

Japanese Trade Policy *

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Abstract

This chapter examines Japanese trade policy to explain how economic interests and domestic political institutions have supported the resilience of free trade policies in Japan. The mercantilist ideas and the reactive state model of past years have been replaced by strong support of free trade and Kantei diplomacy to lead in setting rules for the trade regime complex. Once dependent on the United States and mired in bilateral trade friction, Japan has emerged as an active supporter of engagement with China and pursuit of free trade agreements alongside continued commitment to the multilateral rules. Japanese-style trade adjustment and the slow path to liberalization served to balance economic efficiency with political stability as the government has supported narrow interests along with long term trade strategies for economic growth.

Keywords: Trade policy, globalization, World Trade Organization, free trade agreements, developmental state model.

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1 Introduction

As many countries have experienced backlash against globalization and a turn toward populism, Japan stands out as a stalwart defender of free trade and multilateral institutions. While President Trump openly mocks the World Trade Organization as a 'disaster' and withdraws from liberalizing agreements, Prime Minister Abe stands shoulder-to-shoulder with the WTO Director General and negotiates with proposals for WTO reform and leadership to conclude regional liberalization agreements. Japan has refrained from either initiating tariffs or responding to the trade war with defensive or retaliatory protection measures. Does this support for free trade result from a disconnect with voters or responsiveness to preempt discontent against trade? In asking these questions, this chapter evaluates Japanese democracy with regards to trade policy. It will consider the role of trade as a challenge to democratic effectiveness that requires governments to balance the interests of the mobilized few and the aggregate welfare.

The conventional wisdom about Japanese trade policy among experts and scholars long portrayed it as the "reactive state" seeking to minimize liberalization with partial steps taken after facing threats from trading partners (Calder, 1988b). At best, the conditions to open Japanese markets required a skillful combination of external pressure linked to domestic interests for an effective *gaiatsu* story of outside-in pressure (Schoppa, 1993; Davis, 2003). But by the end of the 1990s, many pointed to changes in this approach. Strengthening law in the multilateral setting gave new options that Japan could use to challenge protection by other countries so it was not only on the defensive (Pekkanen, 2001b; Iida, 2006). Within the proliferation of trade venues, Japan has sought to advance its trade interests with an increasingly diversified set of policies (Pekkanen, Solis and Katada, 2007). Belatedly the government began to take up the trend toward negotiating preferential trade agreements to avoid trade diversion (Manger, 2009). This period could be described as more active navigation of rules, but still left Japan in

the category of rule-taker. The departure of the most recent decade since 2010 represents Japan's foray into rule-making as the government proposes rule reforms and new agenda, initiates more litigation, and shapes high standard preferential agreements.

This chapter reviews the state of research on Japanese trade policy. It examines how preferences, domestic institutions, and the trade regime complex contribute to the evolution of Japan from reluctant to active leadership on trade policy. Empirical trends are evaluated in terms of trade flows and tariffs as well as policies related to WTO adjudication patterns and preferential trade agreements.

2 The Building Blocks of Japanese Trade Policy

Demand for Market Access

From the perspective of economic interests, open markets contribute to Japan's economic prosperity. During the period 2016-2018, trade constituted 17.4 percent of GDP. Japan ranks as the fourth largest exporter of merchandise goods in the world, and over eighty-six percent of its exports are manufacturing sector goods. The United States and China each received nineteen percent of Japanese exports in 2018. Japan also stands as the fourth largest importer of merchandise goods with petroleum as the leading import category. China is the largest source of imports (twenty-three percent), and the United States and Europe each provide around eleven percent of Japanese imports.¹ With its leading industries – automobiles, auto parts, and electronics – heavily reliant on overseas markets for sales, negotiations for market access are a high priority in Japan's trade policy agenda.

From the early years of the postwar era, the Japanese bureaucracy under the guiding role of METI supported an export-orientation backed by industrial policy in what came to be called the developmental

¹All figures from World Trade Organization Country Trade Profiles, available at https://www.wto.org/english/res_e/statis_e/daily_update_e/trade_profiles/JP_e.pdf accessed 25 January 2020.

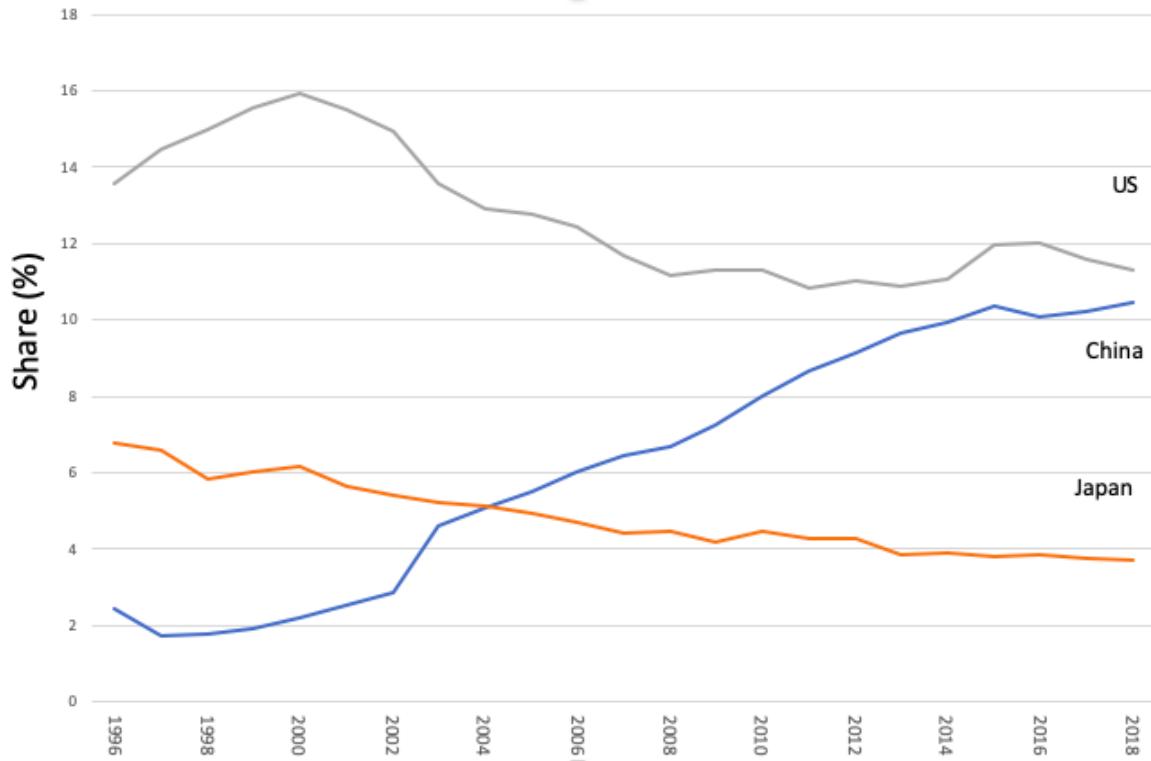


Figure 1: *World Trade Shares*: The graph shows shares of world trade in goods and services (Sum of imports and exports from balance of payments accounts measured in current US \$ figures). Data are from the World Bank.

state model (Johnson, 1982; Woo-Cumings, 1999). Through targeting select industries with potential knowledge spillovers and high returns to growth, the government sought to develop key export industries (Pekkanen, 2003). Much of the research on Japanese trade policy of this era examines the degree of public private cooperation fostered by industrial policy (Okimoto, 1989, e.g.).

With globalization, Japanese industry has been at the forefront of developing global value chains. The shift to invest in developing countries of East and Southeast Asia led to fears of offshoring but turned into a positive force to encourage growth (Hatch, 2010; Katada, 2020). Some scholars emphasize the market-driven logic whereby economic efficiency drove the creation of a regional production network, and others highlight political initiatives that facilitated their emergence (Pempel, 2005; Munakata, 2006; Ravenhill, 2010). Japanese multinational firms have deftly managed political tensions in order to gain

from optimal sourcing of inputs (Vekasi, 2020). The consequence has been to build a greater dependence on open markets in Japan's economy as a wide range of industries are engaged in related party trade with overseas affiliates. Figure 1 shows the declining share of Japan in world trade, but this underestimates the importance of exports by Japanese multinationals based in China and other countries that is attributed to their trade balance. In the year 2018, Japanese firm subsidiaries based in China were the source of twenty-seven percent of Chinese exports to Japan and one percent of Chinese exports to the world (excluding Japan).²

Positive views of Free Trade

There are high levels of public support for free trade. In a 2020 survey conducted by the Ministry of Foreign Affairs, 76.1 percent of respondents positively evaluate the government policy to support free trade.³ This was only a small drop from a high in 2017 when 81.6 percent responded positively.⁴ From this perspective, one could largely explain Japan's trade policy as reflecting broad economic interest and public support for free trade.

Yet the debate over trade in Japan has often given rise to sharp divisions. Leading up to ratification of the Trans-Pacific Partnership Agreement in 2016 (prior to U.S. withdrawal and renegotiation as the Comprehensive Trans-Pacific Partnership), opinion was split between 39 percent approval and 31 percent disapproval with a large number recording no opinion.⁵ Support falls when framing in terms of a tradeoff between gains for access to markets and losses for some industries at home. Concern for farmers is

²Author's calculation: Chinese export values are from "Country Profile: China", World Integrated Trade Solution, World Bank. Japanese manufacturing industry subsidiaries' sales data are taken from the "Trends in Overseas Subsidiaries" (Quarterly Survey of Overseas Subsidiaries, June 2020), Japanese Ministry of Economy, Trade and Industry.

³This combines two categories of response for those who *approve*, and those who *somewhat approve* the policy. The survey was conducted in March by telephone for a nation-wide random sample. MOFA survey available at https://www.mofa.go.jp/mofaj/press/release/press4_008414.html, accessed May 1, 2020.

⁴MOFA survey available at https://www.mofa.go.jp/mofaj/press/release/press4_004390.html, accessed May 1, 2020.

⁵TV Asahi poll results available at https://www.tv-asahi.co.jp/hst_archive/poll/201611/index.html accessed 5 April 2020.

especially high, and some of the views of the public reflect more than direct material interests. One perspective is that consumers consider pro-producer values and concerns about social or environmental outcomes that lead them to support regulatory policies and trade barriers contrary to economic theories about their interest in lower prices (Vogel, 1999). Naoi and Kume (2011) point to more sociotropic origins to preferences for protection, with evidence from a survey experiment showing that farm interests in Japan achieve more public support for protection when information prompts respondents to view them as producers; this elicits support from those who relate to shared job insecurity as producers competing in global economy. Consequently, Japanese trade policy navigates a reservoir of general support for free trade and concern for negative impact on weak sectors.

Domestic Institutional Context

A general pro-trade policy orientation among business and the public allows Japan to largely avoid a populist backlash against trade. The organization of interests by parties and filtering through institutional processes only reinforce this consensus. Without partisan differences or inter-branch conflict over trade openness, the voices of discontent remain on the margin.

There is little variation in the position of Japanese parties toward international trade. With the exception of the Japanese Communist Party, the engagement with the multilateral rules and support of an open position toward free trade holds strong support among the Japanese parties as a whole and especially the Liberal Democratic Party. At the same time, resistance to agricultural liberalization also benefits from political consensus. Rather than shifting priorities within the state, external pressures of negotiations have changed the aggregation of these interests in ways that promoted agricultural liberalization (Davis and Oh, 2007). There have also been critical institutional changes within Japan that relate to aggregation of interests. Naoi (2015) highlights how party centralization and majoritarian politics in the legislature

have enhanced Japan's use of trade liberalization alongside side payments to mitigate the discontents from liberalization.

Rarely has trade policy emerged as a central issue in elections. In particular, one might have imagined prominent attention to the Trans-Pacific Partnership during the 2014 election when negotiations were reaching their conclusion. During the lead-up to joining these talks, opposition within Japan by farm groups and other interests had grown fierce and public opinion was split. The 2012 election saw limited campaign attention as the DPJ was cautiously in favor of the agreement and LDP hedging its position with conditions suggesting it opposed the deal. After defeating the DPJ in the 2012 election, the LDP went ahead to formally join the TPP negotiations the next year. Yet by the December 2014 election, the LDP sought to hide the issue during the campaign to the point that it was a *stealth* decision (Katada and Wilbur, 2016).

Japanese-style Trade Adjustment

While remaining committed to an outward orientation of its trade policy, Japanese trade policy also features strong compensation to help uncompetitive sectors. On its path to liberalization, the government has retained barriers in sensitive sectors at higher levels and allocated subsidies to support declining industries. Packages to accept trade liberalization have been paired with compensation for those on the losing side. This approach is consistent with the broader strategy of redistribution that has helped to sustain the Liberal Democratic Party over decades of economic cycles and policy crises (Calder, 1988a; Estevez-Abe, 2008). It differs from the limited trade adjustment programs of the United States that target individuals harmed by trade, or comprehensive social welfare established in Scandinavian countries to provide general safety net for society. Instead, Japanese policies target sectors and regions with a mix of policies that include some to build competitiveness and others to offset economic losses. Critics

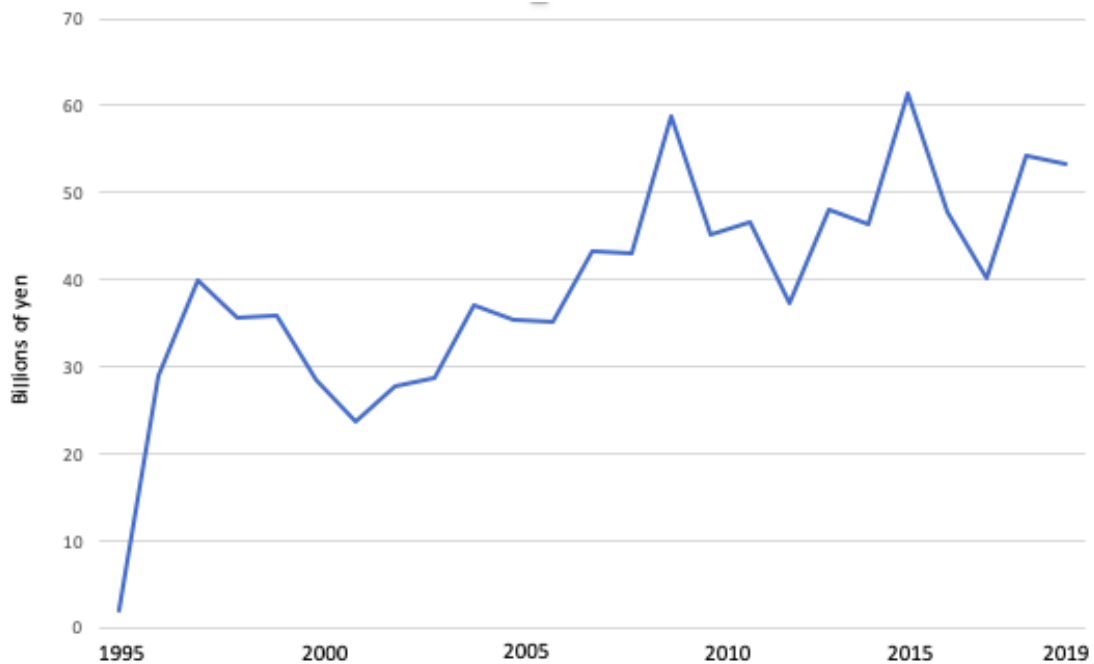


Figure 2: *Opening the Rice Market*: The graph shows the value of imported rice in Japan. Source: Ministry of Finance Trade Statistics of Japan.

worry that the compensation dynamic slows adjustment, but the result has helped to uphold a politically sustainable pace of structural change in the economy.

Nowhere is this pattern of slow reform and compensation for adjustment more evident than in agriculture. After decades of completely closing its rice market to imports, in the Uruguay Round agreement Japan accepted minimum access quotas to import rice. While the conversion to tariff-rate quotas in 1998 left a prohibitive 800 percent tariff on rice outside of the quota, the amount imported within the commitments expanded to slowly bring rice into Japanese markets (see figure 2). Across all protection of the agricultural sector, Japan has lowered the level of total support from 2.5 percent of GDP in 1986 at the start of the Uruguay Round to around one percent of GDP in 2018 (see figure 3). While this still leaves Japan at a higher level than most other countries, it nonetheless represents significant policy change.

Each step to liberalize agriculture has come with compensation and moderate reform. The Uruguay Round was accepted only after the government compiled a \$50 billion dollar package of assistance to ru-

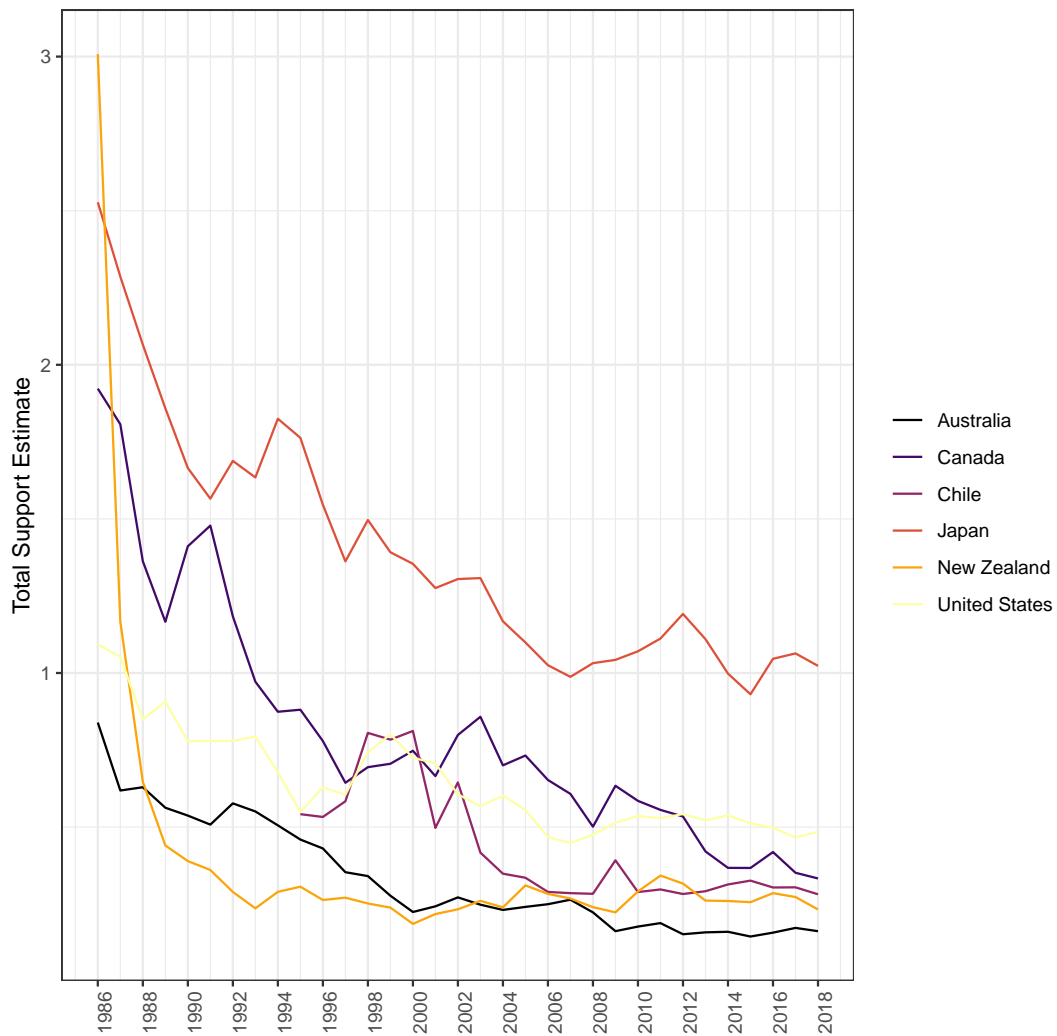


Figure 3: *Trends of Agricultural Protection*: The graph shows the Total Support Estimate which aggregates the net value of all transfers from taxpayers and consumers arising from agriculture policy measures as percentage of GDP. Data Source: OECD.

ral areas (Davis, 2003, p. 201). At the same time, the Uruguay Round Agriculture Agreement established constraints on agricultural spending that reinforced domestic reforms of the sector with the elimination of the Food Control Law that had administered prices since 1942 and further changes to loosen regulations over land ownership and commodity distribution. The Trans-Pacific Partnership agreement also offered a generous budget for counter-measures, with the largest share allocated to farmers and rural regions (Solis, 2017, p. 209). Prime Minister Abe catered to farmers during election periods as farmers remain a powerful political lobby and support for rural regions serves as a popular form of economic

redistribution (Maclachlan and Shimizu, 2016). Yet once he had secured election victory in 2014 with farmer support, Prime Minister Abe moved forward on agricultural reforms. Under the stated goal of doubling farm incomes, the government revised the Agricultural Cooperatives Law in 2015.

As a result of this liberalization and compensation approach, Japan continues to offer more support to its farmers than any other OECD member. The total amount of support provided to farmers reveals that Japan remains at the high end of industrial nations with generous levels of budget and price support provided. Under pressure from trade policies and through gradual domestic reforms after each round of negotiations, overall transfers have been declining.

Trade Policy Process

Scholarship on Japanese trade policy has long described inter-ministry rivalries that contribute to a fragmented policy process (i.e. Fukui, 1978; Calder, 1988b; Schoppa, 1997). Even as the Ministry of Foreign Affairs holds the lead role for international negotiations, it must share authority with the Finance Ministry that manages customs and the Ministry of Economy Trade and Industry that oversees both domestic and external trade policy. Other line ministries from agriculture to post and telecommunications further expands the potential veto players for any reform. Bringing in external pressure helped to overcome deadlock in critical areas such as agricultural liberalization (Davis and Oh, 2007). Such issues confront most governments, but have been notable in Japan due to rigid vertical organization within each ministry and the weak authority of political leaders.

Two changes have shifted this balance. First, as Japanese trade policy has adapted to globalization, METI has become a stronger advocate of liberalizing policies. From leading a mercantilist policy focused on its role to guide industrial policy, it has asserted new roles to advocate for opening the economy. It has developed legal strategies to use WTO dispute settlement instead of bilateral negotiations (Pekkanen,

2001a; Davis, 2012). At the same time, as deadlock of the WTO negotiations prevented progress on key issues for Japanese export interests, METI has led in the push for negotiating preferential trade agreements.

Second, trade has been a focus area for kantei diplomacy whereby the Prime Minister's Office asserts a greater role in the policy process (Shinoda, 2007; Katada and Wilbur, 2016). This new policy-making approach has expanded the authority of committees established at the Cabinet level. It has also been accompanied by more intervention by the Prime Minister's Office in appointments and delegation channels within the ministries (Pugliese, 2017). The emergence of Junichiro Koizumi and Shinzo Abe as long-serving prime ministers supported leadership. They could capitalize on administrative reforms that enhanced political control of the bureaucracy (Rosenbluth and Thies, 2010). Strategic appointments at top levels of the bureaucracy and increasing the staffing within the Cabinet office enabled the prime minister's office to push through policies such as the TPP and agricultural policy reform (Mulgan, 2018).

The new attention to digital trade by Japan is an example of this change in policy process. The issue had been part of a working group within METI on E-commerce that coordinated with counterparts in the WTO for mid-level discussions on data privacy, taxation, and other regulatory challenges. It suddenly emerged at the forefront of Japan's trade agenda when Prime Minister Abe raised it as part of the 2019 Davos World Forum. While there are benefits for Japanese multinationals and the issue represents an area for close cooperation with the United States, few saw strong industry lobbying or high public awareness of the matter prior to the Prime Minister's initiative to call for "Data Free Flow with Trust." He went on to make digital trade governance his signature policy for Japan's leadership of the G20 Osaka Summit in July 2019. The ideas were rapidly put into effect a few months later in the U.S.-Japan digital trade agreement, which sets a new template for digital trade governance. Top-down style and rapid development mark a new approach to trade by Japan that has facilitated shared leadership

of an emerging issue.

3 Japan's Place in the Trade Regime Complex

To the surprise of those accustomed to seeing Japan as mercantilist and reluctant to liberalize, the last decade has witnessed Japan emerging as one of the last bastions of free trade. In an era where the United States has begun to question the value of the multilateral trading system and engages in a trade war with China, it falls on Japan to help support a fragile regime complex built around the WTO and an expanding network of preferential agreements. While Japan remains closely tied to the United States in foreign policy and trade, the government has left behind the days of asymmetric dependence on the United States. China has been Japan's largest trade partner for the past thirteen years, and Japan has forged its own independent voice in regional diplomacy.⁶

Multilateral Rules

From the beginning, Japan was a rule-taker in the trade regime. As a former enemy state after the war, Japan was not part of the creation of the regime in 1948. It joined the General Agreements on Tariff and Trade in 1955 after five difficult years of waiting to earn approval of members and with modest concessions to open its own economy. The lenient rules on accession and geostrategic interests of the United States to support an ally made it easy for Japan to join without eliminating its industrial policy subsidies or making significant tariff reductions (Akaneya, 1992; Davis and Wilf, 2017). In turn, however, Japan's access was limited as several countries including the UK and many European countries granted membership while invoking the waiver to refuse Most-Favored-Nation treatment to Japan for nearly a decade.

⁶See Katada (2020) for comprehensive update on the new approach of Japanese economic statecraft in the region and Tamaki (N.d) on Japan's Asian diplomacy.

Japanese exports surged in the 1960s and 1970s such that trade tensions strained even relations with the United States. The open trading system was a critical condition for export-led development at this juncture that helped Japan retain access to markets while managing trade conflict. The rules allowed Japan to export while engaging in negotiations that slowly brought down its own barriers. The exceptions built into the multilateral regime were permissive of Japan's protection of its weak agricultural sector. Yet even here the pressures of multilateral deals and reciprocity eventually brought Japan to the table to allow more agricultural reforms and service liberalization to open up the underside of its dual economy.

For decades, Japanese trade policy was notable for its defensive response to bilateral demands in the form of a series of managed trade agreements (voluntary export restraints or administrative guidance for import quotas) (e.g. Calder, 1988b; Bergsten and Noland, 1993; Schoppa, 1997). Eager to satisfy U.S. demands, MOFA saw bilateral agreements as an efficient solution to resolve tensions. MITI could retain control as the mediator and enforcer of the agreement vis-a-vis domestic actors as it fell on the ministry to issue directives that would achieve the terms in the agreement. This process reinforced bureaucratic influence in relationships with firms. Entering the 1990s, however, the Japanese government could not as readily pressure firms that were both less reliant on government funds and licenses in a globalized economy and were facing the collapse of the bubble economy and onset of slow growth. Katada (2020) offers comprehensive argument of how this transition to become a *mature developmental state* has forced METI to transform its approach to foreign economic policy. Managed trade was increasingly unsustainable.

Searching for a way out of the endless cycle of negotiations with the United States, many sought a new approach. Joining hands with Europe, Japanese negotiators supported reforms for a more effective enforcement tool within the multilateral system. The more legalized dispute settlement process established as part of the World Trade Organization in 1995 allowed Japan to switch strategies towards a more aggressive use of law to challenge foreign trade barriers and defend against complaints (Pekkanen,

2001a, 2008). Figure 4 shows that Japan has been a regular participant to file complaints against other WTO members. The turn toward relying on WTO for enforcement of trade rules adds leverage against foreign governments and manages domestic demands for accountability (Davis, 2012).

Japan remains a strong advocate for the rule-based settlement of disputes, even as the most frequent user of the dispute process – the United States – challenges the Appellate Body through refusal to approve new justices. Japanese officials negotiated proposals in an attempt to address some of the issues criticized by the United States regarding procedures and judicial activism.⁷ Prime Minister Abe kept the WTO reform issue on the agenda at the G20 Osaka Summit in July 2019 with a leaders’ statement that urged WTO reform and action to support a functioning dispute settlement system. Japan refrained from joining the EU-led Interim appeal arrangement announced in May 2020 as a workaround response to U.S. opposition. In this way, the government seeks to mediate between the opposing sides in this latest challenge to the multilateral system.

Preferential Trade

Japan had long been committed to multilateral rules and less engaged in negotiation of preferential agreements. Indeed, Japanese officials were among those who voiced concerns at the GATT and WTO meetings on regional trade agreement notifications about their compliance with multilateral rules. It was not until the late 1990s that Japan first began to establish study groups and consider negotiating its own preferential agreements. The process went forward slowly, but over twenty years the government has now concluded significant number of preferential agreements to encompass a majority of Japanese trade.

One driving force has been to join the bandwagon and avoid negative effects of trade diversion. Early on NAFTA set up barriers that could have harmed Japanese auto industry access to the critical North American market. Not only for trade but also investment gains, it was critical for Japan to conclude a

⁷“Japan, Australia join reform push with WTO Appellate Body proposal,” *Inside U.S. Trade*, 19 April 2019.

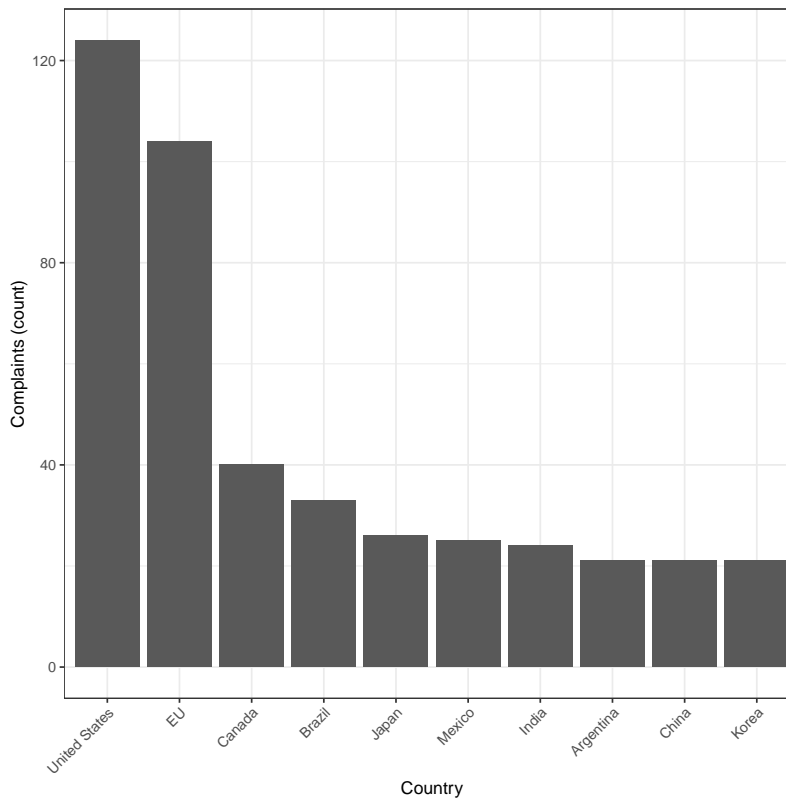


Figure 4: *Initiation of WTO Disputes by Country*: The graph displays the number of complaints filed by a country over the period 1995 to 2019 among the most frequent users.

free trade agreement with Mexico which it did under strong support from industry (Solis, 2003; Manger, 2009). The widening efforts of other countries to negotiate PTAs continued to raise the bar for Japan. In particular, as South Korea broadened its FTA partners including those in East Asia as well as the US and EU, Japanese industries felt urgent need to gain a level playing field. With tariff gaps as large as ten percent for important export products, negotiating an agreement to achieve equal access was a priority for industry and METI (Yoshimatsu, 2015). Entry into effect of the South-Korea EU agreement in 2011 and the U.S.-Korea Free Trade Agreement (KORUS) in 2012 increased the pressure on Japan. The government began trade talks with the EU in 2013 and in that year agreed to consider joining the Trans-Pacific Partnership negotiations that would have brought it into a free trade agreement with the United States.

Deliverable policies such as a free trade agreement also hold greater value in era of political compe-

tion and increasing attention to policy goals. Political conditions in Japan by the late 1990s were more favorable to the move toward active trade liberalization. Electoral reforms had brought in higher attention to policy goals and centralized party coordination (Rosenbluth and Thies, 2010). On the one hand, there is strong consensus to support agriculture across all of Japan's political parties. Yet both Komeito and the Democratic Party of Japan have shown more openness towards agricultural liberalization. Komeito joining the LDP ruling coalition from 1999 and the DPJ assuming ruling party status in 2009 shifted the policy preference of the government toward accepting the need for concessions on agriculture as part of an active trade agenda. Indeed, it was the DPJ government under Prime Minister Noda that advocated for joining TPP negotiations. While the LDP won its 2012 election on a platform that was seen as negative on TPP, this did not stop the government from going forward to enter the TPP negotiations and ratify the agreement (Davis, 2019). Prime Minister Abe would later usher in the agreement as a pillar of Abenomics.

Economic statecraft forms an outlet for diplomacy when pacifism and historical legacy continues to restrain Japan's leadership in the region for security affairs. Japan's foreign aid policy played a major role in diplomacy from 1980s through 1990s. In early years aid was seen as the supporting arm of outward trade and investment policy. Many saw its aid with yen loans as another tool to expand markets, although under pressure Japan shifted to larger shares of grant aid (Orr, 1990). Wan (1995) links the aid and trade policies of Japan during this era with a theory about how spending to support other countries reflected a strategic choice by Japan to offset its reluctance to engage in economic reforms – foreign aid could mitigate the negative impact of its mercantilist policies that accumulated a large trade surplus. By the early 1990s Japan had emerged as the largest donor. The economic downturn, however, restrained further ambition on this front as Japan's total ODA leveled off and began to decline in the late 1990s with policies focused more on partnerships with multilateral and NGO sector organizations. The shift

coincides with the onset of preferential trade initiatives as a new form of economic cooperation with neighbors that would not be as costly. Having begun reform of its own economic model, Japan could turn from spending aid to cover for its trade policy to instead use trade as positive offer for cooperation with countries of southeast Asia.

From a slow start, Japan has rapidly accumulated a large number of preferential trade agreements, which the government prefers to call “economic partnership agreements.” At this time it has completed agreements with Singapore, Mexico, Malaysia, Chile, Thailand, Indonesia, Brunei, ASEAN, Philippines, Switzerland, Vietnam, India, Peru, Australia, Mongolia, along with regional agreements with the ten ASEAN countries, eleven countries of CPTPP, and 28 members of the EU.⁸ Ongoing talks have taken place with the large grouping of the Regional Comprehensive Economic Partnership and trilateral negotiations among Japan, China, and the ROK along with a few additional bilateral negotiations. The phase 1 agreement with the United States for Trade in Goods falls short of the comprehensive economic partnership agreements above, but nonetheless is a significant step toward freer trade with the United States. As noted by former USTR negotiator Wendy Cutler, the terms were “amazingly similar to the provisions and market access commitments of TPP.”⁹ Exclusion of rice liberalization by Japan and auto market liberalization by the United States limits the overall commitments while the digital trade agreement forges new ground.

The early agreements were largely seen as low yield on economic gains. They were characterized by lower trade liberalization through selection of small partners, exclusion of sensitive sectors, and lower trade liberalization in terms of tariff reduction (Naoi and Urata, 2013, p. 329). Furthermore, utilization rates have hovered at lower levels as firms do not opt to trade at the preferential rate either because com-

⁸See METI update available at https://www.meti.go.jp/policy/trade_policy/epa/english.html, accessed 3 July 2020.

⁹“US-Japan trade deal is victory for Abe, not Trump,” *Nikkei Asian Review* 30 September 2019.

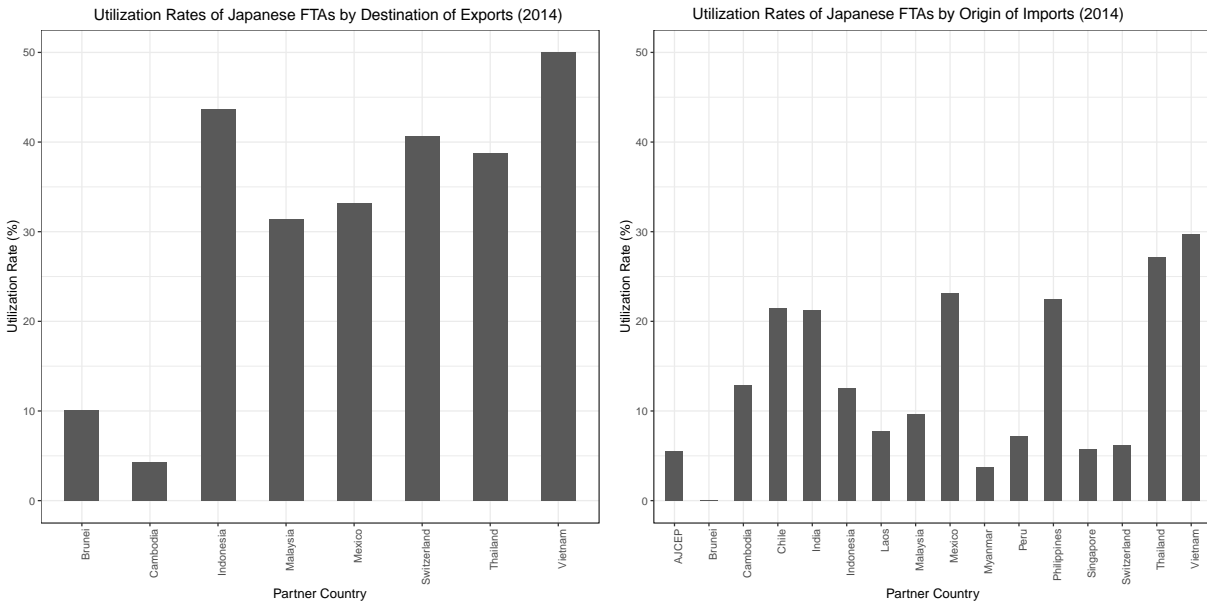


Figure 5: *FTA Utilization*: The graph shows utilization of free trade agreements for exports from Japan (left) and imports into Japan (right). This is a snapshot for the year 2014 when data was last available. Export data is from World Integrated Trade Solutions (World Bank), based on calculations from dollar values for exports under preferential rates relative to total value for exports under both preferential and MFN rates. Import data is from JETRO. The x axis indicates the agreement partners.

plicated procedures and rules of origin are burdensome or because the reductions do not align with trade demand. Figure 5 shows that Japanese firms exporting use the agreements at a higher rate than partner country firms trying to export to Japan. More recently, the CPTPP and the Japan-EU Economic Partnership Agreement stand out for encompassing larger trade partners along with most trade. In particular, the Japan-EU Agreement will eliminate tariffs on 94 percent of EU imports into Japan and 99 percent of Japanese imports into EU alongside significant regulatory harmonization and increased access for government procurement bids.¹⁰ Japan has moved from tentatively engaging in preferential agreements with smaller partners to setting high standard and comprehensive deals with major partners.

Closer examination of the process of negotiating this array of agreements reveals two trends. In comparison to the United States, Japan has been slower in the negotiation process, but faces few hurdles for approval in the legislature. The median time from initiating talks toward an agreement and final

¹⁰“Japan and EU: New leaders on global trade,” *Nikkei Asian Review*, 18 July 2018.

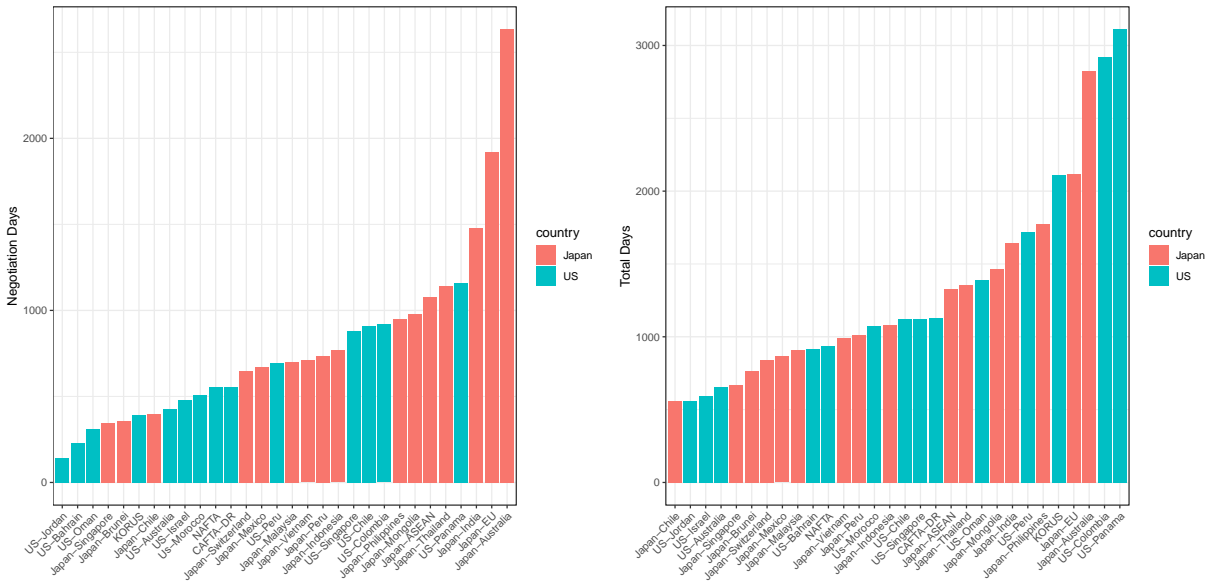


Figure 6: *Completing Trade Agreements*: The graph compares the U.S. and Japanese process for concluding free trade agreements. The figure on left shows time from start of talks to signing agreement and the figure on right shows time from start of talks to the agreement entry into force. The x axis labels identify the agreement partners.

entry into force has been 1047 days for Japan over its sixteen agreements, which is slightly less than the median 1122 days for the United States over its fourteen agreements. Yet the United States has a faster period in the negotiation – 532 days relative to 751 days for Japan, and accumulates longer time with days to ratification and transition for agreement to go into force.¹¹ Japan has not resorted to long phase-in of agreements. Figure 6 shows many long negotiations for Japanese agreements delayed at study group or negotiation phases that contribute to a long negotiation period, but the United States has several agreements that experience delays to achieve ratification in Congress and phase in the agreement.

This pattern is consistent with the Japanese-style trade adjustment discussed earlier. Building consensus and pairing agreement passage with compensation requires coordination that can slow the negotiation process. In the Uruguay Round, this led Japan to be among the last holdouts to agree to compromises for agricultural policy reforms. Within the government, parallel groups of officials in the agriculture min-

¹¹Delays for some U.S. agreements have resulted from the end of fast track legislation or the requirement that counterpart government ratify other treaties and make legislative changes prior to the agreement going into force, as in the US-Colombia FTA.

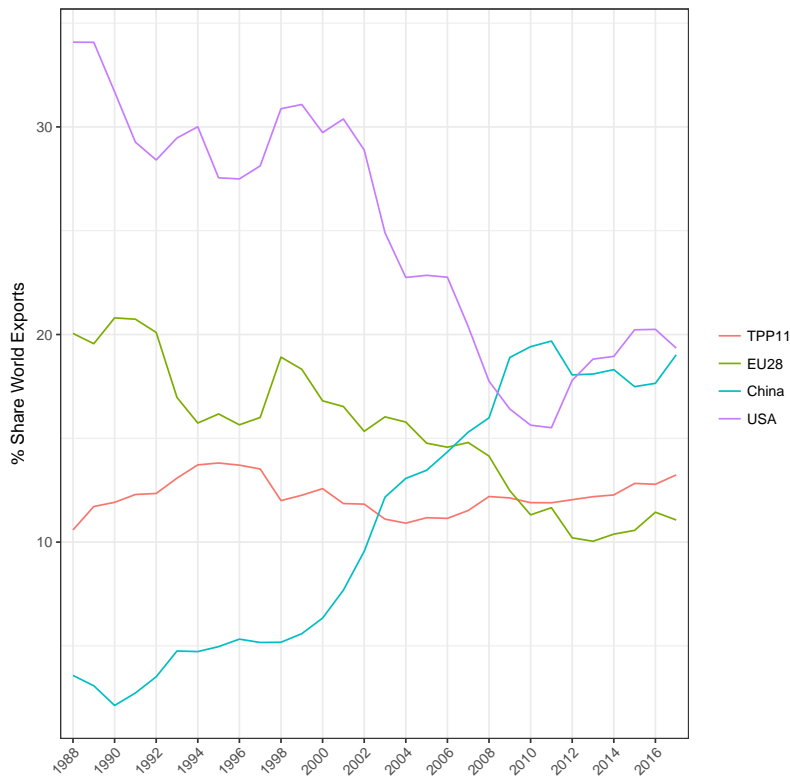


Figure 7: *Expanding Scope of Liberalization*: The figure shows the share of Japanese exports to trade partners as a percent of Japan’s total exports to the world. Data Source: United Nations Statistics Division, UN COMTRADE.

istry were assigned to cover trade negotiations and adjustment assistance planning, and in the final stage approval of the agreement was contingent on the Diet passage of a \$ 50 billion package of subsidies for farmers and rural areas (Davis, 2003, p. 201). For the CPTPP, Japan began considering entry into talks in 2009 but did not formally decide it would join until 2013. As Prime Minister Noda sought joining TPP as a priority of his administration, he was on the verge of announcing he would enter negotiations when the threat of resignation by his agriculture minister led to a vague statement to consider negotiations (Sakuyama, 2015, p. 166). Strong veto players and the need to pair trade agreement with compensation lengthen the time needed for the negotiation period in Japan. On the other hand, that early investment in consensus building saves time at the legislative approval stage.

The cumulative result for Japan now amounts to an impressive array of trade agreements. Figure 7

shows the growing diversification of Japanese exports away from the high dependence on the U.S. market in the 1980s. Having concluded preferential trade agreements with the EU, the eleven partner governments in the TPP, and the United States, Japan has established a high standard regulatory framework for a substantial share of its exports. The notable exception is China, where the government actively seeks a trade agreement.

Sino-Japanese Trade

Japan plays a significant role as referee for China's position in the multilateral trading system. Standing as a key ally of the Western alliance system with deep cultural and economic interests in China, Japan has strong incentives to encourage positive engagement with China. Its greatest challenge ahead lies in the effort to broker a resolution to current hostility between China and the United States.

Sino-Japanese relations were long centered on trade exchanges. From early participation in the Chinese tributary system to merchant trade continuing through Japan's two centuries of self-isolation and then its aggressive invasion of China, business has found ways to navigate complicated political relations. Following the communist revolution in China, Japan severed ties with China at the insistence of the United States, in a move resisted by many in Japanese business and political circles who viewed China as the natural partner for Japan's economic recovery. Indeed, U.S. advocacy for early entry by Japan into GATT was in part compensation to lure Japan away from trading with China (Forsberg, 2000, p. 112). Nevertheless, while following the U.S. policy to recognize Taiwan, Japan allowed private trade agreements with the PRC to continue in different forms. By 1970, Japan stood as China's largest trade partner and had been the source of important technology transfers such as a Japanese-financed synthetic fiber plant, and Japanese businesses provided critical industrial inputs such as fertilizer and steel (Vogel, 2019, p. 320-322). Once the United States announced it was engaged in talks with China, Japan's newly

selected Prime Minister Tanaka Kakuei visited China and normalized relations in 1972. This put Japan ahead of the United States and Europe in the establishment of ties with the PRC and launched a new era of expanding Sino-Japanese trade.

Japan played a critical role for China's entry into the WTO. When the Tiananmen Square killing of protesters sparked worldwide outrage it abruptly halted China's negotiations to join the GATT. Japan followed the West to impose economic sanctions, but it was the first to lift its relatively light sanctions. In 1990, the government announced that it would resume government-backed lending to China, and Prime Minister Kaifu signaled a return to normal diplomacy with a visit to Beijing in 1991 (Vogel, 2019, p. 355). Japan took an early stand in favor of Chinese accession to the trade regime. Early in 1994, the Foreign Ministry came out to publicly urge positive engagement toward letting China join GATT expeditiously.¹² Over the next five years, Japan used quadrilateral meetings with leaders from the United States, Canada, and Europe to urge the importance of accepting China in the WTO (Nakatsuji, 2001, p. 20). Even as other countries resisted, Japan continued its advocacy with Prime Minister Hashimoto making this a major part of his remarks for the 1996 G7 Summit meeting.¹³ The negotiations for China to join WTO would take much longer. Japan concluded its bilateral agreement ahead of both the EU and United States. The announcement of Japan's agreement with China on terms for market access of goods in 1997, was criticized in Europe and the United States for not seeking enough concessions from China and favoring an early deal for political reasons.¹⁴ Japanese negotiators defended the need to let China enter the WTO on realistic terms that recognized it would retain significant tariffs, which should be left for future negotiations to lower barriers after it had become a member.¹⁵ This helped set an approach

¹²“Shushou Chuugoku no Gatto kamei sokushin shiji Nichibei Shunou Kaigi de Hyoumei (Prime Minister supports China's GATT membership, will announce at US president discussion).” *Sankei Shimbun*, 8 February 1994.

¹³“Nichibei Shunou Kaidan no Omo na Hatsugen Hashimoto Shushou Kurinton Bei Daitouryou (Main statements from US-Japan leader talks between Prime Minister Hashimoto and President Clinton).” *Asahi Shinbun*, 18 April 1996.

¹⁴“Japan Takes Soft Approach to China Over WTO,” *The Financial Times* 15 September 1997.

¹⁵“Japan denies EU claims on China talks,” *The Financial Times* 17 September 1997.

that would eventually characterize the decision by all members to let China enter the WTO – demanding some liberalization at accession as part of an ongoing gradual move to open markets.

Heralding Japan’s role to help bring China into the WTO, the 2001 Japanese Foreign Ministry “Blue Book” explains the rationale behind its approach:

Japan has supported the realization of early accession to the WTO by China believing that this will serve to strengthen the multilateral trading system, further promote China’s reform and open policy, and enable China to become a more constructive member of the international community. In 1999, during Prime Minister Obuchi’s visit to China, Japan reached a substantive agreement with China on bilateral negotiations, the first among advanced nations, thereby lending momentum to the advancement of China’s accession negotiations with other countries and groups.¹⁶

Nineteen years later some challenge whether China’s state-led capitalism is compatible with the WTO. Many share disappointed hopes over the degree of reform achieved by China and its role in the organization. This presents the challenge of whether Japan can now mediate the conflict.

The trade war between the United States and China since 2018 has caught many Japanese firms in the cross-fire. Over seventy-percent of Japanese executives surveyed in March 2019 felt the US-China trade war would harm their business.¹⁷ Japanese multinationals with joint ventures in China face new tariffs for sales to the United States that led some to consider moving plants to alternative locations, and the Japanese government bowed to U.S. pressure to limit purchases from the Chinese telecommunications giant Huawei.

To date Japan has avoided direct confrontation with either side. The Japanese government refrained from retaliation against the U.S. tariffs imposed on steel and aluminum even as other governments in-

¹⁶Diplomatic Bluebook 2001, Chapter 1, Section D. Japan’s Main Bilateral Relations. MOFA.

¹⁷“Global economy threatened by China slump: Japan CEOs,” *Nikkei Asian Review*, 27 March 2019.

cluding Canada and the EU as well as China imposed retaliatory measures and initiated a complaint at the WTO against the U.S. measures. Although it has joined U.S. complaints against China as a third party, Japan has to date only been a complainant against China in two WTO dispute cases it filed in 2012.¹⁸ Japanese firms have responded to tensions arising in the Sino-Japanese relationship by diversifying their supplies and supporting host communities in China to counteract the challenges (Vekasi, 2019, 2020). As the leader of the G20 summit meeting in July 2019, Prime Minister Abe managed to smooth over differences among participants to achieve a joint statement in support of the trading system with a commitment to “keep our markets open” and pledge to work constructively with WTO members for reforms of the WTO.¹⁹

Forging ahead with its own trade agreements with CPTPP and Japan-EU trade agreement forms a way for Japan to apply pressure on the United States and China. Japanese negotiators continue to advocate for the RCEP talks that would bring China into a broader agreement for better market access in the region. The bilateral trade in goods free trade agreement with the United States cemented US-Japan cooperation. Japan has joined Canada and EU to formulate proposals for reform of the WTO in hopes to restart a negotiation process for multilateral trade. Since the May 2018 onset of US-China trade war, together with the US and EU, Japan has joined six trilateral meetings to shape consensus on a WTO reform agenda and approaches to their common concerns about China’s trade policies.²⁰ At the same time, Japan renewed engagement with South Korea and China during meetings in December 2019 as another line of trilateral cooperation endorsing the need to build a free trade agreement between the three countries and support the WTO negotiation process. Japan’s strategy represents an open door

¹⁸DS 433 “Measures Related to the Exportation of Rare Earths” resolved in favor of Japan in 2014; DS 454 “Measures Imposing Anti-Dumping Duties on High-Performance Stainless Steel Seamless Tubes” resolved in favor of Japan in 2015.

¹⁹Commentators noted when the G20 finance minister meeting in 2017 dropped the statement to ‘resist protectionism,’ and again when the 2018 G20 leader’s statement in Toronto failed to include any reference to WTO or endorsement to avoid protectionism/uphold open markets. In comparison, the 2019 declaration was positive step for a pro-trade endorsement.

²⁰“U.S., Japan commit to WTO dispute settlement reform, e-commerce rules,” *Inside U.S. Trade* 13 May 2020.

approach to welcome deeper integration with China even while hedging against over-reliance on China by building deeper ties with other partners.

4 Conclusion

As some countries question their commitment to open trade, Japan has been embracing deeper liberalization. Despite slow economic growth and rivalry with China as a powerful neighbor, few calls arise in Japan for decoupling the economy from China or globalization. On the contrary, Japanese trade policy presents a strong commitment to multilateralism and an expanding number of free trade agreements. The foundation of this resilience in Japan's commitment to open trade lies in both interests and policy. Leading export industries, public opinion, and the political elite support free trade. Japanese-style trade adjustment has helped to moderate resistance by limiting the scope and pace of liberalization while pairing it with compensation to targeted regions and industries.

The domestic political context supports this aggregation of interests for a stable policy outcome. Increasing centralization of authority in the Cabinet office facilitates coordination across ministries and policies developed to serve broad interests. Kantei diplomacy today has replaced the reactive state model of the past. Yet this is not an unresponsive form of top-down governance. Norms of consensus and the political influence of declining sectors such as farmers put a brake on liberalization to assure that redistribution softens its impact. The result has been a politically sustainable level of liberalization.

To return to the opening question, how has Japan withstood the backlash against globalization and populism? This chapter argues the answer lies in the building blocks of economic interest and domestic institutions that have been supported by trade policy strategies to pair liberalization with trade adjustment and engage actively in rule-making. Japanese democracy has shown itself effective to navigate the transition from a closed mercantilist economy to a fully open economy with a government that aspires to

lead in support of the free trade regime. The long path of lowering protection walls while still retaining barriers in sensitive sectors frustrated foreign trade negotiators for decades, but also avoided the backlash at home from abandoned regions or workers. To the extent that slowing structural adjustment of declining sectors provided a cushion for employment and regional development, it was less efficient by economic standards. Moving faster, however, may have risked political instability. The choice of Japan in trade policy reflects a careful balancing of both economic and political goals.

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