

Historical Analysis of Japan, East Asian Trade Regionalism & the US

Potential Implications for Japan-US TPP Negotiations

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Introduction

In July 2013, about two years after then Japanese Prime Minister Yoshihiko Noda expressed an interest, Japan officially became a Trans-Pacific Partnership (TPP) negotiating party. The roots of the TPP lie in negotiations started in 2002 among a set of relatively small global economic players including Chile, New Zealand, and Singapore. Three years later, the three countries added Brunei and the newborn P4 successfully concluded the Trans-Pacific Strategic Economic Partnership Agreement (SEPA). In 2008, the United States announced its intention to join the Trans-Pacific SEPA, which by that time had become known as the TPP. Within the next two years, Australia, Peru, and Vietnam announced they would join. By the end of 2012, Canada and Mexico had become part of TPP talks. Other countries that are considering joining the TPP include Cambodia, Indonesia, Laos, South Korea, and Taiwan. At present, the 12 TPP negotiating parties (Table 1) collectively comprise 40% of global economic output and conduct 30% of global trade.

By way of background, the TPP is a WTO-plus Free Trade Agreement (FTA) that will cover a large range of traditional and nontraditional “trade” issues including tariffs, non-tariff barriers, intellectual property rights (IPR), government procurement, competition policy, state-owned enterprises (SOEs), small-to-medium sized enterprises, and labor and environmental standards. Some consider it a “gold standard” or “21st century” FTA because of its prospective number of participants, its scope, the breadth of non-traditional issues it tackles, its incorporation of labor and

environmental standards, and its ambitiousness relative to other conceivable alternatives such as the World Trade Organization (WTO).

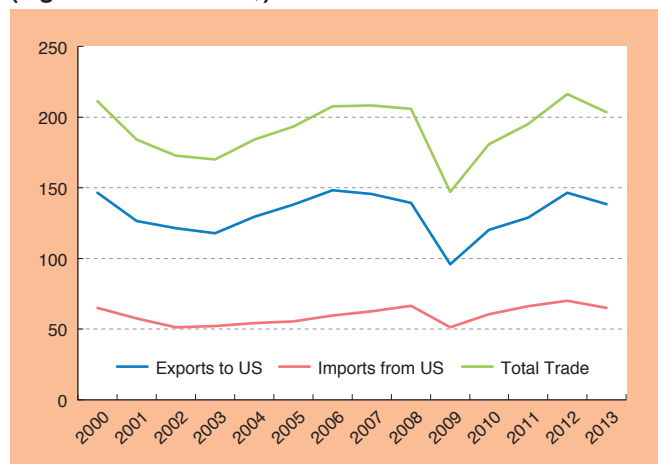
According to various sources, the TPP seems to be heading into the “home stretch”, with some reports indicating the negotiating parties are pushing for a conclusion of the agreement by the end of this year. As the two biggest economies among the TPP negotiating parties, Japan-US disagreements about agriculture, automobiles, and other matters have assumed prominence for those attuned to TPP developments. The TPP’s apparent forward momentum coupled with the centrality of the Japan-US relationship in TPP dynamics make it an opportune time to look at past Japan-US interactions in regards to East Asian FTAs. This is because Japan-US interactions have colored East Asian economic regionalism and *vice versa*.

Snapshot of Japan-US Economic Relations

Japan and the US have been close economic partners for more than 50 years. This is reflected in each country’s importance as foreign direct and/or portfolio investor in the other and aggregate bilateral trade figures (Chart 1). According to the sources used to prepare Chart 1, bilateral merchandise trade hit \$211.4 billion in 2000, \$193.5 billion in 2005, and \$180.8 billion by 2010. As of 2013, US-Japan bilateral merchandise trade ran at \$203.6 billion, with bilateral services trade reaching \$76.7 billion.

CHART 1

Japan-US bilateral trade, 2000-2013 (Figures in billion US\$)



Source: CRS Report for Congress RL32649 (Feb. 18, 2014)

TABLE 1

TPP negotiating parties

Country	Year Joined	2012 GDP (billion US\$)
Australia	2008	1,542
Brunei	2005	17
Canada	2012	1,819
Chile	2005	268
Japan	2013	5,964
Malaysia	2010	304
Mexico	2012	1,177
New Zealand	2005	170
Peru	2008	199
Singapore	2005	277
US	2008	15,685
Vietnam	2008	138

Sources: CRS Report for Congress R42694 (Aug. 21, 2013) and R42344 (June 10, 2013)

Japanese foreign direct investment (FDI) in the US is quite significant, especially in areas like automobiles, while Japanese investment in US stocks, corporate bonds, and government debt totals an astounding \$1.8 trillion. The total amount of Japanese FDI in the US was estimated to be \$308.3 billion as of the end of 2012. While US investment in Japan does not reach the same scale as Japan's in the US, there are still notable investments in Japan's financial, pharmaceutical, information technology, manufacturing, and retail sectors. Moreover, as described below, the US and Japan often have closely interacted in regards to East Asian regional economic integration initiatives including East Asian FTAs.

The bilateral economic relationship has not been free of conflict despite the two countries' high level of economic interdependence, lengthy and rich cultural, educational, and scientific interactions, and close military-security partnership. There have been frictions in regards to the openness of Japanese sectors such as automobiles, semiconductors, and telecommunications and Japanese "dumping" in the US. In addition, the two countries have clashed about Japan's trade surpluses with the US, which were very high from the second half of the 1980s through the first half of the 1990s. Moreover, they have quarreled about Japan's currency policy. The realm of East Asian economic regionalism has witnessed a variety of frictions, too. This was seen in Washington's hostile reaction to Tokyo's proposal for an Asian Monetary Fund (AMF) in 1997.

Japan-US Relations in East Asian FTA Pre-Frenzy Period

Japan took a prominent role in East Asian economic regionalism far earlier than the US. For instance, in 1965, Japanese economists advanced a proposal for a Pacific FTA that gained official sanction from Japanese Prime Minister Takeo Miki in 1967. Approximately 15 years later, Japan worked with Australia to support the birth of the Pacific Economic Cooperation Conference (PECC), a body designed to facilitate information exchange and the discussion and analysis of regional economic matters. It also worked closely with Australia to facilitate the creation of the Asia-Pacific Economic Cooperation (APEC) forum in 1989. Japan's activism reflected its leading position in regional aid, trade, investment, lending, and business as well as East Asia's importance to it (*Chart 2*). It further reflected greater Japanese assertiveness in politics and anxieties about the potential adverse impact of FTAs outside East Asia.

In contrast to Japan, the US remained largely passive or rejectionist due to its penchant for global economic institutions, its desire to preserve the advantages flowing from dealing bilaterally with East Asian countries, and a focus on security versus economic issues. Nevertheless, Japan's economic ascendance, Soviet overtures to the region, the region's economic dynamism, potential diplomatic gains, and a desire to exploit East Asian FTAs to achieve trade goals elsewhere pulled Washington into East Asian integration processes. Yet Tokyo and Washington did not work together with respect to APEC and, in fact, various reports suggest Japan actually was inclined towards more purely East Asian FTAs that would enable it to counter European and North American FTAs. Nevertheless, Tokyo remained sensitive to Washington's preferences vis-à-vis APEC because of the US's continuing political and economic

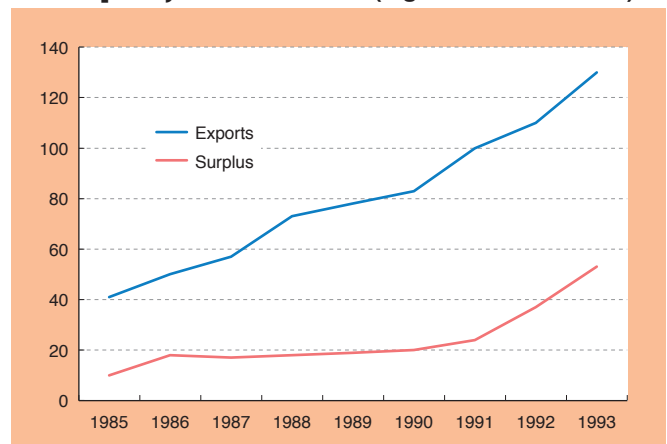
salience. American aggressiveness in pushing Japan to undertake macroeconomic changes, open markets, and reduce its trade surplus no doubt made Japan attentive, too.

East Asian FTAs and economic regionalism assumed a bigger profile in Japan-US relations starting in the early 1990s due to various factors. One was the emergence of proposals such as Malaysian Prime Minister Mohamad Mahathir's call for an East Asian Economic Grouping, later termed the East Asia Economic Caucus (EAEC), that *inter alia* excluded the US. The US fretted about the impact of such proposals on its regional presence. Viewing Japan as a tool that it could use to blunt such initiatives, high-level American leaders such as Vice President Dan Quayle and Secretary of the Treasury James Baker explicitly and persistently pushed Tokyo away from the EAEC. American pressure caused some consternation in Japan, not necessarily because Japan was enamored of the EAEC, but because some Japanese officials and businesspeople saw the EAEC as potentially having value to counter FTAs in Europe and because the US was engaged in its own exclusionary FTA in the form of its North American FTA (NAFTA).

Two other significant influences were the transformed geopolitical security environment and continuing Japan-US economic frictions. With respect to the former, in the absence of the Soviet bloc and Soviet Union, Japan had increased incentives and an interest in acting independently and in exerting leadership on the economic front, and fewer reasons to closely toe the America line economically in order to sustain security bonds. Regarding the latter, persistent trade deficits, intensifying competition among Japanese and American firms, and tensions in numerous economic realms like those listed earlier as well as medical equipment, paper, and tobacco, and the collapse of the Soviet Union (which made the US more willing to confront Japan about economic problems) and American domestic politics led to an intensification in American pressure relating to Japan's currency policies, market access, and export policies. Consequently, Japan had an incentive to exploit East Asian FTAs and economic regionalism to protect itself and to counter American protectionism.

CHART 2

The economic centrality of East Asia to Japan, 1985-1993 (Figures in billion US\$)



Source: Mike M. Mochizuki, "Japan as an Asia-Pacific Power" in Robert S. Ross, ed., *East Asia in Transition: Toward a New Regional Order* (1995)

Japan-US Relations in Period of Explosive East Asian FTA Growth

The Asian Financial Crisis led to an avalanche of initiatives in regards to East Asian economic regionalism. Not surprisingly, the initial wave entailed many ideas for financial and monetary cooperation, many by Japan. Trade did not stay in the background for long, though. In 1999, Japanese Prime Minister Keizo Obuchi argued Japan and South Korea should work together to build a free trade zone in Northeast Asia equivalent to the European Union (EU) and Japan's Ministry of International Trade and Industry proposed that Japan champion a Northeast Asia FTA involving Japan, South Korea, Hong Kong, and Taiwan. Following this, in the early 2000s, Japan moved to negotiate FTAs, which it termed "Economic Partnership Agreements" (EPAs), with Singapore, the Association of Southeast Asia Nations (ASEAN), Indonesia, Thailand, and Malaysia. Japan's motivations for these EPAs, which dealt with much more than trade, had multiple rationales. Broadly speaking, Japan sought to facilitate economic growth, to counter NAFTA, the EU, and the US, to acquire alternatives to overly demanding or inadequate global economic institutions, to solidify the regional economy, and to address China's rise and activism in regards to East Asian FTAs.

Generally speaking, the US, which strongly opposed Japan's AMF initiative, did not react in specific ways to Japan's moves to expand its FTA portfolio, though it was hardly enthused about East Asian regionalism as a whole for political and economic reasons similar to those enumerated earlier, coupled with its desire to privilege APEC. However, Japanese and Chinese FTA initiatives in the region, a view that East Asia offered attractive economic opportunities, and a continuing belief that East Asian FTAs involving the US might give it leverage in FTA negotiations globally and elsewhere spurred the US to become more engaged in East Asian FTA dynamics and to pursue FTAs with ASEAN and various other countries in East Asia. The US further saw East Asian FTAs as a mechanism for rewarding friends (e.g. Australia) and punishing "opponents". Finally, FTAs were a way for the US to maintain its presence in the region at a time when it still was heavily focused on its two wars in Afghanistan and Iraq and the all-consuming global war on terrorism.

In 2004, Japan and the US, which seemed to be running on two separate tracks as far as East Asian FTAs were concerned, found themselves working "together". The wellspring of this was an agreement among East Asian leaders in 2004 that established an East Asia Community (EAC) that would address economic, political, and other issues. Concurrently, East Asian leaders called for the realization of an East Asian FTA on a more aggressive schedule than that touted by the relatively moribund APEC. In response, the US championed a Free Trade Area of the Asia Pacific (FTAAP). In American eyes, the FTAAP offered an alternative to stagnant WTO Doha Round negotiations, a way to support regional and global FTAs and a route to reinvigorating APEC. Aside from these benefits, the FTAAP offered a way to tackle the EAC challenge and to reengage with East Asia as the wars in Afghanistan and the war on terrorism wound down. It seemed that the US's basic expectation was Japan would both support the notion of the FTAAP and seriously consider it.

The balance of the decade saw continued impressive growth in the

number of East Asian FTAs, with ASEAN members, China, and South Korea all signing FTAs inside and outside the region. Japan did not remain outside these processes (*Table 2*). In fact, aside from the EPAs listed earlier, it negotiated EPAs with Brunei, India, the Philippines, and Vietnam and has been pursuing deals with Australia, South Korea, and Mongolia. Japanese activism between 2000 and 2009 made it the second-largest FTA negotiator in East Asia and put it on par with Singapore in terms of FTAs negotiated within the region. Japan also participates in ASEAN's Regional Comprehensive Economic Partnership (RCEP), which would consolidate all ASEAN FTAs with partner countries including Japan, Australia, China, India, South Korea, and New Zealand. The RCEP, it should be noted, was an outgrowth of Japan's 2006 proposal for a Comprehensive Economic Partnership for East Asia (CEPEA). Finally, Japan has been negotiating with China and South Korea about a trilateral FTA.

In their outlines, the factors influencing Japan's embrace of multiple bilateral and minilateral East Asian FTAs in the first decade of 2000s were similar to variables present in earlier decades: a desire for greater Japanese and regional growth, a hunt for alternatives to other global and other regional FTAs, which were stagnating (e.g. WTO) or threatening (e.g. the ASEAN-China FTA), a wish for bargaining leverage, and an interest in becoming a more normal country that exerted a regional leadership role and was more an equal than subordinate of the US. It should be pointed out that pursuing multiple FTAs concurrently also was a means to increase the possibility of success, to promote reform domestically, and to secure natural resources. Two political variables assumed particular prominence in the second half of the first decade of the 2000s. One was, following an interlude of calm towards China, the much-intensified China challenge, which many Japanese observers preferred to label a threat. The other was the decline of the US's relative position in the region.

There is not much of note in regards to US reactions to Japan's pursuit of FTAs in the 2000s, though the US did not welcome Japan's facilitation of or support for FTAs that excluded it. The reason is that, although there were numerous frictions relating to beef, insurance, express delivery, and market access for US autos, Washington did not see Japan as its main economic issue. On the economic front, Japan had become much less of a concern, despite persisting trade surpluses, as a result of Japan's economic woes, its greater focus on China as an economic problem and economic competitor, and each country's attention to other economic relationships and FTAs. Furthermore, the creation of the WTO pulled some economic frictions out of the bilateral relationship and into the realm of the multilateral WTO dispute resolution system. Finally, security and

TABLE 2

Japan's extant FTAs with East Asian countries

Date	Country
2002	Singapore
2006	Malaysia
2007	Thailand
2008	Indonesia
2008	Brunei
2008	ASEAN
2008	Philippines
2009	Vietnam

Source: Japanese Ministry of Foreign Affairs

political issues like Afghanistan, Iraq, and the war on terrorism, the North Korean problem, and the rising China challenge distracted US attention from Japan or gave Washington an incentive to focus on its security relationship with Tokyo.

Japan, the TPP & the US

As many commentators have observed, Japan's entry into TPP negotiations was a major step forward for this FTA initiative and the US. First, Japan is the third-largest economy in the world, the third-largest economy in the Asia-Pacific region, and the second-largest economy in East Asia, and remains a huge economic partner of the US as a buyer of American goods, services, and US Treasury debt and as an investor. Japan's involvement makes the TPP much more economically valuable to the US and other TPP negotiating parties and thus increases the incentives for concluding a deal. Second, Japan's involvement gives the TPP a more Asian character. Third, Japan is an integral player in East Asian integration processes.

Of course, bringing more parties into TPP negotiations always has been the easy part. Finalizing the TPP is another matter. As Mireya Solis, a Brookings Center for Northeast Asian Policy Studies senior fellow and Japan expert, put it, "To be frank, we are talking about a level of liberalization when it comes to Japan that is unprecedented...therefore it's going to take a while to hammer out all the issues." ("Japan Boosts the Trans-Pacific Partnership", *Council of Foreign Relations*, Aug. 9, 2013). Indeed, for the TPP as a whole, the list of issues to hammer out is quite daunting. Negotiators must come to agreements on *inter alia* agriculture and textiles products, IPR, government procurement, investor-state arbitration, and SOEs. As far as Japan and the US are concerned, Washington has been pushing Tokyo forcefully about Japanese policies towards US automobiles and auto parts, US beef, dairy, and rice products, and insurance. For its part, Tokyo feels that Washington is taking an unreasonably hard line over agricultural and autos issues in TPP negotiations and Japanese negotiators are pressing the US to lift its tariffs on Japanese autos and reconsider its anti-dumping methodology.

In contrast to some other East Asian FTA initiatives, Japan has not been out in front with respect to the TPP. Thus, it has found the US recruiting or leading it rather than responding to it, which had so often previously been the case. The US has good reason to be supportive of Japan's involvement in the TPP. Beyond the attractions noted above, Japan might be an ally of sorts in regards to Washington's stance on specific trade issues such as IPR, investor protection, and government procurement. As well, Japan's involvement exerts pressure on others such as China and South Korea to join negotiations and thus brings the FTA closer in form to the US-favored FTAAP. On a related note, the inclusion of Japan makes the TPP a more potent negotiating cudgel elsewhere. Contrary to what some charge, though, there is no evidence that the US is trying to bring Japan into the TPP as part of an anti-China containment strategy.

Japan's willingness to participate in the TPP, though, does relate, in part, to its concerns about China, anxieties about other FTAs (particularly the recently concluded South Korea-US/KORUS FTA), and some domestic changes that limit the ability of certain special



Japanese Minister of Economic and Fiscal Policy Akira Amari (L) and US Trade Representative Michael Froman attend a press conference at the TPP ministerial meeting in Singapore on Feb. 25, 2014.

interest groups to constrain Japanese decision-makers. Of course, economic drivers have been a critical variable shaping Japan's interest in the TPP. Assorted Japanese leaders have viewed the TPP as a way to stimulate demand, foster job creation, and promote economic growth, a central priority for current Prime Minister Shinzo Abe, and have a say in the trade and investment rules that will be established for the Asia-Pacific region. Some Japanese policymakers believe the TPP may be a mechanism to solidify the Japan-US political and security relationship in the wake of frictions flowing from the US Okinawa Futenma base issue and an earlier East Asian turn by some Japanese policymakers.

Japan, the US & the TPP's Prospects

The preceding historical analysis shows that Japan and the US often have been at odds in regards to East Asian FTAs. Most commonly, they have had problems with each other's FTA initiatives (e.g. Japan's CEPEA or the US's KORUS FTA) when these schemes would exclude them or undermine their position in the region. In response, they have opposed the other side's proposals or advanced competing ones. They have found common cause in working together when they felt this would serve their broader security interests, bilateral strategies proved unpromising, or other FTA options lacked viability. While we should not be overly optimistic given the gaps between Japanese and American positions, the preceding conclusions are encouraging as far as the prospects for the TPP are concerned. First, Japan and the US have no other options that could yield the same return as the TPP. Second, each country faces economic and security challenges elsewhere that suggest cooperation in regards to the TPP. On a related note, the TPP not only includes both countries, but also affords *both* Tokyo and Washington an opportunity to play a leadership role in East Asia. Finally, Japan and the US have already embraced the WTO-plus FTA agenda, which is a conspicuous facet of the TPP. **JS**

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