

RESCUING TRADE MULTILATERALISM: JAPAN'S MISSION IMPOSSIBLE?¹

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A Dark Hour for Trade Multilateralism

An Existential Crisis Ahead of the Pandemic

Before the COVID-19 pandemic ravaged the world with immense loss of life and a global economic contraction, the multilateral trading order was already in peril. Its decay was first manifested in the failure of the World Trade Organization (WTO) to update trade and investment rules since its creation. The negotiation deadlock reflected the inability of an international body operating with the consensus principle to find common ground among its 160-plus members on an expanding trade agenda that increasingly delves into behind-the-border issues. The WTO crisis became ever more acute when the Appellate Body ceased operations at the end of 2019 as a result of the U.S. decision, citing judicial overreach, to block new appointments. Irrelevance loomed large for an international regime that could not modernize the trade toolkit or enforce extant rules.

The open, rules-based trading system appeared vulnerable to the harsh realities of great power competition. Support for engagement has been running thin in Washington. Complaints about the lack of a level playing field in China are long-standing, but tensions have escalated with the concern that China is doubling down on its state capitalism model to achieve high-tech dominance. The Trump administration, animated both by a desire to reduce the bilateral trade deficit and to curb market-distorting trade policies, took on the China challenge on its own. It chose to bypass the WTO and rely instead on unilateral tariffs based on a Section 301 investigation on China's intellectual property (IP) and technology practices. The tariff war between the two giants of the world economy escalated quickly: by fall 2019, the United States imposed tariffs on US\$360B of Chinese imports, and China reciprocated with tariffs on US\$110B on U.S. goods.²

Trade tensions have not been circumscribed to the United States and China. In fact, the dubious U.S. decision to invoke national security to impose tariffs on steel and aluminum (and potentially automobiles) produced serious discord among close partners and allies. Not only did it result in tit-for-tat tariff retaliation (except for Japan), but more broadly, it risked rendering meaningless the WTO national security exception, paving the way for easy protectionism. Nor has the U.S.-China rivalry been played exclusively through trade measures. Concerned with cybersecurity risks and leaks of critical technology, the U.S. government tightened foreign investment screening, moved to expand export controls to cover emerging and foundational technologies, and blacklisted Huawei and other Chinese telecom companies, among other measures. One of the objectives of the liberal trading system has been to foster ties of economic interdependence to ameliorate inter-state tensions. By this measure, the system appears to be increasingly ineffective.

WTO dysfunction, rising levels of protectionism (tariffs and non-tariff barriers), and the unrestricted invocation of national security to restrict cross-border economic activity have

emerged as clear and present dangers to the rules-based trading order. Even the much-heralded truce in the form of a phase one deal between the United States and China at the end of 2019 provided little optimism for the outlook of trade multilateralism. On the positive front, the deal marked a pause in the conflict and deflected a fresh round of tariffs. Some progress was made in the area of IP protection and trade secrets, with China agreeing to produce an action plan on improving intellectual property in 30 days after entry into force and making it easier to prosecute theft of commercial secrets by shifting the burden of proof. The deal also validated commitments that China had already made to root out forced technology transfer and liberalize foreign direct investment in finance (insurance, securities, fund management, and future sectors). However, the deal left intact China's interventionist industrial policy, with no commitments on state-owned enterprises, industrial subsidies, and cybersecurity.³

The bilateral deal is bound to introduce significant distortions with its “managed trade approach” on steroids. Indeed, one of the most notable components of the deal was China's purchase commitments of no less than an additional US\$200B compared to the 2017 baseline in various sectors: agriculture, manufacturing, energy, and services. Meeting these commitments would require a massive (and unrealistic) increase in U.S. exports to China, would likely discriminate against existing non-U.S. suppliers (violating one more WTO principle), and the provision in fact reifies state control of the economy—contradicting a core priority of U.S. China policy.⁴ Moreover, the agreement is not trade liberalizing in that it leaves almost intact the existing tariffs on US\$360B. With no realistic timetable for a round two that could eliminate these tariffs in exchange for Chinese structural reforms, the message was loud and clear: the tariffs are here to stay, and companies operating in the global supply chains should plan accordingly.

The dispute resolution mechanism agreed by both parties represented a step back from one of the strongest suits of the multilateral trade regime: third-party adjudication of trade disputes. Instead, the U.S.-China deal-enforcement mechanism is a blend of unilateralism and brinkmanship. A complaining party can impose trade remedies if, at its discretion, it deems the other country is not fulfilling its obligations. But the complained-against party has only two stark choices at that point: to accept the trade penalties or scuttle the agreement altogether. This approach is a step back for the legal recourse to settle disputes and a step forward for coercive trade diplomacy.

COVID-19 Further Dampens Multilateral Trade Co-operation

The hopes that a paused U.S.-China trade war would provide some relief to a battered multilateral trading system were dashed when a new coronavirus hit China and spread throughout the world. Faced with this grave public health crisis, one government after another restricted economic activity and closed borders to international travel. The impact of lockdown economics on Asia will be severe. The IMF projects the worst economic downturn since the Great Depression with a contraction of –3% in 2020. Asia—the world's most dynamic region—will see zero growth, and for the first time in decades China recorded an economic contraction in the first quarter of the year. For 2020, the IMF forecasts a 1.2% growth rate for China, but other

major Asian economies are in negative territory: –1.2% for South Korea, –3.5% for Singapore, and –4.0% for Taiwan. However, at –5.2%, the contraction is projected to be steepest in Japan. While the IMF projects recovery in 2021, this estimate is predicated on the pandemic easing off in late 2020.⁵

The outlook for trade that the WTO released recently is equally sobering: a contraction of 13% to 32% in the volume of merchandise trade for 2020. For Asia, this translates into a trade shock for a trade-reliant region. The sharp trade contraction comes on top of already adverse currents with the slowdown of trade last year due to the U.S.-China tariff war and the fact that the volume of international trade never recovered after the global financial crisis (2008–2009).⁶ If trendlines for trade growth were not good before COVID-19, they now appear to be in a deep dive. The severity of the blow is due to the combined effect of a demand and supply shock with dampened consumption and disrupted production lines hitting all major economies. The shutdown in China in January and February produced a plummeting of economic activity that affected all countries in the region, given China's centrality to the operation of global supply chains. For instance, Chinese exports and imports of automatic data processing units were down 30% and 45%, respectively, compared to the year prior.⁷ The tightly integrated automobile industry soon felt the impact, with Japanese and Korean companies temporarily halting production in some plants due to the scarcity of inputs from China.

The long-term impact of COVID-19 on global economic integration remains unknown, although it is likely to accelerate adjustments underway in the operation of global supply chains already reeling from the uptick of geopolitical tensions and the increase in tariffs and non-tariff barriers. In a situation of heightened risk, just-in-time global value chains will likely give way to supply chains that prioritize resilience and are willing to absorb the larger costs of building redundancy and diversification strategies. A more immediate concern, however, is the rise of export protectionism as governments have quickly imposed sicken-thy-neighbour measures restricting sales abroad of medical supplies and personal protective equipment.⁸ At last count by the Global Trade Alert, 75 countries had adopted such export curbs,⁹ while very few had met their obligation to notify the WTO in conformity with Article XX, which allows emergency measures to protect human health provided they are temporary, non-discriminatory, and transparent. However, as of April 30, 2020, the WTO had only received four notifications of export restrictions related to COVID-19.¹⁰ The export curbs are likely to hinder, not help, the pandemic response as they serve to discourage producers from expanding capacity and invite foreign retaliation, further compromising essential medical supply chains. The devolution of the international trading regime to a law of the jungle would compromise both the public health and economic recovery efforts.

Why Japan Matters to the Survival of Trade Multilateralism

As the third-largest economy in the world, home country to an array of internationalized companies operating vast global supply chains, and an industrialized nation resisting the appeal of inward-looking populism, Japan is of great consequence to the future of trade multilateralism. In the span of a few years, Tokyo has accumulated an impressive track record in supporting rules-based trade. Japan has helped broker three mega trade agreements: rescuing the original Trans-Pacific Partnership (TPP) (minus the U.S.), inking a deal with the EU that covers a third of world GDP, and helping finalize the Regional Comprehensive Economic Partnership (RCEP) talks. Japan has also spearheaded a trilateral effort with the United States and the EU to adopt new disciplines curbing (Chinese) market-distorting policies in the areas of subsidies, disciplines on state-owned enterprises, and forced technology transfer. Tokyo has sought to place itself at the forefront of digital economy governance, making its “free data flow with trust” a signature initiative of its G20 chairmanship. If the United States has increasingly relied on a unilateral approach, multilateralism has been Japan’s brand. As a middle power, Tokyo has sought strength in numbers and has shown the ability to overcome enough of its domestic constraints to advance a proactive trade agenda.

Japan’s trade leadership reflects both long-term evolutionary changes at home and a response to a more severe international environment with the stagnation of the WTO and the intensifying U.S.-China rivalry. In previous work (*Dilemmas of a Trading Nation*), I tracked the confluence of economic and political changes that made it possible for Tokyo to execute a far more ambitious trade agenda: political and administrative reforms that empowered the prime minister to overrule recalcitrant ministries and vested interests, the transformation of Japan’s political economy away from mercantilism toward greater integration into the world economy through global supply chains, and the consolidation of a control tower in Abe Shinzo’s *Kantei* with the return of political stability.¹¹

The dysfunction of the WTO and the leadership vacuum among great powers hindering the rejuvenation of the trading order compelled Japan to act. Japan’s prosperity depends on the survival of a free and predictable trading system, but there are security dividends as well in encouraging a return of the United States to the regional architecture and providing developing Asia with diversification options to avoid overdependence on China. Trade diplomacy is useful to these endeavours.¹²

The End of the Beginning: Testing the Mettle of Japan’s Trade Leadership

Japan has carved for itself a role as leader of a rules-based trading order that would have seemed unimaginable a few years ago. For all the progress made, Tokyo has faced important tests to consolidate its leadership bid, as discussed below. These challenges only became steeper during the COVID-19 crisis, with a global economic slowdown and the rising temptation of protectionism in many quarters, issues that will be discussed in the final section of the paper.

Comprehensive Trade Deal with the United States

In negotiating at record speed, a bilateral deal (with two main agreements, one on market access, the other on the digital economy), Japan was able to stabilize the relationship with its core security guarantor and avoid punitive national security tariffs on automobiles. Japan also prevailed in rejecting auto export quotas. However, the negotiations yielded a narrow trade agreement with Japan offering TPP-level agricultural concessions (except for rice), and the United States refusing to liberalize the auto sector. Because automobile trade is at the centre of bilateral trade flows, the phase one bilateral deal is not consistent with the WTO prescription that preferential trade deals must liberalize substantially all trade. The level of ambition in rule-making is far more modest than the original TPP. Beyond the digital economy provisions, the agreement does not have a comprehensive rule book on cutting-edge trade and investment issues. Nor does the agreement include a dispute-settlement mechanism, an important omission especially as the WTO's trade enforcement capabilities are much weakened. Is a stage two deal that improves the quality and coverage of the trade agreement with the United States feasible?

CPTPP Consolidation and Enlargement

The most powerful reason for Japan to rescue the TPP agreement was to enable the future return of its original 12th member (the United States). Japan's rehabilitation of the TPP project into the Comprehensive and Progressive TPP (CPTPP) catapulted the nation to the big leagues of trade negotiations. However, the chances of a U.S. return decreased after the U.S.-Japan bilateral deal levelled the playing field for U.S. farmers in the Japanese market.

The consolidation of the CPTPP with its current 11 members and enlargement into Southeast Asia are challenging tasks ahead. Four of the original CPTPP countries have not completed the domestic ratification process (Peru, Chile, Brunei, and Malaysia). In a 2019 ISEAS survey, most respondents from non-CPTPP countries in Southeast Asia stated that it was better to keep a "wait-and-see" approach on joining the trade pact, while a third (36.4%) supported entry into the CPTPP.¹³ For Tokyo, Thailand is a natural front-runner for CPTPP admission given its role as a hub for Japanese auto manufacturing, but the push into Southeast Asia has gained greater momentum as Japan seeks to diversify its supply chains and diminish dependence on China to cope with COVID-19 disruptions.¹⁴ Thailand is said to be nearing its decision on whether to seek CPTPP membership, one that has become more poignant with the disruption to trade and investment flows during the pandemic.¹⁵ As the largest economy in the agreement and CPTPP chair in 2021, can Japan bring about the second transformation of the TPP project with a fresh wave of admissions?

RCEP Without India

Japan squared off with China in advocating for the 16-member configuration in the RCEP trade grouping. Tokyo aimed to include a democratic developing country (India) to act as a counterweight to China's influence. Japan and India have elevated their strategic partnership to include 2x2 dialogues, military exercises, and a future Acquisition and Cross-Servicing

Agreement. But the trade/economic component of this partnership is weakest. Prime Minister Modi's last-minute decision to abstain from signing the RCEP deal at the end of 2019 was a severe blow for Prime Minister Abe's vision for the regional architecture. Japan has not given up on the hope to persuade India to come back to the RCEP, but will India ever be ready? How does Japan's calculus on the RCEP shift without India?

WTO Reform

The trilateral effort has made important strides in codifying new rules on subsidies (to improve transparency, update the list of actionable subsidies, and shift the burden of proof with certain types of subsidies). Some of these proposals have already been submitted to the WTO Council. The task of reforming the WTO, institutionally and substantively, is vast, however. A pressing matter is to enable the WTO to play its central role in adjudicating trade disputes among member states. A group of 19 countries, including the EU, China, Australia, and Canada, have launched an interim appellate arbitration mechanism. Japan's absence from this initiative has not gone unnoticed. Appellate arbitration under WTO article 25 does not substitute for wholesale reform to the system, but offers a way to circumvent the U.S. position of fixating on the "why" (did the system overreach) without engaging on the "how" (reform proposals to fix its deficiencies and make the adjudication system functional). Is Tokyo prepared to take positions that may irk the United States when it comes to salvaging planks of the multilateral trading system?

Leadership in the Era of COVID-19

In the past few years, Japan has emerged as a champion of the rules-based, open trading system, and showed deft and skill in bringing together countries on important initiatives: the CPTPP, digital economy standards, and principles for quality infrastructure finance. In contrast, Japan has not positioned itself at the forefront of an international response to COVID-19. A number of factors explain Japan's more subdued response. First, the public health nature of the crisis means that countries that aspire to lead will be the ones with best practices to contain and mitigate the outbreak and avoid or shorten economic lockdowns. South Korea, Taiwan, and New Zealand have captured the spotlight, whereas questions linger about Japan's ability to increase its testing capacity or effectively impose social distancing measures to slow down contagion. While fears of an out-of-control outbreak have not materialized, why the Japan "model" seems to work is little understood, dimming its appeal to others. Second, the impact of the pandemic's onset on Japan's top-heavy diplomatic calendar in 2020 meant that when Prime Minister Abe turned his attention to the international stage he mostly engaged in damage-control operations: suspending the Xi visit and rescheduling the Olympics. Third, fractious politics of COVID-19 at home also played a role. Important fissures in the ruling coalition were evident when Komeito hinted at a possible dissolution of the long-standing alliance if the party's preference for universal emergency cash payouts was not adopted. Prime Minister Abe relented.¹⁶

As the global pandemic unfolds, Japan has resorted to its financial power to support key initiatives in the management of the coronavirus crisis: debt relief for poor nations (with a US\$100M contribution to the IMF's Catastrophe Relief Fund), and US\$800M to an international COVID-19 vaccine development fund. In contrast, Tokyo's leadership on trade has been more lacklustre. The government's plan for emergency economic measures references Japan's existing network of trade agreements to counter protectionism and focuses on restructuring supply chains to avoid overdependence in one country, with re-shoring to Japan and/or diversification into Southeast Asia.¹⁷ Japan's US\$2.2B in subsidies for companies to relocate production of essential goods from China to cope with COVID-19 supply chain disruptions does not amount to decoupling; it is risk management.

But more proactive leadership is needed. Japan can lead by example in one fundamental way: it has not resorted to export restrictions on medical supplies and personal protective equipment. Japan should join forces with other countries that have pledged to refrain from hindering international medical supply chains at the time they are most needed. To that end, it should sign on to the open plurilateral initiative spearheaded by Singapore and New Zealand, which specifically opts out of export curbs.¹⁸ In the past few years, Tokyo found its voice, elevating rule-setting to a key plank of its foreign economic policy. Now, it should double down on the negotiation acumen and diplomatic heft acquired since. The dissemination of principles and best practices that deter sicken-thy-neighbour policies across a range of international platforms (G7, G20, WTO, APEC, etc.), would be a true feat for a committed multilateralist like Japan.

Notes

¹ I am grateful to Laura McGhee for her able research assistance and to the participants of the UBC workshop on “Japan’s Leadership in the Liberal International Order” for their helpful feedback.

² Mireya Solís, “Reinventing the Trading Nation: Japan, the United States, and the Future of Asia-Pacific Trade,” *Brookings* (November 2019), <https://www.brookings.edu/research/reinventing-the-trading-nation-japan-the-united-states-and-the-future-of-asia-pacific-trade/>.

³ Shawn Dawn, Josh Wingrove, and Saleha Mohsin, “U.S. and China Sign Phase One of Trade Deal,” *Bloomberg* (January 16, 2020); David Dollar, “Will the New U.S.-China Trade Deal End the Trade War?” *Brookings Podcast* (January 16, 2020).

⁴ Chad Bown, “Unappreciated Hazards of the U.S.-China Phase One Deal,” *PIIE* (January 21, 2020), <https://www.piie.com/blogs/trade-and-investment-policy-watch/unappreciated-hazards-us-china-phase-one-deal>.

⁵ IMF, “World Economic Outlook, April 2020” (April 6, 2020), <https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>.

⁶ WTO, “Trade Set to Plunge as COVID-19 Pandemic Upends the Global Economy” (April 8, 2020), https://www.wto.org/english/news_e/pres20_e/pr855_e.htm.

⁷ World Economic Forum, “Managing COVID-19: How the Pandemic Disrupts Global Value Chains” (April 27, 2020), <https://www.weforum.org/agenda/2020/04/covid-19-pandemic-disrupts-global-value-chains/>.

⁸ Simon J. Evenett, “Sicken-thy-Neighbor: The Initial Trade Response to COVID-19,” *The World Economy* (March 27, 2020).

⁹ Quoted in Maddy White, “World Bank Urges Against Export Bans Amidst COVID-19 Medical Supply Chain Mayhem,” *Global Trade Review* (April 21, 2020), <https://www.gtreview.com/news/global/world-bank-urges-against-export-bans-amid-covid-19-medical-supply-chain-mayhem/>.

¹⁰ See https://www.wto.org/english/tratop_e/covid19_e/notifications_e.htm.

¹¹ Mireya Solís, *Dilemmas of a Trading Nation: Japan and the United States in the Evolving Asia-Pacific Order* (Brookings Press, 2017).

¹² Mireya Solís, “Follower No More? Japan’s Leadership Role as a Champion of the Liberal Trading Order,” in *The Crisis of Liberal Internationalism: Japan and the World Order*, eds. Yoichi Funabashi and John Ikenberry (Brookings, 2020).

¹³ ISEAS, “The State of Southeast Asia: 2019 Survey Report” (January 29, 2019): 8, https://www.iseas.edu.sg/images/pdf/TheStateofSEASurveyReport_2019.pdf.

¹⁴ Rintaro Tobita, “Japan Scouts More Asian Players for TPP to Cut China Dependence,” *Nikkei Asian Review* (March 21, 2020), <https://asia.nikkei.com/Politics/International-relations/Japan-scouts-more-Asian-players-for-TPP-to-cut-China-dependence>.

¹⁵ Orathai Sriring and Kitiphong Thaichareon, “Thailand Sees GDP, Investment Boost if Joins CPTPP Trade Pact,” *Reuters* (April 27, 2020), <https://www.reuters.com/article/us-cptpp-thailand/thailand-sees-gdp-investment-boost-if-joins-cptpp-trade-pact-idUSKCN2290TF>.

¹⁶ Satoshi Sugiyama, “Komeito Cash Handout Demand Highlights Abe’s Fading Power amid Outbreak,” *Japan Times* (April 19, 2020), <https://www.japantimes.co.jp/news/2020/04/19/national/politics-diplomacy/komeito-cash-handout-shinzo-abe-power-coronavirus/#.XrF7XhNKiu4>.

¹⁷ See https://www5.cao.go.jp/keizai1/keizaitaisaku/2020/20200407_taisaku.pdf.

¹⁸ Kelly Buchanan, “New Zealand; Singapore: New Declaration on Trade in Essential Goods for Combating the COVID-19 Pandemic,” *Global Legal Monitor* (April 17, 2020), <http://www.loc.gov/law/foreign-news/article/new-zealand-singapore-new-declaration-on-trade-in-essential-goods-for-combating-the-covid-19-pandemic/>.