Japan Looks to Trans-Pacific Partnership to Transform its Economy

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Since passage of its “Action Plan for Economic Structural Reform” in 1997, Japan has initiated a number of reform initiatives to restructure its economy. As a result, Japan today possesses a dramatically different business environment than even a decade ago. Much of this adjustment, however, sought results without the political challenges and often-painful adjustments that are an essential part of the transformation process.

Faced with a stagnating economy and an aging population, Japan’s Democratic Party of Japan (DPJ) adopted a New Growth Strategy last June. The Strategy seeks to restructure Japanese industry, encourage advanced business models, and enhance economic integration between Japan, Emerging Asia and other members of the Asia-Pacific community, including the United States.

To further these goals, Prime Minister Naoto Kan took another bold step last November when he announced an intention to “open Japan” and enter talks concerning the Trans-Pacific Strategic Economic Partnership Agreement (TPP). Entry into the TPP will introduce competition and enhance Japan’s ability to participate in regional and international markets. Strong leadership will be required, however, to garner the public support needed to overcome opposition in sectors such as agriculture, which have enjoyed a protected domestic market.

Development of broad agreements such as TPP and the Free Trade Area of the Asia Pacific (FTAAP) are essential -- not only for Japan -- but the world at large. They expand trade and innovation, are necessary to sustain a global economic recovery, and allow continued expansion of the emerging markets of East Asia.
Additionally, measures such as the Growth Strategy adopted at least year’s annual Asia Pacific Economic Cooperation (APEC) Leaders Summit in Yokohama promise further movement toward regional integration through efforts to promote balanced, inclusive, sustainable, innovative, and secure growth.

Japan hopes to build on the success of the Yokohama Summit and to work with the United States and other APEC member economies to further the Yokohama Agenda in the lead-up to the next annual Leaders Meeting in November 2011 in Hawaii.

To facilitate discussion of TPP and East Asian integration as well as the many trade and investment opportunities that will result, the Japan External Trade Organization (JETRO) will be hosting two seminars in Washington, DC, in coordination with the Center for Strategic and International Studies (CSIS), and Chicago, with co-organizers including the Chicago Council on Global Affairs, on March 2-3 respectively.

The Importance of Trade to Achieving Sustainable Growth and Recovery

For several decades, Japan has thrived on exports to developed nations, primarily the U.S. and EU. Over the last ten years, however, Japanese exports to the U.S. have almost halved, and to Europe declined by about 33%. Weakening demand from these traditional trade partners along with anemic domestic consumption, creates an imperative for change. This includes both policy reform, as well as new business models that can address structural deficiencies and introduce growth into Japan’s stagnating economy.

Deteriorating macroeconomic fundamentals are also taking a toll, as rising debt-to-GDP ratio and a reliance on bond issuance to finance government spending is reaching its limit. In remarks at the 2011 opening Diet session, Minister of Finance Yoshihiko Noda stated, “The financial state of our nation is becoming increasingly severe” and noted the nation’s debt burden can not rely on bond sales and an inward focus to cover revenue shortfalls. Furthermore, according to the Organization for Economic Co-operation and Development (OECD), Japan’s public debt is set to exceed twice the size of its economy in 2011 and reach 210% of GDP in 2012.
To address these and other important concerns, Prime Minister Naoto Kan and the DPJ announced a [New Growth Strategy](#) in May 2010, followed by the Ministry of Economy, Trade and Industry (METI)’s [Industrial Structure Vision](#), which further delineated the challenge of reshaping the Japanese economy.

A common theme in the New Growth Strategy and the Industrial Structure Vision is the need to “open Japan” to drive economic growth. Prime Minister Kan admirably stated his intention to lead Japan to this end in his speech at the APEC CEO Summit on November 13, 2010. He noted:

> “Many countries around the world are now “opening up,” entering into economic partnership agreements one after the other and forming free trade areas. Frankly speaking, Japan is now getting left behind this global tide current. It is impossible to conceive of Japan’s prosperity except as walking down the path to growth together with the globe, and with the Asia-Pacific region in particular, a region undergoing marked development.”
Integrating Japan into the Emerging Asia-Pacific Community

Economists view an emergent middle class as a key indicator of prosperity and growth within a national economy. Emerging Asia registers positively in this regard as recognized in a report by OECD, Economist Homi Kharas, who described China and India as having “reached a tipping point where large numbers of people will enter the middle class and drive consumption.”

Other Asian economies are also transforming themselves into leading drivers of growth and consumer demand. In 2009 for examples, Emerging Asian economies including China, India, Indonesia, Thailand, Vietnam and the Philippines registered real GDP growth of 6.2% compared to a global decline of -1.1%. Looking forward, the International Monetary Fund (IMF) projects the share of world GDP held by emerging and developing economies in purchasing power parity terms (PPP) will surpass advanced economies by 2014. This phenomenon is analyzed in detail within a Standard Chartered Bank report launched last year with a release titled “The World is in a Super-cycle once again, this time led by Asia.”

Households with Annual Disposable Income of U.S. $5,000-15,000

Source: Euromonitor International from national statistics. Data for 2010 and 2020 are estimates
Furthermore, J.P. Morgan Securities found from 2007 to 2009 consumption in emerging markets registered 32% of global market share, exceeding the 28% consumption seen in the U.S. Finally, in 2009, China overtook the U.S. as the largest purchaser of automobiles, purchasing three million more vehicles than the U.S.

The shift toward accelerating growth in these markets combined with sluggish demand in the developed world underscores the need for Japanese companies to expand in these economies. Emerging markets are prime targets both in terms of industrial and consumer products. Japanese firms are among the most competitive in transport equipment, general machinery, and electrical equipment. As production continues to be centered in the emerging world and their domestic consumption accounts for an increasing portion of global market share, Japanese firms are well positioned to play a central role in Emerging Asia.

*Japan Works to Create Balanced and Sustainable Growth in Emerging Asia*

The successful advance of Emerging Asia has resulted in a range of new challenges that must be addressed to sustain its growth and development. Rapid growth is causing food and cost inflation, environmental problems, logistical, energy and supply chain constraints. These are
just a few of many issues that will require the development of more capacity, a more sophisticated corporate and financial sector and better regional coordination. Upgrades in the regions physical, financial, institutional and regulatory infrastructure are also essential.

Japan has long played a key leadership role, both in institutions such as the Asian Development Bank (ADB) and the Economic Research Institute for ASEAN and East Asia (ERIA), which are designed to advance regional development as well as through the activities of large and small Japanese companies who are active throughout the region.

While hosting APEC's annual 2010 Leaders Meeting in Yokohama, Japan demonstrated skillful regional leadership guiding APEC member economies toward an economic Growth Strategy that embraced five attributes: balanced, inclusive, sustainable, innovative, and secure growth. The APEC Leaders’ Growth Strategy and Yokohama Vision of 2010 states, “We seek to develop an APEC community in which trade and investment are freer and more open; supply chains are better connected; doing business is cheaper, faster, and easier; growth is more balanced...”

The Yokohama vision also emphasized the need for enhanced regional economic integration by promoting free and open trade and investment and working towards attaining a FTAAP.

**FTA/ EPA’s Enhance Regional Integration and Free and Open Trade**

Multilateral trade agreements like the Doha Development Round of the World Trade Organization (WTO) have proved challenging in recent years due to the varied interests of member-states participating in the negotiations. As a result, the Round has stalled dues to disagreements over the domestic dislocations that would be imposed through adoption of measures relating to agriculture and fisheries, financial and other services and the environment. Specifically, there have been disputes over the elimination of tariffs and subsidies, differential treatment between developed and developing countries, and implementation timetables.
Failure to complete global trade agreements has enhanced the importance of bilateral economic partnership agreements (EPAs) and regional free trade agreements (FTAs). Bilateral and regional trade agreements can provide Japan with economic and diplomatic advantages. Members of the agreement obtain preferred access to each other’s markets through reductions or elimination of tariffs and reduced trade barriers. Bilateral and regional FTAs are also more straightforward to negotiate than broad, multilateral trade agreements.

**Japanese Economic Partnership Agreements Concluded since 2002**

Realizing that bilateral and regional EPA/FTA’s are essential to sustain its competitive viability, Japan has entered into eleven EPAs since 2002. Other economies, however, have been more aggressive in pursuing these agreements. South Korea, for example, has concluded talks for FTAs with the United States, EU, and India and these agreements account for 35.6% of its trade. In comparison, Japan’s eleven EPAs account for 16%. Japan’s agreements have also liberalized trade less comprehensively than the FTAs Korea has sought to sign. The biggest constraint has been an inability to fully address the issue of agriculture.
Agriculture and Japan’s Domestic Focus Impinge on its Ability to Enter EPA/FTAs

Like many countries with entrenched industries that are sheltered by preferential treatment, Japanese ability to enter FTAs has been constrained by domestic resistance. Its agricultural industry opposes any agreement that would reduce or eliminate tariffs on their products. JA-Zenchu, the Central Union of Agricultural Co-operatives, has released reports arguing cheaper imports will destroy Japan’s food sovereignty and “our country’s agriculture will be dramatically reduced and destroyed completely. Regional economies and communities will also collapse including related industries.”

These tariffs, including a 777% tariff on imported rice, a 252% tariff on wheat, and 360% tariff on butter have sustained Japanese farmers for many years without requiring them to raise their competitiveness to international levels. As a result few have sought to expand
their businesses in foreign markets despite the popularity of Japanese cuisine in world markets. Furthermore, the Ministry of Agriculture, Forestry and Fisheries warns that Japan’s inclusion in regional FTAs would cause 3.4 million lost jobs at a cost to the country of about 4 trillion yen. As a result, in previously negotiated EPAs, Japan has always insisted agricultural produce like rice and dairy stay exempt from tariff reductions.

Much of the reason for this special treatment is that Japan’s agricultural industry has substantial influence, electoral clout and effective organization. One recent study titled “Explaining Mass Support for Agricultural Protectionism” examines this phenomenon, and attributes the sympathetic view of many Japanese people to fear over jobs and food security, as well as a desire to protect traditional farming communities, and the environment.

Responding to these pressures, many elected politicians, including those in the Prime Minister’s own DPJ, depend on support from agriculture-friendly constituencies and according to an OECD report, in 2008 government aid accounted for 48% of gross agricultural output value in Japan. This is almost twice the support found in the EU and several hundred percent more than what is seen in the U.S. or Australia.
Free trade advocates, however, question the veracity of claims that high farm tariffs help Japanese farmers improve productivity or raise food self-sufficiency. More than one analyst has pointed out that even with the special treatment accorded to the agricultural sector, 60% of domestic food consumption in Japan on a caloric basis imported.

The bottom line is Japan needs to change its agricultural policies regardless of its impact on Japanese efforts to initiate reforms and to conclude more EPA/FTAs. As Prime Minster Kan stated in an interview with the Wall Street Journal, “In Japan, the average age of agricultural workers is 65.8. When the aging of its population is accelerating so rapidly, it will be difficult to sustain the sector whether we liberalize trade or not.”

*Japan’s Inward Focus also Inhibits its Ability to Succeed in International Markets*

Another issue inhibiting trade is the so-called “Galapagos effect,” the insular application of Japanese innovation and isolationist mentality. As Gerhard Fasol, president of the Tokyo-based IT consulting firm, Eurotechnology Japan stated to The New York Times, “Japan is years ahead in innovation. But it hasn’t been able to get business out of it.” Notably, Japanese cellphone technology capable of doubling as credit cards, boarding passes and metro cards is far more advanced than what can be found elsewhere, yet has little presence overseas. While this was a profitable business strategy when the Japanese market was robust, it does not allow the economies of scale needed to make them globally competitive. Robert Dujarric of Temple University Japan highlighted this problem in an article for The Japan Times, noting “If so few Japanese conglomerates have managed to establish themselves in the premier league outside of manufacturing, it is partly due to their monocultural and exclusively Japanese management. It puts them at a severe disadvantage when competing with foreign rivals run by multinational and multicultural staffs.”
Prime Minister Kan's stalwart intention to pursue trade liberalization, even though it will lead to confrontation within his government and between domestic interest groups, will greatly aid many sectors of Japan’s economy. Kan’s recent cabinet reshuffle with pro-trade and fiscally-responsible appointments such as Kaoru Yosano as Minister of State for Economic and Fiscal Policy and Banri Kaieda as Minister of Trade, Economy and Industry signals his resolve to pursue bold reforms regardless of the political consequences.

Trans-Pacific Partnership Provides Roadmap for Asia-Pacific Community

Facing increasingly strong competition in the region and beyond, the Prime Minister Kan is also emphasizing the need to “open Japan” through participation in talks concerning the development of a TPP, as well as an FTAAP.

The TPP is a multilateral FTA seeking to encourage trade and integrate the economies of the Asia-Pacific region. In 2002, the Pacific Three Closer Economic Partnership was initiated by Chile, Singapore, and New Zealand. Brunei also entered negotiations, and an agreement named the TPP Strategic Economic Partnership was signed in June of 2005. Currently, the
United States, Peru, Australia, Malaysia, and Vietnam are in talks to join the agreement. Prime Minister Kan has also expressed an interest in Japan’s participation as have Canada, South Korea, Taiwan, and the Philippines.

The TPP aims to phase out all tariffs on traded goods among member countries by 2015 and addresses standards including: sanitary and phytosanitary measures, rules of origin, intellectual property rights, government procurement policy, technical barriers to trade, labor rights, and environmental protections.

The TPP is independent of APEC, a forum of 21 Pacific Rim countries promoting free trade; yet, all original and negotiating countries are members. Consequently, the TPP is perceived as a pathway towards developing a comprehensive FTAAP. As APEC’s 2010 Leaders Declaration stated, “We believe that an FTAAP should be pursued as a comprehensive free trade agreement by developing and building on ongoing regional undertakings, such as ASEAN+3, ASEAN+6, and the TPP, among others.”

APEC Members Economies and Date of Membership

Source: Foreign Affairs and International Trade Canada
Joining the TPP would provide Japanese firms privileged status with TPP members. This would increase export opportunities for Japanese manufacturers in emerging consumer markets as well as advanced countries. Since Japan’s per capita manufacturing output is the highest in the world, this advantage would significantly impact its entire economy. Inversely, failure to enter TPP would cause Japanese industries to be at a competitive disadvantage compared to other member countries, reducing export opportunities and its overall competitiveness as a result.

Initiating the reforms and changes needed to participate in the TPP will also improve the efficiency and sustainability of Japan’s economy by introducing greater competition in its domestic market. While this may lead to higher unemployment and dislocations in the short-term, over the long-term Japanese firms will be better able to allocate labor and capital, upgrade their technological capability, benefit from policy reforms and enhance their overall competitiveness.

Finally, joining TPP negotiations would provide Japan with greater influence over the development of economic rules and standards concerning trade, investment, and competition in the Asia Pacific region. Japan can benefit from this integration and ensure that these regional agreements are constituted with Japan’s interests in mind.

**Kan’s Economic Reform and Entering the Trans Pacific Partnership Talks**

Prime Minister Kan understands the challenges facing Japan’s economy and is pushing for substantive policy changes to maintain its competitiveness. His ambitious strategy combines fiscal tightening with policies to stimulate growth. This includes overhauling the social-security system, raising the consumption tax, lowering the corporate tax and joining the TPP. The Economist reports Prime Minister Kan has told negotiating members of the TPP “that if Japan decides to join, it will put ‘everything on the table,’” – including the rules and regulations that currently govern the agricultural sector.
Enacting these reforms will prove a major challenge. Historically, parties that have proposed plans to raise the consumption tax have been punished by electoral defeat. Farmers also form an influential voting block and adamantly oppose cuts to tariff rates. In addition, as in the U.S. and highlighted in the study previously cited, much of the general public is sympathetic to protectionism given their fears over job security, displacement and a long-stagnating Japanese economy.

Nevertheless, Prime Minister Kan believes if Japan is to maintain and maximize its potential, it must pursue these changes. To promote the international competitiveness of Japan’s agricultural sector, he has promised to create a farm reform plan that will promote export-oriented agriculture. In a magazine article in Shukan Asahi, Shigeaki Okamoto, an agro-businessman contends, “If Japan is late in joining the TPP, its export industry will lag, inevitably leading to salary cuts and more unemployment. Should that happen, consumers will buy a lot fewer agricultural products and agriculture will go into a decline.”

To help facilitate the international abilities of small to medium sized enterprises in the agriculture sector, the JETRO has organized a range of targeted outreach activities. For example, JETRO has taken part in a variety of food exhibitions that promotes the export of high quality Japanese foodstuffs. Within the U.S., this includes the Worlds of Flavor 2010, the Winter 2011 Fancy Food Show, and the International Restaurant and Foodservice Show where substantial interest has been expressed for Japanese agricultural products for their quality, taste, and healthiness.

While the challenges of reform are not to be underestimated, neither should its importance. The Economist recently highlighted the necessity of further movement in an article that declares the Prime Minister is “proposing the boldest reforms to Japan in decades”. Recognizing the difficulties, it states its belief if politicians refuse to support Kan’s proposals, he should “go over their heads and appeal to urban voters.” Prime Minister Kan and his administration have already planned to tour the country to lobby for support of reform and free trade. Opinion polls show at least half the country favors these adjustments.
Whether or not Prime Minister Kan is ultimately successful in passing his bold reform strategy, he has brought to the forefront the path Japan must take to remain competitive. While Japan may be entering “the second inning of a first World Series baseball game” in terms of its efforts to enact these measures, passing reforms that enable Japan to join the TPP are essential steps to further restore its dynamism and to integrate itself within rapidly growing Emerging Asian markets.

**Will 2011 be the Year of U.S.- Asia Engagement?**

Following the success of the annual APEC Leaders Meeting in Yokohama last November, Japan handed-off its responsibilities to the U.S., which will host the next meeting in Hawaii in 2011. In an interview, Senior Official for APEC in the U.S. State Department Kurt Tong stated, “Our top priority in APEC is the removal of barriers to trade and investment, to create more opportunities for more jobs and more exports from the United States.” Themes from the 2010 series of APEC meetings in Japan such as small and medium enterprise development, job creation, and improved energy efficiency are likely be continued, and Japan will work with the U.S. and other APEC members to further advance and realize the Yokohama Agenda.

The U.S. has already demonstrated its desire to increase its engagement in Asia by entering TPP talks and completing negotiations to allow passage of the U.S.- South Korea FTA, which will likely be presented for a ratification vote later in 2011. It is also finalizing the Bilateral Investment Treaty with India. The U.S. also hopes to conclude TPP negotiations by the leaders APEC summit in Hawaii in November 2011.

Japan welcomes enhanced U.S. involvement in the region and believes the U.S.-Japan bilateral relationship will be strengthened and stronger global economic growth can be realized through greater engagement and integration of both economies within an increasingly dynamic and expanding East Asia.

This view was reflected in a [policy speech](http://www.jetro.org) delivered in June of 2010 by Prime Minister Kan, who stated, “The Japan-U.S. alliance can be said to be an internationally shared asset, in that it supports not only the defense of Japan but also the stability and prosperity of Asia and the Pacific region.”
At the APEC meeting in Yokohama, President Obama and Prime Minister Kan reiterated their past commitments to a strong bilateral alliance. Japan and the U.S. share values in their political and economic systems and Prime Minister Kan’s ambitious strategy to “open” Japan and expand its presence in East Asia, provides the opportunity to enhance economic activity and the relationship between these two leading economies.

To facilitate discussion of these opportunities and issues as well as the potential for greater economic integration within East Asia, JETRO has organized an annual seminar in Washington D.C. in coordination with the CSIS. This year’s event will be held in Washington D.C. on March 2, 2011. To gain more perspective from manufacturing companies and other industrial firms, an additional symposium with the same agenda will be held in Chicago the following day on March 3, under the joint auspices of co-organizers including the Chicago Council on Global Affairs. Both events are expected to deepen people’s understanding of the significance of East Asian economic integration. For registration information, please email the contact below.
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https://www.jetro.go.jp/form/fm/nya/focusnl

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