

AN ANALYSIS OF A POSSIBLE JAPAN-US FREE TRADE AGREEMENT

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INTRODUCTION (1 of 2)

- **Historic opportunity for starting work on Japan-US FTA**
 - Economic growth in both nations.
 - Japan's reforms
 - Recent progress and continued momentum will make FTA with US easier than before.
 - Growing consensus that major agriculture reforms inevitable.
 - Korea-US FTA
 - Increased Japanese interest in Japan-US FTA.
 - Sent signal that rice can be excluded.
 - Japan-Mexico FTA (2005)
 - Japan opened agriculture in FTA for first time.
 - Doha stagnation
 - Rise of China
 - Motivates Japan and US to strengthen their ties.
 - Labor and environmental standards
 - Japan's high standards increase its attractiveness relative to other potential partners.
 - Global security threats.

INTRODUCTION (2 of 2)

- **Many hurdles persist, though.**
 - **Persistent US suspicions**
 - Many in US believe that Japan has widespread hidden barriers that will not be rooted out, even with FTA.
 - Beef, auto, insurance, medical device, drug industries, and USDA, among others, have reiterated deep frustration.
 - Many in Congress generally irritated with Japan.
 - Stiff opposition to KORUS FTA gives us preview of Congressional reaction to a JUSFTA.
 - **Increased protectionism in US**
 - General increase in globaphobia.
 - FTA skepticism and lapse of TPA.
 - **Stiff opposition in Japan**
 - Agriculture reforms have stalled.
 - Services.
 - **Concerns about hurting WTO.**



POTENTIAL IMPACTS OF JAPAN-US FTA

Economic (1 of 8)

- **Applied General Equilibrium (AGE) Model**
 - 39 sectors, 8 regions, 5 factor inputs.
 - Standard economic structure
 - Perfect competition.
 - Constant returns to scale.
 - Full employment.
 - Factors move between sectors but not regions.
 - Data
 - GTAP6 data: latest version of state-of-the-art global modeling dataset.
 - Additions: 1) Bradford NTB estimates for agriculture and manufacturing in Japan; 2) Services border barriers and internal frictions, drawn from literature. → Table 3.
- **Scenarios**
 - Baseline: Full goods opening with 10% services opening.
 - 3 variations: Exclude rice, exclude services, exclude both.
 - Also: 20% and 30% services opening.

POTENTIAL IMPACTS OF JAPAN-US FTA

Economic (2 of 8)

- Permanent Welfare Gains (from Table 4).

	Baseline	Rice Excluded	Services Excluded	Both Excluded
Japan	\$130 billion (2.7%)	\$110 billion (2.3%)	\$22 billion (0.44%)	\$2 billion (0.03%)
US	\$150 billion (1.1%)	\$150 billion (1.1%)	\$38 billion (0.28%)	\$42 billion (0.31%)

POTENTIAL IMPACTS OF JAPAN-US FTA

Economic (3 of 8)

- Permanent Welfare Gains (from Table 4).

	Baseline	20% Services Reduction	30% Services Reduction
Japan	\$130 billion (2.7%)	\$240 billion (4.9%)	\$350 billion (7.1%)
US	\$150 billion (1.1%)	\$250 billion (1.9%)	\$350 billion (2.6%)

POTENTIAL IMPACTS OF JAPAN-US FTA

Economic (4 of 8)

- **Japan output changes (Table 6)**
 - **Baseline**
 - Rice and wheat contract over 90% each; beef, over 80%; other meat, over 50%. Grains contraction: \$19 billion; meat, \$22 billion.
 - All manufacturing sectors expand, except leather products.
 - All services expand, except construction.
 - **Rice excluded**
 - Wheat and meat still contract by about the same amount. Grains contraction drops to \$5 billion.
 - Expansions in manufacturing and services are dampened.
 - **Services excluded**
 - Ag contractions are slightly larger overall.
 - Manufacturing expansion dampened.
 - General contraction in services.
 - **Larger services opening**
 - Greater expansions and smaller contractions in all sectors except rice, wheat, and meat.

POTENTIAL IMPACTS OF JAPAN-US FTA

Economic (5 of 8)

- **US output changes (Table 7)**
 - **Baseline**
 - Ag and private services uniformly expand. Meat: \$45 billion; private services, \$130 billion.
 - Widespread manufacturing contraction. Nine major sectors shrink by \$60 billion; transport equipment, electronics, machinery, and equipment account for > 75% of this.
 - **Services excluded**
 - Sacrifice huge services output gains, but manufacturing contraction is muted.
 - **Larger services opening**
 - Greater expansions and smaller contractions, except other transport, electronics, machinery, and equipment.



POTENTIAL IMPACTS OF JAPAN-US FTA

Economic (6 of 8)

- **Japan job changes (Table 8)**
 - **Baseline**
 - Large job losses throughout agriculture: about 170,000 full-time equivalents in rice; about 60,000 in the rest of agrifood.
 - Job gains in manufacturing.
 - About 60,000 losses in construction; another 30,000 in other services.
 - **Rice excluded**
 - Prevent huge losses in rice; other sectors about the same.
 - **Services excluded**
 - Losses in ag about the same.
 - Larger gains in manufacturing.
 - Construction losses drop to 40,000; distribution switches from gains to losses.
 - **Larger services opening**
 - More job losses and gains throughout economy: greater adjustment.



POTENTIAL IMPACTS OF JAPAN-US FTA

Economic (7 of 8)

- **US job changes (Table 8)**
 - **Baseline**
 - Large gains in agriculture, especially meat.
 - Large losses in manufacturing: about 300,000 overall.
 - Large gains overall in services.
 - **Services excluded**
 - Overall, less adjustment: fewer losses in manufacturing and fewer gains in services.
 - **Larger services opening**
 - More losses in manufacturing and more gains in services.



POTENTIAL IMPACTS OF JAPAN-US FTA

Economic (8 of 8)

- **Gravity model analysis of trade flows**
 - Increase in Japan-US trade between 40% and 230%.
 - Central estimate: about 100% increase.



POTENTIAL IMPACTS OF JAPAN-US FTA

Political (1 of 2)

- **Japan**
 - Spur and strengthen reforms within Japan.
 - Sustain Japanese domestic support for US involvement in the region.
 - Cause protectionist backlash.
- **US**
 - Negotiations and Congressional debate could inflame Japan bashing.
- **Japan-US Relations**
 - Improve bilateral communication.
 - Strengthen security ties.
 - Should consider what failed negotiation might mean. This could harm Japan-US relations.



POTENTIAL IMPACTS OF JAPAN-US FTA

Political (2 of 2)

- **Rest of World**
 - **WTO: Depends on state of WTO at the time.**
 - Strong Doha deal in place: WTO can weather this FTA.
 - Weak deal in place: This FTA would further weaken WTO.
 - Doha deal still in progress: This FTA would help to spark Doha deal.
 - Doha failure: This FTA would reduce chance of WTO revival.
 - **APEC area**
 - This FTA would probably increase chance of Free Trade Area of the Pacific (FTAAP).
 - Chance of high quality FTAAP, though, is quite small in near term because US will not approve an FTA involving China anytime soon.
 - **Further reduce chance of East Asia bloc (as would Korea-US FTA).**
 - **China**
 - Stronger partnership between Japan and US may motivate China to maintain constructive, strong relations with each.
 - Japan-US FTA could pressure China to join eventually.
 - **Others: could foster reforms in any other nation that would want to join.**

PROSPECTS FOR REACHING A DEAL

Other Key FTAs (1 of 2)

- **KORUS FTA**

- Rice excluded, but nothing else was.
- Most ag trade would open immediately; various phase-ins for other products.
- Virtual free trade in manufacturing.
- Major services opening in Korea. For US, winners include financial services, insurance, telecom, express delivery, professional services.
- Set up trade dispute settlement body for autos.
- Incorporated non-tariff barriers procedures.
- 10-year phase-out of truck tariff.

- **Japan-Australia**

- What will happen with beef? What about rest of agriculture? What kinds of deals in services?



PROSPECTS FOR REACHING A DEAL

Other Key FTAs (2 of 2)

- **EU is key player.**
 - EU-South Korea FTA would probably cause Japan to pursue EU-Japan before Japan-US. But EU claims Japan is too big, while Korea is not.
 - Advantages of EU deal: EU has higher barriers; EU less demanding in agriculture.



PROSPECTS FOR REACHING A DEAL

Key Issue Area: Agriculture (1 of 2)

- **Agriculture stakes in this potential FTA especially high.**
 - Japan is US's largest non-NAFTA agriculture export market; US is Japan's largest agriculture supplier.
- **Japan has far more barriers than US.**
 - Not much scope for reciprocal opening.
 - Wide-scale opening in Japan will likely require unilateral reform within Japan or US "concessions" in other areas.
 - It appears, though, that major agriculture reform in Japan is inevitable.
 - At least, they need to convert from price supports to direct subsidies, which are much more efficient.
- **US will likely demand minimal beef restrictions (no worse than World Organization for Animal Health (OIE) standards).**

PROSPECTS FOR REACHING A DEAL

Key Issue Area: Agriculture (2 of 2)

- Japan would seek rice carve out. US likely would agree, given what happened with Korea.
- Japan seems to have finally accepted apple opening, but fruits/vegetables in general will need fundamental change.
- US has number of other concerns: poultry, pork, fish, cheese, wheat, nutritional supplements, food labeling.
- Japan's concerns: US farm subsidies, emergency restrictions or bans on food imports, fresh fruits.



PROSPECTS FOR REACHING A DEAL

Key Issue Area: Manufacturing (1 of 2)

- **Overarching theme: Hidden barriers vs. Safeguards.**
 - US will not renounce ADDs and other safeguards, especially in relation to country that has frustrated US for so long.
 - At minimum, Japan probably wants bilateral dispute settlement mechanism, a la NAFTA. KORUS FTA has one.
 - US may agree to this if it gets progress on hidden barriers.
- **Autos and parts will loom large in any FTA talks.**
 - Huge trade imbalance: \$58 billion to \$2 billion.
 - Japan has 30% of US market; US has 2% of Japanese market.
 - US automakers worked up over perceived Japanese currency manipulation.



PROSPECTS FOR REACHING A DEAL

Key Issue Area: Manufacturing (2 of 2)

- Other US concerns: medical devices, pharmaceuticals, wood products, marine craft, footwear.
- Other Japanese concerns: trucks, auto regulations, flat screens, bearings, steel, drugs.
 - Truck tariff is one of few US bargaining chips, though auto industry woes complicate this.
 - Auto regulations that hinder Japan's exports: CAFEs, safety regulations, having to declare which engines are not US.



PROSPECTS FOR REACHING A DEAL

Key Issue Area: Services

- More barriers in Japan.
- Key sectors from US perspective: insurance, financial services, telecom, construction, distribution.
 - Potentially huge gains from opening.
 - Caveat: US companies already in Japanese market don't want change.
- Progress on regulation transparency would facilitate services opening in Japan.
- Key sectors from Japanese perspective: shipping, telecom, financial services.

PROSPECTS FOR REACHING A DEAL

Key Issue Area: FDI

- As with services, more barriers in Japan.
- As with services, progress on internal barriers would facilitate FDI opening.
- Koizumi expressed desire to open FDI. What is Fukuda's view?
 - Two countries have been conducting regular talks.
 - Appears to be progress: Inward stock has doubled in recent years.
- Japan worried about CFIUS and impact of Dubai ports uproar. Japan does not want arbitrary government interference with legitimate FDI.

PROSPECTS FOR REACHING A DEAL

Key Issue Area: Other

- **Government Procurement**
 - Japan has concerns about Buy America policies at Federal and local levels.
 - US especially worried about procurement in construction; US perceives lots of bid-rigging.
- **Customs Procedures**
 - Japan worried about excessive inspections in efforts to protect against terrorism.
- **US visa requirements**



POSSIBLE PATHWAYS TO A DEAL (1 of 2)

Agriculture/Processed Food	Rice	Farm Aid
	Wheat	Emergency Export Restrictions/Bans
	Potatoes	
	Citrus	
	Lettuce	
	Cheese	
	Fish	
	Beef	
	Pork	
	Poultry	
	Food additive restrictions	
	Nutritional supplements	
Manufacturing	Autos and Auto Parts	Trucks
	Medical Devices	Autos: Regulations
	Pharmaceuticals	Flat screens
	Wood Products	Glassware
	Marine Craft	Porcelain/Ceramics
	Footwear	Clocks/Watches
		Steel
Services	Insurance	Shipping (Jones Act)
	Financial Services	Financial Services
	Telecommunications	Telecommunications
	IT	
	Energy	
	Construction	
	Distribution	
	Professional Services	
	Aviation	
FDI	Mergers/Acquisitions	CFIUS
Cross-Cutting Areas	Competition Policy	Dispute Settlement (Anti-dumping, Safeguards)
	IPR	IPR
	Regulatory Transparency	Customs Inspections
		Visa requirements
Politics		UN Security Council?

POSSIBLE PATHWAYS TO A DEAL (2 of 2)

- **Adjustment assistance would facilitate needed reforms, especially in agriculture.**
 - **Koreans have proposed buying out farmers for \$135 billion over 10 years.**
 - **What about a similar deal for Japan?**
 - **David Asher: The Samurai were paid to turn in their swords. Might we pay farmers to turn in their plows?**
 - **US auto workers may need similar help.**
 - **Lump sum payments to all current workers would be most efficient. Wage subsidies would probably be second best.**



SUMMARY

- This bilateral FTA would be largest and most important so far.
- Potentially very large economic and political effects from Japan-US FTA.
- Perhaps historic opportunity for starting work on Japan-US FTA.
- Many hurdles persist, though.
 - Will not be simple matter to overcome extensive barriers in Japan and suspicions in US.
 - Timing may not be right for a while
 - Japan's divided parliament, US presidential elections
 - Doha, EU-Japan FTA may come first.