

A New Trading System Following the G20 Osaka Summit

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Outline

- **Introduction**
- **Structural change in the world economy**
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1. Introduction

- The “America first” policy of US President Trump has been undermining the rules-based multilateral trading system led by the WTO
- Factors behind this change:
 - ▢ Domestic: A rising doubt about the benefit of globalization
 - ▢ External: The rapid rise of China perceived to threaten the US’s economic, technological, military dominance
- Will the US and Chinese economies be decoupled? If so what would be the consequences?
- Is it possible to restore a rules-based, free, open and multilateral trading system, and if yes what needs to be done?
- How can we evaluate Japan’s approach?

G20 Osaka Leaders' Declaration (June 29, 2019)

Trade and investment (para 8)

- We strive to realize a free, fair, non-discriminatory, transparent, predictable and stable trade & investment environment, and to keep our markets open
- We reaffirm our support for the necessary reform of the WTO to improve its functions. We agree that action is necessary regarding the functioning of the dispute settlement system consistent with the rules as negotiated by WTO members
- (W)e recognize the complementary roles of bilateral and regional free trade agreements that are WTO-consistent
- We will work to ensure a level playing field to foster an enabling business environment

Innovation: Digitalization, Data free flow with trust (para 10-12)



- Cross-border flow of data, information, ideas and knowledge generates higher productivity, greater innovation, and improved sustainable development, while raising challenges related to privacy, data protection, intellectual property rights, and security
- By continuing to address these challenges, we can further facilitate data free flow and strengthen consumer and business trust
- (I)t is necessary that legal frameworks, both domestic and international, should be respected
- Such data free flow with trust will harness the opportunities of the digital economy
- We will cooperate to encourage the interoperability of different frameworks...

Quality infrastructure investment (para 13)

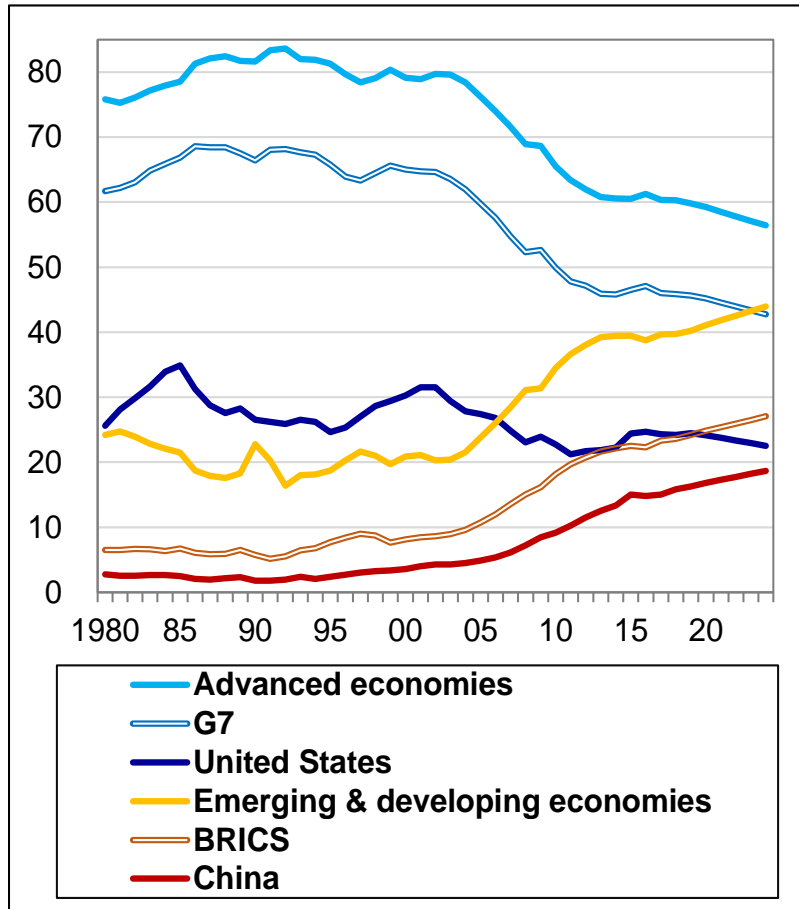
- We endorse the G20 Principles for Quality Infrastructure Investment as our common strategic direction and high aspiration
- These emphasize that quality infrastructure is an essential part of the G20's ongoing efforts to close the infrastructure gap...
- We stress the importance of maximizing the positive impact of infrastructure to achieve sustainable growth and development while preserving the sustainability of public finances, raising economic efficiency in view of life-cycle cost, integrating environmental and social considerations, including women's economic empowerment, building resilience against natural disasters and other risks, and strengthening infrastructure governance

2. Structural change in the world economy

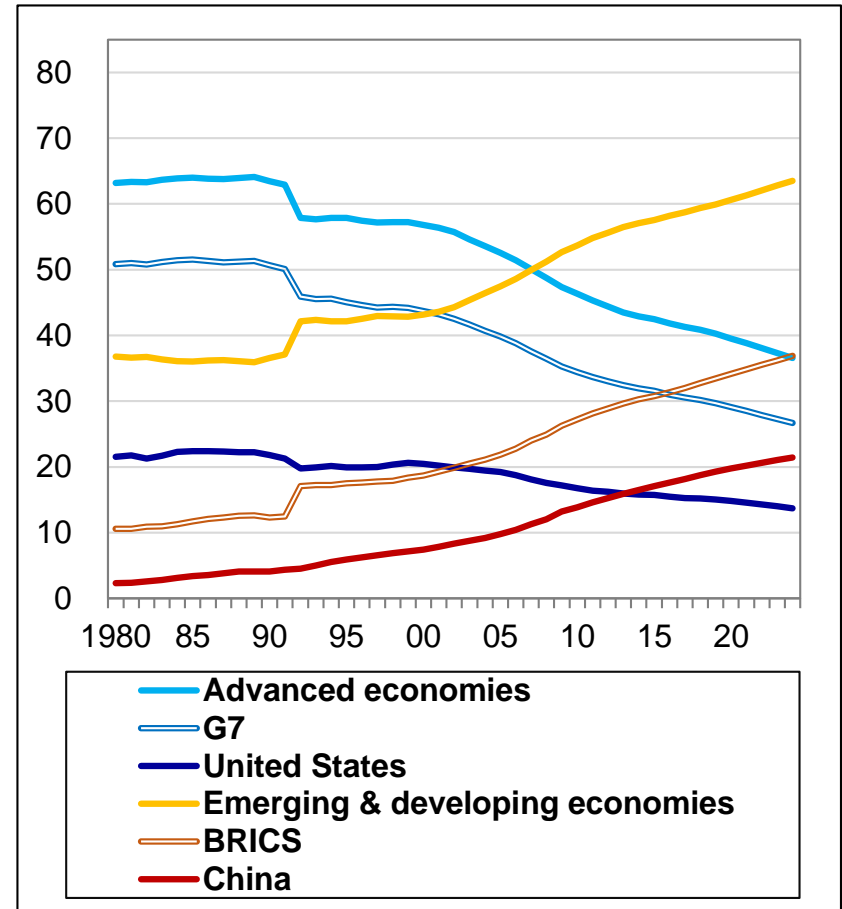
- The relative decline of the US and other advanced economies and the rapid rise of China and other emerging & developing economies in the world
- The emerging & developing economies have begun to demand trade agendas different from advanced economies → Failure to conclude the Doha Development Round
 - ▣ Trade and investment which benefit their economic and social development
 - ▣ Certain degree of protection for industrialization and rural development
- The US has begun to view the rise of economic, technological and military capabilities of China as a threat to its hegemonic dominance

GDP shares of the advanced and emerging & developing economies (%)

GDP at current US dollars



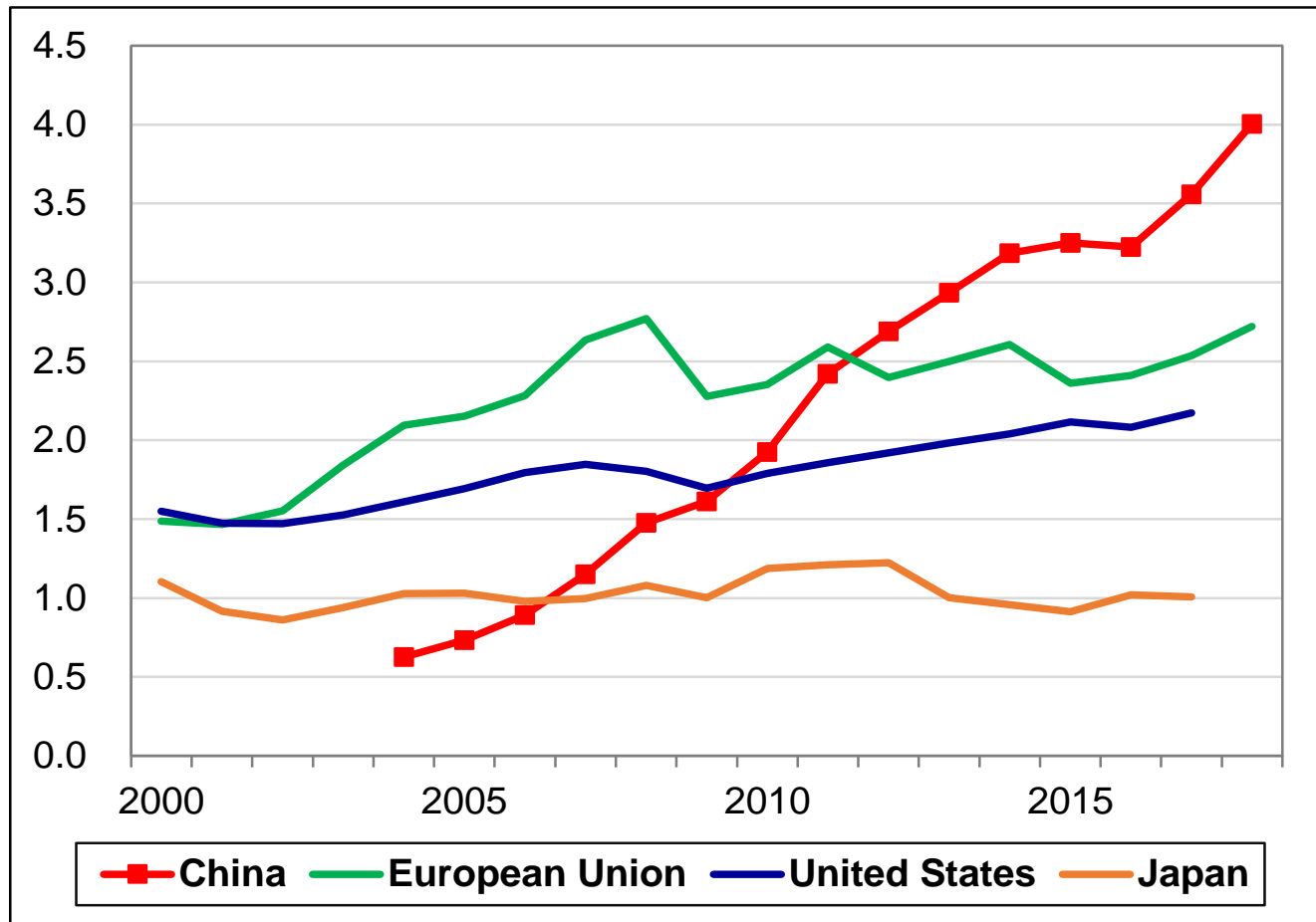
GDP at current int'l dollars, PPP



Note: Projections for 2019-24 are made by the IMF

Source: Constructed by author from IMF, *World Economic Outlook database*, April 2019

Manufacturing value added (Current US\$, trillion)

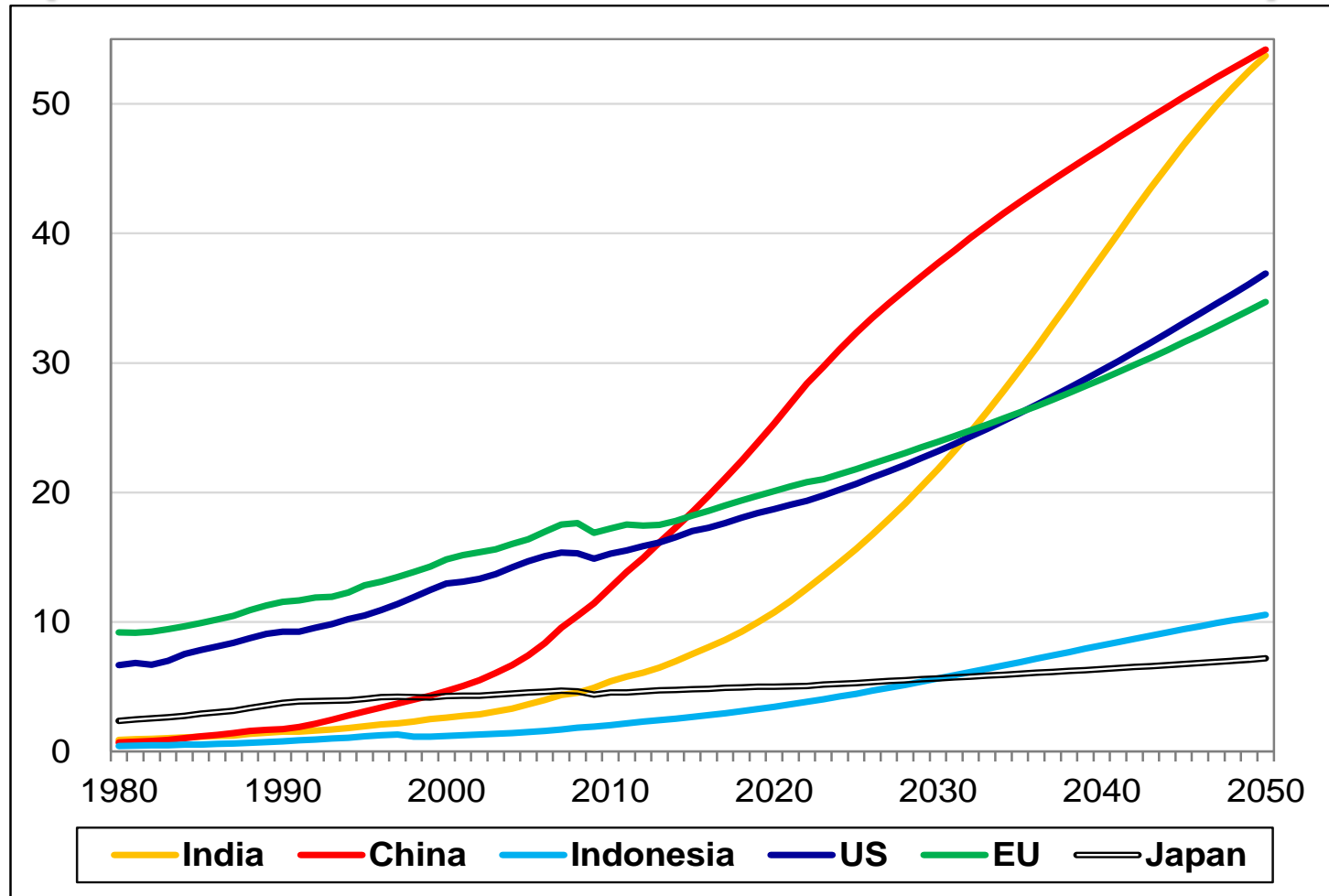


Source: Compiled by author from World Bank, *World Development Indicators*, September 2019

The mega trend and its implications

- Even though China's economy will continue to expand and become by far the largest in the world, the sum of the US and EU would remain larger than China (1.5 times) in economic size
 - ▣ It would not be the interest of China to embark on military conflict with the western advanced powers and challenge the existing international order by force
 - ▣ If China wants to become the largest military power, the US would likely work with other advanced economies (like the EU) and emerging democracies such as India, Indonesia
- For the US to confront the rise of China effectively, it will have to cooperate with the EU and other like-minded countries
- If China achieves a peaceful, harmonious rise and provides an increasing volume of international public goods, the US and China will likely coexist

Mega trend: Projections for real GDP (PPP, trillion international dollars)



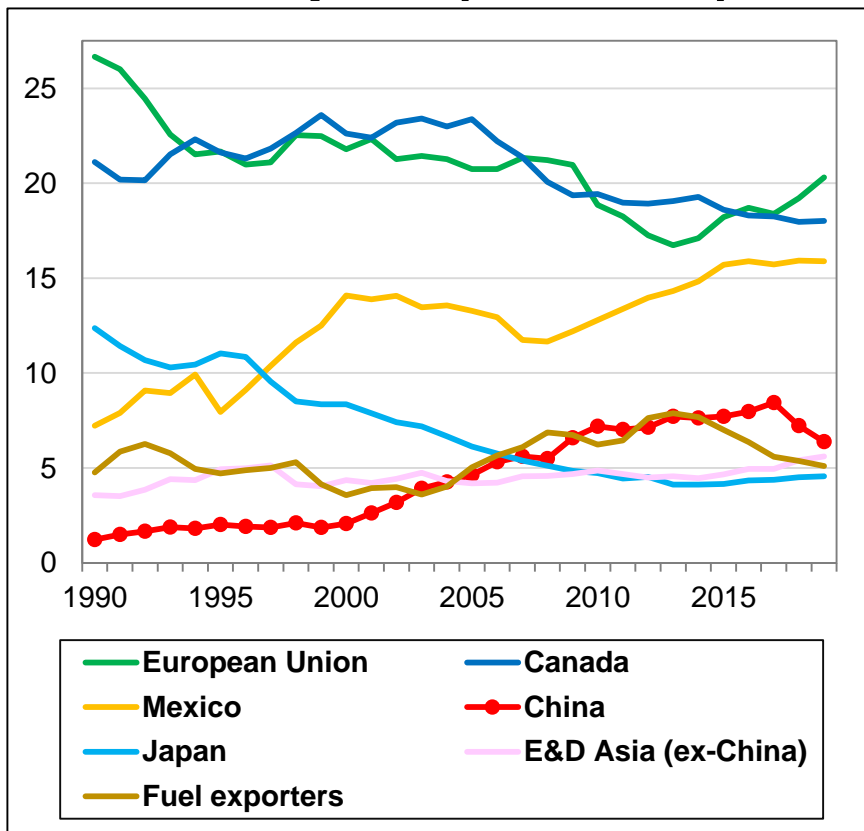
Source: Kawai, Masahiro. 2018. "Will the 21st Century Be an 'Asian Century?': A Global Perspective." In Tomoo Kikuchi and Masaya Sakuragawa, eds., *China and Japan in the Global Economy* (Oxon and New York: Routledge).

3. US-China trade relations

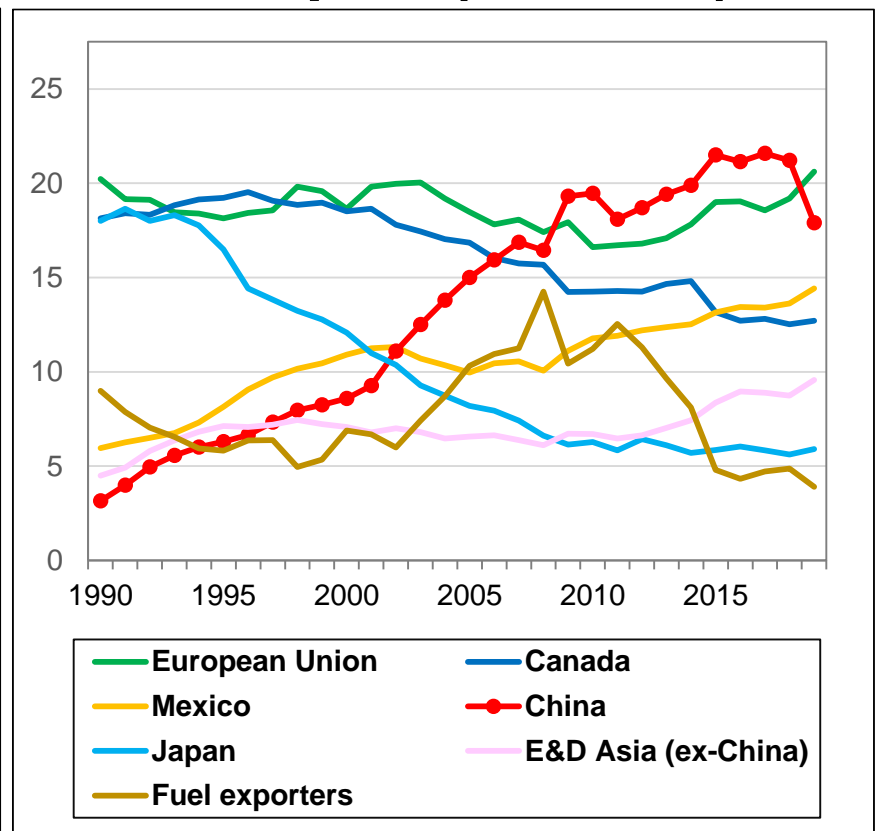
- US-China economically highly interdependent on each other
 - ▣ The US's trade dependence on China, particularly high on the import side, rose rapidly until 2017 but has been declining since 2018 (export) or since 2019 (import)
 - ▣ China's dependence on the US, relatively high on the export side, has been declining since 2019 (export) or since 2016 (import)
- The US had long been running overall trade deficits due to large spending relative to income (or large investment relative to savings)
 - ▣ Its trade partners which run large trade surpluses against the US have evolved over time (Japan in the 1990s, China and the EU in the early 2000s, then China in recent years)
 - ▣ US deficits against China rose rapidly as a trend since the 90s until 2018, with a sign of decline in 2019

The US's trade share by partner (1990 – 2019)

US export (% share)



US import (% share)

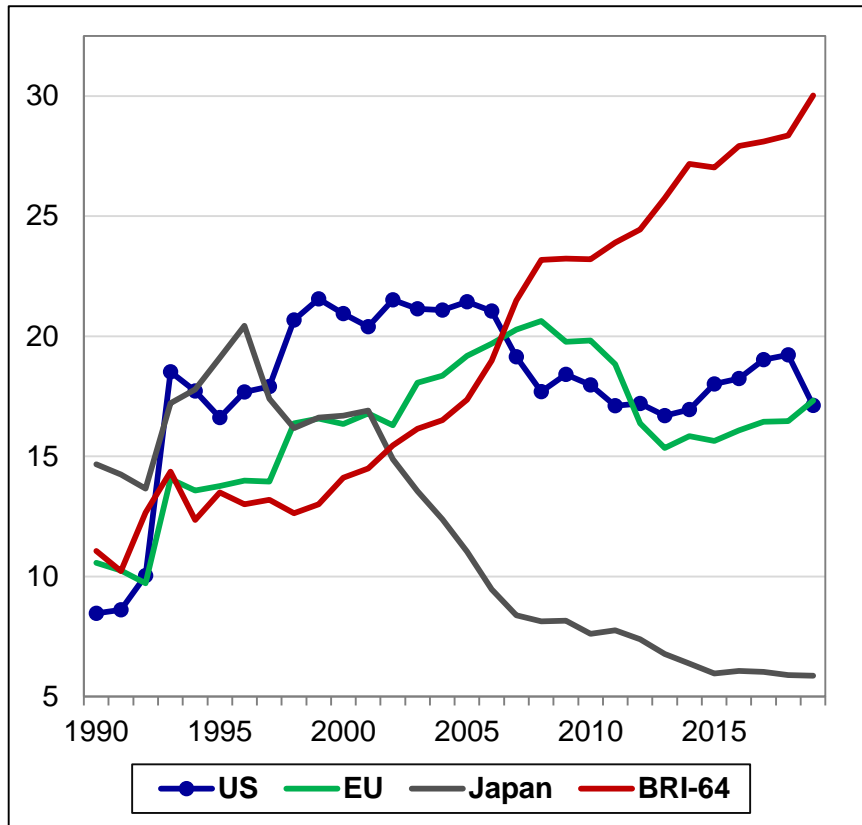


Note: Data for 2019 are for the first 7 months.

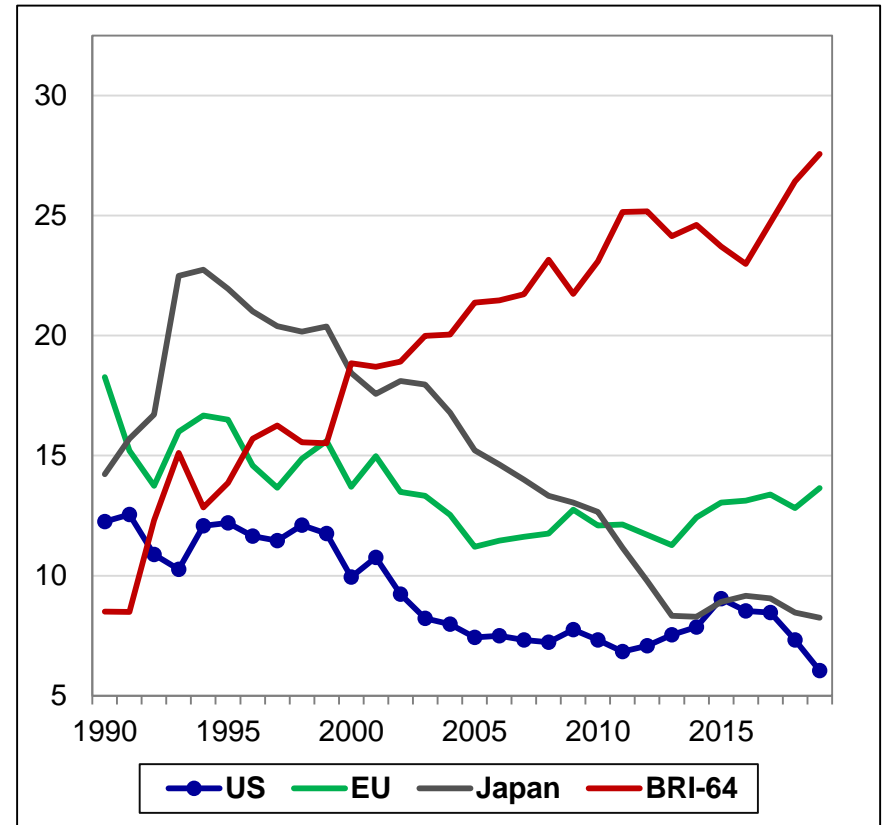
Source: Compiled by author from IMF, *Direction of Trade Statistics*

China's trade share by partner (1990 – 2019)

China's export (% share)



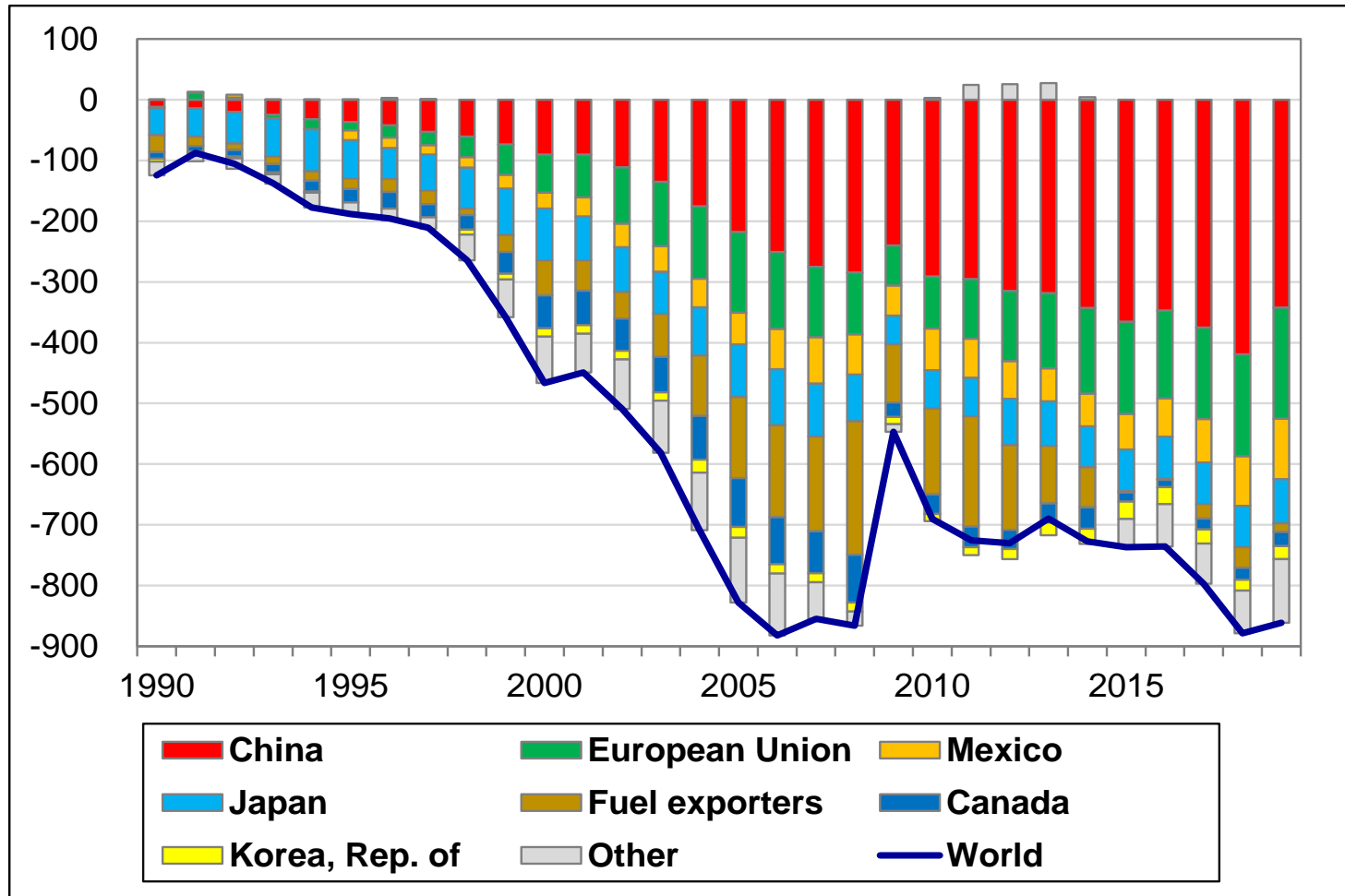
China's import (% share)



Note: Data for 2019 are for the first 7 months.

Source: Compiled by author from IMF, *Direction of Trade Statistics*

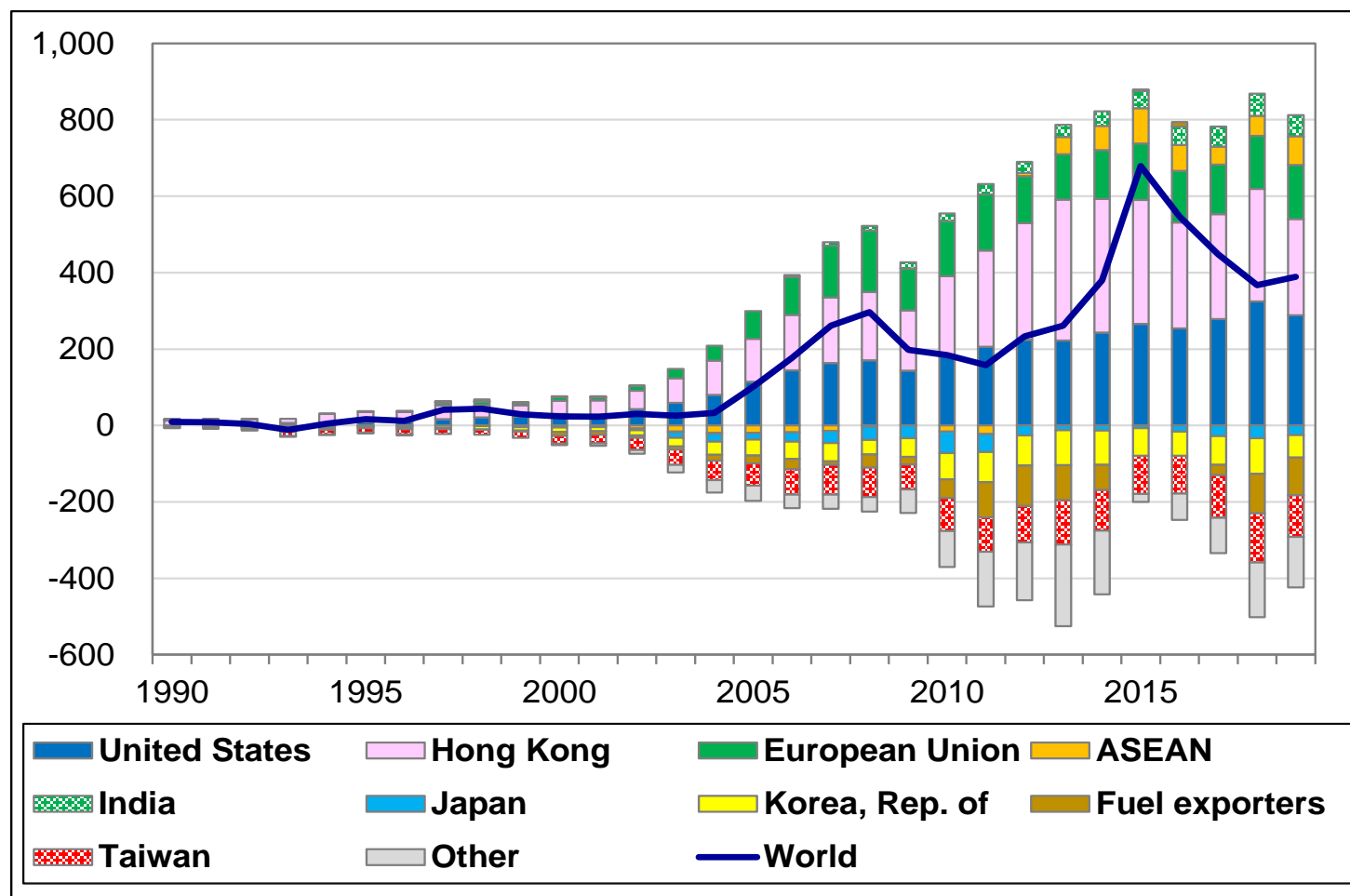
US trade deficits and major trade partners (US\$ billion), 1990-2019



Note: Data for 2019 are the sum of monthly data for January through July, multiplied by 12/7

Source: Compiled by author from IMF, *Direction of Trade Statistics*

China's trade deficits and major trade partners (US\$ billion), 1990-2019



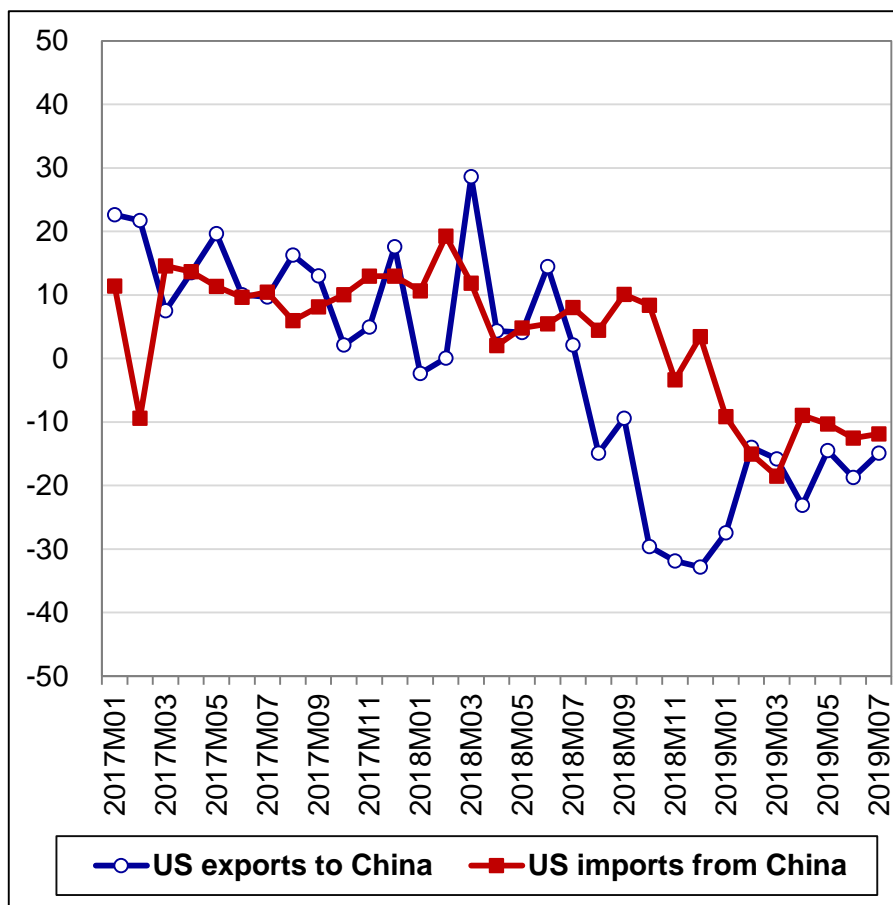
Note: Data for 2019 are the sum of monthly data for January through July, multiplied by 12/7
 Source: Compiled by author from IMF, *Direction of Trade Statistics*

Decoupling of the US and Chinese economies?

- The US seems to be aiming for some economic decoupling
- Full decoupling is costly, but
 - ▣ US import dependence on China declined in 2019
 - ▣ China's export dependence on the US declined in 2019
 - ▣ Further decoupling for the products of listed entities, such as Huawei and ZTE, may take place
- If significant decoupling takes place, then
 - ▣ firms operating in China and exporting to the US would continue to shift their production facilities to other emerging economies (such as Vietnam, Malaysia, Philippines, India)
 - ▣ the US deficits with these emerging economies would rise unless the US adjusts its spending-income (or investment-savings) balance
 - ▣ China would continue to strengthen its economic integration with the Belt and Road Initiative(BRI) countries
- Thus US-China decoupling would:
 - ▣ raise the costs of imports in the US
 - ▣ not reduce the US's overall trade deficits
 - ▣ push China more towards the BRI countries

Growth rate of US-China bilateral trade (Jan. 2017 – Jul. 2019)

US (% , y-o-y)



China (% , y-o-y)



Source: Compiled by author from IMF, Direction of Trade Statistics

US trade balance by goods and partner (2017-18)

2017	WLD	CHN	EU	MEX	JPN	DEU	CAN	KOR
Total net exports	-807	-376	-153	-76	-70	-64	-23	-23
Foods, feeds, beverages	-6	12	-15	-10	12	0	-1	6
Industrial supplies, mats	-55	-6	1	55	4	-8	-68	3
Capital goods (ex. autos)	-110	-143	-16	-11	-29	-19	37	-2
Autos, parts, engines	-202	-6	-45	-83	-53	-22	-1	-21
Consumer goods (ex f&a)	-407	-229	-65	-24	-1	-12	21	-8
Other goods	-27	-4	-14	-4	-1	-4	-10	-0

2018	WLD	CHN	EU	MEX	JPN	DEU	CAN	KOR
Total net exports	-891	-419	-170	-87	-69	-69	-26	-18
Foods, feeds, beverages	-15	2	-15	-11	12	0	-2	7
Industrial supplies, mats	-52	-16	4	60	7	-9	-76	9
Capital goods (ex. autos)	-134	-148	-18	-17	-31	-21	39	-5
Autos, parts, engines	-215	-12	-45	-92	-54	-20	1	-20
Consumer goods (ex f&a)	-445	-241	-80	-24	-2	-14	20	-8
Other goods	-31	-5	-16	-4	-1	-4	-7	0

Source: Compiled by author from Bureau of Economic Analysis, US Department of Commerce

<https://www.bea.gov/iTable/iTable.cfm?reqid=62&step=1&isuri=1#reqid=62&step=2&isuri=1&6210=1>

4. The WTO at risk

- The world trading system under the GATT/WTO worked well until the turn of the millennium
- But new global realities began to pose challenges for the WTO even before Trump
 - ▣ Emerging economies like BRICS started to demand trade agendas different from developed countries
 - ▣ The WTO has been inadequate in coping with the development of global supply chains
 - ▣ Bilateral and regional FTAs have become key drivers of setting new trade agendas
- Trump administration has been threatening the WTO more openly
 - ▣ Unilateral action to use tariffs based on domestic laws in order to induce concessions from trade partners
 - ▣ Blockage of new appointments of judges to the Appellate Body of the WTO

WTO's functions largely constrained

- The WTO, established in 1995, has three primary functions:
 - ▣ Advancing global liberalization in trade in goods & services and trade-related rules by facilitating multilateral negotiations among members
 - ▣ Monitoring the multilateral trade system through trade policy reviews and other means
 - ▣ Managing a system for settling trade disputes
- The first function has not been effectively performed as evidenced by the failure of the Doha Development Round (DDR) to deliver desired, comprehensive outcomes
 - ▣ Since the last Uruguay Round concluded in 1993 and the establishment of the WTO in 1995, trade liberalization and rule-setting have taken place largely outside the WTO, i.e., through bilateral and regional FTAs
- The second function still works, although developing countries have been criticized for not notifying the WTO of their government subsidies and regulations that affect trade
- The third function now faces a significant challenge as the dispute settlement system will likely cease to have a binding Appellate Body by the end of 2019

Trump administration's view of the WTO

- The WTO's existing rules are inadequate to discipline the practices of non-market economies, notably China:
 - ▣ Lack of rigorous intellectual property right (IPR) protection such as preventing forced technology transfer, IPR theft
 - ▣ Weak disciplines over subsidies for high-tech industrial development, such as "Made-in China 2025"
 - ▣ Absence of disciplines over the market-distorting behavior of state-owned enterprises
 - ▣ Undesirable practice of allowing member countries to "self-declare" developing status and avoid the WTO's strict disciplines
- Washington has also expressed concerns over the Appellate Body for its excessively interpretative decisions and overreach on procedural issues
- Even though the EU and Japan do not support the US's unilateral action or its refusal to appoint Appellate Body judges, they agree with the US on China's IPR infringement, industrial subsidies, SOEs
- However, the US has not made any systematic, formal proposal for WTO modernization (or reform)

Inadequate disciplines of the WTO

- Failure to incorporate the Singapore Issue during the Doha Development Rounds
 - ▣ Transparency in government procurement
 - ▣ Trade facilitation
 - ▣ Trade and investment
 - ▣ Trade and competition
- Inability to establish new trade-related rules due to the failure of the DDR
- Current disciplines of the WTO do not reflect the changing realities of the world economy and trade since 1993, particularly on issues related to global supply chains
 - ▣ Rigorous protection of intellectual property right
 - ▣ Liberalization and protection of foreign direct investment
 - ▣ Competition policy
 - ▣ Liberalization of wider services
 - ▣ Liberalization and rule-setting for e-commerce

Lack of multilateral rules on investment

- The OECD began to develop the Multilateral Agreement on Investment (MAI) in 1995-98 with the objective of:
 - ▣ Minimizing the diverse government regulations on investment, thereby creating more consistent, secure and stable investment conditions and to regulate investment in a more uniform, transparent and enforceable manner
 - ▣ Enabling compensation to foreign corporations for proven unfair or discriminatory policies causing loss of profit
 - ▣ Allowing states and corporations recourse to international arbitration
- But because of civil society protests and negative reactions from some OECD members, MAI negotiations were halted in Dec. 1998
- An attempt was made to include investment in the Doha Development Round, but was rejected by developing countries
- So today there are no multilateral rules on investment

Non-binding guidelines for FDI

- Today there are no binding multilateral rules on FDI
- Following the failure to develop multilateral rules on investment in the OECD (MAI) and WTO, several non-binding guidelines have been developed:
 - ▣ World Bank: World Bank Guidelines on the Treatment of Foreign Investment
 - ▣ United Nations: Code of Conduct on transnational corporations
 - ▣ OECD: OECD Guidelines for Multinational Enterprises
- The G20 Guiding Principles for Global Investment Policymaking (endorsed in Hangzhou in 2016): A realistic stock of the state on G20 consensus
 - ▣ Objective: General guidance for investment policy-making
 - ▣ Main drivers: Policy coherence; sustainable development objectives and inclusive growth; non-binding character

9 elements of the G20 Guiding Principles

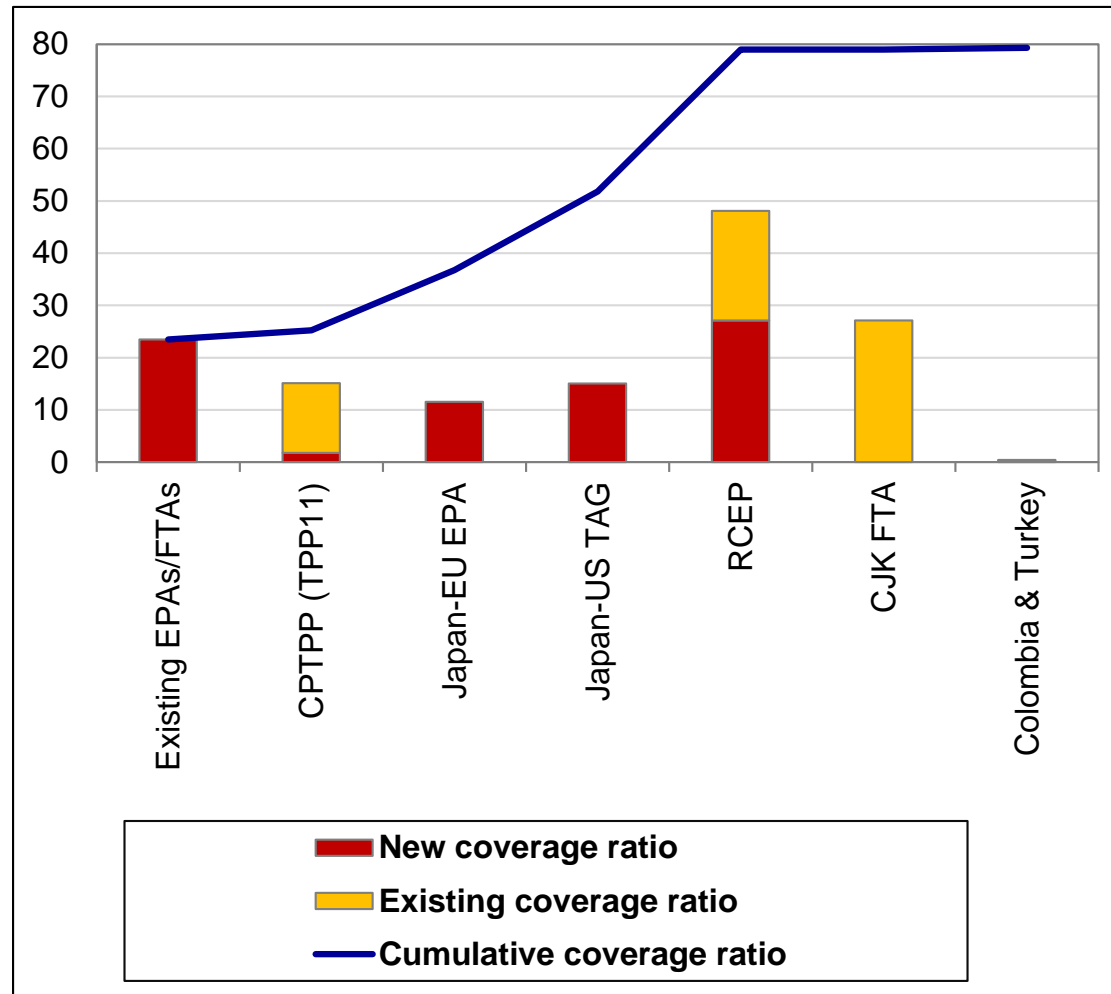
- Avoidance of investment protectionism
- Open, non-discriminatory, transparent and predictable conditions for investment
- Legal certainty and investment protection with fair, open and transparent dispute settlement procedures
- Transparent investment regulation
- Coherence between national and international investment policies
- The state's right to regulate investment for legitimate public policy purposes
- Investment promotion and facilitation
- Responsible business conduct and corporate governance
- International cooperation on investment

Source: G20 Guiding Principles for Global Investment Policymaking, September 2016
<https://www.mofa.go.jp/mofaj/files/000185886.pdf>

5. Japan's approach

- Japan is an active promoter of globalization and multilateralism because the country benefits enormously from the rules-based liberal international order
- Japan still wants the US to return to TPP and rules-based multilateralism
- It has taken leadership in negotiating, concluding and implementing CPTPP (or TPP-11)
- It has worked closely with the EU to negotiate, conclude and implement an Economic Partnership Agreement (Japan-EU EPA).
- It has concluded a bilateral trade deal with the US (under the threat of an automobile tariff hike)
- Japan works with the US, EU and other like-minded countries on WTO reform to address China's trade practices (IPR protection, industrial subsidies, SOEs) and support a functioning dispute settlement procedure

Japan's FTA coverage ratio: Importance of RCEP



KPI:

- Achieving the FTA trade coverage ratio of 70% by 2018
- This KPI was not achieved in 2018, but remains important

Japan's balancing act

- Japan relies on the US for national security but is not interested in a confrontational approach to China
- Japan has been balancing risks and opportunities posed by the rapid rise of China by working with China in several economic cooperation areas
- Japan has been actively negotiating the RCEP and a CJK FTA
- Japan has agreed with China on joint projects in third countries, which is understood to help China's BRI
 - ▣ Japan has argued that the “G20 Principles of Quality Infrastructure Investment” should be observed, particularly economic feasibility, openness, transparency, and debt sustainability of borrowing countries
 - ▣ Such Japanese engagement is expected to improve the “quality” of BRI projects and reduce the concern that the BRI is an instrument of China's “debt diplomacy”

Reforming the WTO

Japan works with the US, EU and others to restore the rules-based liberal international order

- Recovery of a fully operational Appellate Body to preserve a functioning dispute settlement system
- Enforcement of strict compliance with notification obligations for transparency (on government subsidies and regulations affecting trade) through new penalties
- Rigorous disciplines on IPR protection, state subsidies for high-tech industries and new disciplines on SOEs
- Use of objective indicators to define a “developing” country and introduction of a graduation policy for developing countries
 - ▣ Even though China is a “developing” country, China is advised to act as a “developed country” without seeking special and differential treatment in most areas and comply with WTO disciplines

Japan-US trade agreement



- Japan has successfully concluded a Japan-US trade agreement as well as the bilateral digital trade agreement and intends to put them into effect by Jan. 2020
- The agreement is agriculture-centered while not eliminating tariffs on US imports of Japanese vehicles and auto parts

Negative assessments of the trade agreement:

- The trade agreement is not comprehensive, covering only trade in goods
- Low tariff elimination rates:
- 92% for the US (but only 57% if automobiles and auto parts are excluded) and 84% for Japan—questionable if the deal is compliant with GATT Article 24

Positive assessments

- The first FTA concluded by the Trump administration which has ever reduced tariffs on US imports from its partner country
- The agreement does not include clauses on quantitative restrictions, currency manipulation, or trade deals with non-market economies, notably China

RCEP and a CJK FTA



Importance of RCEP

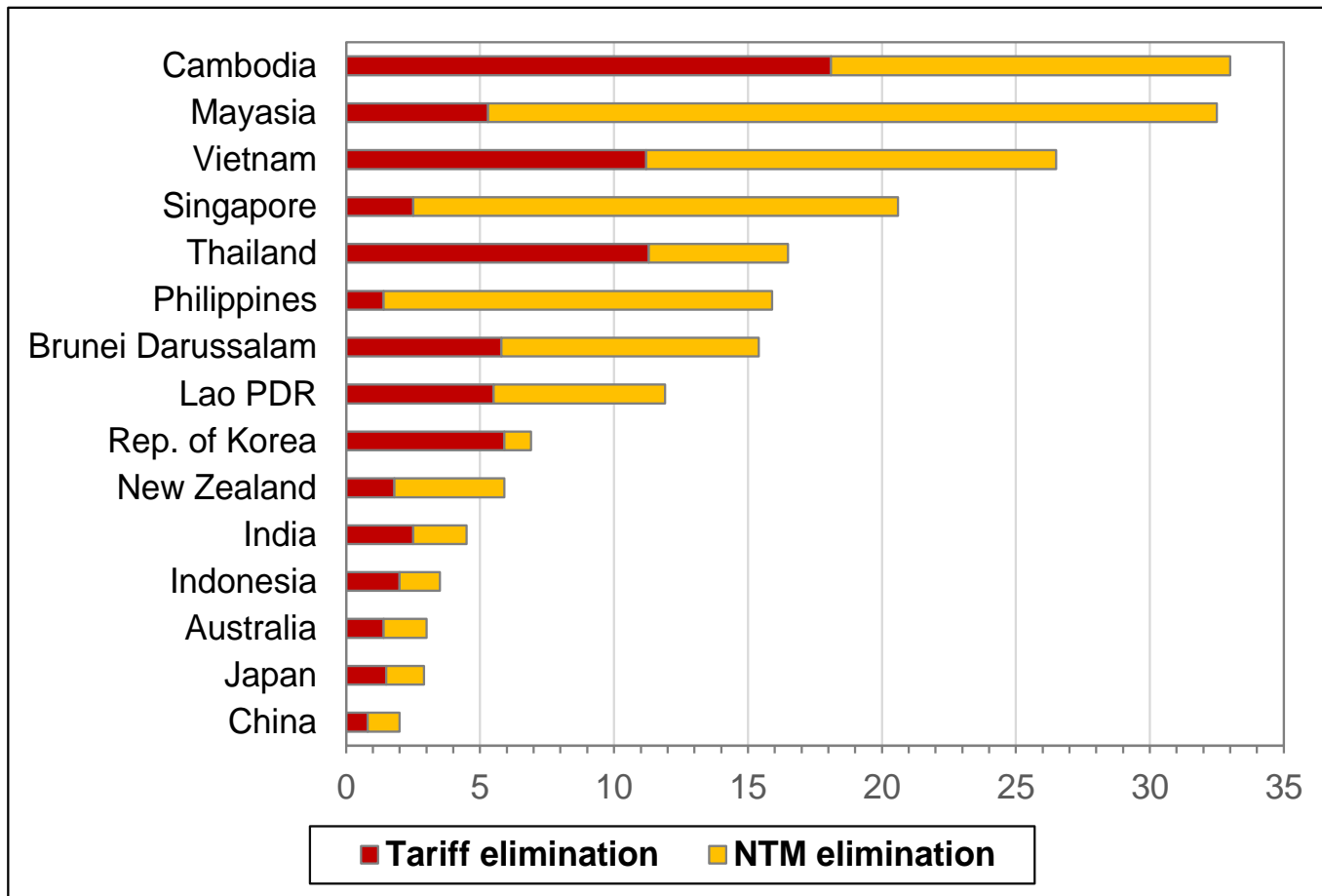
- The world's major economies are in the group: China, Japan, India, ASEAN and ROK
- Accounts for 47% of world population, 32% of world GDP, 28% of world trade and 32% of world FDI stock
- Large economic benefits if RCEP can achieve liberal and high-quality trade & investment agreements

RCEP negotiations

- RCEP has been negotiated over the past 6.5 years
- Of the 20 or so issues, 18 have been agreed on
- Difficult issues
 - ▣ Trade in goods (market access), particularly between China and India
 - ▣ E-commerce, particularly between Japan and China

Economic benefits of RCEP

(% change in real GDP)



NTM = non-tariff measures

Source: Compiled by author from: Kawasaki, Kenichi, "Emergent Uncertainty in Regional Integration: Economic Impacts of Alternative RTA Scenarios," GRIPS Discussion Paper 16-28 (January 2017).

Challenges of and prospects for RCEP

- Differences in views among major economies:
 - ▣ Japan wants to achieve a high degree of trade & investment liberalization and a wide range of high-quality trade & investment rules (services, investment, IPR, e-commerce)
 - ▣ China wants to achieve gradual liberalization in goods & services trade and investment and less rigorous trade & investment rules (IPR, e-commerce) than Japan and Australia
 - ▣ India is reluctant to accept goods trade liberalization vis-à-vis China due to its fear of ever rising trade deficits against China and not being able to industrialize its economy
 - ▣ Recently, Japan-ROK negotiations are becoming difficult because of bilateral conflict
- Negotiation will likely be concluded in 2019 if
 - ▣ China maintains its flexibility vis-à-vis Japan and Australia
 - ▣ China provides sufficient room for India in market access by treating it as a country like the CLMV, giving a long time to achieve bilateral trade liberalization, and allowing generous conditions for safe guard measures
 - ▣ Japan and ROK accelerate discussions for market access

Obstacles to a CJK FTA

- The largest obstacles have been the unfavorable political relations for Japan-China and Japan-ROK
- Another obstacle is the uncertain effects of a CJK FTA on various sectors in China and ROK
- Major challenges:
 - ▣ ROK has been reluctant to trade liberalization in high-value-added manufacturing (general machinery, electronics, automobiles) vis-à-vis Japan due to its weaker competitiveness and fear of widening trade deficits against Japan
 - ▣ In addition, the recent bilateral conflict makes it difficult for both Japan and ROK to seriously negotiate
 - ▣ The CJK FTA is expected to be a substantially higher-quality FTA than RCEP
- If a trilateral FTA is difficult, Japan and China may consider a bilateral FTA first and then wait for ROK to join later
- Following a high-quality FTA involving China, Japan may encourage China and ROK to consider joining CPTPP

Schematic description of comparative advantage of CJK

	China	Japan	ROK
Agriculture and fisheries	Strong	Weak	Moderate (stronger than Japan, weaker than China)
Manufacturing (low-value added)	Strong	Weak	Moderate (stronger than Japan, weaker than China)
Manufacturing (high-value added)	Weak	Strong	Moderate (stronger than China, weaker than Japan)
Services	Weak	Strong	Strong

Source: Compiled by Author

6. Policy recommendations

1. The US must return to multilateralism and global cooperation

- If the US wishes to reduce its trade deficits, it should attempt to improve the income-spending (or savings-investment) balance
- The US should invest more in social safety nets to ensure that losers from globalization and technological progress be compensated
- Japan and the EU should work together to continue to persuade the US to return to multilateralism and global cooperation

2. China must pursue structural reforms and transform itself into a truly market-based economy

- Redefine the role of state in a way consistent with a market economy
- Substantially open up the domestic markets for goods & services and foreign investment
- Substantially reduce state subsidies for high-tech industries, particularly “Made in China 2025” programs
- Aggressively reform SOEs and state-owned commercial banks

3. The US and China must resolve or at least manage their bilateral conflict, avoiding full “decoupling”

Policy recommendations (cont'd)

4. The WTO must be substantially overhauled to regain its central role as a global overseer of international trade and trade-related rules

- Restore a fully operational Appellate Body
- Enforce stricter compliance with notification obligations
- Address IPR protection, state subsidies, and SOEs within the WTO framework
- Objectively define a “developing country” and set a graduation policy for developing countries
- In the medium term, consider incorporating issues that are highly relevant to global supply chains in the WTO disciplines (investment, competition, digital data flows)
- Decision-making process needs to be reformed

5. The WTO members need to support rules-based free, open and multilateral trading system through other complementary approaches (bilateral and regional FTAs, plurilateral processes of the WTO)

7. Conclusion

- The structural change in the world economy—the relative decline in the US and the rapid rise of China—has been an important behind the threat to the liberal multilateral trading system
- This change will persist cannot be reversed even by the US
- This suggests that to restore a rules-based free, open and multilateral trading system, the US needs to engage China and other emerging & developing economies so that they become responsible players within the existing international order

Conclusion (cont'd)

- Reinvigorating global trade rules and norms will require a US return to multilateralism and China's further domestic economic reform and opening
- Japan's approach has been supportive of such efforts:
 - ▣ Focusing on WTO reform by working with the US, EU, and other like-minded countries
 - ▣ Achieving high-level FTAs, i.e., CPTPP and Japan-EU EPA
 - ▣ Urging the US to return to TPP
 - ▣ Encouraging China to pursue structural reform and economic opening
- Japan may further take additional measures
 - ▣ Connecting CPTPP with Japan-EU EPA
 - ▣ Holding policy dialogue with China on WTO reform
 - ▣ Encouraging China to join CPTPP after the completion of RCEP and CJK FTA (of CJ FTA)

Thank you
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