Recommendations for the Development of a Rules-Based International Economic System

By the Research Committee on the Development of a Rules-Based International Economic System

The Concerns of These Recommendations: The Rules-Based International Economic System that Japan Should Aim at

As the international trade and investment system weakens, it faces three challenges: 1) the deterioration of the multilateral free trade system, 2) the decoupling between the United States and China and the convergence of security and trade, and 3) the supply-chain crisis.

The Japanese government has worked to maintain a multilateral trading system that is based on the rule of law and includes both the US and China and to develop a multilayered economic order with the aim of constructing a trading system based on our national interests. Since the turn of the century, as the World Trade Organization (WTO), the mainstay of the postwar multilateral trading system, struggled to make progress in the Doha Round, the Japanese government has achieved progress through regional trade agreements (RTAs), including bilateral agreements, with a focus on free trade agreements (FTAs). One feature of an RTA is that it facilitates the development of a framework that provides an upgrade over WTO rules. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), economic partnership agreements (EPAs), the Regional Comprehensive Economic Partnership (RCEP), and other recent arrangements to which Japan is a signatory have contributed to the development of the rules for the 21st century in a wide range of areas including intellectual property, investment, labor, environment, state-owned enterprises, and e-commerce.

However, rules-based multilateralism has been under siege lately from the rising tide of populism that features anti-globalism in the US and elsewhere in the industrialized democracies and the proliferation of unilateralism, in which the US and China as well as others pursue their national interests by unilaterally imposing trade measures. A framework is emerging in the Asia-Pacific without the US as it abandoned the Trans-Pacific Partnership Agreement (TPP) and the RCEP that entered into force in January 2022. Meanwhile, there is an urgent need to deal with states that adopt market-distorting policies and measures. And recent years have seen the emergence of geopolitical and geoeconomic risks in the Asia-Pacific and Indo-Pacific, with the result that economic security is gaining importance in such areas as supply chains, human rights, data governance, and managing high technology.

It was against the background of these changes in the international economic order that the administration of US President Joe Biden in October 2021 proposed the Indo-Pacific Economic Framework (IPEF) and has been demonstrating a new eagerness to construct an economic order in the Indo-Pacific region. Given its lack of market access commitments, the IPEF is not an ideal approach for promoting the creation of economic rules-of-the-road for the Indo-Pacific region. It remains essential for the US to return to its original TPP initiative, which has now become the CPTPP, and, ultimately for the regional perspective, to explore ways to create the "Free Trade Area of the Asia-Pacific" (FTAAP) which was proposed by the leaders of the Asia-Pacific Economic Cooperation (APEC) forum. On the multilateral front, it is important to look for ways to reawaken the WTO from its stupor and prompt the development of rules on digital trade, labor, human rights, and other concerns. To achieve this, Japan must exercise leadership in building and maintaining economic order as a "global standard-bearer of free trade" with the WTO at its core. However, as part of the international response to the Russian invasion of Ukraine that began on Feb. 24, 2022, 14 countries and regions including Japan, the US, and the EU, who are members of the WTO, decided to revoke Russia's most favored nation status, and developed countries opposed Russia's participation in the G20 summit. The enormity of the impact of Russia's outrageous actions on the international order is obvious. It is necessary to carefully consider how Russia should be treated in international economic forums, taking into consideration the mid- and long-term impact on the international order.

The Japan Economic Foundation (JEF) brought together eminent experts from various fields to set up the Research Committee on the Development of a Rules-Based International Economic System. The Committee reevaluated the rules-based international economic system from the legal, economic, and political perspectives, considered ways to improve it, and makes the following "Recommendations for the Development of a Rules-Based International Economic System."

Recommendations

① Revitalizing the WTO

A) The Question of the Appellate Body

(1) To add to the impasse in the rulemaking negotiations, the Appellate Body, the core of the dispute settlement system, which some call the "crown jewels" of the WTO, has been thrown into disarray since December 2019, when it ceased to have enough members

for a quorum to hear appeals. Securing the rule of law by normalizing the Appellate Body is urgently required, but early resolution is difficult. In the meantime, in order to keep harm from coming to the legitimacy of and trust in the WTO from the accumulation of appeals into the void, Japan should give serious consideration to joining the Multiparty Interim Appeal Arbitration Arrangement (MPIA) led by the EU for the provisional revival of the rule of law. Of particular note is the fact that China is a member of the MPIA, giving it a role in trade policy *vis-à-vis* China. The EU has also adopted enforcement regulations to deal with appeals into the void by MPIA non-members and Brazil has followed suit. The time has come for Japan to consider taking this approach.
Note: *"Appeal into the void" means to put a case on ice by filing an appeal with the currently memberless Appellate Body while refusing to use the MPIA.*

(2) In joining the MPIA, the Japanese government should make it clear that it is doing so as an emergency measure to maintain temporary order and that it does not support the EU proposal for WTO Appellate Body reform. It should exchange views broadly with all the major WTO parties, not just the members of the MPIA.

(3) In undertaking WTO Appellate Body reform, Japan should also give heed to US criticism of the Appellate Body and consider specific measures to place institutional constraints on the judicial activism and procedural discretion overreach of the Appellate Body. This does not mean simply following the US lead; instead, Japan should draw a red line in view of its national interests. In particular, it is desirable in principle to maintain the two-tier system and the negative consensus rule, given the benefits that the judicial dispute settlement that the Appellate Body has historically provided Japan.

(4) The WTO should reconfirm its origins as an international system that is predicated on a system of rules agreed between market economies. When interpreting existing agreements as part of the dispute settlement process, to avoid accusations of overreach from arising, it should not go beyond the elaboration of the agreement of the WTO members according to the standard method for interpreting agreements under international law and should exercise caution in referencing international law other than WTO agreements and make it clear that judicial discretion is not being used aggressively when making interpretations.

B) Reviving the Rulemaking Role of the WTO

(1) While keeping the WTO from leaning too heavily into its judicial function as explained in A), it is essential to revitalize its rulemaking function in order to restore that balance between the two functions. The Japanese government should accordingly take the lead in revitalizing the negotiations for establishing new rules. Its ongoing efforts in this regard can be seen in such areas as digital trade, fisheries subsidies, and investment facilitation for development. To maintain this momentum, it is important to produce tangible results and to institutionalize the plurilateral – as opposed to multilateral – format for negotiating rules.

(2) Regarding (1), it is desirable for the Japanese government to play an active role in the Joint Statement Initiative on Services Domestic Regulation of the WTO, the Ottawa Group, and other plurilateral activities by like-minded countries. It should also work to produce new agreements by incorporating the outcome of the January 2020 Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the US and the EU such as the reinforcement of the rules for industrial subsidies, not to mention the negotiations on e-commerce as part of the JSI (see ④A).

(3) The WTO should reconfirm its original commitment to the system of rules agreed to between market economies and the mutual opening of the domestic market on a most-favored-nation (MFN) basis. Two decades since its WTO accession, China's influence in the WTO and the international economy more broadly has grown enormously. The time has come to consider whether it has fully implemented the reforms that had been expected in the beginning and has complied with the WTO agreements appropriately. This is essential to the development of WTO rules going forward.

② Utilizing RTAs

A) Utilizing the CPTPP

(1) For the US administration of President Barack Obama, the TPP was the means to draw China into new trade rules by making it understand that it would be at a disadvantage to stay out of the framework. It is desirable to use China and Taiwan's bids to join the CPTPP as an opportunity to conduct firm, rules-based accession negotiations. In particular, China's CPTPP accession should be used as an opportunity to put pressure on China to open its economy, in coordination with efforts by the US from outside the CPTPP framework.

(2) As an obvious precondition to its accession to the CPTPP, China should be required to keep the promises it made when acceding to the WTO and to immediately eliminate all economic coercion in violation of WTO agreements.

(3) In the negotiations for China's accession to the CPTPP, it will be necessary to secure its compliance with the intellectual property, forced technology transfer, state-owned enterprise, labor, environment, e-commerce, and other rules of the CPTPP. Where existing rules are insufficient, the incumbent members of the CPTPP should consider demanding that China make commitments over and beyond the existing agreements. In doing so, adding substantive provisions predicated on China's singular socio-economic system (or politico-economic system) should be considered, and effective mechanisms to secure compliance with the agreement (e.g. special provisions for the burden of proof in

the dispute settlement system, periodic inspection system) could also be explored.

(4) China's WTO accession negotiations took 15 years. Similarly, the Japanese government should not compromise in the negotiations on China's accession to the CPTPP and should be comfortable with taking as much time as is required. It should also consider including in the accession protocol provisions to the effect that China could be expelled or that other member countries could withdraw concessions if it is determined that China is not in compliance with the provisions of the CPTTP or its accession protocol.

(5) To construct the implementation surveillance system of the CPTPP, it is important to strengthen the dispute settlement procedures and implementation surveillance system, establish a secretariat, achieve the early accession of the United Kingdom, and strengthen collaboration with the UK, Canada, Australia, and New Zealand.

(6) Connection and/or collaboration between the EU and CPTPP should be explored to deal with market-distorting measures by Chinese governments in the future. Adding the US to this should enable the CPTPP to function as a stepping stone for the creation of the WTO or other multilateral rules.

(7) As the Yokohama Vision and The Pathway to the FTAAP adopted at the 2010 APEC summit in Yokohama make clear, there is an agreement on a long-term vision to create the FTAAP through the expansion of the CPTPP and the RCEP. Efforts towards the achievement of this goal should be continued.

B) Building an Indo-Pacific Order around the US (the US "Return" to the CPTPP and the IPEF)

(1) Japan should be an active participant in the IPEF, which the US is promoting. However, the IPEF is not the best approach for the promotion of economic rule-making in the Indo-Pacific region, particularly since it does not include commitments on market access, a matter on which bipartisan concern has been expressed in the US Congress. Thus, Japan should be persistent in urging the US to return to what is now the CPTPP.

(2) A hard line on China policy has bipartisan support in the US Congress. The Japanese government should make a strong appeal on the strategic importance of the CPTPP to the China hardliners in the administration and Congress who are responsible for trade policy including its strategic aspects, as well as the role the CPTPP has as an effective tool for correcting market-distorting policy practices.

(3) The opposition to free trade in the US comes from certain industries such as steel and automobiles, not the general public. Thus, the Japanese government should strongly appeal to a wide range of stakeholders including businesses, academia, governors and other local officials, think-tanks, and the mass media for the US to return to the CPTPP. The CPTPP's role in improving environment protection, labor standards, and, more broadly, human rights through the framework of a trade agreement should be used to make a strong appeal to enhance the understating of the CPTPP among the constituencies that have an interest in these issues (such as young people).

(4) In the US, the Trade Adjustment Assistance (TAA) Program currently does not include compensation for the damage resulting from trade liberalization. It is important for the TAA to be redesigned and implemented to reduce the negative impacts from the CPTPP and other trade liberalization initiatives.

C) Analyzing the Economic Impact of RTAs and Their Expansion

(1) Ex-ante forecasts and the analysis of ex-post evaluation are both of importance regarding the economic effect of an RTA. Ex-ante simulation using economic models should be utilized in policy planning as if it were a social science laboratory. In developing a rules-based international economic system, the economic effect should be considered and a system that is effective from an economic-benefits perspective should be developed efficiently.

(2) A preliminary calculation of the economic effects of Asia-Pacific EPAs shows that 1) the CPTPP and the RCEP do not compete against each other but instead are mutually reinforcing, so it is desirable to implement both instead of choosing one over the other; and that 2) including non-tariff measures in addition to tariffs increases economic benefits. However, if the US joins the CPTPP or India joins the RCEP, the economic benefits of lower tariffs is reduced or even turns negative for some incumbent members. In expanding RTAs, the key is not to just add new members but also to deepen measures for liberalizing and facilitating trade and investment.

(3) Tariff reduction under an RTA is applied on a preferential basis to the RTA signatories, but many non-tariff measures cannot be applied exclusively to the products of the signatories generally speaking, in which case the potential ripple effect of the reduction through their universal application can be expected. It should be noted that even where global rules are not developed under the GATT/WTO system, the global application of an agreement between certain countries has the potential to generate the kind of economic benefits that would be generated by a WTO agreement.

③ Dealing with China's Market-Distorting Government Support and Regulations

(1) Government procurement is conducted by central and local governments. Foreign companies may be subjected to de facto

discrimination due to political reasons in areas that are nominally opened to the outside world under domestic law. China should be urged to join the WTO Agreement on Government Procurement, which forbids such exclusive procurement practices. The Japanese government should also review its own procurement system with a view to ensuring conditions for fair competition including reciprocity with China and other countries that are not parties to the Agreement on Government Procurement.

(2) The weaponization of interdependence is emerging as part of the economic security landscape. There has been an increase in recent years of China exercising economic coercion through trade restriction and other means, against Australia and Lithuania among others (② A) (2)). It is necessary to persevere in seeking redress through the dispute settlement procedures of the WTO, multilateral frameworks such as the Council for Trade in Goods, and the negotiation process for CPTPP accession.

(3) It is possible that market intervention through sovereign funds, given their high tolerance for risk, could fall under the definition of "unlimited guarantees", one of the items that should be added to the unconditionally prohibited subsidies measures under the WTO Agreement on Subsidies and Countervailing Measures (ASCM) according to the aforementioned 2020 Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the US and the EU. It is necessary to conduct a theoretical and empirical investigation of the mechanism by which sovereign funds would be market-distorting.

(4) As the example of the Chinese steel industry shows, subsidies to cover operating losses, debt forgiveness, or bad debt compensation can lead to excess production capacity. Adding them to the ASCM list of prohibited subsidies should be considered accordingly. As for excess capacity subsidies, it was agreed at the Trilateral Meeting of the Trade Ministers of Japan, the US and the EU to strengthen discipline, so discussions within this framework should go forward as well.

(5) It is possible to demonstrate through economic analysis that the harm caused by the industrial subsidies that are provided in China constitutes "serious prejudice" under the ASCM. Such economic analysis, particularly methods used in justifying competition policy, should be considered favorably.

(6) Japan should engage actively in negotiations over AI ethics rules, the concept of data as a human right, government access, and other areas where digital rules are yet to be established, especially where China is participating actively in the rule-making.

(7) Cases have been emerging where mergers and acquisitions by foreign companies fall through because of delays in the examination by the Chinese authorities (e.g. acquisition of Hitachi Kokusai Electric Inc. by Allied Materials). This has had the effect of preventing rivals to Chinese businesses from emerging. In the IT industry, where product cycles are short and competition is heavy, it may have had the effect of preventing businesses from establishing themselves in the market. There is a gentlemen's agreement to conduct examinations expeditiously to prevent these things from happening, but there have been repeated cases where the examination has taken much longer than foreseen in the gentlemen's agreement. Arbitrary application of the antimonopoly law has also been observed. There is a need for rules that deter the arbitrary application of competition law. International coordination of rules in competition law policy takes the form of creating soft rules such as recommendations and guidelines in the International Competition Network (ICN), the OECD, and elsewhere. Since China is not yet a member of the ICN, consultations between trade authorities and between competition policy authorities should be initiated on this point and China should be urged to participate in the international coordination of rules.

(8) The Japan-China-Korea Trilateral Investment Agreement and the RCEP are rules for China related to investment that are available to Japan but not to the US or Europe and should be used accordingly. The RCEP recognizes in principle the provision of preexisting national treatment and most favored nation treatment. As for the prohibition of trade-related performance requirements, it covers technology transfer demands and royalty restrictions over and above the WTO's Agreement on Trade-Related Investment Measures (TRIMS). It is important to secure compliance with the rules through the appropriate use of state-to-state dispute settlement (SSDS) procedures or the investor-to-state dispute settlement (ISDS) in the Japan-China-Korea Trilateral Investment Agreement.

④ Developing New Rules

A) Developing International Economic Rules in the Digital Space

(1) Japan should work with Australia and Singapore as co-convenors of the negotiations on e-commerce under the WTO to work to achieve substantial progress during 2022 with the objective of reaching agreement at the 13th Ministerial Conference (MC13). The Covid-19 pandemic in particular has given a new urgency to the need for global rules to regulate the surging digital trade. It is desirable to encourage as many countries as possible to join the prospective agreement in addition to developing highly normative rules under the principle of Data Free Flow with Trust (DFFT), which Japan proposed at the World Economic Forum Annual Meeting.in January 2019 and the G20 Osaka Summit in June of the same year.

(2) The multilayered emergence of regional arrangements is occurring for rules on digital trade alongside the multilateral negotiations. There, Japan is securing highly disciplined digital trade rules in the

e-commerce chapters of the CPTPP and the Japan-EU Economic Partnership Agreement (EPA), the US-Japan Digital Trade Agreement, and the like. It should look for ways to broaden the scope of the regional framework by expanding membership in existing agreements while maintaining high discipline and including similar rules in the negotiations on new EPAs and the revision of existing ones. Meanwhile, the Digital Economy Partnership Agreement (DEPA) is now attracting much attention in the Indo-Pacific region. Although it does not match the CPTPP in the quality of its rules – it does not have source code provisions and is non-binding, for example – the Japanese government should consider engaging in this arrangement in coordination with Australia and the like, now that China has applied for membership. It should also engage actively in developing rules for digital trade for the IPEF, which the US proposed in October 2021.

(3) Government access (GA) is an area where the behavior of governments and businesses as well as the views of civil society have an extraordinary impact on the volume and quality of the cross-border economic space being developed for the digital economy. It is extremely significant that the G7 has produced a roadmap for achieving DFFT and aims to developed guidelines for trustworthy GA and that like-minded states are making progress in the OECD with business support in discussions with input from civil society. As Japan holds the G7 presidency in 2023, it should be expected to use its position between the US and Europe to narrow the difference between the two sides and lead the way to a consensus.
Note: *Government access (GA) means enforceable access by public organizations such as governmental organizations to information in the possession of the private sector.*

(4) If the increase in cross-border data transfer generates greater concern over the effectiveness of law enforcement or creates concern over unfettered access to domestic data from abroad, it could lead to greater data localization instead. An international arrangement among many countries will be a stable foundation for international cooperation in investigations. In that sense, the Japanese government should aim at the early adoption of the draft additional protocol to the Convention on Cybercrime. At the same time, in the interests of promptness and feasibility, it is appropriate for like-minded states to go ahead and steadily establish a framework in the spirit of DFFT. It is useful from this perspective for the Japanese government to consider the relevant legal issues for concluding bilateral international agreements that fall under the scope of the US CLOUD Act.

B) Theft of Trade Secrets Through Cyber Espionage and What to Do About It

(1) Existing rules under international law do not provide effective discipline over theft of trade secrets through cyber espionage. Since this is not an easy issue to resolve, the near-term response by the Japanese government should be to enhance the ability to deal with cyber activities by incorporating and using capacity building and cooperation for the relevant authorities of signatory states and other low-key rules in FTAs and other arrangements as in Article 19 of the Japan-US Digital Trade Agreement, Article 19.15 of the US-Mexico-Canada Agreement (USMCA), and Article 8.83 of the Japan-UK Comprehensive Economic Partnership Agreement. However, it is necessary to remember that there are limits to the extent to which strict rules to regulate cyber espionage can be formed.

(2) Japan deals with theft of trade secrets through cyber espionage as civil and criminal cases under the Unfair Competition Prevention Act, but this law is weak as a means of deterrence. The Japanese government should look to domestic regulation in the US and Germany, which have provisions for heavy penalties, and revise domestic law, enhance deterrence against cyber espionage, and strengthen measures.

(3) Directly regulating state behavior is best done through rules as international law. For this perspective, over the mid-to-long term, the Japanese government should spare no efforts in the G7 and other forums where these countries are engaged to develop rules as international law that will enable us to overcome the challenges around theft of trade secrets through cyber espionage.

C) Business and Human Rights

(1) The Japanese government and Japanese businesses should promote human rights due diligence (DD) to prevent forced labor and other human rights violations in the supply chain. It is necessary to develop guidelines as a first step and then consider legislation as necessary. They should be made easy for businesses to undertake, using the human rights DD systems already in place overseas such as the UK's Modern Slavery Act.

(2) It is essential for the Japanese government to deal with human rights issues; they should not be left solely to DD by the businesses. The appropriate government response should be targeted sanctions against individuals and institutions engaged in human rights violations. Article 10, paragraph 1 of the Foreign Exchange and Foreign Trade Act stipulates that the Japanese government may restrict foreign currency remittances, capital transactions, overseas direct investment, provision of services, etc., saying "it is particularly necessary in order to maintain peace and security in Japan". One option is to amend this to add that sanctions may also be applied "if it is particularly necessary to improve the human rights situation overseas". Whether or not individuals and institutions are identified and subjected to sanctions, it is important for Japan as a sovereign state to have the means to impose sanctions against human rights violations.

(3) When considering the introduction of trade restrictions for human

rights purposes, full consideration should be given to the burden on businesses and compatibility with WTO rules.

(4) Japan must also correct its own behavior as appropriate regarding the human rights issues that have identified by the International Labour Organization (ILO), the UN Human Rights Committee.
Note: *For example, Japan decided to ratify ILO C105 (Abolition of Forced Labour Convention) and was in the process of taking the necessary domestic procedures when these recommendations were being finalized. Meanwhile, Japan maintains the death penalty, which has been criticized by the UN Human Rights Committee among others, while virtually all other developed countries have abolished it.*

D) Trade and Labor

(1) The US and the EU have tended to include more extensive labor provisions in their FTAs, a trend that is likely to continue for the foreseeable future. At the same time, regarding labor issues, it should be carefully determined whether it is appropriate to include labor rules in a trade agreement, given the declining significance of the connection between labor and trade. It is desirable to develop rules for substantive discipline regarding labor standards in other forums such as the ILO.

(2) However, a situation where products become competitive due to poor labor law enforcement and the like in other countries is undesirable from the perspective of protecting the rights of workers as well as in terms of international competition. Moreover, if we are going to seek the return of the US to the CPTPP, Japan should at a minimum take the lead in introducing a mechanism to improve working conditions in sectors closely connected to trade in Asia and related areas. In this respect, given the results that the USMCA's Facility-Specific Rapid Response Labor Mechanism has yielded, it is worth considering whether a similar mechanism can be introduced that goes beyond the bilateral side letters signed between the US and Vietnam, etc. at the time of the negotiations over the original TPP. The discussions here will serve as the basis of the discussions for the labor provisions in the IPEF. In all these cases, the system should be designed as appropriate for the actual circumstances on such matters as the role of sanctions, if any.

(3) The Labor Value Content (LVC) clause that was introduced in the USMCA for the automobile sector is not sufficiently justifiable as a policy so caution should be exercised as to its adoption. In addition, it is important to keep in mind that the provisions are criticized for being difficult to apply to complex supply chains, which may be the case for the Asian market. However, given the power of domestic forces in the US behind the measure, the possibility cannot be excluded that it will be aggressively promoted in future trade agreements – a reason for now to keep a close eye on developments under the USMCA.
Note: *The LVC clause requires the use of automobile parts that are manufactured under working conditions above a certain level (wage level).*

(4) Given the heavy involvement of labor law and labor policy, the involvement of labor law practitioners is essential when introducing such measures in trade agreements. It will be necessary to expand the collaboration framework for trade experts and labor experts (regardless of whether a trade agreement winds up covering labor issues).

E) Trade and the Environment: Carbon Border Adjustment

(1) The EU's Carbon Border Adjustment Mechanism (CBAM) is a new trade-related measure without precedent whose WHO compliance is an issue. Although Japan does not export many products covered by CBAM to the EU, it must be actively engaged regardless. The European Commission announced its legislative proposal for the CBAM in July 2021. Beginning in 2026, a business importing merchandise that is covered by CBAM must submit a CBAM certificate. The value of a CBAM certificate is linked to the price of emission allowances in the EU Emissions Trading System (EU ETS). The importer submits the value of the merchandise multiplied by its carbon intensity (emissions per ton). The carbon price in the country of origin will be deducted. The details of the system, which will aim at WTO/GATT compliance, are unclear, but there is potential for GATT violations in most favored nation treatment (GATT Article I), which requires Members to accord to other Members the most favorable treatment given to the product of any one Member, violation of the schedules of concession (GATT Article II), and so on. The EU will impose the obligation on imported products, which would be "internal taxes" imposed at the border" or "other internal charges of any kind", or measures "affecting … internal sale", which are covered by GATT Article III and could be in violation of the national treatment that the article requires. But even if it is in violation of Article III, there is the possibility that the invocation of the General Exceptions as provided for in the main text and items of GATT Article XX for environmental purposes could be an issue.

(2) Going forward, surveillance to see if there will be any double protection such as distribution of free credit to domestic businesses or arbitrary discrimination, any misuse of environmental protection as a policy objective, any negligence in international agreement negotiations, and the like is important. These proposals will not escape criticism from developing countries who believe that carbon budgets are not being used much and that they "have low cumulative emissions and the developed countries are to blame for rising temperatures". Provisions for exemptions should be given careful if cautious consideration so that they will not result in the rejection of free trade or new North-South rifts and divisions. Japan should also begin considering a cooperative approach.

(3) Meanwhile, the US and the EU through their October 2021 agreement on steel and aluminum tariffs under Section 232 of the US Trade Expansion Act invited like-minded economies to participate in negotiations for a first-of-its-kind global arrangement to deal with excess production capacity and high carbon-intensity products (products with high emissions per ton). For the next two years, there will be an attempt to seek out cooperation on the method for calculating the amount of emissions, but restricting market access for non-participants that do not meet standards for low-carbon intensity is also on the agenda. This goes further than the Japan-US and Japan-UK joint statements on steel and aluminum. Japan must participate in these discussions.

(4) 71 countries and regions including Japan participate in the Trade and Environmental Sustainability Structured Discussions (TESSD) group, a WTO JSI, and have confirmed that they will cooperate on such matters as trade-related climate measures, environmental regulation and sustainable supply chains (developing countries in particular), assistance for sustainable trade ("AID for Trade"), the environmental impact and related subsidies on trade. The Japanese government should take an active lead in the discussions.

⑤ The Free Trade System and the Importance of Economic Security

(1) The domestic legal system for economic security will be connected to the agreements on strengthening supply chains for semiconductors and other strategic goods and on technology trade that will be formed in the IPEF and security-oriented cooperative arrangements such as the Japan-US-Australia-India "Quad". Keep in mind that they are likely to move to ring-fence technology and goods among like-minded states, coming into conflict with the non-discriminatory, multilateral, free trade system. It is necessary to keep this from causing a turn to protectionism, undermining the free trade system, keeping in mind the relationship with the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies and other security-related trade control regimes.

(2) Japan faces a harsh geopolitical environment, with Russian expansionism evidenced most recently in its invasion of Ukraine coming on top of Chinese expansion in East Asia and the situation on the Korean Peninsula. It is against this background that the economic security legal system is being established. The importance of economic security cannot be denied, but there is a danger of disturbing the balance between the free trade system if there is excess emphasis laid on insourcing and government intervention. Measures taken for economic security purposes must therefore be implemented in compliance with WTO agreements and other international economic treaties. The recommendations issued in February 2022 by the Japanese government's Panel of Experts on Economic Security makes this point as well.

(3) It is also important, as the Japanese government's draft Act for the Promotion of Economic Security stipulates, to use anti-dumping tariffs (AD), countervailing duties (CVD), safeguards, and other trade relief measures permitted under the WTO to protect the semiconductor and other strategically important industries from unfair competitive advantages. Japan is extremely parsimonious in imposing anti-dumping and countervailing duties compared to its main trading partners, as WTO data on the cumulative number of cases from its establishment in 1995 to June 2021 in the US (AD 828, CVD 296), the EU (AD 538, CVD 91), and China (AD 292, CVD 17) show. The Japanese government should work more closely with the industries with aim of making better use of these trade relief measures.

(4) As the importance of improving supply chain resilience grows in line with the changing international environment, the Japanese government should consider using trade policy against serious human rights violations abroad on the basis of international coordination, which enhances foreseeability for businesses.

⑥ The Potential for Soft Law

(1) Japan should utilize the G7, G20, APEC, OECD, the Economic Research Institute for ASEAN and East Asia (ERIA), and other international economic forums to develop rules and form public opinion. 2023 in particular, when the US and Japan chair APEC and the G7 respectively, should be an auspicious opportunity for this purpose.

(2) In order to promote a free and fair economic order, remedy market-distorting measures, maintain and strengthen high-level and comprehensive economic partnerships, and other elements of the trade and investment agenda, the role of APEC as an "incubator of ideas" should be emphasized. Energy conservation and renewable energy goals present one example where soft law fully functioned as targets were agreed and implemented. For example, in 2011, APEC set an energy conservation goal to reduce energy intensity by 45% from 2005 levels by 2035. If the current trendline (progress is monitored by the Asia Pacific Energy Research Centre (APERC)) continues, the target will be reached in 2034. In 2014, it set the target to double the proportion of renewable energy sources in the energy mix and electricity output from 2010 by 2030. If the current trendline (also monitored by APERC) continues, the target will be met. It is to be also noted as an example of soft law having developed into hard law that the APEC soft-law approach has evolved to become the Institution Technology Agreement (ITA) in the WTO put into effect in 1997. The potential for soft law in a variety of areas as a role for APEC should be explored.

(3) As explained in E)(3), the US and the EU invited like-minded states through their agreement on steel and aluminum to jointly consider the methodology for calculating emissions. Since this could

become the de facto standard for the market in the future, Japan should speak up actively in order to make fair and transparent rules. Meanwhile, German Prime Minister Olaf Scholz, who is chairing the G7 this year, is aiming to include a "climate club" at the June summit. The details are unclear, but his proposal when he was finance minister appears to be aimed at determining a (minimum) carbon price and presenting common rules for carbon border adjustment that can be considered WTO-compliant. In this context, there is the possibility that work may go forward on explicit carbon pricing, measurement methods for implicit carbon pricing under regulation and other non-market measures (and the international comparative analysis of the two), emissions measurement methods for industries, and other matters. This could be the stage for an international cooperative approach in contrast to the CBAM as a measure imposed unilaterally by the EU. It is desirable for Japan to be engaged here.

(4) The CPTPP has the Labour Council, which is now actively taking up issues. For now, the talks are centered on the construction of the framework for cooperation, but the Council should be developed as a forum for the active discussion of labor laws that affect trade. The CPTPP framework does not exclude activities such as setting guidelines and targets for working conditions according to industrial categories and economic conditions or enhancing the transparency of the labor laws of member states in order to urge their improvement, so there should be no limits to the discussions there.

(5) It may be difficult to establish strong rules from the onset for the key points of digital rules such as government access. A soft-law approach may be useful here, judging from the experience of the OECD, which has been a pioneer on government access, discussing the principles for government access and their application. The lack of clarity in the national regulation of the digital sphere could reduce predictability and increase costs for businesses due to differences between national regulatory regimes. This makes it important to enhance the transparency of national regulation and reduce differences. The expeditious soft-law approach that the OECD is taking can be useful in this respect.

⑦ Cross-Sectoral Rule-Based Perspective

This Committee looked beyond the international economic system to use Japan's involvement in disputes regarding its territory and continental shelf to conduct a cross-sectoral inspection to see if Japan has been consistent in its rules-based approach and whether the approach is effective in resolving disputes.

(1) The Japanese government proposes for the rule of law on the oceans the following: (i) states should make their claims based on law, (ii) states should not use force or threats to enforce their claims, and (iii) disputes must be settled peacefully. International law is the foundation of the international order. This is a principle that must be maintained at all costs.

(2) In disputes over territories and the continental shelf, it is not enough for a government to set forth the legal justifications for its claims. It must also appeal to public opinion, both at home and abroad. It is unlikely that Takeshima, the Senkaku Islands, or the continental shelf in the East China Sea will be the subject of an international trial in the foreseeable future, but Japan should urge the relevant states to seek resolution based on international law and to do its best to mobilize public opinion as part of its long-term diplomatic efforts.

(3) For example, the Japanese government takes the position that there exists no issue of territorial sovereignty to be resolved concerning the Senkaku Islands since the Chinese claims have no legal grounds. However, if the issue is brought to the International Court of Justice (ICJ), it is likely that it will rule that there is a dispute. It is necessary to take this into account and justify its territorial title to the international community. It should also seek a legal resolution of the dispute around Takeshima based on the distinction between territorial and historical issues.

(4) To be consistent with a position in favor of a rules-based approach to economic issues, it is also desirable to resolve territorial issues based on law while enlisting public opinion at home and abroad. It may be difficult to entrust some territorial issues to international adjudication since they are entwined with the politics, history, and social issues of the contesting states, but as a practical matter many territorial disputes have been resolved through adjudication.

(5) Japan is unique in having domestic legislation that restricts the application of domestic law on competing continental shelves and exclusive economic zones (EEZs) to within the median line. However, the Japanese position is that it has a 200 nautical-mile title in the Japan Sea and the East China Sea until the boundaries are determined under the United Nations Convention on the Law of the Sea (UNCLOS). It is necessary to raise awareness on this point since the Japanese position does not appear to be well-recognized among experts in other countries.

(6) How Japan responds to Russia's invasion of Ukraine could affect the future state of affairs in the East China Sea (Taiwan, Senkaku Islands). Japan must protect the rule of law in the international community. It must be clear in protesting territorial change by force and must not recognize such changes. JS

Japan Economic Foundation (JEF) initiated the Research Committee on the Development of a Rules-Based International Economic System with prominent Japanese experts in November 2021, and concluded its role by publishing recommendations in May 2022.