



JAPAN AND THE LEADERSHIP OF THE WORLD TRADING SYSTEM

ABE GLOBAL | NYC

NOVEMBER 10, 2017
FACULTY HOUSE
CENTER ON JAPANESE ECONOMY AND BUSINESS
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ABE FELLOWSHIP PROGRAM

The Abe Fellowship Program encourages international multidisciplinary research on topics of pressing global concern. The program fosters the development of a new generation of researchers interested in policy-relevant topics and willing to become key members of a bilateral and global research network. In partnership with the SSRC, the Japan Foundation Center for Global Partnership (CGP) established the Abe Fellowship Program as its flagship program in 1991. The Abe Fellowship Program now includes three core elements: the Abe Fellowship, the Abe Fellowship for Journalists, and the Abe Fellows Global Forum (Abe Global).

Over twenty-five years later, the Abe Fellowship Program, named after former foreign minister Shintaro Abe, has firmly established itself as a critical hub for researchers engaged in US-Japan dialogue and cooperation and continues to facilitate valuable policy-relevant research on pivotal issues facing Japan and the United States. The program has supported over 400 Abe Fellows who continue to make active contributions across the academic and policy worlds not only in the United States and Japan but throughout the world.



ABE FELLOWS GLOBAL FORUM

A new initiative of the Abe Fellowship Program, the Abe Fellows Global Forum (Abe Global) is designed to bring Abe Fellow research and expertise on pressing issues of global concern to broader audiences. Abe Global hosts several events each year in partnership with academic and civic organizations throughout the United States.

Japan and the Leadership of the World Trading System

ABE GLOBAL | NYC

Broad structural changes over the last quarter century are reverberating through the global economy and the institutions that regulate it. Recent US policy has shifted away from a leadership position in both long-standing institutions such as the WTO (World Trade Organization) and newer trade agreements such as TPP-11 (Trans-Pacific Partnership) and RCEP (Regional Comprehensive Economic Partnership). These shifts are creating room for stronger regional ties and raise the question of which nation(s) will lead trade initiatives in Asia. Additionally, the move toward populism across the world threatens to lead countries toward greater economic protectionism.

Since 1991, the Abe Fellowship Program has supported researchers pursuing timely and innovative projects on international trade. For Abe Global | NYC, we partnered with the Center on Japanese Economy and Business at the Columbia Business School to convene a selection of these expert fellows. They discussed some of the most pressing topics facing their field today: the likely outcomes of TPP-11 and its implications for the US and Asia; evolving US trade policy and its potential impacts; how and to what end President Trump could deploy Section 301 of the 1974 Trade Act; prospects for a new US-Japan bilateral trade agreement; and other issues pertinent to Japan, East Asia, and the US-Japan relationship.



Abe Global | NYC: Merit Janow, Hugh Patrick, Christina L. Davis, David E. Weinstein, Taiji Furusawa, Vinod K. Aggarwal, Takatoshi Ito

Table of Contents

A Message from the Japan Foundation Center for Global Partnership	5
Welcome Remarks	
Hugh Patrick , Center on Japanese Business and Economy, Columbia Business School	7
Position Papers	
The Globalization Backlash Vinod K. Aggarwal , University of California, Berkeley	9
From Follower to Leader: Japan in the TPP Christina L. Davis , Princeton University	13
Protectionism and Its Consequences for Domestic Economy Taiji Furusawa , Hitotsubashi University	20
Summary of Moderated Discussion and Q&A	
26	
Closing Remarks	
Barbara Stallings , The Watson Institute for International and Public Affairs, Brown University	31
Abe Global NYC Agenda	
35	

A Message from the Japan Foundation Center for Global Partnership

The Japan Foundation was established in 1972 to conduct cultural exchange around the world; there are currently twenty-four offices in twenty-three countries.

As you know, the '80s were a tumultuous time for Japan and the United States. It was during this acrimonious economic interval that a deep bond of not only statesmanship but also friendship between the Japanese foreign minister, Mr. Shintaro Abe, and the US secretary of state, Mr. George Shultz, quietly crystallized. They visited each other's homes and they were known to discuss immediate state and world issues. Because of this expansive relationship, they realized the necessity for a mechanism to ensure their two countries continued to forge scholarly, people-to-people, and other forms of dialogue, irrespective of the political times. And it was in this context of common and mutual understanding of Japan and the United States as partners sharing major responsibilities with regard to global challenges that the Japan Foundation Center for Global Partnership (CGP) was conceptualized as a means to further enhance wide-ranging exchanges while maintaining a global perspective.

Last year, CGP and the Abe Fellowship Program celebrated our twenty-fifth anniversary. CGP and the SSRC are delighted that over the last two and a half decades we have supported more than 400 Abe Fellows (379 Abe Fellows; 40 Abe Journalism Fellows). This diverse network of scholars and practitioners has been and will continue to be a growing asset to Japan-US bilateral relations and beyond.

The Abe Fellowship is designed to encourage international, multidisciplinary, policy-oriented research on topics of pressing global concern; foster the development of a new generation of researchers willing to become key members of a bilateral and global research network built around such topics; and promote a new level of intellectual cooperation between the Japanese and American academic and professional communities to advance global understanding and problem solving.

This new initiative we are launching, the Abe Fellows Global Forum (Abe Global), is designed to bring Abe Fellow research and expertise on pressing issues of global concern to broader audiences.

The Japan-US relationship has evolved to become a vitally important partnership both regionally and globally. Numerous issues would benefit profoundly from Japan and the US merging our intellectual strengths and diplomatic efforts on topics such as the very issues explored at the Abe Global event in New York City—the dynamics of world trade. At the time of Abe Global | NYC, the US president was in Asia and Japan was his first stop—a major focus of that visit being trade. While trade has always been a complex, multidimensional issue, with the new US administration, it has also become a more divisive one. Our Abe Fellow experts explored this issue and the potential for Japanese leadership in the current environment at Abe Global | NYC.

On behalf of all the staff at CGP and the SSRC, we want to thank our partners at Abe Global | NYC, the Columbia University Center on Japanese Economy and Business, the presenting Abe Fellows, and the audience that joined us to engage in a robust conversation on a topic of global importance to us all.

Junichi Chano

Executive Director

The Japan Foundation Center for Global Partnership

Welcome Remarks

November 10, 2017

Hugh Patrick

Center on Japanese Economy and Business, Columbia Business School

Good afternoon. I am Hugh Patrick, director of the Center on Japanese Economy and Business, which we call CJEB, at Columbia Business School.

On behalf of CJEB, I want to welcome you all to today's event, "Japan and the Leadership of the World Trading System." CJEB is delighted to be cosponsoring this event today with the Social Science Research Council, the Japan Foundation [Center for Global Partnership], and the Abe Fellows Global Forum, which is a new initiative of the Abe Fellowship Program.

Our ties to the Abe Fellowship Program run especially deep: CJEB's director of research, David Weinstein, was himself an Abe Fellow in 1991. We also have a history of hosting Abe Fellows as visiting fellows at our center, including Professor Masazumi Wakatabe, a CJEB Visiting Fellow for the year 2017–2018, who comes to us from Waseda University.

We founded CJEB over thirty years ago with the goal of enhancing the



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knowledge and understanding of Japanese business and economics, both domestically and within the context of the global economy. One of CJEB's primary missions is the promotion of the exchange of ideas and information between the United States and Japan, which is reflected by our continued relationship with wonderful programs such as the Abe Fellowship Program.

Today's program will provide even deeper insight into the complex and evolving economic partnership that the United States and Japan have with each other and the greater influence that relationship has on the world economy. Given the rising tide of populism seen around the world in the last year, it is natural to wonder how the global economy will react. The fate of the TPP, for instance, is a perfect example of how shifting leadership can lead to drastic changes affecting multiple countries seemingly overnight. Fortunately, we have a panel of highly esteemed academics here to help dissect these issues and pose suggestions for the future.

The Globalization Backlash

Vinod K. Aggarwal

University of California, Berkeley

For several reasons, passage of the Trans-Pacific Partnership (TPP) would, on the whole, have been a good thing.¹ For one, a multilateral approach to trade is in many ways better than a bilateral one. Moreover, the World Trade Organization (WTO) is worthy of strong support, and an open trading system should also be generally supported as a means for achieving global growth through efficiency, as long as countries play fair.² Having established that liberal internationalist perspective, however, this essay takes a contrarian view of this conventional—and liberal—wisdom regarding TPP and trade policy more generally.

The rise of anti-globalization has stimulated thinking about the root causes for this opposition and possible remedies for it. For neoliberal economists, with a belief in the miracle of the unfettered market, the answer is simple: keep the state out of the private sector, and everything will be fine. But with the backlash against globalization growing throughout both the developed and developing world, this answer is not only facile but a recipe for disaster. The backlash is not simply a temporary phenomenon led by venal politicians.

With changing patterns in technology, trade, outsourcing, and immigration, current US policy to cope with globalization and prevent such a national



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backlash has proved wanting. Much of this lack of attention to the displacement both of firms and labor has been driven by the unwarranted faith in the smooth adjustment of production factors that is the bread and butter of neoliberal economics. By engaging in “apolitical analysis” because they fear the complexity of including political factors in economic modeling, economists have been blindsided by the rise of anti-globalization, and in their rush to catch up with the newfound appeal of populism—while still wed to a fallacious neoclassical economic paradigm that ignores the role of the state and the importance of political lobbying—they recommend policies that are simply more of the same.

To be clear: the point is not that neoclassical prescriptions and hopes would not be “optimal” in an ideal world where everyone played fair; rather, the economists’ models of how the real world works are simply wrong. Those who understand the political economy of development and trade strategy—rather than the fantasy of apolitical growth and markets—will understand the need to address the problems of the losers that increasing globalization has produced through the creation of a more significant, intelligent activist state. In addition, one must pay attention to the global and institutional impact of the pursuit of industrial policies by countries such as China, instead of simply claiming such policies are “inefficient.” Aggressive policies to prevent massive intervention by the Chinese in critical industries that undermine non-Chinese firms around the world may well be warranted.

Turning more specifically to TPP, the Regional Comprehensive Economic Partnership (RCEP), supply chains, and US–Japan relations from a US perspective, we should remember, first, that the United States already has bilateral agreements with six of the eleven other countries in TPP—Australia, Canada, Chile, Mexico, Peru, and Singapore—as well as an important bilateral free trade agreement with a nonparticipant, South Korea. The United States is also likely to negotiate additional bilateral accords with Japan and, probably, Vietnam further down the line. In short, the United States already has vitally important bilateral agreements.

Furthermore, as John Ravenhill has pointed out based on the economic literature, the supply chain argument about the importance of a multilateral accord like TPP is very weak.³ Without China, supply chains in Asia are much less developed than they are in Europe and the United States. The participation of the larger TPP economies in value chains is also much lower than that of economies in their European counterparts. In an index of Organisation for Economic Co-operation and Development (OECD) countries’ participation in

global value chains, Mexico, New Zealand, Canada, Japan, the United States, and Australia occupy six of the seven bottom places.⁴

Third, the geostrategic claim concerning the importance of TPP was largely an example of overselling by the past Bush and Obama administrations. The whole notion that TPP was an essential counterbalancing accord to RCEP was heavily oversold, and few would believe Secretary of Defense Ashton Carter's claim that "passing TPP is as important to me as another aircraft carrier." Obviously, if this is the case, we have too many aircraft carriers.

The idea that the China-led RCEP will somehow now become a strong twenty-first-century accord—the goal of the TPP—is another dubious claim, believed only by those who have never met an Indian negotiator. India is already pushing back on any stringent intellectual property rules. The Chinese are doing lots of things to undermine the liberal trading order, but RCEP is not a big deal.

In fact, TPP itself wasn't all that great. As several analysts have pointed out, the agreement was a step backward from the bipartisan May 10, 2007, agreement on labor and environment provisions that are fully incorporated in the US–Peru free trade agreement and others but were not in the TPP. It's pretty clear the partnership was strongly pushed by various corporations seeking private goods, but even from a corporate perspective, it was hardly a slam dunk. Because of differing gains and losses among companies, given its provisions, it had very mixed support from corporations, not to mention all its other critics.

Finally, it's time for economists to get away from calculating aggregate benefits coming out of different types of trade accords and ignoring the domestic costs of adjustment. It may be time for them to read the international political economy literature on the costs and benefits of trade and become better versed in the neomercantilist thinking that has been driving China's recent economic policies. Apparently, the Chinese government has managed to obtain a better understanding of this approach to trade policy than our economists have.

At least they have, over the past couple of years, suddenly discovered that trade may produce winners and losers.

NOTES

1. This essay is based on a talk prepared by the author for delivery at the Abe Fellows Global Forum on November 10, 2017. The talk built in turn on a presentation at a Brookings Institution conference, “Japan’s Trade Policy in an Era of Anti-Globalization,” on February 27, 2017; and on a paper coauthored with Sonia Aggarwal, “Backlash against Globalization: Causes and Remedies,” at an ISAS-BASC workshop “Revisiting Globalisation: Comparing Country Experiences from South Asia and the World” held on October 12, 2017, in Singapore.
2. See also the author’s paper, “The Liberal Trading Order under Assault,” *Global Asia* 11, no. 4 (Winter 2016): 110–13.
3. John Ravenhill, “The Political Economy of the Trans-Pacific Partnership: A ‘21st Century’ Trade Agreement?” *New Political Economy* 22, no. 5 (2017).
4. K. De Backer and S. Miroudot, “Mapping Global Value Chains,” OECD Trade Policy Papers, no. 159, OECD Publishing, Paris, 2013, <http://dx.doi.org/10.1787/5k3v1trgnbr4-en>, 12, figure 1.



Abe Global | NYC: Vinod K. Aggarwal

From Follower to Leader: Japan in the TPP

Christina L. Davis

Princeton University

The TPP and Japan's Leadership Opportunity

After years of reluctantly opening Japan's markets, Prime Minister Shinzo Abe has become the leading advocate for the Trans-Pacific Partnership (TPP). Japan's commitment to TPP, despite the exit of the United States, reflects its new role as broker between East Asia and the United States. The embrace of the liberalizing agreement by the Abe administration shows how mega-regulation can be embedded within domestic political reform agendas, and the value of the agreement must be understood within these broader gains. But TPP-11 alone will not uphold the international trade order. The agreement should form the basis for broader regional liberalization. Bringing in both the United States and China will be essential to raise trade standards and uphold open markets. The greater challenge lies on the home front, where political leaders must balance the winners and losers of trade to support this international agenda.

Geopolitical Gains

When Abe announced in March 2013 that Japan would join TPP negotiations, he emphasized the importance of the agreement to revitalizing Japan's



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economy, promised to support the agricultural sector, and emphasized the need for Japan to help create new rules for the economic order with the United States and other countries.¹ The Liberal Democratic Party (LDP) went further, stating that the trade agreement also contributed to national security.² In discussions before the diet, Abe and others repeatedly emphasized the agreement's security and economic imperatives.

With close ties to the United States and Japan's role in East Asia both priorities of Japanese foreign policy, the need for regional leadership by Japan loomed even larger as the United States appeared to be retreating from the region. TPP proponents emphasized the importance of the agreement as a foreign policy tool. As the Democratic Party of Japan (DPJ) began discussions led by former prime minister Noda, the agreement promised two foreign policy



Abe Global | NYC: Christina L. Davis

benefits: strengthened ties with the United States and a response to Chinese challenges in the region.³ While the agreement also promised to counter China's rising economic power on several fronts, Japan's government indicated it would welcome future participation by China. For Japan, TPP was a means to contain, shape, and entice China toward cooperation.

Economic Gains

TPP is a high-quality trade agreement that would open a larger share of foreign markets with comprehensive tariff liberalization and deepen discipline on trade and investment with the World Trade Organization's "WTO-plus" rules. Upgrading the standards for the trade architecture promises gains in terms of both market access and business efficiency for investment.

Studies of the original TPP-12 agreement have shown positive effects on Japan's economic growth. A World Bank investigation, for example, found that larger gains would accrue from liberalizing non tariff measures and services than from traditional efforts to open market access.⁴

Building Support for TPP in Domestic Politics

In Japan, TPP was called the "debate dividing the nation in two," with a close split in public opinion and fierce opposition from agricultural interest groups.⁵ By making various concessions to the latter and by framing TPP as a security issue, the Abe administration successfully diffused opposition, taking a synthetic approach to the agreement that combined geopolitical motivations with a strategic bargain to limit liberalization while adding to compensation for farmers. Even as US attitudes toward it turned increasingly critical, the Japanese government went ahead to ratify TPP, and during the October 2017 House election, it was barely an issue.⁶

TPP fit into the economic growth strategy termed "Abenomics" that has been central to the LDP administration. In the common description, the "three arrows" of the policy consist of monetary easing, fiscal stimulus, and economic restructuring. Abe seized on TPP to force competition and globalization on Japanese industries.

By linking the agreement to his centerpiece economic reforms and geopolitical strategy, Abe also made his commitment to TPP irreversible. By attributing economic gains from the deal to domestic structural reforms of the Japanese economy, he created an economic rationale that was not

contingent on market access gains per se. Furthermore, implementing a two-pronged geopolitical role to deepen ties with the region and exercise rulemaking authority over economic governance represented a nuanced approach toward balancing Chinese influence that went beyond the US–Japan alliance, while compensation to losers helped soften the distributional impact on weak sectors.

These factors have made Japan’s support for TPP resilient in the face of the US withdrawal from the agreement.⁷ Framing TPP as part of Abenomics has also raised the costs to backing out of the agreement following the exit by the United States.

Looking Forward to a Broader Trade Agenda

Fulfilling a campaign promise, President Donald Trump declared the exit of the United States from the agreement as one of his first acts in office. By going ahead with the ratification process nevertheless, Abe hoped to encourage other TPP signatories to do the same. Where Japan had often been the last reluctant party at the negotiating table and took years to go forward with TPP, it has now emerged as the agreement’s greatest defender, and the Abe administration has expressed its commitment to persuading the United States to rejoin the agreement with remarkable persistence. With TPP once hailed as the lynchpin of US–Japan cooperation against China, some fear its failure signals weakening ties.

One alternative is to abandon TPP in favor of a bilateral US–Japan free trade agreement. This idea has gained support, as US industries fear the loss of market access due to Japan’s agreement with Australia and its near completion of a new agreement with the European Union.⁸

Japan has the opportunity to create a stronger trading order from a complex network of overlapping trade rules. While moving forward to implement TPP, it can engage with other regional initiatives, continue bilateral economic talks with the United States, and support the multilateral trade regime. Where the United States once advanced the notion of “competitive liberalization” in a multi front approach to launching a series of free trade agreement negotiations, it is now up to other countries to pursue this in the hopes of challenging the United States.⁹ At the bilateral level, Japan can use TPP to deflect US demands for additional concessions and, in regional talks, to urge

other countries to accept more ambitious liberalization. The double threat of deepening regional trade deals and US unilateral protection may finally shock countries into more serious engagement with a new multilateral trade round.

TPP benefits Japan even if the United States fails to reengage. It is one of many trade agreements under negotiation in the Asia Pacific region, including the Regional Comprehensive Economic Partnership (RCEP) and the Free Trade Area of the Asia Pacific (FTAAP). Japan stands in the middle as the pivotal country included in all three potential groupings, whereas the United States is now outside of both RCEP and TPP and China is outside of TPP.

Ultimately, including China in TPP is economically advantageous for Japan. The world trading system needs a Beijing Round—a new trade round in which China exercises leadership to build consensus among developing countries for reforms that would support development and offer opportunities for business gains from liberalization. In the current hostile political environment, only reciprocity and enforcement of fair trade will persuade the United States to remain in the WTO, let alone grant new market access. Despite its rhetorical support for multilateral rules, Europe may decide to close its markets to export dynamos like China under the rising pressure of populism. To demonstrate serious commitment to a successful trade round and dispute system, Chinese leaders will need to set aside their own victim mentality over deep concessions made to enter the WTO and the issue of nonmarket economy status. The combination of a Japan-led TPP-11 and US threats of protection may be enough to convince China it must step up to engage more seriously in building the WTO.

Conclusion

The phrase “same bed, different dreams” has come to characterize US and Japanese views on free trade agreements.¹⁰ The Japanese government views the economic talks with the United States as a means to manage trade friction and support existing initiatives, including TPP, while the Trump administration sees them as the entry point for its preferred bilateral negotiation strategy to make stronger demands on Japan.

The United States may need to learn from Japan how to build political support for an active trade agenda through gradual liberalization paired

with generous compensation for weak sectors and high investment in skills acquisition by workers and research and development by firms. At the same time, through accepting TPP commitments, Japan hopes to regain its economic dynamism with new impetus for regulatory and corporate governance reform, agricultural sector competitiveness, and liberalization of service and investment markets. TPP offers the chance for Japan to lead after a long stretch as rule-taker in global governance. If the United States later seeks to join, Japan and other members will be in a position to demand concessions.

NOTES

1. Official statement of Prime Minister Shinzo Abe, March 15, 2013, <http://www.kantei.go.jp/jp/headline/tpp2013.html>.
2. Liberal Democratic Party official party statement on the decision to join TPP, March 15, 2013, <https://www.jimin.jp/news/discourse/128489.html>.
3. Takumi Sakuyama, *Nihon no TPP kōshō sankā no shinjitsu: sono seisaku katei no kaimei (The Truth of Japan's Participation in the TPP Negotiations: Revealing Its Policy Process)* (Tokyo: Bun-shindō, 2015), 192.
4. The World Bank estimated the original TPP would generate an overall lift of 1.1 percent in Japan's annual gross domestic product (GDP) by the year 2030. These studies relied on simulations utilizing the Global Trade Analysis Project (GTAP) model, a widely used macroeconomic model that incorporates trade into forecasts of economic growth. Assumptions about key relationships between prices and inputs underlie such modeling exercises. World Bank, *Global Economic Prospects: Spillovers and Weak Growth*, 2016, <https://openknowledge.worldbank.org/handle/10986/23435>, 227.
5. Megumi Naoi and Shujiro Urata, "Free Trade Agreements and Domestic Politics: The Case of the Trans-Pacific Partnership Agreement," *Asian Economic Policy Review* 8 (2013): 326.
6. A comparison of the campaign policy platforms of eight major parties reveals a brief mention from LDP about rethinking agricultural policies to adapt to the impact of TPP, while the Communist Party urged withdrawal

from the agreement, and the six other main opposition parties failed even to mention the deal. See summary of campaign platforms, https://mainichi.jp/senkyo/48shu_koyaku/.

7. See, for example, Leonard Schoppa, "Two-Level Games and Bargaining Outcomes: Why Gaiatsu Succeeds in Japan in Some Cases But Not Others," *International Organization* 47 (1993): 353–86; Christina L. Davis and Jennifer Oh, "Repeal of the Rice Laws in Japan: The Role of International Pressure to Overcome Vested Interests," *Comparative Politics* 40 (2007): 21–40; and Helen Milner and Edward Mansfield, *Votes, Vetoes, and the Political Economy of International Trade Agreements* (Princeton: Princeton University Press, 2012).

8. *Inside U.S. Trade*, November 16, 2016.

9. For a theoretical study on overlapping institutions and bargaining strategies, see Aggarwal, Vinod K., ed. 1998. *Institutional Designs for a Complex World: Bargaining, Linkages, and Nesting*. Ithaca: Cornell University Press.

10. "Keizai mondai ha 'Dōshyō imu'" ("Economic Problems Are 'Same Bed, Different Dreams'") was the headline for an article about the first formal summit meeting between Prime Minister Abe and President Trump in the *Asahi Shimbun*, February 14, 2017, 3.

Protection and Its Consequences for Domestic Economy

Taiji Furusawa

Hitotsubashi University

Globalization, facilitated by the information and communication technology (ICT) revolution, has benefited the vast majority of people in the world. Thanks to globalization, people can get easy access to world news and information about products, shops, and restaurants worldwide. They can buy goods and services at lower prices with better information about their quality. Moreover, globalization certainly has raised the real income of huge numbers of people all over the world, especially in emerging market economies like China and other Asian countries, which have benefited from selling their products in large markets, such as the United States and Europe.

At the same time, though, globalization has created some serious problems. Freer movement of people has increased the number of immigrants, many of whom have not been well integrated into their host countries. The result has been anti-immigration sentiment, especially in Europe, where it is



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University as an Abe Fellow and research associate of the Program on US-Japan Relations from 2010 to 2012. His research interests include international trade, especially regional trade agreements such as FTAs, and the global value chain (or the global supply chain). He has received the Kiyoshi Kojima Award (Japan Society of International Economics) in 2007, the Japan Academy Medal, the JSPS Prize (Japan Society for the Promotion of Science) in 2009, and the IEFS Japan Koji Shimomura Award in 2014 for his research accomplishment in the field of international trade. He has also participated in the Japanese-French Frontier of Science Symposiums as a planning group member and a planning committee member. He has been the associate vice president of Hitotsubashi University in charge of international affairs and research since November 2014.

considered the prime reason behind Brexit. With the offshoring of plants and increased trade with other countries, globalization is also considered a major factor in income inequality within countries. Manufacturing workers in the United States, for example, are often considered its “victims.” This was certainly a major impetus for the outcome of the last US presidential election.

This position paper examines some of President Donald J. Trump’s trade policy proposals, which we can see as a consequence of the rise of anti-globalization. I discuss in particular whether Trump’s idea of eliminating (or reducing) the bilateral trade deficit is grounded in economic reasoning. I also discuss whether protecting domestic industries by raising trade barriers actually benefits the domestic economy.

First, I argue that the trade deficit is not something we should care about. Let us consider the following two macroeconomic identities:

$$Y=C+I+G+(X-M)$$
$$Y=C+S+T$$

where

$$Y=\text{GDP}$$
$$C=\text{Consumption}$$
$$I=\text{Investment}$$
$$G=\text{Government spending}$$
$$X=\text{Exports}$$
$$M=\text{Imports}$$
$$S=\text{Saving}$$
$$T=\text{Taxes}$$

It follows from these two identities that

$$X-M=(S-I)+(T-G)$$

which shows that a trade surplus, $X-M$, is always equal to domestic saving, which in turn is equal to the sum of private saving, $S-I$, and government saving, $T-G$. This identity indicates the trade surplus is the other side of the coin of the country’s net saving. The country experiences a trade deficit if its net saving is negative, regardless of its causes. This does not mean trade barriers are completely irrelevant to the country’s trade balance; they are, however, only one factor affecting it. Moreover, a trade deficit is not in itself

something countries should care about. Trade will balance over time, since a country, as a whole, saves and “dis-saves” more or less cyclically. This is not to mention the occurrence of bilateral trade deficits, as it is natural for each country to have trade surpluses with some other countries and deficits with others, even if the country’s trade account balances.

The United States also tends to have a trade (or current account) deficit for a unique reason: US dollars serve as a reserve currency—that is, US assets are held by the central banks of other countries as a foreign exchange reserve. In addition, US dollars are used as a medium for the international exchange of goods and services. In other words, as a country that issues international currency, the United States maintains a trade deficit so it can supply foreign reserves to the central banks and US dollars to the world market. This sounds bad for the United States, but the country actually benefits from doing so because, after all, importing goods and services without exporting their equivalent value is good for it; the United States can simply “sell” the printed dollar bills to obtain goods and services from the rest of the world.

Although trade deficits are not, then, bad for the economy, countries often try to reduce them by protecting their domestic industries. But can a government



Abe Global | NYC: Taiji Furusawa

eliminate or reduce its deficit by raising import barriers, such as tariffs? Do such protective policies not have any side effects for the domestic economy? Imports will decrease if import barriers are raised. A decrease in imports will mean, in turn, a reduced demand for foreign currencies in the foreign exchange market, leading to the depreciation of the foreign currencies and the appreciation of the home currency. As a consequence, the country's exports will decline. That is to say, raising import barriers can reduce a trade deficit at the expense of export industries.

Countries gain from trade. A policy to weaken comparative advantage sectors—the sectors in which a country has a competitive edge relative to other sectors—is not a good one, and the protection of industries that have to compete against imports goes against comparative advantage forces. It also has negative impacts on export industries through the aforementioned exchange rate adjustment and, in addition, through resource reallocation from export industries to import-competing industries. If trading partners retaliate against the country's move toward protectionism, further damage to export industries may result. Protection of import-competing industries can only be justified as a short-term policy, and only if it is intended to mitigate a large impact of trade liberalization by making the structural adjustment smoother.

Should we, then, dismiss President Trump's idea of protecting manufacturing workers who are adversely affected by globalization, on the grounds that protection is not that effective nor does any good to the economy? Perhaps not. Income inequality caused by globalization is an important issue, although globalization is considered secondary as a cause to skill-biased technological change. Some regions do suffer adverse consequences of importing labor-intensive goods from China and other countries, and people in the United States are less geographically mobile now.¹

As a result, workers in regions severely hit by a surge in imports from China, for example, do experience a decline in real wages. Autor, Dorn, and Hanson estimate that in the United States, 548,000 jobs were lost between 1990 and 2000 and another 982,000 between 2000 and 2007 because of an increase in imports from China.² Feenstra, Ma, and Xu similarly estimate imports from China were responsible for 521,000 jobs lost between 1991 and 1999 and 1,240,000 between 1999 and 2007, although exports from the United States contributed to the creation of 805,000 jobs between 1991 and 1999 and 514,000 between 1999 and 2007.³

Recent globalization forces us to change the idea that imports are bad and exports are good for employment. Thanks to the ICT revolution, international separation of factories has prevailed worldwide (see, for example, Richard Baldwin).⁴ As a consequence, countries import intermediate goods to produce final goods or other intermediate goods. With importing having become an essential part of efficient production, manufacturing industries and their workers may benefit by importing from geographically close countries or partners in free trade agreements, as those countries are likely to be in the same group of what we call the global value chain. Indeed, my preliminary work with Mina Taniguchi suggests the adverse effect of imports from Mexico on manufacturing employment tends to be smaller at a regional level than that from China.

Nonetheless, it is true that international trade in goods adversely affects some regions. This is, indeed, a serious problem, given that people are less mobile nowadays. What can we do to mitigate these adverse regional effects of globalization? An obvious solution is to enhance labor mobility across sectors. For that, each region should have a variety of industries: manufacturing and services; export industries and import-competing industries; and skilled-labor-intensive and unskilled-labor-intensive industries. This, of course, is not easy to realize. But a good start may be to redesign the regions so universities are their hubs of knowledge.

Although international trade benefits all trading countries, it creates winners and losers. What we should do is not limit globalization but, rather, reap the maximum gains from it while compensating the losers.

NOTES

1. *The Economist* reports that people's mobility has declined in the United States. *The Economist*, "Left-Behind Places," October 21, 2017, 19–22

2. David H. Autor, David Dorn, and Gordon Hanson, "The China Syndrome: Local Labor Market Effects of Import Competition in the United States," *American Economic Review* 103, no. 6 (October 2003): 2121–68.

3. Robert C. Feenstra, Hong Ma, and Yuan Xu, "US Exports and Employment," unpublished manuscript, University of California-Davis, 2017, http://cid.econ.ucdavis.edu/Papers/Feenstra_Ma_Xu.pdf.

4. Richard Baldwin, *The Great Convergence: Information Technology and the New Globalization* (Belknap Press of Harvard University Press, 2016).

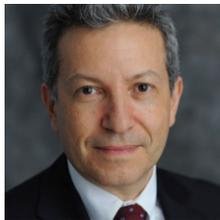
Summary of Moderated Discussion and Q&A

Moderated by: **David Weinstein**

Columbia University

Moderator David Weinstein opened the discussion by identifying major similarities in US trade with Asia between his time as an Abe Fellow in 1991, when Japan occupied China's current position as a major trade partner that threatened US trade dominance in the region, and the present. He cited changes that took place between 1991 and 2016 and noted that both periods saw rising inequality, with very different political outcomes.

Highlighting how important US interest in promoting free trade was to global welfare in 1991, Weinstein suggested that the present differs from the past in two key respects: labor has become more automated, and trade with China has become indispensable at the expense of trade with Japan. Since entering the World Trade Organization (WTO) in 2001, he noted, China has vastly increased its exports to become the number one trade partner to both Japan and the United States. Given these factors, he asked the group to what extent the ascendant "America First" policy has been a reaction to China's



David E. Weinstein (1991 Abe Fellow) is the Carl S. Shoup Professor of the Japanese Economy at Columbia University. He is also the director of research at CJEB, director of the Japan Project at the National Bureau of Economic Research (NBER), a member of the Federal Economic Statistics Advisory Committee, and a member of the Council on Foreign Relations. Previously, Professor Weinstein was chair of the Department of Economics and a senior economist as well as a consultant at the Federal Reserve Bank of New York, the Federal Reserve Bank of San Francisco, and the Federal Reserve Board of Governors. Prior to joining the Columbia faculty, Professor Weinstein held professorships at the University of Michigan and Harvard University. He also served on the Council of Economic Advisors from 1989 to 1990. His teaching and research interests include international economics and the Japanese economy. Professor Weinstein earned his PhD and MA in economics from the University of Michigan and his BA at Yale University. He is the recipient of many grants and awards, including five National Science Foundation grants, an Institute for New Economic Thinking grant, a Bank of International Settlements Fellowship, and a Google Research Award. Professor Weinstein is the author of numerous publications and articles.

rise, and what the policy means for the future of global trade relationships.

Responding first, **Christina Davis** argued that the rise of China represents a powerful rationale for the United States to engage in cooperative trade relations. While acknowledging concern that China puts its trade gains toward building its army, Davis suggested total opposition to China's benefiting from global trade would be wrongheaded. She inverted Weinstein's comment on China's entering the WTO, pondering why China had not tried harder since then to uphold the world order by holding a Beijing Round and making more trade concessions.

"The real puzzle," Davis said, "is when will China wake up and realize that if the United States turns to protectionism, it will be the biggest loser?" She pointed to two possible, opposing outcomes. In the first, the Chinese government shifts its policies to draw other countries to the negotiating table, thereby strengthening international trade. In the second, China continues to evade rules and norms or takes a passive position, and the global trade system languishes and erodes without leadership.

Davis went on to emphasize the role of domestic politics in the United States in 1991 versus the current situation, pointing out bipartisan resistance in 1991 to conceding too much to those losing out in the international trade regime. She contrasted the current US situation to that of Japan's politicians, who seem to be less concerned about losing market share to China.

Vinod Aggarwal responded next. The United States' main motivation to encourage free trade in 1991, he said, was the geopolitical environment that resulted from winning the Cold War against the Soviet Union. Ensuring a strong alliance with its trade partners was tactical and had nothing to do with encouraging global welfare. Aggarwal argued protectionism has increased since the collapse of the USSR because it is no longer in the United States' self-interest. With the caveat that he was not supporting Trump's policy, Aggarwal argued that Japan and the United States should put pressure on China to embrace an industrial policy that is fair and favorable to more countries.

Taiji Furusawa echoed Aggarwal's opinion that US self-interest guided its open trade policy in 1991, just as it has driven the current turn toward protectionism. He noted that protectionism did not originate with Trump, and income inequality in the United States has been a significant factor in

its recent “inward turn.” The problem with a rising China, he cautioned, is that “if China is setting the rules,” it may do so at the expense of its trading partners.

David Weinstein opened the floor for questions from the audience.

The first came from **Hugh Patrick**, also from Columbia’s Center for Japanese Economics and Business. Patrick suggested a paucity of stable, well-paying jobs in the United States, rather than the broadly applied concept of “income inequality,” was behind the current trend toward protectionism. He asked the panelists to weigh in on the utility of “income inequality” to describe the challenges of the economies and political situations in Japan and the United States.

In response, **Furusawa** acknowledged that while he often refers to “income inequality,” stable, decent employment is, indeed, important. On the other hand, he admitted, temporary workers are economically necessary for firms and industries in Japan.

Aggarwal disagreed on the importance of “stable” jobs, using the example of Silicon Valley: “People lose jobs [there] all the time” and find new ones with relative ease. He pointed to depressed wages and job shortages in places like Michigan as the bigger problem.

The second question from the audience concerned China’s Belt and Road Initiative (BRI): How likely is it that a China-led transcontinental trade network will supersede the Pacific alliances?

Aggarwal explained that BRI has been a continuation of China’s strategy to imagine a world without the US and European markets; it was an investment in market diversification, should US and European protectionism cut into China’s exports. The strategy was very clever, he remarked, but he declined to answer clearly how likely it was to replace the Pacific alliances.

The next question concerned the trade deal among the eleven Trans-Pacific Partnership nations: What kind of leverage does Japan have to draw TPP-11 negotiations to a close, especially in light of Canada’s recent rejection of the pact as it currently stands?

Furusawa assured the audience that Japan is serious about reaching final agreement on TPP-11, and that it had stepped into a leadership position in part because of the United States’ withdrawal.



Abe Global | NYC: David E. Weinstein

Davis pointed out that Japan's goal was to make it easier for the United States to join the agreement down the road and surmised that Canada would be back at the negotiating table.

The next question was posed by Columbia Business School visiting scholar **Hideaki Sakawa** from Nagoya City University. Given that both Japan and the United States face workforce and inequality problems, why had the Japanese continued to support the Abe administration's backing of TPP-11, while Trump in the United States pulled out of the pact based on the same issues?

Davis acknowledged the importance of the question, especially given that TPP had not polled well in Japan in the first place. She suggested political coalitions in Japan had made it possible for the Liberal Democratic Party (LDP) to keep the country in the agreement despite wavering public support. She also remarked that opposition to TPP in Japan's urban areas was insufficient to mobilize Japan's political elite against the pact, in contrast to Trump's spearheading its opposition in the United States. She noted that, except for the Japan Communist Party (JCP), none of the political parties in Japan's most recent election highlighted their positions on TPP in their manifestos.

Pamela Fuller, a tax lawyer in New York, asked a question regarding human rights in China with respect to the subject of global trade.

Davis pointed out that the power of trade to improve human rights has proved to be limited and acknowledged that China's admission into the WTO in 2001 had represented a decision to stop linking the two. Still, she offered as an example of this power the introduction of collective bargaining rights in Vietnam through TPP negotiations. Cautiously optimistic, she rationalized that modest, slow changes imposed externally could encourage countries to implement institutional reforms.

Aggarwal expressed additional skepticism about any causal relationship between economic growth and democratization and/or human rights. His own research had demonstrated that linking trade to human rights or the environment is only effective when the nation being pressured is relatively weak: "If you're trying to push Vietnam around, you can push Vietnam around. That's possible. You can push Peru around, but it's a lot harder to push China around." He also emphasized the importance of the geopolitical changes since the end of the Cold War and argued that using Japan's success during that time for comparison was a false equivalence.

Closing Remarks

Barbara Stallings

Brown University

I am listed in the program as a faculty member of Brown University, a university to the north, but that's not the reason I'm here. I'm here as chair of the selection committee for the Abe Fellowship Program. On behalf of the committee, I would like to thank all the people who gave presentations, moderated, welcomed all of us, all of you who came out on a very cold afternoon, and, most of all, the various people on the Abe Fellowship Program staff who arranged this event. The new Abe Fellows Global Forum is clearly a very exciting initiative. This afternoon's discussion certainly demonstrated that.

I was asked to close the session briefly. I want to do that by highlighting two sets of issues that were raised by the speakers' initial presentations. I'm quite interested in the China questions myself, but I will forgo that.



Barbara Stallings is William R. Rhodes Research Professor at the Watson Institute for International Studies at Brown University and editor of *Studies in Comparative International Development*. Before arriving at Brown in 2002, she was director of the Economic Development Division of the UN Economic Commission for Latin America and the Caribbean in Santiago, Chile (1993–2002), and professor of political economy at the University of Wisconsin–Madison (1977–1993). She has been a

visiting professor or visiting scholar at Harvard, Yale, Princeton, Columbia, Berkeley, the University of Tokyo, the Institute for Southeast Asian Studies, the Institute for Fiscal and Monetary Affairs of Japan's Ministry of Finance, and a number of universities and research centers in Latin America. She has doctorates in economics (University of Cambridge) and in political science (Stanford University) and is a specialist in development economics, with an emphasis on development strategies and international finance. In addition, she works on issues of economic relations between Asia and Latin America and comparisons between the two regions. Her most recent books are *Innovation and Inclusion in Latin America: Strategies to Avoid the Middle Income Trap* (2016) and *Promoting Development: The Political Economy of East Asian Foreign Aid* (2017). She has been teaching this spring at the Schwarzman Program at Tsinghua University in Beijing.

What I want to do is to talk about two things. One is to summarize the analysis of the current situation presented by the speakers, then to talk about where we might go from here, again taking off from the speakers' own ideas.

The discussion on the current situation, as I drew it from the presentations, focused mainly on three topics: globalization, institutions, and policy. Globalization and an open trading system, more particularly, it was said, are desirable goals since they can bring benefits to many people based on comparative advantage, as we heard from Taiji [Furusawa]. But—a large underlying “but”—they also have important downsides, because they can create both winners and losers. You could call those “jobs” or “inequality” or however we want to think about it, each of us individually.

We certainly don't need to worry about the winners. They can take care of themselves. But it is important to identify important groups of losers. The discussion here centered on losers in developed countries. Not much discussion about losers in developing countries. That's an interesting topic, but I think it's a topic for another day.

The developed country losers that we heard about that are probably best known are workers in many of the developed countries losing jobs, especially in the manufacturing sector. These jobs are, in many cases, going to developing countries. That's another story. We can also talk about entire sectors losing competitiveness—for example, agriculture. Not a coincidence that agriculture has caused so many problems in the WTO [World Trade Organization].

Then, of course, our president claims that the United States as a country has been losing vis-à-vis our trading partners, especially our trading partners in Asia, but also Mexico, some EU countries, etc. So individual groups of workers, sectors, and perhaps an entire country can be considered losers.

The second element of the current situation is institutions. Institutions supporting global trade have clearly been endangered. It's clear that TPP-12 [the most recent Trans-Pacific Partnership] was a much stronger entity than TPP-11, but, as was suggested, at least the US withdrawal allows Japan to take a greater leadership role. That may be a good thing.

With regards to RCEP [Regional Comprehensive Economic Partnership], in this sense, I agree with Vinny Aggarwal. It is possible that it will be approved,

but it's not really a high-quality agreement and therefore not clear if its approval would be a significant step forward.

But the WTO is something we do really need to be worried about. The WTO was in trouble well before Trump ever became president. You see this by the failure of recent rounds of negotiation, especially the Doha Round. But now, of course, the US is threatening to leave the WTO as well. This would be a major step and much more important than the TPP.

The third element, then, of the current situation policy responses (here mainly with an emphasis on the United States) is the idea that these responses have often been misguided. As we heard, Trump or those around him misunderstand the nature of causality in the trade accounts, and thus the policy proposals are not very helpful either internationally or domestically. In particular, protectionism is not a good approach because it reduces exports as well as imports, and it fails to deal with the underlying savings investment balance or imbalance, which has been a problem in the United States for many years.

These three elements—globalization, institutions, and policy—seem to me to be very important components to the analysis of the current situation, which we heard in terms of three presentations.

Perhaps more exciting is the idea of where we should go from here. There are clearly many, many things that could be put on the agenda, but I just want to mention four ideas that were put forward in the presentations that I found particularly interesting. One—and there was more discussion of this than I had expected, though it was mainly Professor Aggarwal who brought this up—but the first point is that it is very necessary, even for economists, to understand the frictions created by trade liberalization and especially the role of politics. Liberalization is not just an economic process. We need to figure out, whether it's through models or some other way, how politics will fit into an ideal set of economic policies.

Second, clearly everyone agreed that we need to look for ways to compensate losers. There are lots of ways that have been suggested—job training or simply compensation packages. One interesting idea that came out was this idea of worker mobility. Certainly, especially in the United States where workers can't even sell their houses if they own them, as well as not wanting to move to the other side of the country, this is a serious problem.

I thought that Professor [Christina] Davis' point about the way that Japan has put together a pro trade coalition through a package of compensation on the one hand and other kinds of supports for trade agreements on the other was an interesting thing, and we might be able to learn something from the Japanese case.

Third, many people talked about the fact that we need to strengthen Asian regional institutions, whether that be TPP-11 or ASEAN [Association of Southeast Asian Nations] or FTAAP [Free Trade Area of the Asia Pacific] or even RCEP. As we've been talking about, perhaps Japan can take a leadership role here, but we can never forget that right behind or right in front of Japan wanting to take a leadership role is [President] Xi Jinping and China.

Then, finally, we need to look for ways to strengthen the WTO. Christina Davis had a very interesting proposal in her paper, which didn't really make it into her presentation though she did mention it in passing here in the discussion. That was to put forward a Beijing Round of negotiations in the WTO and to force China to step up and let us really know what they think. If they're really interested in pushing forward liberal globalization, take leadership and see what they can push. I thought that that was actually a pretty creative idea and I was sorry that it disappeared in the presentation. I hope that we can find another way to talk about the possibility of a Beijing Round in the WTO.

Thank you very much. Thank you for all coming.

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Welcome Remarks

Hugh Patrick

Center on Japanese Economy and Business, Columbia Business School

Junichi Chano

Japan Foundation Center for Global Partnership

Takatoshi Ito

School of International and Public Affairs, Columbia University

Panelists

Moderator: David Weinstein

Center on Japanese Economy and Business, Columbia
Business School | 1991 Fellow

Vinod Aggarwal

Travers Department of Political Science,
University of California at Berkeley

Christina Davis

Woodrow Wilson School of Public and International Affairs,
Princeton University | 2006 Fellow

Taiji Furusawa

Graduate School of Economics,
Hitotsubashi University | 2009 Fellow

Moderated Discussion and Q&A

Closing Remarks

Barbara Stallings

The Watson Institute for International and Public Affairs,
Brown University



CENTER ON JAPANESE BUSINESS AND ECONOMY

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