



Focus of Japan-U.S. Economic Dialogue (I) Japan Should Pull the U.S. Away from Protectionism: Exploring the possibility of FTA negotiations

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Key Points

- The most alarming course of action the U.S. could take is unilateral action.
- Japan should stress that it is pointless for the U.S. to see its trade balance with Japan as a problem.
- Japan should constantly push for liberalization negotiations to maintain the trading system.

A Japan-U.S. Economic Dialogue, led by U.S. Vice President Mike Pence and Japan's Deputy Prime Minister Aso Taro, is scheduled to be held in Tokyo on April 18. Since this is the first meeting in this new dialogue, there may be no in-depth discussion on individual problems. However, given that the Trump administration continues to make remarks about protectionism, it will be interesting to see how discussions on the yen-dollar exchange rate and commerce-related problems unfold.



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On March 31, 2017, President Trump signed a Presidential Executive Order aimed at reducing the U.S. trade deficit. The U.S. President has also indicated his intention to impose sanctions and tariffs against unfair trade. He has also previously remarked that he is ready to take measures that breach World Trade Organization (WTO) rules, giving precedence to U.S. trade laws.

There is apparently vague unease that the advent of the Trump Administration may bring about the collapse of the multilateral free trading system that evolved under the WTO. The recent Presidential Executive Order has brought such concerns to the fore in a more concrete form. One of the important roles of the Japan-U.S. Economic Dialogue will be to prevent the

U.S. from adopting unilateral protectionist policy measures through discussion between the two countries.

Before assuming office, President Trump made it clear that he would attach importance to bilateral negotiations. He argues that the U.S. cannot fully protect its national interests under multilateral rules such as those of the WTO or the Trans-Pacific Partnership (TPP). He also says that it is important that the U.S. negotiates properly in bilateral discussions with trading partners such as the U.K., Japan and China to protect its national interests. If Trump strengthens his stance, thus shelving the TPP and incapacitating the WTO, the multilateral trading system will face major difficulties.

In this sense, bilateral negotiations - apparently the Trump Administration's keyword for trade negotiations - tend to be regarded as undesirable both for Japan and the world as a whole. Indeed, bilateral negotiations that disregard multilateral frameworks are, in many respects, undesirable.

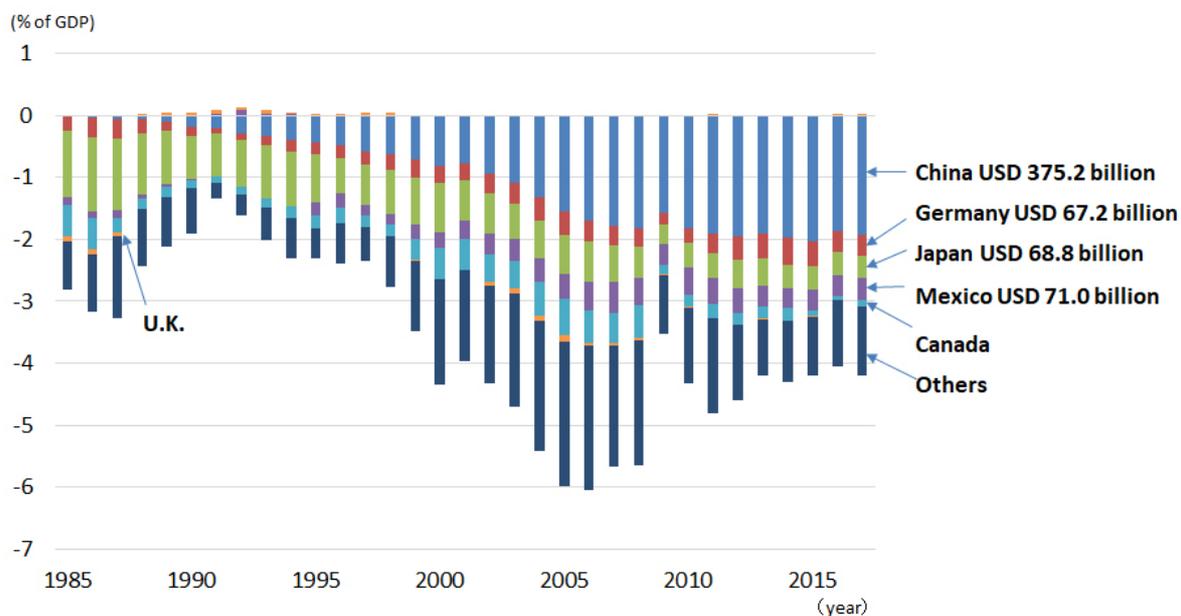
That said, bilateral negotiations are still better than unilateral action. Out of three types of action: multilateral, bilateral and unilateral, the most alarming course of action the U.S. could take is unilateral protectionist action. Bilateral negotiations could act as an important breakwater preventing the U.S. from running wild.

The policy stance emphatically adopted by the U.S. Government goes like this: The fact that the U.S. has an enormous trade deficit is hugely detrimental for the U.S. economy. This situation has arisen because of the unfair regulation and trade practices of countries such as China and the U.S. The U.S. is willing to exert pressure and, in some cases, adopt unilateral sanctions to give teeth to its demands. It is all very reminiscent of the Japan-U.S. trade frictions of the 1980s.

No-one knows whether the Trump Administration will actually adopt protectionist policies that majorly deviate from WTO rules. This is because trade policy measures are a matter for Congress and it would be difficult for the administration to continue with protectionist policy measures unless it obtains Congressional approval.

As symbolized by the withdrawal of the healthcare bill intended to replace the health reform law (Obamacare), the Trump Administration has thus far been unable to deliver on key policies. The extreme remarks of the President and his entourage may work in elections, but delivering these remarks as actual policies is not easy. Hopefully, mainstream Republicans who support the current trading system will act as a citadel against the extreme protectionism of the Trump Administration.

Breakdown of U.S. Trade Deficit by Trade Partner



Note: Based on 2017 U.S. trade deficit figures.

Source: <http://www.census.gov/mtis/>
<https://bea.gov/national/index.htm>

Even so, there is the undeniable possibility that the U.S. will implement protectionist policies that breach WTO rules. Looking back on history, the U.S. has implemented unilateral policies where necessary on numerous occasions. The 1971 Nixon shock is a good example.

President Nixon suddenly announced a policy of cancelling the convertibility of the dollar to gold, completely overturning the international monetary system that had evolved under the International Monetary Fund (IMF) after World War II. At the same time, President Nixon decided to impose a uniform surcharge on imports, which he claimed, could be expected to have the same effect as exchange rate realignment.

Compared to Nixon's overturning of the IMF/General *Agreement on Tariffs and Trade* (GATT) system or his actions in breach of their rules, it would come as no surprise even if the Trump Administration did embark on a course of action that would destroy the WTO.

However, it is important that we do not end up in this situation. The Japan-U.S. Economic Dialogue has a role to play in this. It is imperative to properly discuss matters in the economic dialogue to ensure that the U.S. does not take unilateral action against Japan, and to push the U.S. into a more positive direction. Even if it is difficult to steer discussions in the bilateral talks between Japan and the U.S. in a direction that is favorable for Japan, hopefully, the outcome of the dialogue will be to prevent undesirable unilateral action by U.S.

Initially, the issues of the yen-dollar exchange rate and the trade balance are likely to be central themes. Given that the Trump Administration sees its trade balance with Japan and the strengthening of the dollar against the yen as problems and that the thinking behind this is clearly economically incorrect, it is important to fully debate these problems. The yen-dollar exchange rate is a problem that is also closely related to Japan's escape from deflation.

The trade balance is a problem on which it will be difficult to reach a conclusion that satisfies both Japan and the U.S. However, polite discussion is required, as the Trump Administration regards this as an important issue. As shown in the Figure, a breakdown of the U.S. trade deficit by trading partner shows that, apart from China which accounts for the largest share by far, the U.S. runs a large deficit with Japan, comparable to that with Germany.

However, the trade balance or the current balance strongly reflects macroeconomic trends and is not determined by trade or other policy measures. Seeing the bilateral trade balance as a problem makes absolutely no sense in the first place. Japan has no option but to persistently stress this obvious fact.

Ideally, Japan should pursue the theme of economic cooperation in the interests of both Japan and the U.S. The Trump Administration has hinted at the expansion of exports of shale oil and shale gas. If the U.S. becomes a stable source of supply, this will also be good for Japan as it will lead to diversification in the countries that supply Japan with oil and natural gas. If Japan increases exports of oil and natural gas from the U.S., Japan's deficit with the U.S. is bound to shrink as a result.

It will be interesting to see how trade negotiations are handled in the future. As explained before, much discussion is required to ensure that the U.S. does not move in the direction of unilateral protectionist policy measures. Is there then the possibility of even more in-depth trade negotiations? President Trump himself appears, if anything, positive toward bilateral trade negotiations between Japan and the U.S. This development opens up the possibility of free trade agreement (FTA) negotiations.

Before the TPP vision emerged, there was some expectation in economic and academic circles in Japan for implementation of the Japan-U.S. FTA vision. However, the U.S. was not interested at the time. On this occasion, there appears to be some interest in the U.S. camp. The conclusion of an FTA with the U.S., Japan's most important economic partner, would be highly significant for Japan. I propose that, in the upcoming Economic Dialogue, Japan discusses whether it would be possible to start Japan-U.S. FTA negotiations.

Trading system experts often compare the trading system to a car. A car will fall into disrepair if it is not driven regularly. In the same way, a good trading system will deteriorate without constant liberalization negotiations

Like driving a car regularly to keep it in good working order, repeated Japan-U.S. dialogue is important to stop the U.S. from adopting protectionist policy measures. On this basis, though a little premature perhaps, I hope that the possibility of Japan-U.S. FTA negotiations will also be examined in the forthcoming talks if the opportunity presents itself.

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