

Over the course of the last decade, Japan has been undergoing a major policy shift towards a new multilateral approach to trade, which will lead to the gradual opening of the country to new goods and services but also labor flows. The country's willingness to increasingly embrace multilateralism and globalization is all the more remarkable as these two forces face growing backlash in a number of countries, particularly in the US and Europe. These contradictory trends were thrown into sharp relief in October 2018: while the political campaign in the US for the mid-term election went into hyper-drive over the issue of a "caravan" of Central American migrants looking to cross the US border, Japan made plans to let in blue-collar foreign workers without a time constraint, thus representing a major break with longstanding policies. The Japanese Prime Minister, Shinzo Abe, aims to revise the current immigration laws to offer relief over severe labor shortages in industries such as health services, construction and agriculture. This proposal, which was extensively debated at the extraordinary Diet session in late October, is in line

with Shinzo Abe's broader strategic shift towards increasing the country's commercial multilateral footprint, under the aegis of new comprehensive trade agreements. The goal is to not only address the structural issues hindering Japanese economic growth but also to bolster Japan's position in the future economic world order.

This strategy is, however, under the growing threat of the US administration under President Donald Trump. Faced with the US leader's protectionist views on trade, which led to the country's withdrawal from the Trans-Pacific Partnership (TPP) in early 2017, Japan has sought to maintain its policy course. Adjustments to US pressure, including the acceptance of bilateral talks, as Shinzo Abe did in September, seem unlikely to derail Japan's multilateral push. The first reason is domestic, as this push actually supports the broader economic strategy of the country, called Abenomics. Structural reforms – the third "arrow" of the Abenomics – have encountered the most resistance and slowest progress so far. External pressure (or "Gaiatsu") –

here embodied by the TPP - was politically useful for Shinzo Abe to push for difficult reforms at the domestic level. The second is regional and global: the ideological foundations of current trade patterns are presently shared by a large coalition of economic actors, as illustrated by the survival of the TPP following the US withdrawal. Finally, as the US leadership on trade appears to fade, a situation especially salient in the Asia-Pacific region, Japan is offered the strategic opportunity of asserting its position as a global defender of multilateralism.

The TPP Shift

The strategic turn towards multilateralism was encapsulated by Japan's endorsement of the TPP, the negotiations of which it officially joined in 2013. This ambitious deal initially encountered resistance in Japan, as it touched on several key sensitive sectors of the Japanese economy (the agricultural sector and the automotive industry in particular). However, the option of joining the US-led TPP came at a point of political inflexion in Japan. The return of Shinzo Abe at the premiership in December 2012 (after a short stint in 2006-2007) and the launch of his eponymous signature economic strategy, Abenomics, constituted a catalyzing force for change in Japan's trade policy. At that point, Japan was lagging behind its economic rivals in terms of trade deals: South Korea in particular had concluded FTAs with both the EU (provisionally applied in 2011) and the US (entered into force in 2012). Under the TPP, Japan was gaining access to new economic opportunities

in Australia, Brunei Darussalam, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam and the US. In order to do so, the country made significant concessions, including the opening of its agricultural sector, which required the still ongoing reform of the powerful farming lobby, the Agricultural Cooperatives (JA). Crucially, however, this type of new generation deals goes beyond the narrow focus on trade and tariffs. It includes not only services but also aims at setting the rules for complex economic ties (on intellectual property, environment, labor) and investment.

The New Mantle of Free Trade

Japan's commitment to multilateralism was confirmed by the prime minister's speech at the United Nations General Assembly (UNGA) in September 2018, when Shinzo Abe stated that "Japan has now taken on the mission of imparting to the world the benefits of trade." Since the mantle of the world's advocate for free trade was relinquished by the US under Donald Trump, there have been a few contenders for the title, including China. The Chinese president, Xi Jinping, gave several speeches, at the World Economic Forum in Davos in January 2017¹ or at the BRICS Business Forum in South Africa in July 2018,² where he

¹ Larry Elliot and Graeme Wearden, "Xi Jinping signals China will champion free trade if Trump builds barriers," *The Guardian*, 18 January 2017, <https://www.theguardian.com/business/2017/jan/17/china-xi-jinping-china-free-trade-trump-globalisation-wef-davos>

² Mu Xuequan, "Xi says China firmly supports free trade, opens market with new platforms,"

delivered a strong defense of globalism. Meanwhile, Japan's credentials for this global title were buoyed by its key role in keeping the TPP alive³ after the withdrawal of the US. Japan was the second country to ratify the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in July 2018, which is set to come into force in 2019. The country's claim to the title of global leader on trade was also supported by the signature of the EU-Japan Economic Partnership Agreement (EPA) in July.^{4,5} Japan's eagerness to engage with a broad coalition of partners, such as India, Australia, Indonesia or Russia (for energy in particular and connectivity), also highlights its willingness to take the global mantle. Meanwhile, at the regional level, the country maintains its commitment to conclude negotiations for the Regional Comprehensive Economic Partnership (RCEP),⁶ a proposed free

Xinhua, 26 July 2018, http://www.xinhuanet.com/english/2018-07/26/c_137348277.htm

³ Eunseo Kim, "The CPTPP and Its Implications for Japan," *The Diplomat*, 4 May 2018, <https://thediplomat.com/2018/05/the-cptpp-and-its-implications-for-japan/>

⁴ Fukunari Kimura, "Japan-EU agreement provides ballast amid the rising tides of protectionism," *East Asia Forum*, 11 September 2018, <http://www.eastasiaforum.org/2018/09/11/japan-eu-agreement-provides-ballast-amid-the-rising-tides-of-protectionism/>

⁵ Edward Danks, "The EU-Japan Partnerships: Advancing the Abe Doctrine?," *The Diplomat*, 17 August 2018, <https://thediplomat.com/2018/08/the-eu-japan-partnerships-advancing-the-abe-doctrine/>

⁶ Mie Oba, "TPP, RCEP and the Liberal Economic Order," *The Diplomat*, 2 September 2018, <https://thediplomat.com/2018/09/tpp-rcep-and-the-liberal-economic-order/>

trade agreement between the ten member states of the Association of Southeast Asian Nations, Australia, China, India, Japan, New Zealand and South Korea. Japan, along with China and South Korea, are also calling for an acceleration of ongoing talks on a trilateral agreement between the three countries.⁷

Managing the Trade Surplus With the US

Japan's multilateral trade policy must nonetheless account for the disrupting impact of Donald Trump's approach to trade, focused on reducing US trade deficits on a bilateral basis. In the zero-sum-game view on trade embraced by the US President, a deficit appears to be interpreted as the sign of being taken advantage of by trading partners. Japan, with its total trade (goods and services) surplus with the US of US\$55.5bn in 2017, was bound to be the target for Donald Trump.⁸ Acknowledging this risk, Shinzo Abe has worked on building personal rapport with Donald Trump at his Mar-a-Lago property and on the golf course. These efforts seem to have, however, yielded only limited results as it did not prevent the US from exerting

⁷ Laura Zhou, "China, Japan and South Korea aim to speed up talks on free-trade agreement to counter US tariffs," *The South China Morning Post*, 22 September 2018, <https://www.scmp.com/news/china/diplomacy/article/2165260/china-japan-and-south-korea-aim-speed-talks-free-trade>

⁸ "The US is wrong to obsess about its trade deficit with Japan," *The Financial Times*, 7 June 2018, <https://www.ft.com/content/ca72afcc-6961-11e8-ae1-39f3459514fd>

intense pressure on Japan to redefine ties in the favor of the former within a bilateral framework.⁹

During his trip to Japan in November 2017, the US president asked his host country to buy more American products and invest more in the US. More recently, he commented on social media about his efforts, with Shinzo Abe, to “balance-out the one-sided trade with Japan.”¹⁰ On the latter point, Donald Trump appeared oblivious to the fact that Japan already ranks second in terms of foreign direct investment in the US, behind the UK. Japanese companies are heavily invested in the US market, employing directly and indirectly about 1.6m Americans, according to Keidanren, the Japan Business Federation.¹¹ On the former point, Japan can do little on its own to address the current macroeconomic dynamics driving US trade, with America’s appetite for cheap imports sustained by its dominance of the global financial system and its ability to issue US dollar denominated debt. On a more limited and shorter-term horizon, Japan can reduce its merchandise trade surplus with the US by increasing its energy

imports. Others have also employed this strategy, as is the case of South Korea, which has also been on the receiving end of Donald Trump’s obsession with trade deficits.¹²

Increasing US Military Purchases

Another mitigation strategy for Japan is to ramp up US military equipment purchases. This strategy has already been deployed, partly for that trade purpose but also amidst a trend of increased military spending in Asia (driven partly by China’s rising assertiveness in the South China Sea and by North Korea’s rapidly improving ballistic and nuclear capabilities).¹³ Over the summer of 2018, the Japanese Defense Ministry proposed a total defense spending of around US\$ 47,7 billion for the fiscal year starting in April 2019, representing a 2% increase compared to the previous year.¹⁴ This spending excludes the funds to support the presence of US troops in Japan.

Such a strategy of increased US military equipment purchases is, however, not

⁹ Liz Moyer, “President Trump hints to WSJ that trade fight with Japan could be next,” CNBC, 6 September 2018, https://www.cnbc.com/amp/2018/09/06/president-trump-hints-to-wsj-that-trade-fight-with-japan-could-be-next.html?__twitter_impression=true, <http://time.com/5375925/donald-trump-misunderstands-trade-japan-trade-minister/>

¹⁰ <https://twitter.com/realDonaldTrump/status/1053070661302669312>

¹¹ “The US is wrong to obsess about its trade deficit with Japan,” *The Financial Times*, 7 June 2018, <https://www.ft.com/content/ca72afcc-6961-11e8-ae11-39f3459514fd>

¹² “S. Korea’s trade surplus with U.S. drops 24 pct on-year: data,” *Yonhap News*, 30 September 2018, <http://english.yonhapnews.co.kr/news/2018/09/30/0200000000AEN20180930001100320.html>

¹³ “Abe reaffirms to Trump that Japan is willing to buy American military equipment,” *Nikkei Asian Review*, 28 September 2018, <https://asia.nikkei.com/Economy/Trade-War/Abe-reaffirms-to-Trump-that-Japan-is-willing-to-buy-American-military-equipment>

¹⁴ Alastair Gale and Chieko Tsuneoka, “Japan to Spend Billions on U.S. Missile-Defense System,” *The Wall Street Journal*, 31 August 2018, <https://www.wsj.com/articles/japan-to-spend-billions-on-u-s-missile-defense-system-1535693483>

only a short-term limited fix, but also gives in to Donald Trump's problematic impulse to tie trade to defense and security alliances. The US president has not shied away from stating that the US should obtain better commercial returns in exchange for maintaining its security alliances in East Asia. He has publically complained about the costs associated with maintaining US troops in South Korea and Japan, and has hinted at his readiness to withdraw them, partially or fully. This readiness was also confirmed by his surprise announcement regarding the cancellation of a joint military exercise between the US and South Korea at the US-North Korea summit in Singapore in June this year. This decision was met with uneasiness by Japanese officials and only reinforced existing concerns regarding the future of the security alliance.¹⁵ Reducing US security commitments (in terms of bases and troops in Japan) and forcing Japan to further increase its spending on its own defense would be an attractive kill-two-birds-with-one-stone strategy for Donald Trump.

Giving In to Pressure: TAG Talks

Even leaving the security alliance issue aside, Japan's ability to resist mounting US pressure on bilateral trade talks was fading. The most visible sign of pressure came in March 2018 when Japan failed to secure an exemption

from the worldwide US tariffs imposed on aluminum and steel imports.¹⁶ Such exemptions were granted on a temporary basis to a few allies (such as the EU) and on a permanent basis after the tariffs fulfilled their pressuring goal: South Korea obtained a permanent exemption after agreeing to Donald Trump's demands to renegotiate the bilateral FTA on better terms for the US. After almost two years of pushing back against US pressure, Shinzo Abe appeared to give in to Donald Trump, by announcing in late September, on the sidelines of the UNGA in New York, Japan's agreement to start negotiations for a bilateral "Trade Agreement on Goods" (TAG).¹⁷ This shift in Japan's position was triggered by the US threat to impose tariffs of 25% on Japanese automobile exports voiced in the summer of 2018.¹⁸ Such tariffs would have dire consequences for the Japanese economy as a whole: the value of auto exports accounted for about 40% of the total Japanese trade surplus with the US and the losses for the six largest Japanese carmakers

¹⁵ "Editorial: As US, South Korea suspend military drill, allies need to communicate more," *The Mainichi*, 21 June 2018, <https://mainichi.jp/english/articles/20180621/p2a/00m/0na/005000c>

¹⁶ "Japan plays it cool on response to US steel tariffs," *The Financial Times*, 4 August 2018, <https://www.ft.com/content/c7fc9ae0-37e4-11e8-8b98-2f31af407cc8>

¹⁷ Reiji Yoshida and Cory Baird, "Japan-U.S. trade talks may be less of a concession than they appear," *The Japan Times*, 27 September 2018, <https://www.japantimes.co.jp/news/2018/09/27/business/japan-u-s-trade-talks-may-less-concession-appear/#.W69B4TuVvdk>

¹⁸ "Japan girds for Trump auto tariffs with trade talks set to resume," *Nikkei Asian Review*, 16 September 2018, <https://asia.nikkei.com/Economy/Trade-War/Japan-girds-for-Trump-auto-tariffs-with-trade-talks-set-to-resume>

would directly impact their activities in Japan, in terms of employment and taxable revenues. According to Shinzo Abe, the threat of US tariffs to Japanese auto imports will be put on hold during the TAG negotiations. This is a similar arrangement – a commitment to talks – as the one found between Jean Claude Juncker, the European Commission President, and Donald Trump in July, as the US was dangling the same tariff threat on European cars.

Limited Pain?

There is still a risk that the US could implement the 25% tariffs should it feel that the pace of the talks is lagging. However, based on the details that emerged from the meeting between Donald Trump and Shinzo Abe, the scope of the talks appears to be relatively limited¹⁹ and therefore manageable on the domestic political front for the Japanese Prime Minister. In the statement issued on the subsequent meeting between US Trade Representative Robert Lighthizer and Japanese Economic Revitalization Minister Toshihimitsu Motegi in New York, the US did not appear set on pushing too hard on the politically sensitive agricultural sector, as it promised to keep its market access demands within the framework of “previous economic partnership agreements.” This would match the Japanese position of not offering better terms than the ones that

had been previously negotiated within the TPP. Meanwhile, the US will likely concentrate its efforts on obtaining an increase in automobile production based in the US and on related employment opportunities. This was already part of the ongoing corporate strategies deployed by Japanese automakers²⁰: according to the Japan Automobile Manufacturers Association, its members built nearly 4 million vehicles in the US in 2016.

Another reassuring factor for Japan’s leadership is the recent track record on trade talks of the US administration.²¹ Based on the outcomes of the renegotiations of the North American Free Trade Agreement (NAFTA) and of the US-Korea Free Trade Agreement (KORUS FTA), it appears that limited tweaks to existing deals, touted by Donald Trump as the greatest deals ever, are enough to please the American side. After threatening to withdraw from both NAFTA and KORUS and months of aggressive rhetoric, these updated deals present little change and are set to leave existing trade flows and patterns predominantly unchanged. Shinzo Abe will aim to achieve similar results – limited changes to existing trade patterns - with the TAG talks. The conclusion of a new NAFTA deal – the United States-Mexico-

¹⁹ Tobias Harris, “Abe’s Art of the Deal: What the Japanese Prime Minister Won in New York,” *The Diplomat*, 2 October 2018, <https://thediplomat.com/2018/10/abes-art-of-the-deal-what-the-japanese-prime-minister-won-in-new-york/>

²⁰ Daniel Shane, “Trump wants Japan to build more cars in the U.S.,” *CNN Business*, 6 November 2017, <https://money.cnn.com/2017/11/06/news/economy/trump-japan-autos-fact-check/index.html>

²¹ “Nafta Is Dead. Long Live Nafta,” *Bloomberg*, 2 October 2018, <https://www.bloomberg.com/view/articles/2018-10-02/usmca-united-states-mexico-canada-agreement-is-trump-s-new-nafta>

Canada Agreement (USMCA) - in early October also offers significant relief to Japanese manufacturers based in Canada and Mexico, which are exporting their output to the US.

Navigating the US-China Trade War

Shinzo Abe may have avoided greater pain for the country's auto industry and its agricultural sector by making the calculated concession to start trade talks with the US. However, Japan is still exposed to Donald Trump's global approach to trade and to the ripple effects on the global economy of the ongoing US-China trade war.²² The latest episode in the tensions between the world's two largest economies came in late September, when Donald Trump announced new tariffs of \$200 billion on Chinese imports, prompting China to retaliate with counter-measures on \$60 billion in US goods. This, in turn, led to another threat by the US president of further levies of up to \$257 billion being imposed on Chinese products. Far from being isolated from the tariff war between China and the US (respectively its first and second largest trade partners), Japan is heavily exposed through its regional and global supply chains, in which China plays a crucial role.²³ More broadly, dimming global

trade prospects – and weaker global demand - will weigh down on Japanese export performance.

The prospects of continuing trade tensions between the US and China may force Japanese companies to move their manufacturing operations out of China to avoid the tariffs. This would reinforce existing trends to shift production to other locations in South-East Asia, owing to both rising wages in China and a persistently challenging environment in terms of competition fairness. This assessment still relies, however, on the assumption that a broader redefinition of global trade flows, away from a US-centric model, is unlikely in the short to medium term. In particular, rising Chinese consumption levels are still not sufficient to compensate for the tariff-driven loss of market share in the US by Japanese companies operating in China. Japanese businesses are also facing increasing competition from their Chinese counterparts on the Chinese market for consumer goods.

Finally, the relationship with China remains politically fraught. The economic pragmatism, recently illustrated by Shinzo Abe's visit to China in late October, shows that there is a mutual understanding on strong common economic interests, as well as a degree of opportunism on both sides as the US rolls out protectionist measures.

²² Lingling Wei, "China Cancels Trade Talks With U.S. Amid Escalation in Tariff Threats," *The Wall Street Journal*, 22 September 2018, <https://www.wsj.com/articles/china-cancels-trade-talks-with-u-s-amid-escalation-of-tariff-threats-1537581226>

²³ Cory Baird, "Japanese firms face tough choices as U.S.-China trade war drags on," *The*

Japan Times, 24 August 2018, <https://www.japantimes.co.jp/news/2018/08/24/business/economy-business/japanese-firms-face-tough-choices-u-s-china-trade-war-drags/#.W7PqhDuVvdK>

However, the trade relation remains more geared towards competition, for markets and influence, than coordination. Further increasing Japan's reliance on China for its external trade performance would also come with matching political risks: for Shinzo Abe domestically, vis-à-vis his conservative base, and geopolitically, owing to China's willingness to implement economic retaliatory measures over international disputes.

Closing Ranks With EU Allies

Going forward, Japan's trade policy will remain tested by Donald Trump's attacks on multilateralism and its institutions, such as the World Trade Organization (WTO), but also by China's rising global economic weight and its appetite for a matching global influence. This context will further support the need for a diversified multilateral strategy. In this context, Japan will be able to rely on the EU's support, owing to fundamentally shared visions on trade. This has been highlighted recently on both the economic and strategic levels with the signature in July 2018 of the long-awaited Economic Partnership Agreement (EPA) and of a Strategic Partnership Agreement. The EPA is important not only in terms of its coverage of almost 30% of the global GDP, but also in terms of its content: in addition to the commitment to trade in goods, services and investments, it includes the most up-to-date EU provisions on corporate governance, the mobility of natural persons for business and Intellectual Property Rights (IPR) protection. This

joint effort to develop models for new generation trade agreements is all the more important that it can help anchor the US trade policy. Interestingly, a senior US Agriculture Department official, Ted McKinney, expressed optimism in late October that negotiations with Japan would proceed quickly as the two countries have "templates" – including the EPA – that could serve as starting points.²⁴ Joint efforts by Japan and the EU to maintain coordination on economic affairs with the US were also illustrated in late September during the UNGA by the statement on the trilateral meeting of the Trade Ministers of the US, Japan, and the EU.²⁵ This jointly issued document showed shared concerns in defending existing market rules (on subsidies, state-owned companies and technology transfers) against non-compliant "third countries" (a thinly veiled reference to China). It also highlighted common interests in reforming the WTO and in the future of digital trade and e-commerce.

Japan's way forward is uneasy, and navigating its ties with the two largest economies (and its main trade partners) will prove unnerving. However this situation also offers Japan the opportunity

²⁴ "USTR to hold hearing in December over trade talks with Japan," *The Japan Times*, 27 October 2018, https://www.japantimes.co.jp/news/2018/10/27/business/economy-business/ustr-hold-hearing-december-trade-talks-japan/#.W9jnTDsu_dk

²⁵ "Joint Statement on Trilateral Meeting of the Trade Ministers of the United States, Japan, and the European Union," 25 September 2018, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/september/joint-statement-trilateral>

to shape the future rules of trade, along with like-minded partners such as the EU. This will be all the more crucial for Japan, as the country continues its domestic efforts towards structural reforms amid challenging long-term trends, such as aging demographics, in order to maintain its global economic status.