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**Trade Policy Issues and Policy Options
for Japan and the United States:
Introduction and Overview**

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TRADE-POLICY ISSUES AND POLICY OPTIONS FOR JAPAN AND THE UNITED STATES

Introduction and Overview

Gary R. Saxonhouse and Robert M. Stern¹

1. INTRODUCTION

Since January 2002, the WTO members have been engaged in discussions and meetings designed to achieve agreement on the important negotiating issues that comprise the Doha Development Agenda (DDA). These issues include: reductions of import tariffs on manufactured goods; reductions in agricultural import tariffs, export subsidies, and domestic support measures; liberalization of barriers to trade in services; anti-dumping and safeguards measures; intellectual property rights (IPR) protection; dispute settlement; and the implementation of the (1994) Uruguay Round Agreements. In July 2004, the WTO member countries agreed on a framework that is intended to provide the basis for DDA negotiations. However, the long delay in the conclusion of the Uruguay Round, and the long and contentious negotiations that were required before the DDA framework for future negotiations, have led many countries to actively pursue regional and bilateral free trade agreements even as they continue to be involved in efforts to forge a multilateral trade agenda at WTO. Since 2000 Japan has already signed a bilateral FTA with Singapore and is actively considering FTAs with a variety of other countries. The United States has also recently negotiated several bilateral FTAs and is actively pursuing a number of others.

The symposium that follows includes papers that analyze a number of the issues that are likely to play a key role in the DDA negotiations.² These issues are analyzed from the

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² This symposium includes a group of policy-oriented papers that were presented and critiqued at a conference in Tokyo on May 22nd – 23rd, 2004. This conference was sponsored by Japan Foundation's

perspective of US-Japanese economic relations. In these papers the economic effects of the WTO negotiating options available to both countries are explored. A final paper examines the important issues raised by the FTAs that have or will soon be negotiated by the United States and Japan, including in particular the economic effects that the arrangements will have on those two trading giants, other member countries and non-member countries, and the extent to which the FTAs may undermine the momentum towards and the potential benefits of a successful conclusion of the WTO DDA multilateral negotiations. Brief summaries of the trade policy papers are provided in the following section after which we will offer some concluding remarks on Japan's role in the WTO and in the Doha Development Agenda multilateral trade negotiations

2. OVERVIEW

In his paper, "Failure of the WTO Ministerial Conference at Cancun: Reasons and Remedies," Robert Baldwin notes that the breakdown of the 2003 Ministerial Conference in Cancun, Mexico and the only modest progress made since then in carrying out meaningful trade-liberalizing negotiations in the Doha Development Round is a disturbing indication of the fragility of the existing institutional arrangements for settling trade disputes and promoting the further liberalization of world trade. He first discusses four general developments in the world trading system that have made it increasingly difficult in recent years for nations to reach multilateral agreements aimed at further liberalizing international trade, namely: (1) the increased technical complexity and disruptive domestic economic effects of the issues being negotiated; (2) the shift in relative bargaining power among the negotiating participants in favor of the developing countries; (3) the proliferation of bilateral and regional free trade agreements in contrast to multilateral agreements, and (4) the increased emphasis on achieving "fairness" rather than reciprocity in trade liberalization.

Center for Global Partnership. Another group of papers from this conference will be published in the June 2005 *Journal of the Japanese and International Economies*.

Baldwin then examines differences in the negotiating positions of the WTO members on the major specific negotiating subjects of the Doha Round, such as new rules covering investment, competition policy, government procurement policy, and trade facilitation (the so-called Singapore issues); agricultural liberalization; changes in antidumping and countervailing duty rules; the tariff-cutting rule to increase access to nonagricultural markets, and further liberalization in the services sector. Finally, he considers the possibilities of reaching acceptable balances of concessions and gains for such key participants as the Group of 20 developing countries, the European Union, the United States, and other industrial countries.

Baldwin's general conclusions are that achieving a balance of gains and concessions for all participants does seem feasible if a more limited agenda is pursued than outlined in the Doha Ministerial Declaration. But the major developed-country trading powers must also recognize that the new bargaining power of the developing countries means that the negotiating goals of the developing countries must be given much more consideration if the negotiations are to come to a successful conclusion. At the same time, the developing countries must appreciate that a successful negotiation is not possible by simply applying concepts of "fairness" to establish new rules.

The paper by Masahoshi Honma, "WTO Negotiations and Other Agricultural Trade Issues in Japan," examines the current stage of WTO negotiations on agriculture and discusses the issues of greatest concern to Japan. These issues include the multi-functionality of agriculture, food security and safety, and tariff peaks. Honma also discusses agricultural issues in free trade area (FTA) negotiations relating to Japan. He examines in particular the proposed FTA between Japan and Korea as a model for further negotiations with other Asian countries especially.

With regard to Japan's domestic agricultural policies, Honma stresses that: (1) structural reform in Japanese agriculture is essential to promote the WTO agricultural negotiations and to make negotiations on FTAs more effective and prompt; (2) Japan must consider various measures

to increase the investment of capital from outside agriculture and the accumulation of new human capital; (3) there should be increased market competition in Japanese agriculture so that productive resources can be better concentrated in efficient farms and farm businesses, through various developments in management, instead of adherence to farming by family-farms. On international issues, he notes that it may be desirable to establish an international forum, particularly among Asian countries, to discuss important agricultural issues in the region. This forum should consider not only agricultural tariff reductions, but also sanitary and phyto-sanitary (SPS) measures that might be addressed in working toward a broader FTA in Asia. Honma suggests that this forum might be called “Agricultural Partnership in Asia.” The objective would be for Japan to play a strong leadership role in seeking wider cooperation on agricultural policies and agricultural resource management together with potential FTA partners in the Asian region.

Keith Maskus in his paper, “Intellectual Property Rights in Agriculture and the Interests of Asian-Pacific Economies,” describes recent and ongoing processes of technological change in agriculture, which has become a highly R&D-intensive sector in many countries in the Asia-Pacific region. He also considers the role of various forms of intellectual property rights (IPRs) in promoting such technological changes and in affecting their diffusion through the region. A central part of his discussion is a review of how these various IPRs operate and are protected in major economies of the region.

Maskus then turns to an assessment of the economic interests of key countries, including the United States, Canada, Australia, China, Japan, and the Republic of Korea, in global and regional policy evolution in agricultural IPRs. These interests are a mix of comparative advantage in farming, which is quite distinctive among these countries, and the technological basis of production, which is more convergent. A review of available measures of innovation in the region suggests that all of these economies are active in developing new agricultural technologies, although there is considerable specialization in the types of processes developed.

Given this mix of divergence in comparative costs and convergence in technology interests, Maskus notes the difficulty in describing sharply the preferences these economies are likely to have in continued globalization of agricultural IPRs. However, his analysis points to some areas in which countries may continue to specialize -- thereby retaining the ability to remain in specific areas of farming --- and other fields in which international collaboration may be sensible.

New international arrangements on competition policy and antidumping, on the one hand, divide the US from Japan and Europe, and, on the other, East Asia from the rest of the world. These issues have hamstrung multilateral negotiations in the past, and are likely to complicate negotiations in the future. Thomas Prusa, in "East-Asia's Antidumping Problem," examines the growth of antidumping (AD) actions initiated against and by East Asian countries, which have been the leading targets of antidumping investigations for more than 30 years and, in fact, are subject to a disproportionate share of AD actions. AD is a serious problem for East Asia and the extent of the abuse towards East Asia has not been well recognized in previous studies.

Two findings emerge from Prusa's review of AD disputes. First, over the past 25 years the East Asian economies -- Japan, Indonesia, South Korea, Malaysia, Philippines, Singapore, Thailand, China-Taiwan, and China-PRC -- have been subject to an extraordinarily large number of AD actions and have accounted for most of the worldwide growth in AD actions. Thus, East Asian countries accounted for about one-third of all AD actions during the 1980s, more than 40% of all AD actions during the 1990s, and almost 50% of all AD actions in recent years. Prusa's analysis suggests that the growth of AD has largely come at the expense of East Asian countries. Secondly, the data also suggest that East Asian countries have largely shunned the use of AD. Historically, East Asian countries have accounted for less than 5% of AD filings worldwide. In contrast, with almost all other countries, such restraint is highly unusual.

More formal statistical methods confirm Prusa's findings. After controlling for factors that might influence filings such as the exchange rate and trade volume, Prusa finds that East

Asian countries are subject to about twice as many cases as compared either to North American or Western European countries. Moreover, he finds that the trend in filings against East Asian countries is increasing, meaning that in recent years the propensity for countries to direct their AD filings against East Asian countries is growing. In interpreting his results, Prusa considers whether the growing intensity of using AD against East Asia is driven by actions directed at China-PRC. He finds, however, a rising propensity, even excluding China-PRC from the analysis. Looking from the other side of AD actions, Prusa finds that North American countries file more than six times as many actions as do East Asian countries, holding other factors constant. On either side of the AD process, East Asian countries thus definitely stand out as outliers.

Safeguards actions are an alternative to AD for coping with import competition within the WTO framework. In “An Evaluation of Japan’s First Safeguards Actions,” Arata Kuno notes that Japan has been one of the major GATT/WTO member countries with relatively little experience in implementing protectionist measures. But, in April 2001, for the first time in its history, Japan invoked provisional safeguard measures against imports of Welsh onions, Shiitake mushrooms and Tatami mats mainly from China. Kuno reviews and evaluates the chain of events regarding these safeguard actions, and he considers the means by which Japan might be able to deal with its “trilemma” policy problem involving how to coordinate the promotion of trade liberalization, the administration of WTO-consistent safeguards, and responses to domestic political demands for protection.

Kuno reviews the theoretical rationale for implementing safeguard measures and counterarguments against these measures. He also discusses the economic circumstances in which Japan implemented the safeguard measures and evaluates these measures critically from the standpoint of economic efficiency and the political economy interests involved. He recommends that the aforementioned “trilemma” policy problem can be best addressed by means

of the introduction of a domestic program to provide adjustment assistance to ameliorate the displacement resulting from import surges.

Ichiro Araki, in his paper, “The Evolution of Japan’s Aggressive Legalism,” characterizes “aggressive legalism” as the use of WTO multilateral trade rules and processes as the chief framework for dealing with disputes with trade partners. He notes that Japan’s use of the dispute settlement mechanism since the formation of the WTO in 1995 is a marked departure from its past practice of favoring bilateral, non-legal settlement of trade disputes. However, on closer examination, he suggests that, while Japan has been moderately active in using the WTO dispute settlement process for resolving its trade disputes, it behaves more like a country that resorts to surgical strikes on selected targets, usually the United States, under a powerful cover of actions taken jointly especially with the European Community. In comparison with Japan, Araki notes that Korea’s attitude in using the WTO dispute settlement mechanism appears to be more aggressive.

Araki further observes that the Japanese Ministry of Economy, Trade and Industry (METI) may not be content with the status quo and may wish to bolster its aggressiveness in the WTO dispute settlement mechanism. But he suggests that METI may face an uphill battle, especially because of the difficulty facing trade officials in Japan arising from the lack of a national system for registering WTO complaints that is open to any citizens or firms, similar to Section 301 of the U.S. Trade Act of 1974 or the European Trade Barriers Regulation. Nonetheless, in the historical context, he concludes that Japan is far more aggressive than in the past in utilizing the rules of the GATT/WTO to advance its national interests, and that it is unlikely, notwithstanding the contentious safeguards case described in Kuno’s paper, ever to resort to bilateral actions or the imposition of grey-area measures.

In their paper, “The Menu of U.S.-Japan Trade-Policy Options,” Drusilla K. Brown, Kozo Kiyota, and Robert Stern (BKS) use the Michigan Computational General Equilibrium (CGE) Model of World Production and Trade to calculate the aggregate welfare and sectoral

employment effects of the menu of U.S.-Japan trade policies. The menu of policies encompasses the various preferential U.S. and Japan bilateral and regional free trade agreements (FTAs) negotiated and in process, unilateral removal of existing trade barriers by the two countries, and global (multilateral) free trade. The U.S. preferential agreements include the FTAs approved by the U.S. Congress with Chile and Singapore in 2003, those negotiated in 2003-04 with Central America, Australia, and Morocco and receiving Congressional approval in 2004, and prospective FTAs with the Southern African Customs Union (SACU), Thailand, and the Free Trade Area of the Americas (FTAA). The Japanese preferential agreements include the bilateral FTA with Singapore signed in 2002 and prospective FTAs with Chile, Indonesia, Korea, Malaysia, Mexico, Philippines, and Thailand.

The welfare impacts of the FTAs on the United States and Japan are shown to be rather small in absolute and relative terms. The sectoral employment effects are also generally small in the United States and Japan, but vary across the individual sectors depending on the patterns of the bilateral liberalization. The welfare effects on the FTA partner countries are mostly positive though generally small, but there are some indications of potentially disruptive employment shifts in some partner countries. There are indications of trade diversion and detrimental welfare effects on nonmember countries for some of the FTAs analyzed. Data limitations precluded analysis of the welfare effects of the different FTA rules of origin and other discriminatory arrangements.

In comparison to the welfare gains from the U.S. and Japan bilateral FTAs, the gains from both unilateral trade liberalization by the United States, Japan, and the FTA partners, and from global (multilateral) free trade are shown to be rather substantial and more uniformly positive for all countries in the global trading system. BKS note that the U.S. and Japan FTAs are based on “hub” and “spoke” arrangements, and they depict graphically how the spokes emanate out from the hubs in different and often overlapping directions. The patterns of spokes thus suggest that the complex of the U.S. and Japanese bilateral FTAs reflect distortions of the global trading system. They conclude that these distortions resulting from preferential arrangements

could be eroded or eliminated by means of multilateral trade liberalization, as in the current Doha Development Agenda negotiations.

3. JAPAN AND THE MULTILATERAL TRADING SYSTEM

Japan's role in the multilateral negotiations that have shaped the international trading system have never been commensurate with its large share of global GDP and global trade. For decades these negotiations have been dominated by the United States and Western Europe. It was only at the very late stages of the Uruguay Round that Japanese negotiators began to exhibit the skill, experience, and capacity for alliance-building that allowed them to play a central role in resolving a number of important outstanding issues.

Japan's coming of age in economic diplomacy has been quickly upstaged by still newer actors, first in Seattle in 1999, and more significantly in Cancun in 2003. At Cancun, developing countries led by Brazil, China, and India were able to scuttle the meeting in a manner almost unimaginable a decade before. As Baldwin notes, to the extent that developing countries demand the reduction of agricultural subsidies and the lowering of import barriers, it is difficult for Japan to make common cause with them. The decline in the potential power of Japanese agriculture has lagged by many decades its decline in economic power. Rationalization of agricultural policy of the sort recommended by Honma and Maskus will be necessary before Japan is able to be a diplomatic bridge in the Doha Round between the developing countries, the European Union, and the United States.

Perhaps no country has benefited more than Japan has from the reconstruction and elaboration in the second half of the twentieth century of the international trading system. The multilateral lowering of tariff and non-tariff barriers decade after decade has allowed Japan to receive significant gains from the global division of labor, even as its economic structure changed dramatically over these years with the accumulation of capital and skills and the importation and local development of new technologies. The emergence of the World Trade Organization has

afforded Japan new guarantees that its access to important foreign markets will remain unimpaired. While, as shown by Araki, the newly strengthened Dispute Settlement Understanding has been used only selectively by Japan, it is now clear to Japan's trading partners that attempts to exert pressure on Japan outside the WTO framework are unlikely to be successful. As in the automobile dispute with the US in the spring and summer of 1995, to deflect pressure, Japan will turn to the WTO for help.

While the new Dispute Settlement Understanding has strengthened Japan's hand in its dealings with the United States and the European Union, it has had much less impact on its diplomacy with the world's developing countries. Unlike the United States and the European Union, as Prusa and Kuno note, Japan has hardly used anti-dumping or safeguard measures to soften the impact of positive structural change abroad on its domestic market.

With all the advantages that have accrued to Japan from the multilateral trading system, it is not surprising that for many years Japan, alone among the world's major economies, stayed aloof from regional trading arrangements. As already noted, the very past success of the multilateral trading system has made further progress at this level far more complex and has pushed many countries, Japan included, to look to new and deeper regional trading agreements as a more productive path. It should not be forgotten, as Brown, Kiyota, and Stern make clear, that regional FTAs may be easier to conclude, but their benefits are modest compared with what can be gained from a successful Doha Round, and the costs from new distortions imposed on regional trade can be very significant for some of the world's poorer economies. Every good reason remains for Japan to continue to wish to be a pillar of the WTO and of the new Doha Round.