



The Economics of Abenomics—A Pre-Summit Assessment Panel 2: A Need for Initiatives in Trade Policy?

Presenters:

Motoshige Itoh, University of Tokyo
Jeffrey J. Schott, Peterson Institute for International Economics
Clayton Yeutter, former United States Trade Representative

Chair:

Daniel Bob, Sasakawa Peace Foundation

Peterson Institute for International Economics, Washington, DC
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Dan Bob: My name is Dan Bob and I'm a senior fellow and director of US-Japan Programs for SPF USA; and in this second panel, we'll be focusing on how trade strategy including TPP, as well as structural reform, particularly deregulation, fit into Abenomics. As has been noted, Abenomics consists of three arrows and the first two were primarily covered by the previous panel, the Monetary Using and Fiscal Stimulus and those, of course, are aimed primarily to giving a near-term boost to the economy.

The third arrow is the Growth Strategy and this, while the Fiscal Stimulus has its own political issues, I think, arguably, the Growth Strategy may be politically even more difficult; but it's aimed at sustaining Japan's economy over the medium to long term. And this strategy is going to be developed by the Industrial Competitiveness Council as well as the Council on Fiscal and Economic Policy, which are both chaired by the Prime Minister. There's also a Regulatory Reform Council, which will play a role in this as well.

The Growth Strategy is to be based on two pillars, first strengthening economic partnership agreements to promote trade in an investment, and second, on instituting domestic reforms to increase competitiveness.

The specifics of these policies will be offered toward the end of June to the Prime Minister, and that, of course, will be just before the Upper House elections in Japan in July; and, depending on the results of that election, more details about the Growth Strategy should be released shortly thereafter.

We've had a few indications about some aspects of the Growth Strategy. For example, on January 25th, in the aftermath of the first meeting of the Industrial Competitiveness Council, the Prime Minister instructed his cabinet to focus on such things as regulatory reform, innovation, information technology, energy policy, enhancing the role of women and young people in the workforce, and trade liberalization. We'll hear more about that from our panelist, more specifics on that.

And Japan's trade strategy has been mentioned, of course the big question here is whether or not Japan will enter the TPP negotiations. And if press reports the last couple days are to be believed, Mr. Abe apparently is now leaning toward joining the negotiations and perhaps making an announcement shortly after his summit with the President here next week.

Now, to address these issues, we really have a terrific group of panelists. I'll keep their introductions short since they've already been talked about; but leading off will be Professor Motoshige Itoh, who is a close adviser to the Prime Minister and is a member of Mr. Abe's Council on Economic and Fiscal Policy. He is also the President of the National Institute for Research Advancement and on the Faculty of Economics of Tokyo University where he previously served as Dean of the Graduate School of Economics.

Itoh [inaudible 00:03:43] will be followed by Jeff Schott, who is a senior fellow here at the Peterson Institute and a leading expert on international trade policy and economic sanctions. And his most recent book which was available—I think still is available—out front is entitled Understanding the Trans Pacific Partnership.

And then batting cleanup, our final panelist will be Ambassador Clayton Yeutter who is a senior advisor at Hogan Lovells and, of course, served a distinguished career in government as, among other things, US trade representative and as secretary of agriculture. So with that, let me turn things over to Professor Itoh.

Motoshige Itoh: Thank you, Dan, for that very kind introduction. It's my pleasure to be here. We have discussed a lot about the monetary side of economics, so I'm going to speak about the real side of economics, okay. It's complementary. And of course trade policy, TPP, one of the most important issues. And probably we are having a lot of discussion about TPP later.

So in the first part of my presentation, I discuss the wider issue about the real side of economics and discuss where trade policy is just placed; and then, in the latter part of my presentation I'm going to discuss about trade policies.

Now let me just reiterate what happened in Japan in the last ten years, which is very important because we have to think where we start Abenomics. Okay? So this isn't the typical phenomenon the country can experience under deflations. For instance—I try to be brief.

What I want to say is just the household sector and the corporate sector is building up a lot of saving because they didn't want to spend because they have a very pessimistic prospect about the future. And they're just huge on saving. They are just throwing it into the international market. But the banking sector could not find any place to lend money, so what happened is that most of the money just went to the government bond.

Also the Japanese government, they lend a huge amount of deficit, but fortunately, or unfortunately, the amount of saving coming into the market is larger than the amount of deficit. So, as we heard, just the rate of return, or interest rate, was very low for many years because this was a typical picture.

Now the most important implication about the real economy, the last part, Japan did not make investments for the future for many years. Congress didn't make investments; households did not spend much money on education. Well we have very declining amount of public investment and so on and so forth. We are using our saving only for just covering deficit of the government and this is not good for Japan's economy.

So the important thing is how we can just vitalize or dynamite the saving investment trouble, and it is one of the most important features of the economics. And so stopping

deflation is very important; but at the same time we have to think about what we can expect after stopping deflation.

Now the very good thing is the situation in Japan now is very different from the situation say, in Europe. The situation in Europe is very similar to the situation in Japan ten years ago. I mean the household sector and corporate sector just built up a huge amount of debt, took over [inaudible 00:07:29] and the financial market is overregulated; so there is a lot of difficulty. So they have to do anyway a very difficult adjustment for some time. And we did, but that was ten years ago.

So what happened is now the household sector is cash rich rather than overdrawn and the corporate sector is also. It's very cash-rich rather than overdrawn. The problem is they don't spend much, just keep in the form of the international asset.

And the financial market is under-leveraged. Maybe rather than having just a huge amount of under-leverage, what happened is they have a lot of accumulation of savings money coming, but they don't have any place to spend other than just government bonds. So in that respect, Japan is now in a very good position to restart this savings investments cycle. The problem is, because of the different international expectations, we couldn't start. So some kind of stimulation is important.

So that is the reason why Abenomics is very important. And also there's some very good news from outside of the world. It seems to be the case that the world economy is moving gradually from risk off to risk on. You can have several very interesting numbers like the exchange rate of the emerging countries, North Korea but also other emergent countries. They are appreciating.

Well appreciation in Korea alone has nothing to do with the depreciation of the yen, because Korean appreciation started already, which means money is moving back to emerging countries because of risk on. And similarly, if you look at the interest rate on the government bond, of the so called "safe government bond," like the Germany's government or US government bond or the German government bond, there is a very gradual increase, which means the risky money is getting out of the government bond to more risky one. And of course you can just see many other things.

So maybe former Prime Minister Noda just has chosen a very good timing for him to resign—although he didn't intend that. And the change of the projects is provide a very good opportunity for Japan to just to look at rash diplomatic policies. Probably now is the best and maybe rare opportunity for Japan to have a very concentrated effort to depart from the deflation. And that is just the background of the Abenomics.

Okay, so everyone now knows about the three arrow policy. But some Japanese journalists call this a Triple A policy, which is very important for the three A's. One A is Abe, who is very eager for monetary expansion. The second A is Mr. Aso, which is very famous or notorious, I don't know—maybe famous, but very fiscal stimulators. And the third is Mr. Ha'amori, who has been working a very long time for the Industry Policy; he is maybe the most influential person for industry policy now in Japan. These three people are actually in front of the now Abenomics, and just maybe is the other side of the future of the economics. So I think the personality and politics is very important for you to just recognize what is going on.

Now about the diplomatic policy, we have already made discussion. What I just want to emphasize is it is still a continuing process. Everybody is very much interested in who is going to be the next governor of Bank of Japan. And then the next thing is what he will do after that. So the monetary policy discussion is continuing and so far the market has a very large amount of expectation about more expansion. I don't know, but anyway it's domestic policy.

Now fiscal policy has some discussion all day. The fact I want to emphasize is the short term stimulation and the long term of fiscal conservation is completely different matter. As you probably know, the present supplementary budget, which is very stimulating, the government has to issue another five trillion Japanese yen bond, which is about 50 billion US dollars, which is a lot. However, as you probably know, the present amount of debt the government has is about 1,000 trillion yen or 10 trillion US dollars.

So a 5 trillion yen addition or not is not very significant to the already big issue of 1,000 trillion. So what happened is, just now, we are using our very concentrated fiscal stimulation in order to be away from deflation. However the long term fiscal management is so important. So Prime Minister Abe has already ordered us to ask the Council to discuss seriously about what Japan should do for the reform of fiscal spending in the long term and there must be some serious discussion going on now.

Important thing is that we have to think about what is the main reason for the big amount of deficit? Well, it's very difficult to analyze, but if you just have a very simple coordination factors, the most important element for the large amount of deficit is reduction of taxed revenue, which is very much related to the economic activities.

So that means two things. It is very important for us just to revitalize the economy in order to get a higher amount of revenue and second is tax reform is very important. In that way Mr. Noda had a very important commitment to raise consumption tax and there must be continuing discussion about reforming tax so that we can have enough revenue, to one area.

And second and equivalently important factor for the deficit is the social security, of course, and this is another very important issue. So although public spending on the road construction is old fashioned, the fiscal policy is still a very interesting issue, but that is not the most important issue. The most important issue in magnitude is the social security issue, which is very difficult and which is very time consuming and which depends very much on the rapidly aging population of our society. But anyway, that is the most important thing so far—fiscal stimulation. But we have to think very seriously about the long term strategy for fiscal reform.

And third is growth strategies. There are many things discussed in growth strategy, but I just have to raise three. One is the deregulations, okay? And second is the pro-business tax scheme or this is included in the overall issue of tax reform, so corporate tax or just they reform other tax schemes. And the third is trade liberalization or actually stronger policies. So this is kind of the essence of the three arrows.

So let me just talk more about the growth strategy. The one is deregulation. Of course there are many issues about deregulation, but I'd like to emphasize these three areas. As Prime Minister Abe explicitly mentioned, these three areas are the most important areas so far about the deregulation.

The one is labor market reform and the second is just energy and environment, and the third is just healthcare. There are common features among these three. One is we are facing a serious problem in each of these. Maybe labor market not only in Japan. Any country has serious problem in the labor market, including the women and the young workers and so on and so forth.

And second: energy. I don't have to say anything about energy in Japan. Actually I was a Chairman for Reform of the electric system and spent most of my time last year, so I hope the most of the reform, the unbundling the form of the national line networks and the irrigation and consumption side must be enforced. But anyway, that is a very big issue and it had a scare because we have the rapidly aging which are facing many many problems.

So these are the areas Japan has to introduce drastic measures. Otherwise, we cannot survive. But if we can introduce drastic measures of change, this may provide a lot of potential for driving up the growth of the economy.

We had a good experience in the 1970s when we faced the oil crisis. We had a lot of difficulties and Japan did a lot of things to cope with the increasing energy costs and I think we could just contract a so-called very energy efficient society. This is not just the idea of one business leader. It is just the result of efforts of many many people, and it is also much related with the change of the lifestyle of the people. So it's a very good challenge.

But if we can just adjust to the challenge by doing reform, that may provide a long term opportunity for the innovation. So this is kind of a big issue we discuss. Of course there are many other areas which we have to discuss about deregulation.

Now trade policies, TPP is very important, but also you have to remember we are not involved in various other trade schemes such as the Economic Partnership in association with the European Union, with Canada, with Australia, and also ourselves. That is the FM plus 6.

So there are many channels where we can just push forward the trade policy, and I'm not talking much about provisionist tax policy today because I don't have much time.

The important thing is just—now we're talking about trade policies—we have to think that ten years ago, the picture in Asia was very different. One of my friends just recently looked up the top 30 countries in terms of GDP: number one is the United States, and Japan at that time, and then China and so forth. There are only four countries which were not any FDA or EPA around 2000, Japan and China, Korea, and Thailand. That means that East Asia was very much behind the trend of the deflated agreement and you know there's a very big change after that. So there are very drastic changes in the environment of trade policy in East Asia in the last ten years. You have to remember this.

So that means just the speed of the changes is very important and you have to, you must forget what happened ten years ago. And there is some reason. This is a kind of very famous model of gravity model that I [inaudible 00:18:09], which means just the amount of trade between two countries just has a very much created a distance. The shorter the distance the more trade and also the other thing is just the size of the country is very big.

And this is very important when we think about the future of the rate for Japan because, for example, if you compare that in Japan and Germany—the economic export dependence—our export over GDP is like 14 or 15 percent; in the case of Germany it is 38 to 40 percent. Why Germany can't raise so much GDP as compared to Japan? The reason is very simple. We didn't have big countries around us 20 years ago. Twenty years ago, China was only one-eighth in terms of GDP of us. And now there is something like one over 20.

But Germany has many big countries around, for many years, which provided a lot of GDP of course for division of labor and also trade. Now the direction is just because of the rapid growth of the Asian countries. We have the opportunity to trade more with our neighbors, both export and import. The important thing is just expansions just really have come, too, with the very drastic change of industry structures. So there must be very [inaudible 00:19:26] inference on the changing pattern of [inaudible 00:19:29]. Again, the main thing I want to say, but I don't have time, I don't get into detail of the industry structure change, but this is very important.

And this also gives you another reason why this stage is very current. This stage actually came from the research of my research institute about simple accounting, a significant number of people who are middle-income to wealthy people. Now I'll just give you one typical example.

The GDP of China expanded three times in the last ten years. The number of middle-income people in China expanded eight times in the last ten years. You know why? When the country becomes bigger, an increasing number of people become poor people, too, middle income people. So according to this estimation, there were about 800 million people, new middle income in Asia and there are going to be another 100 million middle-aged people coming up, which just means lots of economic opportunity for trade in this area.

So the EPA is very important, and just to give you a very complete picture of what the Japanese are now involved, so many processes of the FTA and the EPA and the important thing is, not only just the individual FTA is important, but also the EPA is going to become very important to just set the rule for the global economy.

Unfortunately, the WTO or GATT is not very active at this moment and if the United States has the EPA, say with Europe, or if the TPP is realized ... and these are the kinds of things going on. And Japan is also doing negotiation with the European Union. And the rule decided there can be a very important standard for the rest of the world. So in that respect, it is very important for Japan to participate in this process. And that is the reason why TPP is also very important.

And finally, I just speak a little bit about the politics. That was a very interesting question in the previous session about the, what is the implication of the privatization posture, saving? Personally, I don't think that is the most important issue for Japan. There are many other important issues.

But what is the most important contribution by Mr. Koizumi, is the policy science issues. Now if you just count the number of the Japanese people who are in favor of privatization, opposed to saving, there are a lot; but they are not speaking loudly because the benefit for them is very small. There are a very limited number of people who strongly say against the

privatization. So in ordinary politics, what happened is just a small number of those very loud voiced people can influence the politics.

One of the very smart behaviors Mr. Koizumi, what I should say “political entrepreneurship,” is just to raise the issue as a very important issue for voting and ask each individual people, “Are you yes or no?” If you just counting the number of yes, certainly the number of yes is much larger than no; so he actually changes the politics in that way.

Actually even Mr. Noda, intentionally or unintentionally, succeeded that strategy; so “Are you yes or no for raising consumption tax or TPP?” What I want to say is the heated discussion on TPP just shows the position of trade policies now is changing a lot.

I was involved in the FTA with Thailand during the period of Mr. Koizumi; but I know that Mr. Koizumi spent maybe only one minute every week on that issue and the remaining time only for personal saving. He actually asked each individual ministry to deal with the issue and no hope to just very traditional making.

But one big difference from this case to TPP is everybody’s now talking about TPP, and everybody is talking about yes or no to TPP; so we are in a different stage. I personally prefer and hope TPP will be realized, but with or without realizing TPP, the stage of the trade policy—politics always changes it. Because of TPP which is giving high target, it seems to be easier for us to have a FTA with the European Union or even Australia or Canada, and so for that respect, the trade policy is now becoming very important driving force for the most people.

And of course realizing TPP is very important. I don’t know what kind of discussions will be made between Prime Minister Abe and Mr. Obama next week, but it seems to be the case that Mr. Abe is trying to follow the style of politics as Mr. Koizumi did and I hope he mentions about the TPP in his talk with Mr. Obama. Thank you very much.

Jeffrey Schott: Good morning. I’m very grateful to Professor Itoh for setting the table so well for a discussion of how trade policy fits into the broader issue of Abenomics. So what I’d like to do this morning is just talk a little bit about TPP and put it in the context of the debate that is going on in Japan.

As is well known, the TPP is a big deal and it’s been going on now, the negotiations, for three years. In fact, I was in Japan more than three years ago at a APEC meeting in Tokyo where I first broached the issue of Japanese participation in TPP even before the big negotiations began. I also said Canada and Mexico should join and officials from the three countries looked at me like I was crazy. Well, I guess I was crazy only for two and a half years because now Canada and Mexico are part of the TPP talks and Japan is considering it very comprehensively.

The TPP is a big deal in the making and it involves, right now, the eleven countries combined count for 30 percent of GDP. Japan is considering joining and so is Korea and if those two countries join the talks, then the TPP will account for 40 percent of global GDP and really will be a big deal.

Now what the negotiators are doing is developing a comprehensive new rule book for trade and investment in goods and services, and that’s why it’s so important in the context

of Abenomics. Trade agreements are often thought of, “Well, this is how we’re going to increase exports.” And, if an agreement is done correctly and complemented with the right domestic policies, trade agreements will spur increased exports and they will also increase imports and that’s the key point; that what a trade agreement will do is spur greater competition in the market and create better incentives for investment in the market so that there can be growth and to spur greater productivity gains. And that is why it is so critical that trade policy be considered as part of a program of domestic economic restructuring, and that I think was well explained by the comments of Professor Itoh.

Now in the TPP, everything is on the table: goods, services, a comprehensive new set of rules. That’s the idea of setting up a rule book. And the negotiators have been steadfast in saying everything is on the table. Nothing has been taken off the table, no issue, no product, no good, no service, and that of course is for negotiating necessity.

If you start taking goods off the table, pretty soon everybody wants to take something, their most politically sensitive issue, off the table and suddenly you look at the table and it’s bare. So the experience of trade negotiations has been that negotiators go through the process and then at the end of the day, deals are generally comprehensive, at least the ones the United States is party to and the ones that are fully consistent with international trade obligations.

But there are some areas where issues will only be subject to partial liberalization, partial reform. And in very rare instances, there are products or issues that are left off the table at the end of the day. Rice was left out of the US-Korea Free Trade Agreement for example, and sugar was left out of the US-Australia Free Trade Agreement. But generally those are the exceptions to a broad rule that you need to have comprehensive coverage.

Now the other thing that TPP is doing and Professor Itoh noted the extensive network of agreements that Japan already has, is substantial upgrading of existing trade pacts among participating countries and also building a pathway to a broader Asia-Pacific pact and I’ll get back to that in a few moments.

And, as Professor Itoh also noted, what the TPP negotiators are doing is establishing precedents and those precedents are already informing talks elsewhere in Asia, even in the ARCEP, and they’re also going to be a strong foundation for the nascent negotiations between the United States and the European Union that were announced just earlier this week.

Now this is for your information, since this short presentation will be on our website, to show you who’s involved, how big they are and how much Japan adds to the mix and fits in with the other eleven countries. Again, the addition of Japan will make a big deal a really big deal.

What’s the current status? Right now we’ve had fifteen rounds of negotiations and there are three more scheduled for this year. What is important for Japan is that the TPP leaders seek to finish the talks in 2013. But, if you go through the book that was left for you outside, now you’ll notice that a good deal of that book talks about the sticking points in the negotiations, both with regard to goods and services, and some new rule making.

And so going through those difficult issues, winnowing them down to a smaller number that can be resolved by ministers or political leaders, will be a difficult task in the coming months. It is doable, but it is likely that the negotiations could well spill over into 2014. So

there is still room for Japan and/or Korea to come into the talks this year and participate as an initial signatory.

Now, if that does not happen, there will be an accession clause in the TPP and it's possible that new members could join using the accession clause after the deal has been signed, sealed, and implemented. Now if you look into historical precedent, there are very few countries that ever have been able to use an accession clause and while it is possible in the TPP context, it is much more likely that big countries would have to renegotiate the deal with the existing membership. And so there is a big incentive to be a first mover and to be in on the initial deal, but that doesn't preclude joining later, but it will be much more difficult later because you will have to do a new negotiation.

Now what are Japanese interests and objectives? Like any trade agreement, and indeed like almost every trade agreement that I've ever seen, there are important strategic as well as commercial objectives at play and certainly for Japan, there is a strategic interest in strengthening the bilateral alliance with the United States. This is a critical point. The TPP would certainly reinforce the US-Japan alliance, especially important given the rise of China and provocations from North Korea, and our joint efforts to deflect Iran's quest for nuclear weapons.

Japan is working very closely with the United States on economic sanctions aimed at forcing Iran to forego its weapons program. President Obama has exempted Japan from those sanctions. That's one part of the goodwill that's been exhibited.

I think there's another area of goodwill that could be exhibited through our mutual benefit, and Adam stole my thunder on this point in the first panel. The TPP could strengthen the economic security relationship in another way and that is by the—in the area of US exports of LNG in the future to Japan. The United States in my view, should work with Japan to insure that reliable and diversified supplies of energy are available to fuel renewed economic growth in Japan at a time when the aftershocks of the terrible tragedies of March 2011 still constrain power generation and Professor Itoh was the expert on that and can address questions on that point in more detail.

But one advantage that the TPP has is that under US law, FTA partners are exempted from export licensing requirements for energy shipments; so TPP participation would facilitate future US exports of LNG to Japan as we develop the capabilities to ship more goods and go through the regulatory processes that are now under way; and I think doing so would provide Japan a tangible payoff for its decision to join the TPP and undertake the trade liberalization and regulatory reforms that would be required for each signatory.

Now, certainly that is a crucial consideration, but there's the commercial side as well and the ability to reinforce efforts to reform domestic economic policies, as Professor Itoh mentioned in his presentation, are the core reason, I think, that Japan is now reconsidering very seriously, the participation in the agreement. And in the interest of the time I won't go over the points that he made that I fully subscribe to.

In addition, as I mentioned earlier, the TPP is much more comprehensive than your standard trade agreement, and certainly those that have been agreed to among countries in Asia; so the agreement should upgrade and expand bilateral and regional trading arrangements. Japan has agreements, relatively lower quality economic partnership agreements, with most of the

members of the TPP already and the TPP would help them harmonize those new accords and upgrade them. You can call it an EPA modernization program.

It would also deal with a number of countries in which Japanese trade talks are still underway or have been stalled for a long time, as with Australia and Canada and New Zealand and South Korea. Prospects in all of these talks are clouded by problems in agriculture, and none of the prospective bilateral deals alone is sufficiently important, in economic terms, to spur the needed changes or generate the political forces for reform in Japan farm policies that are needed.

The TPP would accumulate the prospective trade gains from the other countries where agriculture impedes the negotiating process and, simply put, Japan could substantially multiply the trade concessions it gets for its own farm trade reforms in the TPP. I could go into more detail on that, but why would I when Clayton Yeutter is going to be the next speaker?

The final consideration is avoid discrimination from other trade pacts and here, Japan lives in a very dynamic neighborhood and a lot of countries are moving well ahead of it and certainly the EU-Korea deal has put—has created the potential for substantial trade diversion and this is something that Japan can offset through the negotiation of the TPP.

Final points, and as a companion volume to the primer of the TPP that I produced, my colleagues, Peter Petri and Mike Plummer have put together estimates, going forward, of the potential trade and output gains from a potential TPP and other integration initiatives in the region. And I've tried to accumulate this to show what its prospective impact would be for Japan.

A TPP 11 would be an integration arrangement excluding Japan. TPP 13 would be Japan and Korea in the deal, and that shows over the next, the medium term by 2020, 2025 very substantial output and trade gains for Japan as a result of participating in the deal, undertaking the reforms that would lead to substantial increments of economic growth. Over 2 percent increase in economic growth about the baseline projections for those years is a lot, and certainly, in trade policy, that's a big deal for what trade policy can do in and of itself.

But what's interesting in this regard is, if you look at it, Japan also does well in participating in the ARCEP—almost as well, or about as well as the TPP. And Japan is participating in the ARCEP; those talks are only starting, so they're well behind the TPP. They forecast a much shallower level of integration, many more exceptions, and so the overall output, even though there's a larger economic area involved, would be as much or about the same as in the TPP.

What is interesting, though, is that these are not substitutes for each other. Japan can participate in the TPP and in the ARCEP, and the results from Professor Petri show that the two initiatives, rather than being alternatives, are rather complementary and the results are largely additive. And so if you look at the bottom result, an FTAP, a broad Asia Pacific integration arrangement, which could possibly fall somewhere between the TPP high standards and the ARCEP medium standards, then you see a very substantial growth for Japan and almost the combination of being in TPP and ARCEP. It's something to think about that Japan can do both and indeed should do both as a complement for its broad-based domestic economic reform program. Thank you very much.

Clayton Yeutter: Thank you very much, Jeff, and my compliments to you and Professor Itoh as well, both are excellent presentations. I said I would go last in this event behind Jeff to try and not to duplicate everything he had to say to you; that's a little hard to do. What I should do is just say, "Amen," to what both of them had to say because those are excellent presentations and right on target.

I might add a little more of a geopolitical dimension to this discussion because ultimately some decisions are going to have to be made with respect to TPP, and some of those decisions are going to have to be made rather quickly; so I will mention that now and put it in the context of the forthcoming visit by Prime Minister Abe to Washington, which is just a few days off.

Will President Obama and Prime Minister Abe come to an agreement on how TPP is handled at that meeting and will that result in an announcement by Prime Minister Abe of Japan's participation in TPP not too long after he returns to Japan as was speculated to some degree earlier? Well, nobody knows. At least those of us who are outside the circle of the two administrations do not know the answer to that question.

But giving it a timely dimension, I would simply say that people need to understand, particularly folks in Japan, that this train is not going to sit in the station forever. It's been sitting there, to some degree, waiting for Japan, and maybe Korea as well, as Jeff indicates, for quite a substantial period of time; but eventually, it's got to leave the station. As Jeff indicated, the present participants in TPP have indicated a desire to terminate this negotiation in 2013. That's a rather ambitious goal and one that, in my judgment, is not likely to be realized in any case, whether or not Japan and Korea join in. It's sure not going to be realized if these two countries join.

But nevertheless, this indicates at least some wariness on the part of the existing participants about what is happening in the way of delay and some nervousness and impatience on the part of those countries including the United States. So it seems to me that the prime minister and the president need to focus on that when they meet here next week.

As you know, the procedure to add a country to a TPP is that that nation has to be invited by the existing participants, including the United States, and the reason the United States is rather critical in that context is because the United States is obligated to give a 90-day time period pre-announcement, if you will, or period of consideration to the US Congress. So that delays participation for at least that additional 90 day period.

What I would hope would occur when they're here next week is that the two presidents, with the help of their top team of course, will figure out how to handle the potential entry of Japan into TPP because there are some sensitivities there, of course, particularly on the Japan side. Those have to be figured out so that, at the right time, the United States and the other participants issue the invitation and Japan then comes along and accepts it.

Professor Itoh indicated that there is heated discussion of TPP in Japan, and I'm sure that's accurate. Having dealt with Japanese rice folks for about 30 or 40 years myself, I can understand that that's the case. I hope President Abe finally says to the rice folks and anybody else who is heatedly negative on this, "Time to get over it." It is clearly, clearly in the long-term best interests of Japan to join TPP. There is no doubt about that; that is

not a close case issue at all! And therefore what we really need out of Japan right now is some political leadership, maybe some political risk-taking on the part of President Abe and his top team to say, "We're going to join TPP because that's important to Japan. We're persuaded that the people of Japan want an economic growth strategy and if there be any economic growth strategy in Abenomics, it's going to have to have a TPP component. Therefore, let's go!"

Now if that's politically risky, then so be it. There are times in life when Prime Ministers have to take political risks and this may be one of those times in Japan. We went through this same kind of debate with the European Union on agricultural issues 20 to 25 years ago because the European Union had the common agricultural policy, which was comparable in many respects, politically at least, to rice in Japan. And the Europeans used to tell me over and over again, "You can't touch the Common Agricultural Policy, the CAP. It is sacrosanct. It is what is holding Western Europe together. If you attempt to reform the Common Agricultural Policy, the European Union will collapse!" I never did believe that, and I'm not sure that the people in Western Europe believed that, but nevertheless that was the view that was articulated by government officials there for years and years.

Finally, one human being in Western Europe took that on, took the political risk of reforming the policy. That was Ray MacSharry from Ireland and the MacSharry Reforms went into place about 20 years ago and in the aftermath to that, the European Union has gradually reformed its Common Agricultural Policy in a very major way over the last 20 years or so.

That is precisely what needs to happen in Japan. Everybody knows that we need the reform of Japan's Rice Policy. My argument to Japanese government officials, which I have made over and over again, comparable to what I've done with the European Union, is "For heaven sakes, why don't you take advantage of TPP as an opportunity to do in rice policy what you know you need to do anyway and in essence, get paid for it in the TPP negotiations." That ought to be the policy position that is taken by the prime minister and his team and it ought to be one that is viable in the context of TPP.

Now how do you handle that when people say, "Well, we need an exception for rice," or if they come back, the Japanese Agriculture comes back and says as Jeff pointed out, "Gee, Korea got off scott free in the US-Korea negotiation, and you Americans got off scott free on sugar in the US-Australia negotiation. How to you justify telling Japan you're going to have to liberalize rice in TPP? Aren't you being a little inconsistent?" Absolutely!

Absolutely, and if you want to put that in terms of hypocrisy, absolutely. It is hypocritical. The fact is those exclusions in those earlier negotiations were mistakes and everybody today I think, understands that they should not have been made for the reasons Jeff outlined. Once you start taking something off the table, even at the end of the game, you have an enormous pressure to take other things off the table and you narrow the results, the outcome, and the benefits of the negotiation. And if you want the benefits of TPP in an economic growth strategy in Japan, you can't afford to have the outcome narrowed down to where it becomes much less meaningful than the kind of numbers that were put up here by Jeff.

TPP, as Jeff indicated, is a big deal. We should emphasize that because, even though there are all these other negotiations and free trade agreements underway around the world, with Japan participating in a whole host of them and we're doing more including the US-

European Union, they're all way behind TPP in the negotiating process. The only big deal that's on the table right now is TPP and that's the one that's going to be the Gold Standard in trade negotiations in the world for the next several decades.

We still have the World Trade Organization, of course, with a Doha Round that is pending, but the fact is, that's behind time, too. WTO's going to have to change its negotiating modus operandi in the future. That's to come along at a later time and all of these other negotiations, as important as they may be, fall by the wayside in terms of relative importance compared to TPP.

Now Jeff, I agree with you on the regional negotiation here. I think that will be a wonderful complement to TPP, but Japan needs both and I think the United States needs both. Eventually this is going to get folded together. We're going to have a consolidation of free trade agreements in the world, and TPP is going to be the role model for consolidation, too, at least for all of Asia. You're going to see some of these agreements that Jeff cited up there that will, before long, be folded into TPP, into a much larger agreement, which will be almost comparable to the World Trade Organization.

Now the other point that Jeff mentioned, that we should also consider here for just a second, is should Japan just wait and sign on later, or should the train just leave the station? Should everybody say, "The heck with waiting any further; let's keep going and Japan can sign on later." And there are a number of participating nations that are making that point right now, that we should not wait for Japan.

If I were Japan, I would say, "No way. We're just not going to play that game. We're one of the largest, most significant economies in the world. We need to be treated like an adult in this process and we are not going to be treated like second class citizens, if you will. We want to be a participant in the first crunch of negotiations. We don't want to be added on at a later time. You're not going to bolt us onto this negotiation at a later time and we're not going to inconvenience the existing negotiating nations of TPP by saying go ahead and do your deal and then open up a new negotiation with us and let's start all over again." That's just not going to sell.

So we need to get Japan into this first round of TPP and it ought to be done without any misunderstanding on Japan's part about exclusions and exceptions. In my view, at the end of the day, everything is going to stay on the table in TPP. Rice is not going to drop off; US sugar is not going to drop off; everything is going to be on the table.

Now, people are going to strike deals on those super sensitive products at the end of the day, and the challenge that Prime Minister Abe has is to say to the Japanese public, "This is the way it's going to play out. This isn't an issue for negotiation; we're not going to solve that now. The Japanese rice issues are not going to be resolved at the beginning of the negotiation; they will be resolved at the end."

That's why we have negotiations. We don't do all the—handle all these issues—in a preliminary sense and they're not going to be any sideline deals with the United States or anybody else. What will happen at the end of the day, on super sensitive products, is that the nations are going to negotiate trade TRQs, tariff rate quotas, and there will probably be a tariff rate quota on sugar for the United States, there will probably be a tariff rate quota

on rice for Japan, and a number of others. Nobody wants to talk about that right now because everybody will say, “Well, what’s going to be the tariff rate quota?”

Well, the fact is, Japan ought to argue that, “This is the way we’ll handle rice reform in Japan in terms of the magnitude of change and the timeliness of change. What we agree to in a tariff rate quota will match with our reform program in rice.” And that’s achievable in rice in Japan; it’s achievable in sugar in the United States, it’s achievable on all the super sensitive products in other countries and that’s the way it should play out at the end of the day. I think I’ll stop right there because we need to get to questions. Thank you.

Dan Bob: Well, those were three really terrific presentations. We do only have fifteen minutes, so if you could keep your questions relatively short and we can avoid long statements, that would be best. So, who would like to begin?

Ben Hancock: Hi. Thanks. Ben Hancock from Inside US Trade. Mr. Schott, you made a comment about LNG exports and how that could be a really important selling point to try to get Japan to open up, we would be able to give them LNG right away under the exclusion. I wonder if you think that’s really enough to overcome the political sensitivities, especially given the July elections, or the summer elections in the Upper House. I also would like to get Professor Itoh’s perspective on that as well. Is that—for energy issues specifically. Is that enough of a selling point for Japan to be willing to take on new trade globalization?

Jeffrey Schott: I’ll leave most of the answer to Professor Itoh because the simple point is this is a promise of future cooperation; this isn’t anything that’s going to be implemented very quickly. We have a lot of infrastructure investment to do as well as the regulatory process, but it is a potential for stronger economic ties going forward.

Motoshige Itoh: I think the Japanese people did not recognize the importance of an energy policy just right after the earthquake, because they only considered the problem of the typical in that area. But the next summer, because of the stop of the nuclear plant, all over the nation, increasing number of people just started recognizing the importance of a secure supply of the energy and obviously, gas is the most important substitute for nuclear for a while.

The importance of the energy in the discussion of the TPP or any FTA was not very visible before, but now it is increasingly important. And that may be a very good thing because previously, everybody was thinking about the pro or against TPP as a battle between the big companies which wanted to export versus the farmers which just wanted to protect their market. But now, encouragingly, enough of the Japanese people start recognizing the issue is much bigger. So energy, the energy issue I think, I hope is becoming more important in the talk of the negotiation.

And also, as I said before, we are now in the process of negotiating with Canada, and Canada has a very strong incentive to sell their gas and energy to Asia, and that is again, the energy is becoming a very important issue for the discussion, for trade discussion.

Jeffrey Schott: Dan, can I add a point? The point I would simply add is where Japan has concerns about security which arise on the energy side and also on the food side, the United States should do everything in its power to satisfy Japan’s concerns in that respect, in other words, to assure Japan, and the rest of the world for that matter, that we’re prepared to export natural

gas to Japan and we're prepared to export food to Japan and we don't want you folks to follow foolish internal policies that, in unproductive ways, generate energy supplies or food supplies where we can meet those needs in a much more efficient productive manner through exports and through avoiding export controls. Now it's more complicated than that on the energy side at the moment, but the fact is, in principle, that's what we need to be doing for Japan and the rest of the world.

Dan Bob: In the back.

Bill Levy: Thank you. Bill Levy from the University of Virginia. Jeff, I want to ask you. You had an enticingly optimistic take about the interplay between TPP and the US-EU talks where you said that discussions in one could inform the other.

You could have an alternative interpretation of this that sometimes the hard part of striking a deal is that you have multiple, sort of conflicting interests that narrow the central space for agreement and having simultaneous negotiations that have to line up with each other. If you're talking about a topic like, say, regulation, would constrain things even further.

I guess I'm inviting you to elaborate more on what you see as the sequencing of how these discussions would go, how you harmonize across them. Maybe Ambassador Yeutter, who has some experience trying to do these things, might want to weigh in as well.

Jeff Schott: It sounds like a good topic for another conference, which maybe we'll do after we've done the appropriate research, but the short answer is that TPP is running on a much more immediate timetable than ARCEP or US-EU trade talks—or anything that will come out of the WTO, if there is a WTO recovery package that tries to revive the Doha Round.

The TPP, as Ambassador Yeutter said, is going to set the standard in many of these areas, and then the question is, will that standard be applicable to broader Asia-Pacific? Will it fit given the cultures of US and European commercial relations? Can it be put together in a way that provides a precedent for building new multilateral accords?

I think all of those questions can't be answered definitively, but the TPP will set a precedent; and indeed, from what I could see in the US-EU context, in a number of the new issues on the agenda, it at least is providing some fodder or some grist for the mill of US-European negotiators when they start working on this later this year and next year. So I view this as all optimistic sign.

Clayton Yeutter: I would just add a couple of quick comments to that on the agricultural side. In the US-EU negotiation, the issues that are expected to be exceptionally difficult are those relating to biotechnology and specifically, genetically modified organisms where the European Union has a nonscientific stance, if you will, compared to the scientific requirements that are built into the WTO rules and which will clearly emerge in TPP. So that's one of them.

And the other one is sort of a sanitary/phyto-sanitary area. Food safety and other related activities where the European Union has a precautionary, principled approach, again, which is considerably different from the science-based approach that's called for in the WTO and will also emerge in the TPP. So in those areas I believe getting a really sound agreement in TPP will be helpful in setting the table, if you will, in the US-EU agreement. In other

words, it's really going to make our European friends squirm as they try to defend those policies in the US-EU context.

Motoshige Itoh: Well just to reiterate the point, when you have two different types of negotiations or the opportunity for the negotiation, two different possibilities conflicting with each other or actually reinforcing each other and maybe about the content of the negotiation there may be some kind of conflict there; but the important thing is just when you are successful starting or finishing the negotiation, the existence of all the old [inaudible 01:03:23] is always important.

I personally feel we have been working for many years the Japan, China, Korea FTA [inaudible 01:03:30], discussion, discussion, discussion for ten years, no change. But when Japan has some kind of intention to participate in TPP, suddenly just the temperature of Chinese and Korean negotiators is changing and now when we discuss going then suddenly they just go back to the original position.

So I think that kind of a mutual interaction is very important, just like NAFTA, for example, had a very important contribution to the conclusion of the [inaudible 01:03:58] because Europe has a lot of threat from the regional agreements. So I hope, too, the two, the US-EU and TPP will be reinforcing each other. Thank you.

Jeffrey Schott: We call that competitive liberalization here.

Dan Bob: In the back.

Bob Vastine: Bob Vastine, Georgetown Center for Business and Public Policy. The question really is about something called de Campo. It was broached earlier. It's certainly one of the most vexing issues in US-Japan commercial relations over the last number of years has been the privatization or quasi-privatization of that enormous operation, financial operation, financial institution and its disposition into the future. It has not gone very well, from our standpoint and I'm wondering if what your review is will the Abe regime, as part of Abenomics, be prepared to truly liberalize, revise, privatize that sector as the price of the TPP?

Clayton Yeutter: You ought to be [inaudible 01:05:09] the first thing.

Motoshige Itoh: Japan position.

Clayton Yeutter: Go ahead.

Motoshige Itoh: You are mostly thinking of the personal saving? Until now?

Bob Vastine: Yes.

Motoshige Itoh: I'm not an expert on that issue, but the important thing is that there's a very big decision making by Mr. Koizumi is to privatize; and then there's some kind of going halfway back to the present position. I think the situation is still very shaky. So the international negotiation and if our politicians just find the opportunity by moving forward, there can be a very important moving factor. So, I think, in that respect, that most people don't think at first to set the issue on the table and see whether our politician can persuade our people that

this reform is very important now. And that is actually I think one of the most important purposes for the trading negotiation.

I had opportunity to talk with EU people about Japan-EU negotiation, and European people always say, whenever they ask the reform request of Japan, the Japanese bureaucrats are always very defensive. But that is the behavior of a bureaucrat. From the economist's viewpoint, that kind of reform is always an opportunity for the other people in general. I don't know what kind of discussion can be made about the personal saving privatization because it is still in a shaky position. So we have the opportunity to take it whichever direction we like and so I hope there's going to be open discussion about this issue. Thank you.

Clayton Yeutter: Bob, as you know, that's been on the bilateral agenda for a long time and it's almost like rice in a different area. The United States was—has been hopeful that there would be some progress, significant progress on that issue even before Japan enters a TPP. I can't assess those probabilities, but as you well know, and as I implied earlier, achieving much progress on these kinds of trade issues at the beginning of a negotiation is really hard. You've got to make sure it is on the agenda and it certainly will be; but we're more likely to see the progress at a later stage.

Will it be a high priority for the US? Absolutely. Absolutely. And by the way, Bob, since you're so involved and have been most of your life with services, I should say that we haven't talked much about services at all this morning. That's been a missing element of this discussion and obviously, with both Japan and the United States being huge services economies, there should be and will be significant liberalization benefits from TPP in the services area.

Dan Bob: Well I think we're just about out of time here, but I'd like to thank our three panelists for an excellent presentations. Just one side note. When the Prime Minister named these the Three Arrows, that was actually to a Samurai from the 16th Century names Mori Motonari, and he faced some difficulties from rival clans, had three sons, gave each of the sons one arrow and asked them if they could break it, which of course they could. He then gave them three arrows and asked them if they could break it and they couldn't. The implication of course is that all three arrows are critical for Abenomics to be a success. But again, thank you all very much. Please join me in applauding the group.

Adam Posen: And thanks to you Dan for doing a great job of chairing this session. Everyone is about to leave. It was a long, but I hope a very rich, I certainly feel very rich and very useful, session.

Just two programming notes and then the thank yous. One, Ambassador Yeutter just mentioned, rightly, services. For those of you who read it, you'll notice that in his successor, Ambassador Kirk's letter to the Congress, he mentions our study on services trade by Brad Jensen. We will be having an event closer to the Congressional voting date with Brad, some people from the Hill and some people from USDR to push that agenda and obviously if you'd like to join, that would be lovely.

Second, as has been mentioned both in the questions and over the course of this panel and hinted at in the previous panel, there is of course a very rich third arrow structural agenda and even TPP alone isn't enough to do that. We will probably not be having as big an event as this one on those issues, but we will be continuing to work on those issues and are very

open to exchange with people on those issues that will continue, particularly on the labor market side, as we mentioned, but also as John Lipsky raised in financial reform as part of a global issue.

Finally, let me just say thank you again to the Sasakawa Peace Foundation USA, to its president, to its Washington representative. We couldn't have done this today without them. Let me thank particularly Professor Itoh for traveling so far and making time when he's on a very tight schedule. Of course, Ambassador Yeutter, Professor Armada, the distinguished people who have content. It's really nice to get people who are both distinguished and have content and that's what we try to do, provide here.

My again, thank my colleagues Jeff and Marc Noland for having taken their role in this. It is genuinely exciting to be able to do a substantive Japanese event in this time when it's relevant and it is genuinely exciting to see how much, whatever we think will actually come out the other end, how much genuine economic analysis does seem to be motivating, or at least partially guiding, some of the policies, subject to the well-known limits that we already spoke about. That's all anybody at a think tank or any economist can aspire to. So thank you all. Today is closed.

