tariff preferences to increase their market share in Japan at the expense of American producers. In early 2019, American beef producers complained of a 6% market share loss, while beef imports from CPTPP members — Australia, Canada, and New Zealand — increased by 56% compared to the year prior. American beef producers feared a more disadvantageous situation, if the rapid increase of beef imports were to trigger a Japanese safeguard raising the MFN tariff to 50%, whereas CPTPP producers only pay a 27.5% duty (which will eventually go down to 9%).

Moreover, the impact of the CPTPP goes well beyond economic competition for market share. The shifting geopolitical context has given the CPTPP a new meaning: a shared project by middle powers to defend rules-based economic multilateralism. As China’s appetite for reform has waned and the United States is turning inward, the CPTPP offers a hedge against the adverse trends of Chinese mercantilism and U.S. protectionism.

As the CPTPP circle grows with the admission of new members, its heft will increase. For instance, Peter Petri, Michael Plummer, Shujiro Urata and Fan Zhai estimate that a potential TPP-16 with South Korea, Thailand, Taiwan, Indonesia, and the Philippines joining the current 11 members would generate larger economic gains for members ($486 billion by 2030) than the original TPP with the United States. Nevertheless, the recent trade spat between Japan and South Korea has dented the expectations that South Korea could make a bid for CPTPP entry any time soon. On July 1, 2019, the Japanese government suddenly announced tighter export controls on three chemicals that are critical for South Korean semiconductor manufacture, and a month later it dropped South Korea from its “whitelist” of preferred trading partners, requiring instead catch-all controls on dual-use products. Tokyo has cited South Korean breaches in the export-control protocols and the absence of periodic meetings among export control officials to justify these actions. Rejecting these arguments, the South Korean government, considers these moves retaliation for the South Korean Supreme Court’s decision in favor of individual claims of compensation for wartime labor. The South Korean government’s countermeasures were swift and expansive: removing Japan from its own whitelist, refusing to renew the military information sharing agreement, and
lodging a WTO complaint accusing Japan of abusing the national security exemption to unduly restrict trade. Both Japan and South Korea have much to lose if the current trade row adds uncertainty to the operation of global supply chains, slows down the dissemination of CPTPP standards across the region, and compels a weakened WTO adjudication system to address a national security exemption case. Tokyo’s approval of some licenses under the revised protocols has a helped alleviate some of these concerns. But both sides will be better served by launching export control talks with the aim of achieving an eventual return to preferred whitelist status.16

Asia’s regional trade architecture will also be shaped by the fate of the Regional Comprehensive Economic Partnership (RCEP) agreement. Negotiators from 16 nations (the 10 members of ASEAN, plus Japan, South Korea, China, Australia, New Zealand, and India) launched these trade talks in 2013 with the aim of concluding them by 2015. Getting to the finish line in these negotiations has been difficult, especially as India has resisted ambitious liberalization targets out of concern with worsening the trade balance with China.17 RCEP negotiators pushed hard to conclude talks this year, but at the end India balked. After a ministerial meeting in Bangkok in early November, the remaining fifteen nations announced they intend to sign the agreement next year, while continuing to engage with India to address its concerns.18 If RCEP materializes, especially with its original membership configuration, this trade agreement would generate substantial economic gains given the size of the markets involved and its ability to streamline Asia’s FTA spaghetti bowl. With a new CPTPP in hand, Japan aimed to improve the quality of RCEP’s rules and speed up the negotiation process. This new level of effort was reflected in Japan hosting the RCEP Ministerial Meeting on July 2018, the first time this gathering took place outside of ASEAN. But as Takashi Terada points out, RCEP standards will not mimic CPTPP rules (the agreement comprises three least developing economies) and there are no plans to introduce provisions in areas like environment, labor, and state-owned enterprises.19 For these reasons, Japan has pursued a different route to curb China’s market distorting policies, one that also seeks to avoid the perils of U.S. unilateral tariffs and an all-out U.S.-China trade war: a trilateral effort at rulemaking with the United States and the European Union. The rulemaking campaign builds from Japan’s two mega trade agreements: the CPTPP and its trade deal with the European Union.

Japan and the European Union inked their trade deal on December 2017. When it entered into force in February 2019, it inaugurated the world’s largest trade agreement, comprising a third of the world’s GDP. The Economic Partnership Agreement (EPA) eliminates most tariffs, including the eventual phase out of European auto tariffs, and Japan’s opening of the wine and cheese markets to European producers, while also recognizing scores of European Geographical Indicators. In the end, the EU and Japan decided to set aside the two issues that had bedeviled the talks: investment protection (with the European Union pressing for an investment court which Japan declined), and data flows (opting instead for a separate adequacy decision to enable the safe transfer of personal data).20 The decision of both parties to wrap up what had been protracted negotiations and seek swift ratification of the partnership agreement reflects strategic intent. European Commission President Jean-Claude Juncker and Prime Minister Abe noted in their joint statement concern about “widening protectionist movements” and their desire to jointly “wave the flag of free trade.”21
Japan’s efforts at global coordination on updated trade and investment rules has centered on a trilateral initiative launched on the sidelines of the WTO Ministerial Meeting in Buenos Aires in December 2017. Its mandate is to tackle non-market policies that create overcapacity and distort trade flows. The trade ministers of Japan, the United States, and the European Union identified areas where improvement is sorely needed, including stronger rules on industrial subsidies and non-market behavior of state-owned enterprises (SOEs), the elimination of forced technology transfers, WTO reform, and the codification of rules on digital trade. The trilateral effort has made headway with a reform proposal on transparency and subsidy notification tabled at the WTO in the fall of 2018. Japan, in particular, has made digital governance a focal point of its contribution to WTO reform. At the Davos World Economic Forum in January 2019, Prime Minister Abe announced the launch of an Osaka track under the WTO to enable free data flows with due provisions for privacy and cyber security. In this way, Japan is pushing back on rising digital protectionism and offering an alternative to China’s cyber sovereignty vision. These efforts to address the China challenge share a common denominator, which is that they represent an investment toward a rules-based multilateral framework. This approach is likely to gain more traction than a purely bilateral negotiation for reasons well-elucidated by Wendy Cutler: It will be easier for China to acquiesce to reforms framed as part of systemic change and not exclusively as a “China problem,” and the demandeurs of change (U.S., EU, Japan) will have greater leverage working together given that they represent 40% of China’s exports. Problems like overcapacity, Cutler admonishes, cannot be addressed with bilateral solutions.\(^22\)

There is great promise in the like-minded approach, but it has always rested on an uneasy premise: that the United States would not train its auto “national security” tariffs on treaty allies and that parallel bilateral trade talks with both the European Union and with Japan would manage to reach safe harbor.

**NEGOTIATING TRADE AGAIN: THE FUTURE OF THE U.S.-JAPAN ECONOMIC PARTNERSHIP**

Although U.S.-Japan relations are robust and strong, trade once again had the potential to be a divisive issue among the two allies. The differences in the trade philosophy animating each government were on display in the Abe-Trump joint statement released in fall 2018 giving the green light for bilateral talks. President Trump emphasized reciprocity and the reduction of the bilateral trade deficit as his main concerns, while Prime Minister Abe endorsed the principle of rules-based trade. Both sides also took the opportunity to reference sensitive areas. For the United States, the achievement of market access outcomes that increase American manufacturing production and jobs, and for Japan, a ceiling on agricultural liberalization to be on par with its existing economic partnership agreements.\(^23\)

In the months prior to the launch of the trade negotiations, each side characterized differently the scope of the proposed bilateral agreement. Japan insisted the negotiations aim for a trade agreement on goods as well as some services where early achievements are possible. Tokyo was interested in narrower (and faster) negotiations that fend off problematic demands from the Trump administration on issues such as currency manipulation, FTAs with non-market economies, and “voluntary” export restraints; while reserving the TPP as the most comprehensive rulebook in order to incentivize an eventual American return to the deal. In contrast, Washington aimed for
a comprehensive FTA that can be negotiated in stages, with a particular interest on an early harvest agreement in agriculture to appease American farmers losing market share in Japan.

Japan and the United States have pursued contrasting trajectories on trade since they parted ways on the TPP. Therefore, their most pressing objectives motivating the bilateral negotiations were different this time. For Japan, it was about deflecting U.S. unilateralism. In effect, avoiding the harm to a major economic sector if a 25% national security tariff were to hit the 1.7 million vehicles exported annually to the United States (equivalent to a third of all Japanese brand cars sold in the American market). For the United States, it was about catching up with Japan’s trade leadership. In essence, preventing the marginalization of American farmers from lucrative markets now that Japan demonstrated it could mobilize others in support of rules-based trade.

The high-stakes trade talks moved uncannily fast with Prime Minister Abe and President Trump announcing a final deal by the time they met on the sidelines of the UNGA meeting in late September 2019. Described as a first stage outcome, American and Japanese negotiators hammered out two separate agreements: one on market access and the other on the digital economy. Ratification will also move expeditiously: Japan has already started deliberations in the Diet and the ruling coalition has the votes to pass the agreement; while the U.S. Congress will not vote on the deal given that the executive branch has availed itself — for the first time ever — of limited tariff proclamation authority to negotiate an entire trade agreement (section 103 of Trade Promotion Authority). Four months after the expected entry into force in January 2020, both sides have promised to come back to the negotiation table to hammer a truly comprehensive trade agreement.

The United States and Japan stand to benefit greatly from avoiding trade friction that could hinder the alliance at a time of profound geopolitical change and the proliferation of security risks in Asia.

The mini trade deal has important upsides for the U.S.-Japan relationship. American farmers — long the casualties of the tariff war with China and the decision to abandon TPP — will find relief with some of the improved terms of access to the large Japanese market. The chances that the Trump administration will impose punitive tariffs on Japanese cars have gone down. Both sides stand to benefit greatly from avoiding trade friction that could hinder the alliance at a time of profound geopolitical change and the proliferation of security risks in Asia. And yet, the bilateral trade agreement is inferior to the original TPP project, both in terms of economic benefits and the potential for the U.S.-Japan partnership to improve global governance.

Given the centrality of the digital economy, it is certainly a positive for the United States and Japan to reconfirm their shared vision on the importance of free data flows and unhindered e-commerce. But even here, the (CP)TPP has greater potential: it has hammered out a compromise on high level standards that both developed and developing countries can abide by. In terms of reciprocal tariff reductions, the bilateral market access agreement is decidedly TPP-minus. Japan excluded rice, refused to allow participation for 33 goods in the broader CPTPP import quotas, did not make allowances in dairy to avoid restrictions based on Geographical Indicators (GI), and made no concessions on soybeans. On the other hand, American beef and pork
producers are big winners in this negotiation receiving the same tariff preferences than their competitors from CPTPP nations. USTR Lighthizer’s negotiation strategy — making no concessions in autos and focusing first on agricultural outcomes — meant that Japan scaled back some farm commitments available in the original TPP, and that some American industries were put on the waiting list for a future negotiation (pharmaceuticals and the services sector).

Four pages long (plus annexes and side letters), the market access agreement stands out in many ways for its omissions. On the positive side, there are no provisions on export quotas, as Japan remained steadfast in its opposition to such quantitative restraints. There are, however, two other major omissions that are of concern to Japan: U.S. commitments on tariff liberalization of automobiles and an explicit pledge to retire for good the threat of punitive tariffs on cars. Since autos represent a third of the value of Japanese exports to the United States, the mini trade deal is not in compliance with the WTO’s injunction that preferential trade agreements must liberalize substantially all trade. The leaders’ joint statement of September 25, 2019 made only an indirect reference to the 232 threat, noting that as long as both parties faithfully implement commitments, neither one will adopt measures contrary to the spirit of the agreements.26 Also missing from the trade deal is an explicit dispute settlement mechanism to adjudicate differences, with provisions instead for a consultation process and an expedited exit mechanism with four months’ notice.

In the span of few years, Japan and the United States have sharply reoriented their trade strategies as they navigate the dilemmas of a trading nation in their quest to ink trade agreements that can reconcile the goals of economic competitiveness, social legitimacy, and political viability. In the recent past, these two countries have twice met at the negotiation table — and the outcomes of each negotiation have been dramatically different. In the original TPP project, the United States and Japan were ready to forge a regional trade architecture; in the mini trade deal they settled for the minimum necessary to avoid friction in bilateral relations. However, the broader horizons of coordinated economic statecraft for Japan and the United States still beckon. These two nations have an abiding interest in working as partners to improve international economic governance through the dissemination of digital economy standards, the supply of high-quality infrastructure finance in the developing world, and the codification of rules that alleviate the distortions of state capitalism in the trading system. Equally pressing and consequential is for the allies to work towards achieving a high-quality comprehensive bilateral trade agreement and engineer an American return to the regional economic architecture.
REFERENCES

1  For a broader analysis of the decline of multilateralism, the rise of great power competition, and the full-set of Japan’s economic statecraft see the author’s forthcoming book chapter “Follower no more? Japan’s leadership role as a champion of the liberal trading order” in *The Crisis of Liberal Internationalism: Japan and the World Order*, eds. Yoichi Funabashi and John Ikenberry (Washington, DC: Brookings Press, February 2020).


6  Mary Lovely and Yang Liang show that foreign firms operating in China have been the hardest hit: More than half of the products targeted in that tranche of U.S. tariffs are produced by multinational corporations in China, and in the case of computer and electronic products the share is as high as 86%. See Mary Lovely and Yang Liang, “Trump tariffs primarily hit multinational supply chains, harm U.S. technology competitiveness,” (Washington, DC: Peterson Institute for International Economics, May 2018), https://piie.com/publications/policy-briefs/trump-tariffs-primarily-hit-multinational-supply-chains-harm-us.


8  The original target was to sign an agreement on the sidelines of the Asia-Pacific Economic Cooperation (APEC) leader’s summit. The Chilean government’s decision to cancel the APEC meeting due to domestic political unrest, through a wrench at those plans.


15 Tokyo's position is that this ruling undermines the treaty normalizing bilateral relations where all compensation claims were settled, and that this disagreement should be taken by the arbitration mechanism contemplated in said treaty. But Seoul has not agreed to an arbitration proceeding. Broadly speaking, unsolved historical issues emanating from Japan’s annexation of Korea and divergent threat perceptions regarding the North Korea threat and the China challenge have long hindered this bilateral relationship. However, the current downturn is more severe as it has affected economic ties and valuable defense cooperation. For a discussion of the vicissitudes of the Japan-South Korea relationship and its impact on U.S. Asia policy, see: Richard Bush, Lindsey Ford, Ryan Hass, Adam Liff, Michael O’Hanlon, Jonathan Pollack, and Mireya Solís, "Stress Test: Japan in the Era of Great Power Competition,” (Washington, DC: The Brookings Institution, October 2019), https://www.brookings.edu/research/the-stress-test-japan-in-an-era-of-great-power-competition/.


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