



# TPP AND THE POLITICAL ECONOMY OF U.S.-JAPAN TRADE NEGOTIATIONS

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The world is awash in trade negotiations. The 12-member Trans-Pacific Partnership is the most important of them all, with vast economic potential as it could set new standards for commercial integration. The geopolitical benefits to a successful TPP are perhaps even more important. The key is whether a few of the large TPP countries can negotiate a balanced package.



### Why TPP and Why Now?

The proposed free trade agreement between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam aims to be a comprehensive, high-standard and ambitious free trade pact. The TPP sets new standards by bringing to the bargaining table 21st century issues such as regulatory coherence and administrative transparency, value-chains, e-commerce, and state-owned enterprise, as well as labor, environment, and intellectual property. Early ambitions were to reach 98 to 99 percent trade liberalization rate for tariffs.

In addition to ambitious liberalization, member countries have placed on themselves aggressive deadlines. Each year since 2011, they have optimistically tasked themselves to finish that year. This year is no exception, and the same optimism may

be repeated in 2015. It may be repeated again in 2016.

Successful regional trade negotiations ultimately must agglomerate numerous bilateral negotiations over the most sensitive issues, any of which could be make-or-break issues for the overall agreement. For TPP in the summer of 2014, attention is focused on the negotiation between the United States and Japan over what agriculture products can be excluded, limited or offered special compensatory protection mechanisms. Success at this stage means opening Japan's five so-called sacred agriculture markets: rice, sugar, wheat and barley, dairy, beef and pork.

The United States, supported by most member countries, has pushed for all commodities to be included for liberalization within phase-out periods of no more than 20 years. Japan insists that such a scenario is politically impossible and

could force Japan to withdraw from the TPP. Indeed, there is talk both in Washington and in Tokyo of proceeding without Japan. This paper assesses the likelihood and timing of an agreement between the United States and Japan that would satisfy other TPP members and, in turn, lead to serious progress on the trade negotiations. In particular, specific problem areas will be examined, and the politics behind the positions, the probabilities of resolution, and, finally, possible compromises that might lead to agreement. There are reasons to be optimistic that a robust trade agreement can be reached. It is clear, however, that despite the heroic efforts to complete a deal, and the great benefits to come from a successful TPP agreement, the politics of trade in both the United States and Japan pose formidable barriers that are likely to require several years to overcome.

### **The Politics of U.S. Trade**

Trade politics in the United States are complex. As TPP negotiations drill down into specific issues and commodities, policy gets less complex but more difficult. The usual good cop (Executive)/bad cop (Congress) tactics are intensifying: the negotiators are pleading for recognition of the benefits of a trade agreement; Congress is adamantly demanding more, and then more. Industries seeking to open Japanese markets are pressing negotiators hard, and quietly signaling that they recognize realistic goals. Organized special interests that want to avoid liberalization or at least delay negotiations are coalescing and becoming more formidable. Difficulty in negotiations means delay.

Delay presents a substantial political problem in the United States, given that 2014 is a mid-term election year. Trade liberalization is not a popular topic in election years. Trade liberalization, typically a target for Democrats and the left, is also

unpopular on the right. Recent polls show that Democrats are more supportive than Republicans of both a free trade agreement with Europe (60 percent to 44 percent) as well as a free trade agreement with Japan and other countries around the Pacific (59 percent to 49 percent).<sup>1</sup>

Compounding the problem, if negotiations continue past early 2015, TPP risks being caught in the beginning of what will certainly be a heated 2016 presidential election. An election, especially in the early stages-- the primary elections to select the final candidate for each party—could hamper progress on TPP. Primaries are generally more ideological than general elections in the United States and can be substantially more anti-trade. Moreover, opponents of TPP will come from multiple fronts: those on the left and on the right who oppose trade liberalization and those who are upset that not enough market opening is being achieved. Not surprisingly, powerful agricultural interests are leading both camps.

Can TPP beat the looming political deadline? It will be difficult. Even a successful negotiation between the United States and Japan on agriculture would, as United States Trade Representative (USTR) Michael Froman has indicated, only lead to a new stage of the TPP negotiations in which the other 10 TPP countries would engage with Japan on their own market access issues. Meanwhile, U.S. officials have said that concluding market access talks with Japan will clear the way for them to negotiate agriculture problems with Canada. This next stage of agricultural negotiations, if reached, could also take considerable time.

Political pressure is growing inside Washington to force more effective opening of Japan's agriculture markets. U.S. negotiators have hinted that they

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do not believe they can get a better deal from Japan, at least on beef and pork. In December, a broad coalition of U.S. agricultural groups sent a strongly worded letter to the USTR recommending that they consider moving forward to a conclusion of the TPP without Japan if Japan did not open its market across a range of farm products. A joint statement on May 28 by five major agricultural associations expressed their displeasure with statements by Japanese TPP negotiator Akira Amari at the May 2014 ministerial that his country would not abolish tariffs on the five sensitive sectors. That same message has been reinforced by the American Farm Bureau Federation, U.S. Wheat Associates, and the National Oilseeds Processors Association.

These letters are bluntly worded signals to U.S. negotiators and to Japan that:

1. Important and influential agricultural interests will put increasing pressure on USTR not to agree to a TPP without opening Japan at least on beef and pork,
2. Strong pressure will be applied to Congress to resist Trade Promotion Authority (TPA) as a way to stop a TPP agreement without more liberalization, and
3. A high-level dialogue will commence in Washington to consider TPA approving TPP without Japan. Even a credible discussion of TPA authorizing TPP without Japan—especially in an election year in the United States—could become a reality and, in turn, a potentially embarrassing process for Prime Minister Abe.

At the same time, U.S. dairy industry groups concede that they do not expect full

tariff elimination. They have called on the administration to secure “comprehensive” and “meaningful market access” in Japan and Canada through TPP.<sup>2</sup> The USA Rice Federation press release in April stated that it does not expect to get substantially reduced specific tariff levels, but are looking for overall market access to Japan. The federation has called for more to be done without specifying publically what level of market access would be satisfying.

The next level of political problem for U.S. negotiators is that the Congressional Democratic leadership has made clear it will not consider Trade Promotion Authority (TPA) in the near term. In November 2013, 151 Members of the House of Representatives sent a letter to the President opposing TPA. The influential Republican Senator Charles Grassley (Iowa) expressed a growing sentiment in Washington that, while a successfully completed TPP would be best with Japan and appropriate agricultural liberalization, it could be concluded without Japan. New Zealand’s Prime Minister, during a trip to Washington, suggested that a TPP agreement without Japan is a distinct possibility.

Further, it is gaining acceptance in Washington that allowing Japan to protect key agriculture would set a bad precedent for the current TPP talks (notably with Canada), for negotiations with the European Union, and for future TPP participants like China. House Ways and Means Subcommittee on Trade Chairman Devin Nunes (R-CA) and Rep. Aaron Schock (R-IL), a member of the Ways and Means



Committee and Sub-committee on Trade, insisted that all agricultural tariff lines in the Trans-Pacific Partnership (TPP) must go to zero, even though it is already clear the administration will likely fall short of that goal with respect to Japan: “I will tell you specifically on agricultural components,” Schock stated in a speech June 10, 2014 at the Center for Strategic and International Studies (CSIS), “if the administration goes forward with excluding certain lines within agriculture, I think that (TPA) bill will be dead on arrival in the House of Representatives.”<sup>3</sup>

To add yet another wrinkle in the negotiation, three-quarters of the House Democratic caucus (including 11 members of the House Ways and Means committee) in a letter in late May urged President Obama to negotiate labor action plans for Vietnam, Malaysia, Brunei and Mexico as part of the TPP. The letter stated that they resist supporting TPA without improvements in those nations’ labor and human rights practices.<sup>4</sup> Pressure over labor and human rights simply adds to the many issues over which the TPP Partners are in disagreement. These are not simple issues. Non-tariff barriers involve many regulatory practices, legislative changes and powerful domestic interests opposed to opening up markets.<sup>5</sup> It is difficult to imagine a quick solution to TPP even after so many negotiation sessions. Given the political uncertainty in Washington over TPP, and skepticism toward trade in general during the coming election seasons, TPP partners are not likely to sign an agreement with the United States without TPA. There simply are too many diverse anti-trade pressures on Congress, especially from the President’s own party, to sign an agreement that will not have a fast-track through Congress.

## **The Intractable Politics of Trade in Japan**

Japan’s entry into the TPP is an important pillar of Prime Minister Shinzo Abe’s much-promoted three arrows strategy to increase economic growth, enhance competitiveness, and recover the “lost decades.” For Japan, the key to long-term economic vitality in the face of an aging population and shrinking labor force is broad economic restructuring, including the agricultural sector.<sup>6</sup> The TPP negotiations may be a one-shot opportunity to use external pressures (*gaiatsu*) to implement an unprecedented level of trade liberalization and the economic reforms promised by Prime Minister Abe. However, there are both external strategic constraints and intense domestic pressures that will make it difficult for Japan to sign the kind of agreement TPP aspires to be any time soon.

First, Japan’s present and future are tied heavily to trade with China, its largest trading partner. China, for geopolitical reasons, has been wary of the TPP, even though Beijing has since warmed to the idea. In turn, China’s recent push for a broader Free Trade Agreement of Asia Pacific (FTAAP) is consistent with Japan’s long-term economic interest to expand economic ties to China and its geopolitical interest in incorporating both India and the United States as balancing forces in Asia. Given the growing tensions between Japan and China, the TPP is both strategically important on the one hand and problematic on the other. While still in negotiation, the TPP offers Japan the opportunity to balance a potential formal agreement with the United States against antagonizing China with an actual agreement. Given China’s active and effective use of subventions and punishments, Japan is likely to be comfortable with a long negotiation

process, with an eye to the FTAAP by 2025 proposed by China.

More importantly, opening markets to foreign competition has never been easy for Japan, especially for agriculture. OECD calculations show that 45 percent of the value of Japanese farming comes from subsidies and trade protection. Yamada Masahiko, a former minister of Ministry of Agriculture, Forestry, and Fisheries strongly opposed joining the TPP and described it as the “black ship” that would propel the complete collapse of Japanese agriculture.<sup>7</sup> Many felt Japan already has paid too much to enter TPP by lifting the BSE ban on U.S. beef and permitting Aflac, Inc. to market its health insurance products through the postal network.<sup>8</sup> A bipartisan group of more than 230 lawmakers remain opposed to the TPP, and even politicians that generally support the trade agreement insist that Japan protect its farmers.<sup>9</sup> The Japanese Diet is highly unlikely to approve a TPP agreement that fully liberalizes the five key commodities: rice, dairy, wheat and barley, sugar, and beef and pork.<sup>10</sup>

In the Fall of 2013, TPP members agreed to aim for eliminating tariffs on 98 percent of more than 9000 tariff lines. The more realistic expectation recognized by members is to reach at least 95 percent coverage. Japan’s excluded categories include 586 commodities, or 6.5 percent of its traded goods. Japan falls short simply on numerical score-keeping. More importantly, the shortfall is on goods of intense interest in Japan and to other TPP members. The question is not whether Japan’s leadership is sufficiently enthusiastic about a successful TPP agreement. The question is whether, and how, an internal accord can be reached among the powerful special interests inside Japan to let much needed market opening and economic reform to occur.

## Japan’s Agricultural Conundrum

Japan’s agriculture sector is small: less than 0.9 percent of total GDP and only 4.8 percent of Japan’s population, mostly elderly (average age 65.8 years), part-time farmers. Nonetheless, Japan’s trade policy continues to be driven by a well-organized and highly focused informal network of politicians and agricultural groups, led by the Central Union of Agricultural Cooperatives (ZenkokuNōgyō-kyōdō-kumiai Chuōkai-- or JA-Zenchu). JA-Zenchu, with 10 million members and a bank with \$532 billion in deposits, is the country’s single most powerful special interest group. The success of the TPP is, at least in part, dependent on how well the Abe government can manage the political process of transforming the costly old structure into a profitable, efficient, modern, agri-business sector.

JA-Zenchu serves as both a comprehensive advisory organization for the agricultural administration and as prime lobbyist for and leader of the powerful “agricultural policy sub-government”<sup>11</sup> composed of farm politicians in the ruling Liberal Democratic Party (LDP) and bureaucrats in the powerful farm ministry.<sup>12</sup> This coalition shares strong common interests in supporting and protecting domestic agriculture. Eighty percent of LDP politicians agreed to the anti-TPP parliamentary appeal.

Japan’s recent series of prime ministers have challenged and then in large part succumbed to the power of JA-Zenchu. On October 1, 2010, in his policy platform delivered to the Japanese Diet, Prime Minister Naoto Kan indicated the government’s intention to participate in the TPP as the pathway to build the FTAAP, and toward making the East Asia Community a reality. Succeeding Kan as prime minister, Yoshihiko Noda publicly and dramatically announced Japan’s interests in joining



TPP negotiations at the APEC summit in Honolulu on November 11, 2011, again as a path to the FTAAP.

To promote the TPP, Kan tried to weaken the opposition from the agricultural sector by establishing the headquarters for the Revitalization for Japan's Food, Agriculture, Forestry and Fisheries and reviewing the numerous agricultural support measures. He pushed "individual income support allowance for farmers," or side payments, which had been at the center of DPJ's agricultural policy. Side payments for farmers has been encouraged by the WTO for developed countries to use as direct payment instead of tariffs. The United States and the EU have shifted to side payments to farmers. In Japan, JA-Zenchu has successfully blocked it, at least in part because they derive their income from commission on sales, which is determined by price. Side payments are not commissionable transactions.

In a similar way, duties imposed on beef imports used to be funneled to the livestock

department of the Farm Ministry. Part of this was earmarked for paying large annual salaries (¥20 million) to retired ministry officials who move into jobs in the Livestock Industry Promotion Corp.<sup>13</sup> The revenue from beef import duties — which used to amount to ¥100 billion — will drop sharply as a result of the recent Japanese FTA with Australia.

The Abe administration seeks to abolish rice production allocations and volume targets within five years while promoting the production of crops like wheat, soybean, and feed rice using market-in production methods.<sup>14</sup> The goal is to increase Japan's agricultural competitiveness. Opposition comes primarily from the nationwide network of agricultural cooperatives,<sup>15</sup> which have severely hindered the progress of regulatory reforms on rice. Abe also faces strong demands by domestic interests to sustain protections on beef, pork, sugar, and dairy.<sup>16</sup>

Reform is underway, albeit slowly. To improve the use of farmland in Japan,



prefectural intermediary institutions will be established in each prefecture to consolidate the fragmented farmland ownership.<sup>17</sup> Unlike stalled action on reforms in rice production, this plan was approved by the Diet in 2013. The goal is to consolidate and aggregate farmland for the next generation of farmers, including agricultural corporations, large-scale family farms, community farms, and enterprise-run farms. Abe aims over the next 10 years to quadruple the number of these next generation farmers and shift 80 percent of all farmland to their control. Embracing the concept of market-in production, the government will assist improvements in productivity and value of wheat, soybean, feed rice and other crops, including more productive use of rice paddies hampered until now by production regulations.<sup>18</sup>

JA-Zenchu's campaign against the TPP reaches beyond agriculture. It has successfully recruited insurance and the Japan Medical Association (JMA) into the opposition, which argues that the TPP will erode if not eliminate the country's universal healthcare insurance system because it will be forced to pay higher prices for medicine and medical equipment. JA-Zenchu has staged at least one massive farmer demonstration and submitted a petition with 11 million signatures against the TPP. It has raised the specter of unsafe food to mobilize support from consumers.

## **Domestic Political Strategy**

### *Japan's Decision-Making Process*

A number of ministries are involved in the decision-making process on trade policies in Japan. While the Ministry of Economy, Trade and Industry is largely seen as a market-oriented department, the farm ministry holds firm to its reputation as a staunch protector of Japan's farmers. Because of the conflicting objectives and

perspectives within the government, the Abe administration made a number of institutional changes to facilitate the TPP talks, including an interagency team comprising more than a hundred members from the foreign, farm and trade ministries and other government bodies, to set aside their own ministry's interests and develop a unified set of objectives and negotiating positions. The team is headed by Akira Amari, the Minister of State for Economic Revitalization. Senior trade experts from METI were tasked with preparing an analytical assessment of the present situation, and strategy recommendations for the negotiations.

The creation of the negotiating team is an attempt to give the government and its trade negotiators greater autonomy from the political pressure of vested interests.<sup>19</sup> However, once TPP members reach an agreement, Japan's highly political National Diet must approve the final deal. Prior to a vote in the upper and lower houses, Diet members will have the opportunity to ask government officials questions and hear from different political parties and groups. The agreement becomes law when it passes by a majority vote in both houses. In the event that a bill fails to gain enough support in the Upper House (House of Councilors), another vote can be taken in the Lower House (House of Representatives), where a two-thirds majority is needed.

The composition of Japan's National Diet gives rural areas more representation than urban ones. As a result of JA-Zenchu's fierce opposition to trade, Japan's 13 previous free trade agreements have exempted sensitive food products. A small break has come in the Japan-Australia Economic Partnership Agreement approved earlier this year. Tariffs on beef have been dropped from 38.5 percent to 19 percent phased in over 10 years. These cuts are further tempered by



stringent ‘safeguards’ that can easily restore original tariffs.<sup>20</sup>

Domestically, the most important supporters of the Trans-Pacific Partnership are Japan’s major corporations and businesses, such as Mitsubishi and Toyota Motors. Unlike Japan’s inefficient agricultural sectors, many of Japan’s manufacturing companies thrive globally. Six of Japan’s top automakers were responsible for 23 percent of Japan’s exports in 2012. Free trade agreements offer the opportunity to boost sales in foreign markets. Keidanren, the country’s largest business group, has been actively lobbying Diet members and developing public support.

However, the business community is mixed on TPP. An April survey of 1,400 small and midsize enterprises in the Kansai region (surrounding Osaka) showed that only 13.7 percent strongly back Japan’s participation in the TPP, although nearly half reported that they tend to support it. About 7

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percent were strongly opposed and another 33 percent said they were generally against it. TPP support was strongest among firms with more than 50 employees and which believe they can match and beat other nations on price and service. Opposition was fiercest among companies with fewer than 10 employees, which cited worries about production and labor costs being cheaper in other TPP countries.<sup>21</sup>

### *A Domestic Political Strategy*

A number of factors increase the chances of success for TPP in Japan.

First, as a result of the LDP’s landslide victory over the Democratic Party of Japan (DPJ) in the 2012 election, Prime Minister Abe returned to power and the LDP’s control of the lower house was restored. Shortly afterwards, in July 2013 the LDP--together with its coalition partner New Komeito--gained a majority in the Upper House. Of the 722 seats in the Diet, 461 are occupied by members of the LDP and Komeito (135 of 242 Upper House seats and 326 of 480 Lower House seats). Intense domestic political opposition undoubtedly makes National Diet approval of TPP challenging.

While a group of LDP and DPJ members are showing opposition to the TPP (roughly 56 members in the Upper House, 180 members in the Lower House), many politicians are supportive as long as the Abe administration fulfills its promise to protect the five sanctuary agricultural categories. This leaves the agricultural lobby without a national party willing and able to crusade hard against an agreement. In addition, Prime Minister Abe still has high approval ratings (near 60%) due to the success of his strategies to revitalize the economy, and he is not up for re-election until 2016. Japan has a window of opportunity to confront the political structures inhibiting the economic changes necessary to move forward on the TPP and revitalize Japan’s economy.

### *TPP and Sectoral Reforms in Japan*

Reforms are needed across a number of industries in Japan. Each has its own political dynamic that will have to be overcome for TPP to be completed.

**Rice:** Rice farming is still seen as a “spiritual



cornerstone” of Japanese culture and fundamental to Japan’s “food security.”<sup>22</sup> Japan produces 100 percent of rice for its own consumption. To do so requires 12.6 percent of total land area. Unlike the large agribusinesses in the United States, where the average rice farm is nearly 400 acres, 77 percent of rice farms in Japan are family-owned two acre plots. Most of the farming sector in Japan is elderly rice farmers cultivating extremely inefficient, small-scale plots. Their survival depends on government protection, such as the 778% tariff and a government import-purchasing program.<sup>23</sup> Government policies support 1.3 million farmers (60 percent) and 3.4 million jobs.<sup>24</sup> It is common for office workers, including many government officials, to plan to retire to a pastoral life of part-time rice farming. In the past, rice output greatly exceeded consumption. In order to prevent prices from sliding, the government paid farmers to reduce production. Japan still spends \$2.3 billion annually on the *gentan* system. Finally, rice production is geographically dispersed, so virtually all Diet members must listen with great care to the concerns of rice farmers when they vote on reforms.

Letting in cheap foreign rice is therefore the most controversial issue for Japan. This is well understood by U.S. rice producers, also a carefully protected group, who recognize that rice is “uniquely sensitive” in Japan and have no expectations for full liberalization.<sup>25</sup> Meanwhile, reforms are being made in Japan that change both the market and the politics of rice. The inefficient structure is the result of the *gentan* acreage reduction policy. It was specifically designed and implemented in 1970 to protect small family farms by prohibiting large enterprises from renting land. In the three years following removal of the restrictions in 2009, more than 1,000 companies began agricultural businesses through leasing (approximately five times more than prior to liberalization).<sup>26</sup>

**Wheat:** The Japanese position on wheat is more difficult to understand. Japan supplies 9 percent of its total consumption. Sixty percent of the remaining six million tons consumed is by the United States; the rest is evenly divided between Canada and Australia. Since wheat is considered a staple food, most imports are controlled by the government through the Act on Stabilization



of Supply, Demand and Prices of Staple Food. The government purchases wheat from foreign companies, and then marks up the prices in order to protect domestic producers. If flour-milling companies choose to buy imported wheat from non-government sources, a 252 percent tariff is applied.

High levels of protection seem odd for a country so reliant on imports. It is seen as necessary because 99 percent of the 140,000 domestic producers would not be competitive in an unprotected market. Although wheat is a reasonable sector for Japan to offer concessions, and Abe has signaled a willingness to do so, a dramatic drop in wheat prices could be seen to hurt the all-important rice industry. Negotiations will be tough because Japan is an extremely important wheat market for the United States, as well as for Canada and Australia. The United States exports half of its wheat production. Excluding wheat in the TPP would hurt both Japan's immediate wheat industry interests and the United States' long-term agricultural trade policy interests.

**Sugar:** Japan produces only 40 percent of its own sugar. Thailand accounts for 70 percent of imports; the U.S. about 20 percent. TPP could shift a substantial portion of imports to the United States. Domestic production is 80 percent from beet sugar grown by farmers located in Hokkaido. The rest is cane sugar from Okinawa. Demand for sugar has been decreasing in Japan. But as a result of rising global demand, the prices of imports have actually increased more than 20 percent over the last five years. Inefficient production has kept domestic prices for beet sugar 220 percent higher than import prices. For cane sugar, prices are 680 percent higher. Survival requires ample subsidies and protection.

Despite the fact that there are only 17,000 cane sugar farmers in Japan, eliminating

tariffs will be difficult. Sugar is vital to the Okinawa prefecture, which is home to the largest U.S. military base in Japan. Poor soil quality in most parts of Okinawa means that cane sugar is the only commodity farmers can grow. As partial atonement for allowing a U.S. military base in Okinawa, the government has historically sustained sugar farmers. Abolishing these tariffs would cause further dissatisfaction in the prefecture, which the government strenuously wants to avoid. It would be far easier for Japan to lift tariffs on processed sugar products, such as caramel and other candies, chewing gum, and milk sugar. The general tariff rates for these goods are 10 to 50 percent.

The U.S. sugar industry has also long been protected and cannot expect much from the TPP.<sup>27</sup> Sugar was excluded from the US-Australia FTA and other trade agreements. Such carve-outs have set precedents that Japan can take advantage of in its negotiations. Protections and long phase-outs are highly likely in a TPP agreement.

**Pork and Beef:** More than 60 percent of beef, and over 90 percent of beef tongue consumed in Japan, is imported. Since 1991, when Japan reduced tariffs and opened up its beef market, it has become Asia's biggest beef importer. Australia accounts for 65 percent of beef imports, followed by the United States at 23 percent and New Zealand at 6.1 percent. For pork, 40 percent of imports come from the United States and 24 percent from Canada. Current tariff rates in Japan are 38.5 percent for beef, and 12.8 percent for beef tongue. Studies suggest that if tariffs are reduced to zero, imports could jump by 40 percent.

Japan imposes stringent safety standards on cattle and beef imports due to concerns about mad cow disease. In order to gain U.S. support to join the TPP negotiations, Japan's health ministry agreed to change

the age restriction on U.S. beef from 20 to 30 months. Opening Japan to imported beef may be less politically disagreeable than other agricultural commodities.<sup>28</sup> Japanese beef, for instance, is highly differentiated, with unique cattle breeds and production methods. It is the most expensive and sought after beef in the world.<sup>29</sup> Lowering beef tariffs would likely expand the beef market in Japan and lower prices while preserving the dominance of Japanese producers in the high-end market.<sup>30</sup> It could be possible, in exchange for lowering beef tariffs, for the United States to agree to enshrine Kobe beef for protection under a geographic indicator. This could ease competitive concerns from Japanese beef producers in those areas, and benefit their efforts to export.

Pork, on the other hand, is more complicated. Japan is the world's largest pork importer (750,000 tons in 2010). Nearly half of all pork consumed is imported; 40 percent of which is from the United States. The rest is from other TPP partners. The pork industry is protected by a complex gate price system (GPS), under which imports are taxed if price falls below prices set by the government. A tariff of 4.3 percent is applied on top of the tax. Import prices above the government set price face only the tariff. The system, not surprisingly, leads to many "deals" among foreign and Japanese firms to structure mixed shipments that shelter pork cuts to keep shipment CIF prices roughly aligned with the government price even while FOB prices consistently fluctuate actively below that price level.<sup>31</sup>

According to one government estimate, free trade would displace 70 percent of Japan's 907,000 tons of annual pork production. While Japan has promised to protect cattle and pig farmers from foreign competitors, steps toward liberalization have been taken. Mexico, a major exporter to Japan,

negotiated in its FTA a 2.2 percent tariff and created a Mexico-specific annually increasing TRQ import level. Mexico, as a result, may be a less enthusiastic supporter of U.S. and Canadian pressures on pork liberalization. Japan could potentially abolish tariffs on a small number of meat products with little political cost, including beef tongue, liver, frozen pork liver, and any products using beef tongue as an ingredient.

**Dairy:** Overall, Japan produces 67 percent of its dairy products. However, it only imports processed dairy products and not raw milk, which is supplied by 32,000 farming households. Domestic supply is posited as a public safety issue because it is mostly children who drink milk in Japan. Japanese dairy tariffs are complicated. The average dairy tariff is about 93 percent; the highest is 650 percent. Powdered milk faces a 218 percent tariff; butter 360 percent, as well as mark-up fees and high SPS standards. Similar to wheat, imports for most dairy products—with the exception of cheese and ice cream—are controlled by a state-owned trading enterprise called the Agriculture and Livestock Industries Corporation, which is in charge of maintaining a stable supply.<sup>32</sup>

In recent years, the domestic supply of milk and processed dairy products has been erratic. Changing weather conditions, a decline in the number of farmers, closures near the Fukushima nuclear plant, and increasing costs of production from rising oil prices have contributed to shortages. In 2012, for instance, the government was forced to announce emergency imports of butter after raw milk supplies fell short of demand. A more open market could ensure adequate supplies and reduce prices for consumers. A complication for TPP negotiations is the U.S. dairy industry's demand for special market protection, using New Zealand alleged market imperfections.<sup>33</sup>



### *Manufactured Goods, Energy and Mineral Resources*

Although there has been a shift to the service industries in recent years, the manufacturing sector remains one of the leading contributors to economic growth in Japan. Manufacturing is responsible for about 16 percent of Japan's GDP and 26 percent of employment. Further, the majority of exports are manufactured goods. About \$130 billion is exported to the United States each year, facing tariffs less than 2 percent.

**Energy:** Prior to the Fukushima Daiichi meltdown after the March 2011 earthquake, Japan generated 30 percent of its electrical power from nuclear reactors. After the nuclear reactor shutdown, Japan shifted to imported natural resources to meet its energy needs. Since it does not produce any liquefied natural gas domestically, it has been forced to import from the Middle East at unusually high costs. The boom in hydraulic fracking in the United States has made it an exporter of

LNG. Reducing the price of natural gas by looking to the U.S. as an alternative supplier served as one of the main drivers behind Japan's push to join TPP negotiations. Success yielded near immediate results. In an ironic deal, given the potential leverage LNG exports could have given, in May 2013 the United States agreed to export up to 22 million cubic meters of LNG every day to Japan for the next 20 years. Also, in September Canada agreed to export LNG to Japan until 2019. As a result of securing a steady supply of LNG at a reduced price, Japan is expected to be able to meet its LNG needs while halving the cost.

Despite these deals, the TPP agreement could still give Japan further gains by reducing prices of coal imports. Japan currently relies on Australia for 60 percent of its coal. It also imports 5.5 percent from Canada, and 3.6 percent from the United States. Japan would like to increase imports from the United States and Canada in exchange for compromising on other issues in the TPP negotiations. Unlike other



commodities, sales of natural resources to foreign countries require government approval in both the United States and Canada; therefore, Japan must negotiate with these countries to increase the supply. An FTA alleviates that.

**Mineral Resources:** Japan relies on foreign countries for most of its mineral resource needs. As a result, it has zero or very low tariffs on any mineral imports. Indeed, mineral demands are a substantial reason to support a TPP Agreement. As the global demand for mineral resources increases, it is essential for Japan to secure steady supplies in order to achieve continuous economic growth. The 2010 delays in importing rare-earth minerals from China shocked the Japanese manufacturing industry. To reduce reliance on a single country for critical resources, the government is seeking to strengthen imports of metallic minerals and rare-earth elements from other countries, including the United States. Among the TPP member countries, Japan is interested in importing platinum from the United States and Canada, carbonatite from Vietnam and Australia, cobalt from Australia, and tungsten from the United States.

**Automotive Market:** Japan's automotive industry is a prominent and highly dynamic sector of the economy. Six of the world's top ten automobile manufacturers are Japanese. Japan is the world's third largest automotive producer. Japan seeks to increase exports through the elimination of all tariffs on Japanese automobiles in foreign markets. In particular, it has called for better access to the U.S. auto market, currently the second largest in the world. The United States imposes a 2.5 percent tariff on Japanese cars and a 25 percent tariff on light trucks. Most Japanese automakers have circumvented tariffs by building production bases abroad. In the bilateral negotiations, both countries agreed

that U.S. auto tariffs would eventually be eliminated, but only by using the longest phase-out period given to any other product in the TPP agreement—a concession Japan made over the protests of its auto industry association in order to protect its agricultural sectors. Japan is pushing Vietnam to eliminate its 83 percent tariff on passenger cars.

Japan's auto tariffs are not a problem. Rather, U.S. automakers claim non-tariff barriers shield domestic producers from international competition. These include regulatory hurdles, high safety standards and certification requirements. In addition, taxes levied by Japan on mini-vehicles are much lower than on the larger cars the U.S. exports. Japanese automakers claim loss of the preferential acquisition tax on mini vehicles will hurt sales of cars in rural areas, where mini vehicles predominate.

The U.S. government contends Japan has one of the most closed automotive markets among developed countries, with total foreign penetration being no more than 6 percent. Japanese automakers are also accused of having a price advantage due to currency devaluation. As a result, U.S. auto exports totaled \$1.5 billion in 2011, while imports from Japan were \$41 billion, accounting for two-thirds of the \$76 billion U.S. trade deficit with Japan. These long-standing concerns keep U.S. auto manufacturers, labor unions and several influential Democratic lawmakers in the United States strong skeptics of TPP. A broad range of non-tariff measures, including greater transparency in regulations, standards, and the certification process, must be negotiated between Japan and the United States

A successful TPP agreement will likely require expansion of Japan's preferential handling procedure—a simpler and faster certification method used by foreign



automakers to export to Japan. Under previous rules, the United States could only export up to 2,000 vehicles per vehicle type using this fast-track process. Japan has agreed to allow up to 5,000 American vehicles of each type. That number may have to increase. Along with changes to the tax system, Japan will also need to improve regulatory transparency in both the regulations themselves and the process by which they are made. Japan may be required to allow looser U.S. safety standards to apply instead. These are difficult negotiation problems, but still fall far short of political barriers to the changes needed in the agricultural sector.

**Intellectual Property Rights:** Japan's entry into the TPP negotiations was viewed as helpful for U.S. negotiators on intellectual property rights, one of the toughest issues to resolve in the negotiations. To date, little progress has been made beyond clarifying specific disputes between the United States and emerging economies. Many matters remain unresolved. Japan generally supports U.S. efforts to strengthen IPR laws and enforcement since the proliferation of pirated and counterfeit products overseas is a problem for Japanese companies. Japan was also the first country to ratify the Anti-Counterfeiting Trade Agreement (ACTA). At the same time, because of concerns over high drug prices, Japan has resisted the United States' request to extend patent periods on pharmaceuticals.

### **Completing TPP with Japan**

Japan has considerable leverage due to its market size. Japan is the third largest economy in the world. Its \$6 trillion GDP exceeds that of all other non-U.S. TPP partners combined at \$5.6 trillion. Japan is a highly attractive export destination. There are, of course, geopolitical reasons behind U.S. support for Japan's entry and for an expedient, successful conclusion of the

TPP. President Obama also has important political reasons for reaching an agreement before the presidential elections in 2016.

In addition, because the United States already has bilateral trade agreements with six other TPP countries, Japan greatly increases the TPP's economic rationale. One study found that Japan's participation could triple the economic gain to the United States from the TPP. Japan has bilateral trade agreements with five TPP countries and ongoing negotiations with two more. In previous agreements, Japan only lifted or reduced tariffs on 85 percent of its tariff lines. A successful TPP presents the opportunity for other countries to gain greater access to Japan's market. Japan, which originally offered an 85 percent liberalization rate, was forced to raise its own rate to 89 and then 92 percent after joining the negotiations. Pressed to go higher, protracted negotiations allow room for maintaining some level of tariffs while trying to handle the difficult internal pressures resisting liberalization.

Innovative solutions are needed within and between Japan and the United States. Can Japan save its terribly uncompetitive agricultural markets by conceding greater access to its competitive auto market? Are there specific products within the five sensitive groups that can be opened to help Japan approach the 95 to 98 percent liberalization rate, such as secondary or derivative products (e.g., processed pork rinds, chocolates, cookies, beef tongue, rice for processing, pancake mix, caramel and other candies, chewing gum, milk sugar, ice cream, frozen yogurt, and cheese). Japan can also lift tariffs on wine, sake, leather goods, salt and cigarettes, which have previously not been proposed for elimination. This could bring Japan up to a 95 percent liberalization rate and appease other TPP members.

More creative solutions must come from within Japan. It may require an even more proactive program of directed internationalization of Japanese agriculture. One study suggests that wide-spread consolidation of rice production in Japan could drop the price of a 60 kilogram bag of rice by 30 percent. However, simply increasing the size of Japan's agricultural producers is not a complete solution. The amount of land available for farming is limited, especially compared to countries like Australia and the United States. JA-Zenchu argues that 20 to 30 hectares (50 to 75 acres) is about as big as an enterprise can get before running into a mountain, forest, sea, and other barriers to efficient farming. Moreover, while the younger generation seems less inclined to farm, it could take many years of negotiating to get a million individual farmers to give up their way of life.

Since it is impossible for Japanese producers to ever be as productive in staples as U.S. or Australian agri-business, the government must encourage farmers to shift production to high-value products that command premium prices. In many areas, Japanese farmers are globally competitive. For example, consumers already place a premium on wagyu, a type of high-end Japanese beef. Yet in Japan, only four factories are authorized to process beef for export to the United States and Hong Kong. To boost sales in overseas markets, the government can encourage beef processing companies, expanding the number of facilities and, as necessary, renovating them to meet the strict international standards on food sanitation. Increasing exports of specialized and high-value varieties could save Japanese farmers' livelihoods.

Moving in this direction, the Japanese government recently invested \$20.3 million in a three-year research project run by the agriculture ministry focused on

developing new varieties of rice, soybeans, barley, onions and buckwheat. In addition, targeting the rapidly growing organic market in Japan, Korea, China and the United States is an attractive shift toward higher-value food production amenable to Japan's land constraints and competitive advantage in high-technology. So-called functional foods are strains of fruit, vegetables and grains that go beyond basic nutrition to provide additional health benefits to consumers. The retail value of the U.S. organic food industry, for instance, exploded 10-fold between 1997 and 2011.<sup>34</sup>

For certain categories such as dairy, where the government purchases imports and resells them to companies at marked-up prices, liberalization will require dissolving the cooperative system and allowing farmers to sell directly to companies in the dairy industry. Competitive pressure—with support on R&D and best business practices—will improve the quality and increase productivity. The government would need to change the way subsidies are distributed to dairy farmers. Currently, all subsidies are given by a government agency known as the Agriculture and Livestock Industries Corporation (ALIC). However, some farmers are not members of the ALIC, so the government should provide subsidies directly to allow non-members to receive the benefits.

## Conclusion

The stakes and hurdles for success are high. Thus far, contrary to the hopeful predictions of negotiators for the past three years, the required reforms and negotiating concessions are still to be had. One can remain highly optimistic that over time success will come. If success is not found in early 2015, the shadow of election politics in the United States and Japan, and other nations, will hang darker and success will be even more difficult.



## NOTES

- 1 Bruce Stokes, "Is America dangerously divided?" Special to CNN, June 15, 2014.
- 2 Inside U.S. Trade, June 6.
- 3 Speech, June 10, 2014, Center for Strategic and International Studies (CSIS).
- 4 "We must do everything possible to prevent the American marketplace from being flooded with imports manufactured by workers laboring without human dignity and individual rights," the Democratic lawmakers wrote in a letter sent to U.S. Trade Representative Michael Froman. In addition, Advocacy group Public Citizen and the Communications Workers of America (CWA) labor union are leading the grassroots campaign against TPP and Trade Promotion Authority (TPA). They are joined by a coalition of Congressmen, primarily Democrats. A confidential letter signed by 67 sent to President Obama on May 3, 2012, urged him to exclude from TPP any waiver of the Buy American Act.
- 5 For a clear summary of the many outstanding issues in the TPP that need resolution, see Henry Farrell, "The U.S. is Isolated in the Trans-Pacific Partnership Negotiations," *The Washington Post*, November 18, 2013, and Gabrielle Chan, "Trans-Pacific Partnership: a guide to the most contentious issues," *The Guardian*, December 9, 2013.
- 6 Tomomi Inada, "Japan's Breakthrough in its Economic Revitalization." Speech at Peterson Institute, January 13, 2014. For a critical view of progress, see Richard Katz, "Voodoo Abenomics, Foreign Affairs, July/August, 2014.
- 7 Jemma Kim, "Japan and the Trans-Pacific Partnership (TPP): Rule Setter or Follower?" *Journal of Asia-Pacific Studies*, August 2013.
- 8 Japan Times, May 30, 2014, at: <http://www.japantimes.co.jp/opinion/2014/05/30/commentary/japan-commentary/tpp-no-longer-about-free-trade/#.U6W3O9y4lFK>
- 9 The TPP is unlikely to be the defining issue for many Japanese voters. According to NHK News 7 on November 26, 31 percent of voters are in favor of Japan participating in the TPP, 16 percent are against, and 44 percent do not hold a strong view either way. Voters rate other issues as far more important, including the economy, social security, and nuclear power. Jemma Kim, "Japan and the Trans-Pacific Partnership (TPP): Rule Setter or Follower?" *Journal of Asia-Pacific Studies*, August 2013.
- 10 For a good discussion of Japan's broader FTA strategy, see J. Nakagawa and Wei Liang, "A Comparison of FTA Strategies of Japan and China and their Implications for Multilateralism," presented at the Annual Meeting of the International Studies Association, San Diego, CA, April 1-4, 2012.
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- 12 The Food Department of the Ministry of Agriculture, Forestry, and Fisheries has the exclusive right to import rice, wheat, and barley within those TRQs, and the Agriculture and Livestock Industries Corp (ALIC) has exclusive importing rights to two of the biggest dairy TRQs. The government, through the state-trading enterprises, decides how much to import, when to import, and at what price to resell the imports into Japan's market.
- 13 Japan Times, May 30, 2014, at: <http://www.japantimes.co.jp/opinion/2014/05/30/commentary/japan-commentary/tpp-no-longer-about-free-trade/#.U6W3O9y4lFK>.
- 14 "The Latest Progress and Achievements of the Abe Administration." January 2014, ppt, at: [http://japan.kantei.go.jp/ongoingtopics/pdf/2014/140422\\_abenomics\\_rev.pdf](http://japan.kantei.go.jp/ongoingtopics/pdf/2014/140422_abenomics_rev.pdf)
- 15 Yashiro Naohiro, "Reforms as the Key to a Successful Growth Strategy," *Nippon*, November 21, 2013, <http://www.nippon.com/en/in-depth/a02501/>.
- 16 Michael Auslin, "Japan's TPP Fight Has Just Begun," American Enterprise Institute, March 22, 2013, <http://www.aei.org/article/foreign-and-defense-policy/regional/asia/japans-tpp-fight-has-just-begun/>.
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- 19 Japan formally announced its intention to join the TPP trade talks on March 13, 2013, less than three months

after Prime Minister Abe took office. To obtain U.S. support, Japan agreed to bilateral discussions on several outstanding issues, resulting in a series of agreements on automobiles, insurance and non-tariff trade barriers. On April 12, 2013, the U.S. announced it would support Japan's participation, and eight days later, the country was invited by TPP members to join the negotiations

- 20 The trigger is imports less than the yearly average of Australian exports to Japan over past five years. In fact, it is trade control, rather than trade liberalization: a tariff quota system setting Australian beef's share in the Japanese market that maintains current protection for Japanese farmers as well as protecting Australian beef from other importers in the Japanese market. Similar tariff quotas are also applied to cheese, frozen yogurt and ice cream imports. Moreover, food producers importing cheese and cocoa preparations at low duties are required to use domestically produced ingredients to certain percentages.
- 21 Eric Johnston, "Why Kansai's corporate captains are trumpeting TPP," Japan Times, May 17, 2014.
- 22 Vietnam will almost certainly join the fight on rice, since it strongly opposes Japan's efforts to protect this sector. The rice industry employs 60 percent of Vietnam's labor force, and in 2012, total rice output reached 44 million tons. Rice is also the country's second-largest export product, comprising nearly 30 percent of its total exports. Since Vietnam does not presently enjoy access to Japan's market, it has been particularly aggressive in opening up this sector. It will likely be supported by the U.S., whose large, efficient agribusinesses currently export 360,000 tons of rice to Japan each year. However, in the parallel negotiations, the U.S. and Japan have already discussed the possibility of retaining the high rice tariffs in exchange for increasing the import quotas. Moreover, New Zealand and Mexico are not major rice producers. All of New Zealand's rice is currently imported, and while it seeks to obtain a high trade liberalization rate from all countries in the TPP, it has said it will support Japan in exchange for a favorable agreement on beef and dairy. In Mexico, annual rice production has fallen to 260,000 tons, most of which is consumed domestically. It is currently seeking tariff elimination on its main agricultural exports to Japan—corn, oranges, tomatoes, and coffee—as well as lower non-tariff barriers for its automotive exports.
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- 27 Generally see, "The Bitter Taste of Sugar Protectionism: How Congress and the U.S. Sugar Industry Kill Jobs, Raise the Cost of Living for Americans, and Compel U.S. Companies to Move Overseas," at: <http://www.cato.org/multimedia/events/bitter-taste-sugar-protectionism-how-congress-us-sugar-industry-kill-jobs-raise>
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- 30 Obara, Kakuyu, Michael McConnell, and John Dyck. "Japan's Beef Market." USDA, Aug. 2010.
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- 32 ALIC falls under the MAFF and responsible for controlling imports of dairy, sugar and starch. Its primary duty is to maintain prices by buying and selling stocks of the commodities. Wheat, barley and rice TRQs are managed by MAFF.
- 33 “New Zealand, U.S. Share Common Interest In Japan’s Ag Market.” Inside U.S. Trade, May 2013.
- 34 Economic Report of the President, 2014, Chapter 8, p. 246. Organic food revenues grew from \$3.6 billion a year in 1997 to \$21.1 billion in 2008 and \$31.4 billion in 2011. Per capita food expenditures rose from \$3,600 per year to nearly \$4,300 per year by 2011.

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