

# **Where is the US-Japan Alliance Heading for in the Dynamically Changing 21<sup>st</sup> Century?**

**- How do domestic politics in the US and Japan deal with those challenges? -**

**September 30, 2014**

**Washington, DC**

This conference addressed how emerging issues in the global political system will affect the US-Japan relationship. Specifically, how public opinion, limited government budgets, energy needs and organizational complexity constrain both nations. The participants included former trade officials and senior embassy officials from both nations as well as distinguished Washington, D.C. academic and think tank experts. They presented ideas for how the two nations should move forward and how they can work within these constraints to find new solutions for the 21st century. This conference was co-hosted by the Reischauer Center of Johns Hopkins School of Advanced International Studies (SAIS) and the Japan Economic Foundation (JEF).

## **Welcoming Remarks**

Dr. Calder opened the conference by introducing Dean Vali Nasr of SAIS.

Dean Nasr welcomed the participants and extended special thanks to the Japan Economic Foundation and the Reischauer Center. He noted the special place the Japan Studies department has within SAIS and how special the US-Japan relationship is to the global economy. Any advancement in the global economy will require cooperation from the two countries. His hopes were that this conference would simply be an initial step in a prolonged dialogue involving SAIS and US-Japan relations.

Dr. Calder and Mr. Kusaka introduced the conference as dealing with the challenges of constraints.

## **Kazumasa Kusaka, Chairman and CEO, Japan Economic Foundation**

Mr. Kusaka extended thanks to all the participants and staff. He explained how the conference came to fruition through a breakfast meeting between himself and Dr. Calder. They discussed the political mechanisms that resulted in the decision to not conduct military operations against the Syrian government. They discussed the inherent differences between parliamentary and presidential systems. American leaders are much more beholden

to public opinion than leaders in the parliamentary systems of Europe. Further, traditional institutions no longer have a monopoly on information. There is a need to explore the role that think tanks and universities will play when compared with the role that the internet and social media can have in shaping public opinion. We should consider how the US-Japan security treaty would be affected by this change in shaping public opinion. He then shifted the attention to the economic relationship between the US and Japan. Until macroeconomic policies are coordinated, changes in policy will have little impact when going up against the powerful financial markets. In order to implement successful structural reform, leaders must overcome domestic opposition. This can be accomplished through peer pressure. Politicians can utilize political capital to combat opposition. Past leaders who formed the G7 and G8 would come together to form economic policies and then fight for them in their home countries, overcoming domestic opposition. Are we following their example? At their breakfast meeting, Dr. Calder took an interest in this and suggested a conference.

#### **Kent Calder, Director of Edwin O. Reischauer Center for East Asian Studies, SAIS**

Dr. Calder highlighted four main constraints:

1. Public opinion – playing an increasingly important role and augmented by the internet and the ease of access to information
2. Finance – limited government budgets
3. Energy – we should examine if this has disappeared as a constraint in the era of shale gas
4. Organizational complexity – the general issues involved with governing. How should we govern a nation while responding to public opinion

#### **Session I: Changing World Geopolitics and New Constraints**

This session gives special attention to geopolitical changes in the energy and security areas, with special attentions to the shale gas revolution and to the Ukrainian crisis, together with its broader geopolitical ramifications across the continent of Eurasia.

#### **Session I - Panel I: Energy**

**[Presider]**

**Kent Calder, Director of Edwin O. Reischauer Center for East Asian Studies, SAIS**

**[Speakers]**

**Nobuo Tanaka, Former Executive Director, The International Energy Agency (IEA); Global Associate for Energy Security and Sustainability, Institute of Energy Economics, Japan**

**(IEEJ)**

**Guy Caruso, Senior Adviser, Energy and National Security Program, Center for Strategic and International Studies (CSIS)**

Mr. Tanaka opened the panel by commenting on a recent seminar where General David Petraeus made a speech. The General said that the coming decades would be the decades of North America and neither Asia nor the Middle East. This is because North America will soon be the largest producer of oil and gas because of the shale revolution. He then talked about the geopolitical situation with regards to energy. Japan and Korea import 100% of their oil and gas, so they cannot become any more dependent. The shale revolution has enabled energy independence and significantly strengthened the US geopolitical positioning. It will be able to export LNG to Japan, resulting in downward price pressures. The financial sanction on Russia, a major exporter, is affecting the future stability and security of the global energy supply. Russia can be a partner to cope with the “Islamic State”. The Japanese government is unprepared for a global gas or oil crisis that could be triggered by the blockage of the Strait of Hormuz. Without operating nuclear power plants, Japan has nowhere to turn.

Globally, nuclear reactors have aged and the average operational lifespan is over 25 years old. The Japanese age limit on nuclear power plants is 40 years. It is important to decide quickly to what kind of reactors world will move. Korea decided to develop an integral fast reactor and pyroprocessing. The U.S. Argonne National Laboratory developed this technology and the reactor proved its passive safety through an experiment simulating total plant blackout like the Fukushima accident in 1986. It provides solutions to the three goals that Japan, Korea, and the US need to achieve altogether, namely passive safety, nuclear proliferation resistance and easy high-level waste management. One challenge is how to demonstrate this system within Japan to regain public trust in nuclear technology. It is American technology. Mr. Tanaka proposes that the US, Korea, and Japan jointly demonstrate the technology in Fukushima. Turn the disaster into a chance for change. When he proposed this in Fukushima, there was support for discussing the future of Fukushima with a concrete proposal like this. Because of the shale gas revolution in the US, there is no urgency in American nuclear policy. However, America, as the nuclear technology leader, should partner with Japan and Korea to demonstrate this technology now or else this technology could be lost forever.

Mr. Caruso said that the United States is undergoing a tremendous revolution. This change has let the US go from a demander in LNG to an exporter. In addition, the US no longer has to rely on Middle Eastern countries for oil. Current technology leads to the current wells

drying up fairly quickly. This leads to substantial investment in drilling new holes. While it is still profitable, the costs are rising. The most optimistic EIA predictions have the US as a net oil exporter by 2035. This can help Japan. The gas from Qatar and other locations in the Middle East can now go to Japan instead of the US. The US is now also exporting coal because gas is replacing coal domestically. Mr. Caruso believes that the LNG market will result in lower prices that will help both Japan and Korea.

## **Discussion**

Dr. Calder asked the first questions. He inquired about the costs to continue to secure the sea-lanes for energy transportation. To Mr. Caruso, he asked what the domestic political constraints would be on US energy exports and whether they would change from the current Congress to the next Congress.

The next question from Mr. Kusaka focused on what would happen to China, with the second largest reserves of shale gas, but without the technology necessary to harness those resources. As of now, they would need American technology to tap into the resources. What are the implications not only in the North American context, but also in a global context?

Dr. Yoshino, of the Asian Development Bank Institute, asked the next question. He wanted to know what kind of changes in the United States industrial structure might come about as a result of the shale gas revolution. He also asked how a decreased reliance on Middle East oil might destabilize the region.

An audience member wanted to know the prospects of US oil exports. Can this actually happen in the short term?

Mr. Tanaka responded to the sea-lane protection issue by pointing out the sea routes for energy transportation to Japan. Because of the cost of having aircraft carrier groups, China started to focus on pipelines. China is already using these pipelines for more than half of its gas importation. There have already been some commitments from the Japanese self-defense forces to deal with Somali pirates and he believes there may be further commitments in the future. Mr. Tanaka also pointed out that Japan may soon use pipeline connections with Russia. Studies have shown that it is much cheaper than current LNG transport systems. He believes that in order for Japan to remain competitive with regards to its energy intake, it must re-activate the nuclear power plants.

Mr. Caruso responded to the issue of the long-term cost of maintaining a military presence in the gulf by pointing out that no high ranking US officials had discussed removing the military presence. He said the biggest battle over energy in the next congress could be whether or not the export of crude oil will be allowed. He went on to address shale gas in China, saying he believes that it will become more common, but that it would not reach the “revolution” levels that it has in America.

Amb. Deming asked about the possibility for regional cooperation between Japan, the US and South Korea.

An audience member, wanted to put the energy question in a global financial context. If America starts to export shale gas and relies less on imports, less US dollars will be distributed abroad. He wanted to know how soon the panelists see this exportation of shale gas happening.

An audience member asked about the potential for Japan-Korean cooperation with the support of the US to tackle future challenges in energy.

Dr. Hufbauer asked for the panelists’ 10-year outlook for energy prices as well as the roles that Russia and Saudi Arabia will play in those outlooks.

An audience member wanted to hear the panelists’ thoughts on the most effective way for governments to communicate with the public about energy and government policies.

A questioner wanted to know about the implications for Japanese access to Russian gas given the recent Russia-China energy deal.

Mr. Tanaka responded by saying that the Russia-China deal will help Japan because the pipeline will physically come close to Japan and Russia will need alternate consumers besides China. Relying too much on China would give them too much power. Therefore, Japan may get a connection to the pipeline or LNG distribution. He also believes that Korea-Japan cooperation is possible after he talked with officials from Korea who did not seem opposed to this idea. One way this may come is through a link between the Japanese and Korean power grids. Building a Japanese power station and importing energy to Japan is also a possibility. Therefore he is optimistic about possibilities for cooperation, but as of now, Korean public opinion is much more excited for cooperation than the Japanese public. The next step is to convince the Japanese public. He believes that Korea-Japan is the core of Southeast Asian cooperation.

Mr. Caruso said that the reduction in imports has already started. If everything goes right (Iran sanctions end, ISIS does not disrupt Iraqi production, Libya produces at a higher rate and America continues to grow), he believes that oil prices could be at \$80-90 in the medium to long term. Public opinion and regulatory measures are adding to the costs of natural gas prices. Therefore he sees prices as \$5 to \$6 MMBTU and export rates at about the same as Qatar.

### **Session I - Panel II: Security**

**[Presider]**

**Ambassador Ichiro Fujisaki, President, The America-Japan Society; Former Ambassador of Japan to the United States**

**[Speaker]**

**Eliot Cohen, Robert E. Osgood Professor of Strategic Studies, Director of the Strategic Studies Program at SAIS; Former Counselor of the U.S. Department of State**

Amb. Fujisaki opened the session by asking a few questions to Dr. Cohen. Chinese officials have recently said that East Asian security should be maintained by East Asians. To what degree should China be allowed to project its power if it is done within legal means?

Dr. Cohen responded that the US does not intend to give up its role as an East Asian power. While it is important for the world that China develop and remains stable, it should not come at the expense of Asian neighbors. America should remain firm and strong in its stance. Chinese leaders cannot feel like they will have much to gain by confronting Japan and America. While Japanese sovereignty should not be violated, it is important to maintain the open order that has occurred so far in East Asia.

Amb. Fujisaki then asked about the stability of China's one party system. Can growth be maintained along with the current system or is corruption going to be too much to overcome?

Dr. Cohen responded that Chinese leaders probably view the Hong Kong protests as a threat to political order. They have studied the downfall of the Soviet Union and are determined not to let it repeat.

Amb. Fujisaki asked Dr. Cohen's opinions on the future of US-China relations. Until now it has been a pendulum swinging back and forth between the good and the bad. What is the 1-year outlook for relations? Will they improve?

Dr. Cohen responded that it is important to view the relationship in the 20-year context. There have been many changes. Twenty years ago, many people were excited about the opportunity to do business in China, but it has not always been successful. In the immediate future, the US will become a net exporter of energy. With cheaper energy, manufacturing will come back to the United States. He believes that the Chinese government will use a heavy hand in dealing with the Hong Kong protesters and would not be surprised if there is bloodshed in Hong Kong.

Amb. Fujisaki then approached the issue of Russia. Is time on the side of Russia or the West and if it will affect the relationship over Crimea?

Dr. Cohen said that time is not on Russia's side. They face demographic problems, similar to Japan, including problems with minorities and the size and health of the Russian population. However, in the short run, he believes Russia will do well. The population is used to suffering and the government is popular after their actions in Ukraine. Putin wants Russia to be a dominant power again, meaning that they will try to change borders and circumstances abroad. Russia's ability to change a country's borders by military force is a major threat to world order.

Dr. Cohen also addressed American foreign policy, saying that America usually focuses on everything around the world. The question to American officials is not "what is your position?" The question is "what will you do?" The fact that the red line in Syria was not actually a red line has been noticed by the Chinese and will make American foreign policy more difficult to conduct in the coming years.

### **Discussion**

Amb. Deming asked for the speakers' views on the effect that economic sanctions play on enforcing norms and forcing certain actions.

A questioner asked if Europe would be more stable if NATO were dissolved.

Dr. Calder then asked what constraints finance would put on American security policy.

Dr. Hufbauer asked what effect bloodshed in Hong Kong would have on it as a financial center.

Mr. Tanaka then said that he feels like the Ukraine issue should be solved as a domestic issue and not as a global issue. He believes that Russia and Europe should find an amicable way to resolve the situation. He also asked about the risk of the US dollar no longer being a

default currency once America turns into a net exporter of gas.

Dr. Cohen responded by saying that economic sanctions have limited effects. He pointed to past examples where sanctions did not have huge effects. He said that it should not be the only tool used for enforcing policy. He does believe that in response to Russian aggressions, the US and its allies should deploy ground forces in Poland and the Baltic States. Europe would not be more stable without NATO. The organization is what keeps the US deeply engaged in European security. Without it, he feels that Russia would divide the region. He said the financial constraints should be limited. The political will should be there to support continued defense spending. He believes that Hong Kong will eventually be displaced as a financial center anyway, but that bloodshed would speed that process along. He says that Ukraine should be a global issue because Ukraine does not have the ability to defend itself against Russia.

### **Session I - Panel III: The Role of Asia**

**[Presider]**

**Ambassador Rust M. Deming, Adjunct Professor, SAIS; Former Ambassador of the United States to Tunisia; Director of the Office of Japanese Affairs in the Department of State; Principal Deputy Assistant Secretary for East Asian and Pacific Affairs**

**[Speaker]**

**Charles Morrison, President, East-West Center**

Mr. Morrison opened the talk by showing projections from the National Intelligence Council for how global power will have shifted by 2050. This took into account several different factors including soft power, economic power and military power. Asia as a whole will increase its power, but no country will match how powerful the United States has been. Asia has seen a second rise in its share of gross product and it should continue. However, the United States and North America will continue to be a major force because of the role immigration can play in refreshing America. While the next century will be a “global century,” Asia-Pacific will play a vital role in it. In order to do this, there must be cooperative international relations. Japan must face its demographic challenge. The US-Japan partnership needs to be a global partnership. But there are domestic constraints in both countries. In Japan, small interest groups such as farmers and whaling groups can help determine international positions. This makes Japan look small and narrow-minded. At the end of WWII, the US developed a great deal of moral authority, but the US has lost some of that in the 21<sup>st</sup> century. In America, it is very hard to inject foreign views into the domestic debate. In Japan, there is the nemawashi decision making process in which all



groups must be brought together to make a decision, making it hard to change that decision when facing the rest of the world.

Amb. Deming then asked about the dividing lines in emerging Asia. Would the territorial disputes involving Japan, Vietnam, etc. hurt the emergence of Asia?

Mr. Morrison responded that one of the dividing lines is between the Muslim world and the Western world. The other is between the Western world and the Confucian world. This can be seen even within China.

Amb. Fujisaki asked how accurate the US intelligence projections of future global power can really be considering previous projections that Japan would become the world's strongest power by the early 2000s. He then said that one of the brightest points of the US is its support for freedom and human rights internationally. He asked how Mr. Morrison viewed that as continuing into the 21<sup>st</sup> century.

One questioner then asked about the importance of the rest of North America, not just the United States, for the 21<sup>st</sup> century.

An audience member asked if the immigrants coming from China and Korea could change US society and, more specifically, the Japan-US relationship.

Mr. Morrison responded that the power projections are something to consider and that certainly things will change, but that it would be a mistake to assume the US will maintain its dominant position. America can only maintain dominance if it carries out successful partnerships with other countries. There are three arrows to maintain dominance:

1. Diplomatic security – strong alliance system and engagement with China
2. Trade arrow – TPP both with countries that are eager to participate and those that need convincing
3. Educational and culture - doubling students who study in America, there is no multi-lateral initiative that would engage a core of people

He said that human rights are essential to US foreign policy. It gives the country moral authority to carry out policies. Democracy cannot be forced on another country, it is something that must be chosen by the country's own people. He emphasized the need for remembering both Canada and Mexico and their resources when considering the international system. He also said that while Koreans and Chinese are larger groups within

the US, the Japanese are still a significant minority group. However, they do not project as well onto American foreign policy and that is why there is a need for the US-Japan Council to bring in more Japanese voices.

Amb. Deming then asked about the multiple meetings and frameworks that are present in Asia and how these will overlap. Whether they will produce multiple outcomes or can somehow streamline them.

Mr. Morrison said that the US essentially treats Japan as a developing country when it comes to agriculture and the TPP. Japan should try to step out of that boat. TPP should ultimately act as a benchmark for the world and the region. He said that the US should not have joined the East-Asian summit and that they should have let Asia have its own say.

One questioner asked about the fact that many wealthy people from China immigrate into the US. Will this cause a problem for China?

Mr. Morrison responded that emigrants can still give their skills back to their country of origin. It would be better if Americans would also emigrate to China. But there must be cleaner air and a freer environment for intellectual activity. It would be a win-win if foreigners come to your society and then back to their society and in that sense have Chinese leave China and come back again.

Dr. Calder then mentioned that a significant factor in political stability is housing policy.

Mr. Morrison explained that the Singapore housing fund involves the government taking money in order to provide housing. However, he noted that this would never be acceptable in America. He said that a key factor would be how China evolves politically. Systems can change and evolve dramatically and it will be interesting to see where China goes.

Amb. Deming then asked about India's role in the growth of China.

Mr. Morrison responded that India will be an increasingly important player in the region and with respect to China.

#### **Session I - Panel IV: The Role of the United States**

**[Presider]**

**Ambassador Ichiro Fujisaki, President, The America-Japan Society; Former Ambassador of**

## **Japan to the United States**

**[Speaker]**

**James Zumwalt, Deputy Assistant Secretary of State, Bureau of East Asian and Pacific Affairs, U.S. Department of State**

Amb. Fujisaki asked DAS Zumwalt whether or not there was any truth to the image that America is feeling tired of being the world's policeman and that America has been overstretched.

DAS Zumwalt thanked the organizers of the conference. He thanked Amb. Fujisaki with an emphasis on his role in getting Japanese students to come to the US. It is more important to think about partnership and how to address concerns together. He mentioned that at a recent Japan-US conference of government officials, 90% of the discussion was focused on issues that were not Japan-US specific. The US is eager to partner with similar countries to address similar concerns.

Amb. Fujisaki asked about the recent "Asian pivot" from the US government and whether or not it can continue with the crises in Ukraine, Syria, Iraq, etc.

DAS Zumwalt said that US government officials have generally stopped using the word "pivot." The word implies that the US is turning its back on other countries. Rather, the US welcomes friendly nations in Europe to work together to advance common values. The word also implied that this is a change from past policies but they are hoping to sustain a strong policy from both Republican and Democratic administrations. He said that the situations in the Middle East will not weaken the US relationship with Japan. Because the Japan relationship is a partnership, he hopes that Japan will work with them to confront the situations in the Middle East.

Amb. Fujisaki talked about the importance of China. There has been talk of China's recent increases in defense spending, which has been a concern for many countries in the region.

DAS Zumwalt said that the US hopes to increase dialogues with the Chinese. The two countries have had recent discussions about crisis management and how to respond if one country misinterprets the other. Arms control may also be included in talks down the line.

Amb. Fujisaki (noting the delicate position of DAS Zumwalt as an ambassador-designate) asked how the US midterm elections might affect US foreign policy.

DAS Zumwalt responded that mid-term elections generally focus more on domestic policy issues rather than foreign policy. Part of his job at the State Department will be to reach out to elected officials and explain the importance of foreign relations to individual districts and how it can matter to their voters. He also expressed a hope for increased congressional travel and an understanding from the public as to why travel is necessary for members.

## **Discussion**

Dr. Yoshino from the Asian Development Bank Institute asked what would be the best way to convey the real situation in Japan. He says that Japan has not been good in the past at conveying the real situation in Japan.

Dr. Calder asked for an update on the efforts to get Japanese students to study in the United States.

Dr. Hufbauer asked what DAS Zumwalt saw as the size of the US military troop footprint on Japanese soil. He noted that the alliance could be secured in ways that did not necessarily involve troops on the ground.

DAS Zumwalt said that similar to the need for US diplomats to travel, there is a need for journalists to travel as well. He pointed to efforts to bring Korean media to Japan to tour American military bases in order to better explain the role that Japan plays in assuring Korean security. Regarding education, it is vital to provide opportunities for today's students. They will be the ones making decisions in twenty years. There is concern about the decline in students coming to the US. He mentioned four factors behind the trend:

1. Demographics – fewer college-age Japanese students
2. Economic factors – harder to find enough money to study abroad
3. More options for Japanese students – it is good that there are more options for students to study abroad, but it is harder to convince students to come study in the United States
4. Structural issue – Japanese corporate recruitment of college graduates seems to discourage students from studying abroad

The US government can help stop the decline by trying to find more scholarships for students and addressing the structural issues as well. There are programs that are aimed at helping international students come to the United States and not only study, but find internships as well. This program has been very successful in Korea and they would now like to see

Japanese students involved. Another issue is Japanese students' level of English. Compared to Korea, the language level is quite low. As far as the future of American military involvement in Japan, DAS Zumwalt believes there will be a smaller footprint, a greater dispersion of forces throughout Asia and more shared facilities in Okinawa.

Amb. Fujisaki mentioned that the media does not want to give up old images of various cultures. For instance, the idea that Republicans have better relations with Japan than Democrats is an old notion that is no longer true. When going back to America, he often hears from senior corporate officials that they want students to go abroad but it is too expensive for parents. In order to tackle the issue of low-English levels, it is necessary to teach teachers. Teachers should study abroad for a year in order to improve their language skills.

One questioner asked what would be an appropriate way to have China engaged in foreign development.

The next question was about Europe's role in the US-Japan relationship.

Dr. Calder asked about areas of joint projects that could show promise for Japan and the US.

DAS Zumwalt noted the importance of how China's growing economy affects its neighbors. It is important to have investment in a sustainable way that promotes good governance and stability. He said that it is important to engage China on these issues. He does not see the US-Asia relationship as in competition with the US-European relationship. He sees the EU as a partner in the US-Asia relationships. One example of this is the role Swedish diplomats play as the US representative in North Korea. He pointed to the US-Japan Policy Cooperation Dialogue on the Internet Economy as a great example of a pilot project. This is a way to ensure not only US-Japan government cooperation, but also the business lobbies of both countries. This has had a significant impact on the internet policies of both countries. It is important that the US and Japan maintain strong relationships on this.

### **Luncheon**

#### **[Presentation Topics]**

#### **A House Divided? Foreign Policy Implications of the 2014 Mid-Term Elections**

#### **[Speaker]**

**Daniel Bob, Former Senior Adviser, Senate Finance and House Foreign Affairs Committees;  
Director of Programs and Senior Fellow, Sasakawa Peace Foundation, USA**

Mr. Bob started by explaining that there is little certainty in the upcoming elections. However, he did point out Nate Silver's predictions that the Republicans are virtually certain to maintain control of the House of Representatives and that they had a 61% chance of taking over the Senate. Midterm elections tend to favor the party not in control of the White House. Which party wins the Senate will not have huge significance as GOP control of the House will ensure divided government with a lame duck President. However, there is not much difference between the two parties when it comes to foreign policy, especially Asian foreign policy. There are differences between the extremes of both parties and their center, but mainstream members on both sides of the aisle generally agree. He discussed Marco Rubio, Ted Cruz and Rand Paul's chances at the Presidency.

Asia foreign policy is mostly bipartisan. The relative stability of the region and lack of conflicts is one contributing factor. While there has been criticism on Obama's "re-balance" to Asia by the GOP, it is more on the execution and lack of follow-through as opposed to objections to the substance. Obama may try to make the "re-balance" a part of his presidential legacy. There is generally support for the policies. Therefore, the midterms should not have much of an impact on Asian policy. Further, most of the key Senate confirmable officials with regards to Asia are already in their positions, so Republicans cannot hold up those confirmations.

The midterms should not halt the Trans Pacific Partnership either. Republicans tend to be more in favor of free trade than Democrats. GOP control might actually be easier to pass TPP related legislation. Chairman Wyden has Trade Promotion Authority legislation that is awaiting the 2014 lame duck session, at which point he will submit it if a deal is made. However, if Republicans take control of the Senate they may wait until 2016 to pass the relevant legislation. This will ensure that a Republican President can take credit for it. It may come down to whether Republicans value free trade more than they dislike President Obama. The last two years of presidencies are about legacies. Because the potential in other areas is low, TPP might become Obama's focus. Looking at the President's stated goals in the most recent State of the Union, there is not much chance for success; therefore Asia may be his best chance for a successful legacy.

## **Discussion**

Dr. Calder asked about how potential GOP committee chairmen would affect American foreign policy. He also wondered if a GOP takeover could mean a policy supporting shale gas exports and other changes to shale gas policies.

Mr. Bob responded that the chairmanship would change for Senate Foreign Affairs from

Senator Menendez to Senator Corker. The two men have very little difference when it comes to Asia policy. Senate Armed Services will change from Senator Levin to Senator McCain. McCain has been outspoken on intervention. While it may give him a better platform to push these changes, it will probably not have much of an impact on policy. Senator Hatch, who has been a supporter of TPA legislation, would replace Senator Wyden. Senator McConnell would become Majority Leader if he wins his election. As far as shale gas exports are concerned, Republicans should be in favor of allowing exports. However, it is important to remember that while producers of shale gas may favor this, users of shale gas would be opposed. As of now, users enjoy a reduced price because they have a protected market. Sellers are not able to go outside of the market. This keeps prices low. In terms of nuclear power, America was on track to ramp up nuclear power, but after the 3/11 incident in Japan, projects have slowed down considerably.

Amb. Fujisaki asked about the viability of the Tea Party in the midterm elections. While they seemed to have faded recently, are they now posed for resurgence? He also asked about the legacy issues facing American Presidents. Because of the difficulties in dealing with Congress on domestic issues, they often look to foreign policy. But they often focus on the Middle East and find it impossible. At that point it is too late try to focus on Asia. Amb. Fujisaki asked what Mr. Bob's thoughts were on the issue.

Mr. Bob responded that as far as the Middle East is concerned, President Obama wanted to pull back America's footprint there. Congress has tried to avoid the issue because of the dangers to them in the mid-term elections. Looking for last minute accomplishments has been a past theme with Presidents. Although the Clinton administration tried to make advances with North Korea, the Obama administration does not seem as eager to engage the country. One other aspect is that Obama may try to make a deal with Iran. When the deal was initially introduced, Senator Menendez organized a group of 60 senators to try and add additional sanctions in order to sink the bill. Mr. Bob does believe that the Tea Party has peaked, and that the Tea Party cost the GOP the Senate in 2012.

Mr. Kusaka then asked whether the President, with his legacy in mind, might use more political capital to get the TPP and TPA agreements through Congress.

Mr. Bob said that the last time the TPA was able to pass the Congress, the GOP controlled the White House and both chambers of Congress. Even then, the vote in the house had to stay open longer than usual. It required a lot of arm-twisting from GOP leadership to get a Republican President the TPA legislation. Even under the best circumstances, TPA is difficult to get through the House. A legislative method to pass TPA is to link it to TPP so that it is

essentially two votes at once. This could help the bill pass because it “kills two birds with one stone” or it could be bad for the bill because it could sink TPP along with TPA. In the Senate, it will be much easier to attach an amendment that kills the bill. No matter the case, President Obama will have to put in effort, work the phones, and go to the Hill to get the legislation passed.

### **Session II: Challenges of Global Political Economy**

This session considers many of the classic economic topics, including macro-economic and trade issues, as well as structural reform. It approaches them, however, from a distinctive political-economic perspective, with special attention to how the politics of a changing Washington constrain American and in turn other global decision makers.

#### **Session II – Panel I: Macro-Economy and International Finance**

**[Presider/Speaker]**

**Naoyuki Yoshino, Dean, Asian Development Bank Institute (ADBI); Professor Emeritus of Keio University, Tokyo, Japan**

**[Speaker]**

**Robert Dohner, Deputy Assistant Secretary for Asia, United States Department of the Treasury**

Dr. Yoshino replaced John Makin as the presider. He started by giving an overview of sustainable growth in Asia and the development of financial markets. If current growth rates continue, Asian countries will produce 50% of world GDP. There are 9 conditions necessary to ensure sustainable growth:

1. Political and macroeconomic stability – Including sound monetary, fiscal, and exchange rate policies.
2. Equitable growth and income equality – Many countries in the region have experienced economic growth, but disparity is growing. Housing policies must also ensure access to housing.
3. Central-local government relations – In China the fiscal stability of local governments is a concern and central-local government relations are not well established.
4. Competitiveness and innovation is key.
5. Protect the environment and stable energy supply.
6. Develop financial markets



7. Education and healthcare – In some Asian countries, private schools are becoming popular and their tuitions are high. Good public schools will be vital to a sustainable Asia.
8. Enhance seamless connectivity – Infrastructure investment is necessary.
9. Improvement of governance issues and transparency is also necessary.

There are 5 characteristics of the Asian Financial Market:

1. Most systems are dominated by banks
2. There is a lack of long-term financing
3. There is a lack of long-term investors because banks are short-term oriented. Long term oriented pension and insurance companies must be further developed
4. There is a high percentage of small and medium enterprises which have trouble with access to finances and venture capital
5. Micro-lending becomes the default option because of trouble with access to finances and venture capital

When examining the difference between the Japanese bubble burst and the Lehman bubble burst, he saw three factors leading to the bursts:

1. Monetary policy is important – In the US case, the federal funds rate kept falling right before 2008, monetary expansion was growing leading up to the Lehman shock
2. The bank credit/GDP ratio was growing very rapidly in both the US and Japan case – this may be one of the indicators to predict a bubble economy
3. The housing price/national income was also a factor as the housing price rose well above income before falling again as the bubble burst

The bubble usually can be seen in the housing markets because there is a time lag in the markets, it takes time to construct houses and the demand for housing will shift upwards. Demand for housing will usually take two to three years to adjust to the rest of the market. China currently shows a very high ratio of loan supply to the real estate market. The Chinese central bank has its exchange rate pegged to the US dollar, and the US dollar and the Euro are both growing within the central bank because of the current account surplus. Therefore, there needs to be a way to reduce the excessive money supply. This is done through the private bank side. Deposits are increasing, and if this trend continues, the amount of loans will continue to rise. As a result, the central bank is increasing reserves so that deposits will be coming back to the central bank again. It has been ineffective. Housing loans continue to rise in China. China has to change exchange rate policies. China had a fixed exchange

rate until 2005, but since then their weight on the US Dollar rate has been diminishing. It used to be 1.0, now it is 0.814. There are five possible policies for the Chinese government to follow with respect to its exchange rate:

1. Keep on the fixed exchange rate
2. Gradually adjusting the basket currency system
3. Suddenly change to the basket system
4. Pure floating system
5. Managed floating system

Using a dynamic model, Dr. Yoshino determined that the second option of gradually adjusting the basket currency system is optimal. A gradual adjustment taking 18 quarters (4.5 years) would be optimal. Thailand, Singapore, and Malaysia are already following the lead of the Chinese adjustment. Therefore if China adjusts its exchange rate under the 2<sup>nd</sup> model, Singapore and Malaysia would probably follow. In Thailand, over 99% of businesses are small and medium enterprises (SMEs). The number of people employed by SMEs totals 76%. This makes these types of companies vital to maintaining stability within the country. SMEs often mention a lack of information sharing between lenders and borrowers. It is important to make it easier for SMEs to borrow money from banks and other capital markets. He did an analysis of 1,363 SMEs and grouped them into 3 categories in terms of their health. He hopes that by grouping them, banks will have an easier time distinguishing to which SMEs they should loan money.

Dr. Yoshino then went on to talk about Hometown Investment Trust Funds. These are found in Japan and several other countries are starting to form their own as well. Hometown Investment Trust Funds put money into venture businesses and startup companies. The companies are ones that might have difficulty borrowing money from banks. The money collected by local individuals makes it possible to create these products. Local bank branches can administer these funds. Banks have to lend money to “safer” companies, but hometown investment trust funds can compensate for riskier companies.

Mr. Dohner discussed East Asian industrialization. It has been very heavily trade and tradable goods oriented as opposed to an import based model. This can be seen in Japan, Korea, Taiwan, Singapore and Hong Kong. This orientation eliminated the need for lobbying because there was little the government could provide besides a successful macroeconomic environment and a good exchange rate for the exporting companies. As a result, non-tradable goods, such as the services sector, have been slower to develop and are not as competitive. Technology and foreign demands have pushed companies towards non-tradable goods. Therefore the pressures on these sectors have become much more intense. In Japan and Korea a lack of growth from the services sectors have accounted for the lack of

overall growth in the country.

He went on to say that the first arrow of Abenomics is the best test of pure monetarist economics. Bank of Japan Governor Haruhiko Kuroda has a chance to change the expectations and image of the bank. So far, the verdict on Abenomics is mixed, but generally positive. Core inflation has risen to slightly above 1%. However, the effect on real wages is not as good. While bonuses and overtime pay is up, real wages are still down because of the consumption tax and the slow response of wage setting. The second arrow of Abenomics, flexible stimulus and fiscal policy, is temporarily ignoring a long-term problem to deal with a shorter-term issue. Fiscal stimulus can continue for some time but will have to be rolled back because of Japan's high debt. Japan has taken the first step in a medium term fiscal consolidation program through the rise in consumption tax. However, it does have its dangers because the effects of the monetary reforms are still not completely known. The third arrow, structural reforms, will attempts to deregulate and increases incentives for business entry, investment, economic activity and growth. It is the most important, yet hardest to accomplish of the three arrows. Part of the reason for that might be the difficulty in measuring progress in a reform package with hundreds of pieces to it.

### **Discussion**

Dr. Yoshino asked the first question. Currently, one-third of Japan's government spending is on welfare. Japanese companies have recently been shifting away from the seniority based compensation system and towards a merit based system. This may allow older people to work longer and rely less on the welfare system. What are Mr. Dohner's thoughts on this?

Mr. Dohner said that the demographic shift could mean the society becomes more conservative and averse to change. This could cause growth rates to fall and the domestic market to grow less rapidly. Companies planning where to make investments may look outside of negative population growth areas. He disagreed that there is a necessity to have the ability to extend your time in the labor force. There is an importance to add flexibility to the labor force throughout the course of your career. This includes the ability to leave and re-enter the labor market (a challenge facing mothers), and the ability to switch companies during your career. With the labor force declining, this becomes much more important.

Mr. Morrison asked to hear more the role of women and immigration in the economy.

Mr. Dohner responded that expanding the role of women is extremely important. The inability to join a major corporation other than immediately upon graduating from college makes it nearly impossible for women to spend any time out of the labor market. In

households where the husband and wife both work, the lower earner's wages are tax free up to roughly 1 million yen, but after 1 million yen the whole earnings are subject to taxation, not just the marginal earnings. This creates a disincentive to work.

Dr. Yoshino added that in some recruiting materials this year on college campuses some positions are only open to women, so there are small steps being taken to change the status quo.

## **Session II – Panel II: Trade**

**[Presider]**

**Hideichi Okada, Senior Executive Vice President, NEC Corporation**

**[Speakers]**

**Gary Hufbauer, Reginald Jones Senior Fellow, Peterson Institute for International Economics**

**Bill Brooks, Senior Adviser, Reischauer Center for East Asian Studies; Adjunct Professor, SAIS**

Mr. Okada opened the session by showing the development of the supply chain in East Asia. More than 60% of exports from Japan to China are parts and components, and more than 70% of exports from Japan to ASEAN countries are parts and components. Further, more than 60% of exports from ASEAN Countries to China, are intermediate goods. Using these components, China exports finished goods to Europe, North America and Japan. International supply chains are formed in East Asia. China exports an iPhone 4S to the US for \$140 but the value added by China is only \$6. This tells us that trade analysis based upon value-added term is necessary to draw the right picture of world trade. Recently, negotiations of the Doha Development Agenda came to an impasse, and regional free trade agreements began to play major roles to promote world free trade system. Now, some major regional free trade agreements, including TPP and RCEP, have been negotiated.

Dr. Hufbauer then began by asking whether we have seen the highpoint of globalization. Globally there seems to be a negative attitude towards trade. The world is suffering from a lack of jobs at the moment. Even if Japanese women wanted to work, it would be difficult to find jobs. Globalization increases productivity, efficiency and the supply side of the world economy. The trade to world GDP ratio is very discouraging. For the last half of the 20<sup>th</sup> century, world trade grew 2-4% faster than world GDP. For the past 8 years, it has grown at the same rate as world GDP. This is mostly due to a lack of large-scale policy liberalization. Foreign direct investment has also decreased. It peaked in 2007. There is a lot of micro

protection occurring. In the US it takes the form of “buy America.” It prohibits liberalization in federal government. Most politicians want to prop up small and medium sized companies, but 8,000 corporations conduct 80% of world trade. When US corporations go abroad, it leads to good outcomes in the United States. Globalization is often blamed for inequality, but it is not necessarily true. The next two years will be a make or break time for whether or not we get back to liberalization. If Japan does not join the TPP, it will lose \$100 billion in income and \$160 billion in trade. Without Japan, the TPP becomes much less significant. The next 3 months are critical to the deal and to global liberalization.

Dr. Brooks gave his analysis of the Japanese press coverage of the TPP negotiations. Prime Minister Abe initially announced that Japan will be participating in TPP negotiations. Because they are held in secret, the Japanese press speculates about what is being discussed at the negotiations. Japanese negotiators are depicted as going into the last rounds of negotiations to break a stalemate. Japan wanted to rush to a conclusion, especially on 5 sensitive agricultural products. This is due to the fact that after that, they will have to negotiate similar deals with 10 other countries. News coverage of the negotiations has been scarce in America, whereas in Japan it is hard to find any part of the negotiations that go uncovered. However, reporting in both countries has said that the negotiations are in trouble. Further, without Japan signing the TPP, the agreement itself is “dead in the water.” There is talk on the Japanese side that the US negotiator is waiting until the last minute to coax more concessions from the Japanese side. Because of the November mid-term elections, he must appear hard-nosed and cannot make any compromises until after the election. Otherwise, he would be heavily criticized and the treaty would not get fast-track approval from Congress. The agricultural lobby is standing in the way in Japan. It wants special protections for certain commodities. The automobile lobby in America is standing in the way. It is arguing that the Japanese market is still closed and that there need to be tariffs on Japanese cars and trucks. Rural areas in Japan are over-represented in the diet and that has led to stronger opposition in the diet.

Dr. Brooks then gave us a picture of how the issues are depicted in Japan. One senior member of the LDP said that entering the agreement without the exemptions would be like “putting our heads on the chopping block.” Further issues include sugar, sugar beets from Hokkaido and sugar cane from Okinawa. Because of the base sensitivities in Okinawa, neither side wants to encroach on Okinawa’s sugar products. If the market were to be opened, it is believed that Australian sugar would take over the market. New Zealand’s dairy products would also wipe out Japan’s. In 1990 the agricultural industry was worth 11.5 trillion yen, but now it is only worth 8 trillion yen. Even without TPP, agricultural production will continue to drop. TPP could spell its downfall. A letter from 140 members of Congress said that allowing a country to enter into TPP while protecting certain agricultural products

would be unacceptable. This was aimed at Japan and Canada.

If Japan does not stay in the TPP, an alternative is the RCEP (Regional Comprehensive Economic Partnership). It is composed of various ASEAN countries, but does not include the US. Japan seems to prefer TPP for economic reasons and to keep China in check. But if the TPP fails, the RCEP would be the only choice. The RCEP would benefit China and Japan, but would not help America. The RCEP covers 90% of the locations from which Japanese companies procure parts. Therefore, the RCEP would be a logical conclusion if the TPP fails.

### **Discussion**

Dr. Yoshino asked who would be able to provide guidance and advice to weakening and damaged sectors of the economy. Japanese automakers and farmers do not know what to do next year because of the uncertainty of the TPP.

Mr. Morrison, President of the East-West Center, asked how viable RCEP actually is as an alternative. He believes that TPP would be strong even without Japan and that RCEP might be harder to execute because of Indian involvement.

A questioner, asked whether the trilateral negotiations between China-South Korea-Japan and the TPP were complimentary or clashing in nature.

Dr. Brooks responded that the bar for entry into RCEP is much lower than TPP but would still establish one of the largest economic blocks in the world. With TPP, it is very difficult to reach a consensus. Noda tried to get agreement between industry and the Diet, but failed. Abe has been given a fairly free hand, but even LDP members have been attaching conditions to protect sacred positions in the Japan economy. If those positions are protected in the TPP, the US Congress will reject the treaty.

Dr. Hufbauer addressed the question of workers having to adjust to the treaty. He claimed that reports of workers who are displaced from free trade agreements are exaggerated. America needs demand and fiscal expansion and that can happen with the TPP. TPP is essentially a US-Japan free trade agreement. As a standalone agreement it would nearly be impossible to pass, but the TPP allows an easier vehicle to execute this. This is also a free trade agreement between Japan and Korea. It can help smooth political difficulties between the two countries. He added RCEP is simply a political agreement and has little "hard" economic content to it. He reiterated the necessity of secret trade negotiations. This allows countries to adjust its positions without constant opposition from domestic groups.

Mr. Okada added that he is optimistic that there will be a successful agreement in the end because the leaders of Japan and the U.S. recognize the importance of the agreements.

### **Session II - Panel III: Structural Reform and Its Global Context**

**[Presider]**

**Kazumasa Kusaka, Chairman and CEO, Japan Economic Foundation (JEF)**

**[Speaker]**

**Kurt Tong, Principal Deputy Assistant Secretary, Bureau of Economic and Business Affairs, United States Department of State**

Mr. Kusaka opened the panel by discussing the importance of structural reforms. He emphasized that Abenomics needs TPP in order to succeed. He then introduced Mr. Tong.

Mr. Tong reiterated the importance of structural reform for global growth. The main emphasis of the G20 this year will be the basic fundamentals required for creating long-term sustainable growth. This includes investment in infrastructure and structural reform. Because the US and Japan are mature economies, they need to consider structural reforms as a path for growth. The two countries cannot grow from an increase in the labor force or an increase in capital investment. There are already significant amounts of capital. In Japan, even with “womenomics,” the labor force will continue to shrink. In the United States the labor force will stay approximately the same, but that will not be the source of growth. Further, the already existing capital is depreciating. Over the past 20-30 years, the two countries have used technological change to spur growth. Without the internet, the two nations would have suffered significant declines in their economies. However, going forward technological change is not an area upon which the two countries can rely for growth. Technology is now too easily accessible to less developed countries that can quickly adapt. Therefore, efficiency is key. For the United States, there is a need for educational reform, an improved health care system and income distribution systems that are not sustainable.

When Mr. Tong moved back to Japan after over a dozen years, he expected to find the “old” economy. One that is still dominated by a main bank system and a government-led government growth model. Instead, he found that companies had undergone significant change in how they are organized and are financed. But there are still weaknesses. The services sector especially small and medium sized enterprises continue to be inefficient because of both regulations and business practices. Japan has struggled with innovation as well. Sony had the people, the financing and the ideas to make the iPhone, but they were not able to put it into practice. While there is no way to develop a more aggressive business

attitude into the TPP, it is something that must be improved in Japan. Another example is of a valley in Hokkaido called Tokachi. The mayor there is trying to create a “food valley” similar to Silicon Valley in the US. Hokkaido is a very good brand in East Asia for food, it is known as clean and beautiful. Currently, the land can be used profitably with little effort by collecting subsidies from the government to produce low-quality goods that are made into rice crackers.

## **Discussion**

Mr. Kusaka made the first point. He said that one of the goals for TPP should be to make the service or agricultural industries more competitive within 10 years. However, Japanese politicians must be convinced that TPP is good and one way to do that is to be able to convey success stories. Mr. Tong brought up many good examples of these successes. Within TPP we have the factors needed for the economy to succeed.

Amb. Fujisaki asked whether the size of Japanese farms could prevent competitiveness. Japanese farms are on average very small. Some politicians point out that there is the possibility of people in Hong Kong and Korea buying very expensive Japanese fruit, but is that just a niche market? He also talked about whether a “one-size-fits-all” economy is really what the Japanese people would want. Whether there is something to be said for smaller businesses that are not all the same.

Mr. Tong responded that while Japan does not have much land, there are significant resources such as human capital, financial capital, and water. Japan is well endowed with water, but China is turning into a desert. It will be difficult to produce enough food to feed that region. Hokkaido currently produces grain because of government subsidies. But rice is always seen as a safe product because it is very valuable. He went on to say that the “big box” issue can also be seen in the United States with opposition to Wal Mart and McDonalds. Because we are in a price competitive world, this will probably happen in Japan regardless of whether it enters the TPP.

The next questioner asked what would be the best way to pursue structural reforms on a global scale if TPP passes.

Mr. Tong responded that once TPP is passed, there will not be much economic work to be done between the US and Japan. One of the areas that will continue to be explored will be civil aviation. The US and Japan could also turn their attention to the internet economy and other multi-lateral agreements within the WTO. It will not encompass all countries within



the WTO but will cover around 80% of all countries.

Dr. Calder asked if the issue of food security and trade embargos still play a role in negotiations like they did in the past.

Mr. Tong responded that in 2008 and 2009 there were some countries that imposed export restrictions because of production shortfalls. In 2011 APEC countries agreed to not place restrictions on exports. However, the enforceability of that agreement is up for debate. That issue has mostly faded away. TPP will forbid export restrictions. This includes energy. The case-by-case approval process of the energy exports will end because Japan will automatically be eligible. Export restrictions have not been debated much in the TPP negotiations.

### **Closing Remarks**

Mr. Kusaka began the remarks by calling the forum a success and that participants were able to cover a wide-ranging portfolio of issues. They were able to put them into context and understand them within specific constraints. He expressed his pleasure in carrying out the conference with the Reischauer Center.

Dr. Calder summarized the restraints covered at the conference: constraints of budgets and finance, political constraints of technical innovation, and constraints of public opinion. Solutions may need to be decentralized and be considered in smaller, more local solutions. It is also necessary to present solutions that seem plausible from a broader social point of view.

Co-chairmen Calder and Kusaka then thanked participants from both Japan and the United States, as well as staff of both the Japan Economic Foundation and the Reischauer Center, and declared the conference closed.