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# Prospects for “free trade” in 2021: Japan’s leadership and the US new administration

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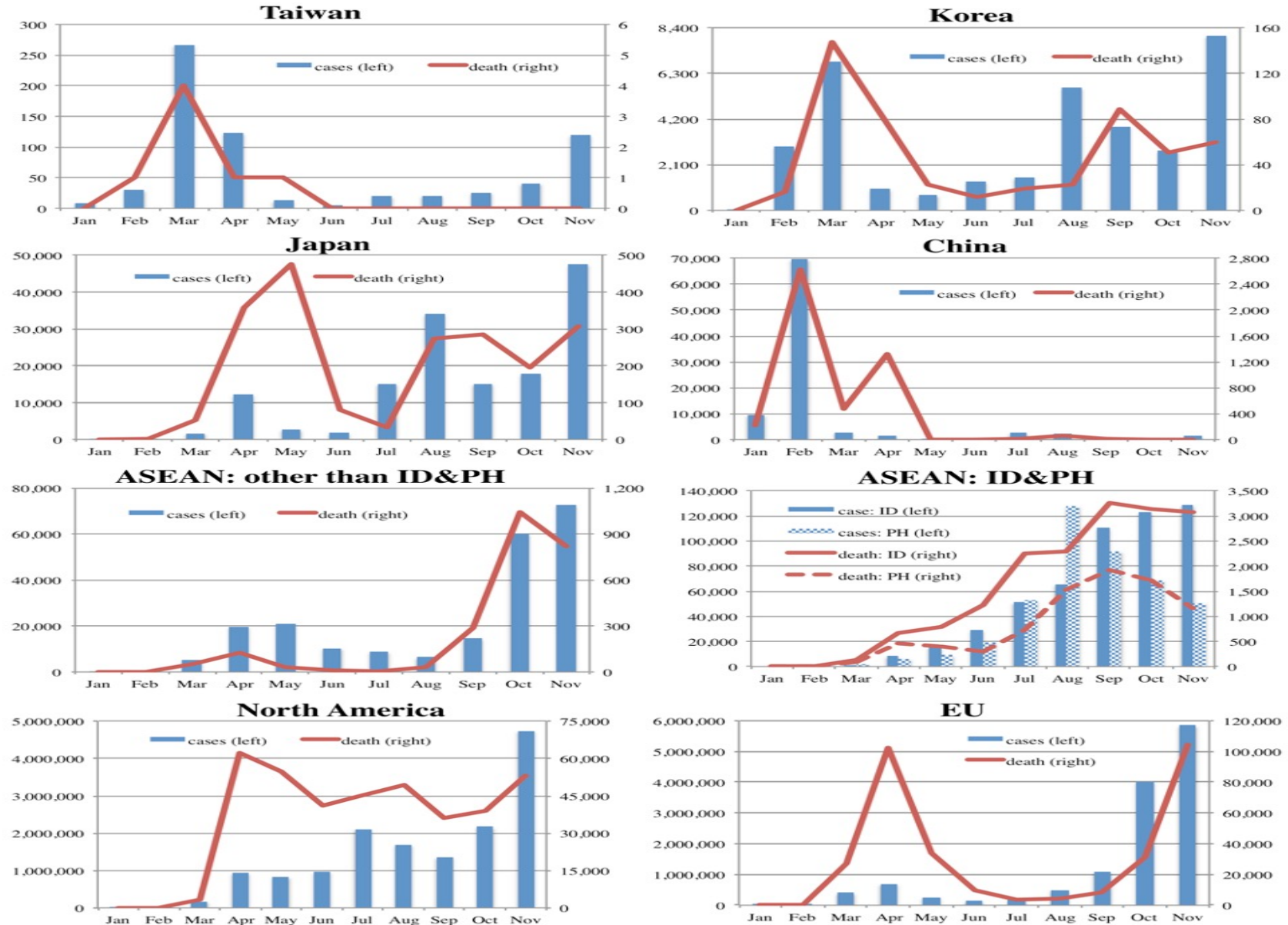
# 0. Homework from the year 2020

- COVID-19
- Aggravation of the US-China confrontation
- The weakening of the rule-based trading regime and the formation of mega-FTA network
- Digital transformation

# 1. The road to overcome COVID-19

- Unprecedented drop of GDP, particularly in pandemic countries
  - The US: The total cost of the pandemic (including both economic and health costs) is estimated at more than \$16 trillion, approximately 90% of the annual GDP of the US or \$200,000 for a family of 4 (Cutler and Summers 2020).
- However, different from the Global Financial Crisis, we have not experienced a financial crisis or a collapse of asset markets.
  - Aggressive mitigation policies worked, looking at a possibility of quick recovery.
  - Need to watch carefully the expanded government debt in newly developed economies (Zen and Kimura 2020).
- GDP and international trade bottomed out in May 2020 for many countries.
- However, some countries would experience the pandemic beyond their medical capacity or face the second or third wave of infection for a while.
  - Likely to take some time to overcome a demand slump and lift restrictions on people's movements.
  - It would take time to extensively apply vaccines.
- Slumps in transportation, tourism, on-site services, and others are serious.
  - Need to carefully watch a possible expansion of poverty.

Figure 1 The number of COVID-19 cases/deaths in 2020



Data: author's calculation, using "Our World in Data COVID-19 database" available from the <https://ourworldindata.org/coronavirus>.

Notes: the case in December 2019 for China is 27. No case is reported for Hong Kong. EU is composed of 27 current EU members plus UK.

Source: Ando and Kimura (forthcoming).

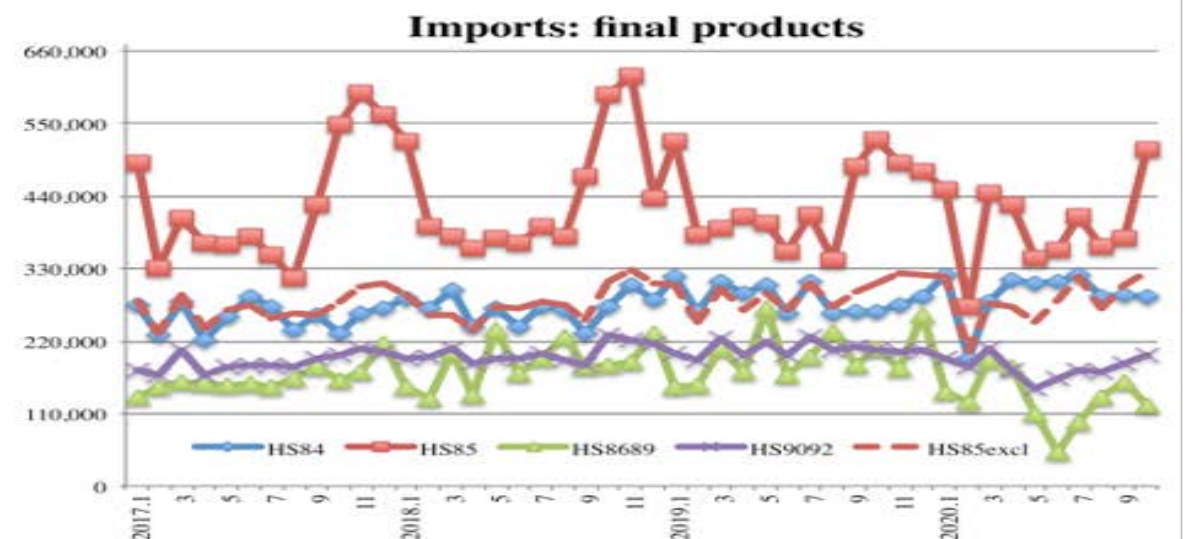
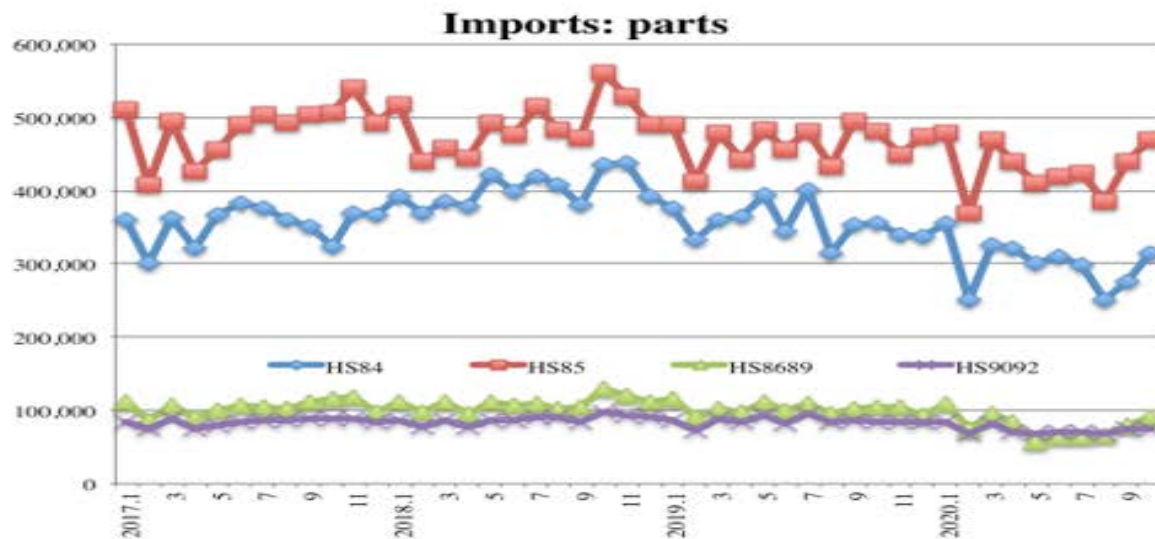
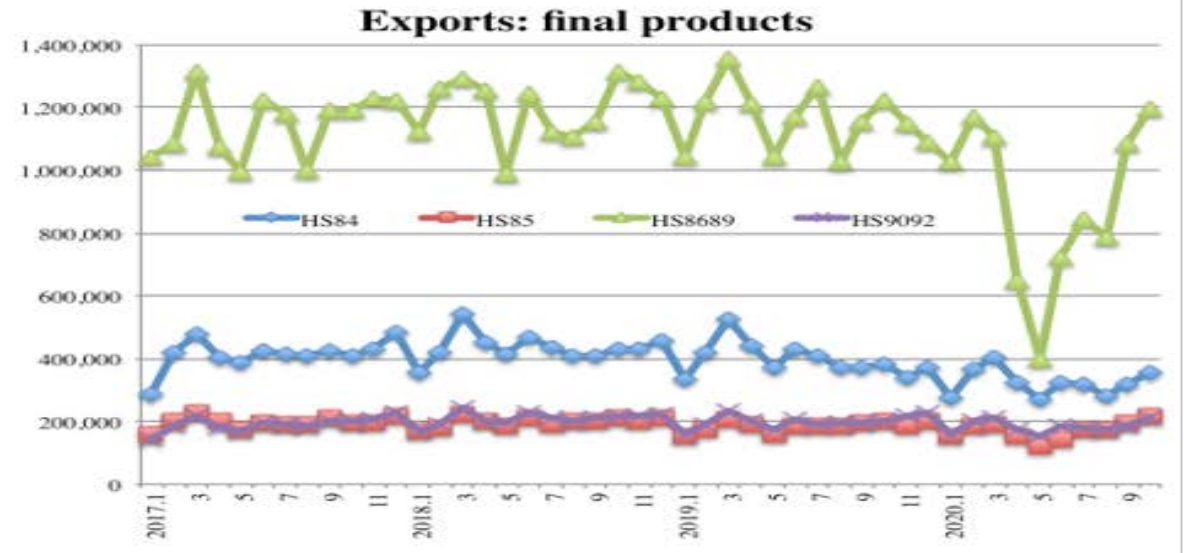
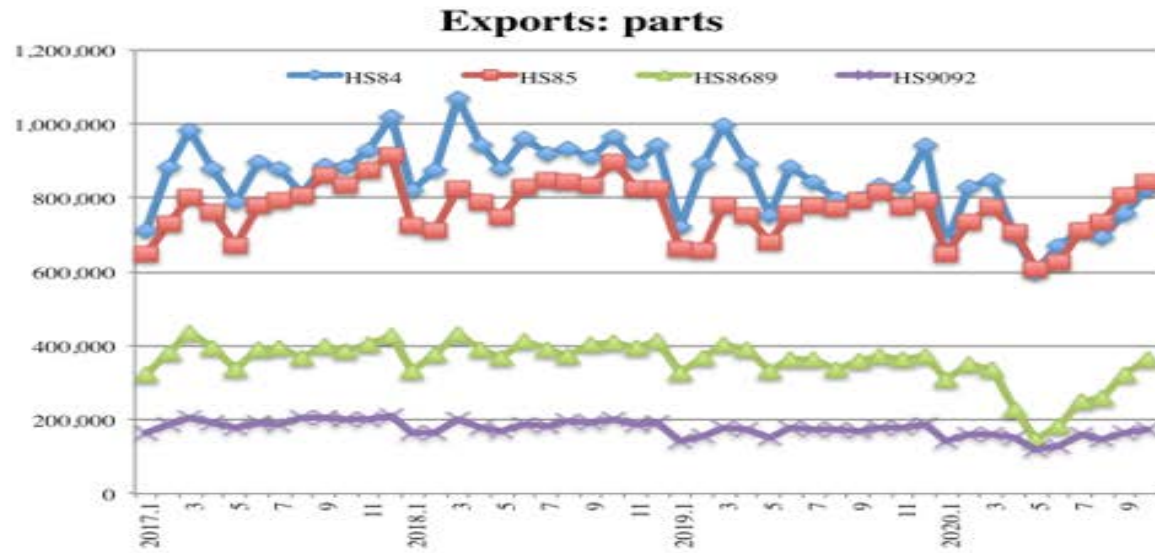
# International production networks (IPNs) in East Asia

- Negative supply shocks
  - China (Feb.), other countries (due to lock-downs, short period)
- Positive demand shocks
  - Telework, do-it-yourself, medical-related goods
- Negative demand shocks (Kimura 2020; JETRO Survey Sept. 2020)
  - Each country (due to lock-downs and prolonged social distancing)
- Production systems in East Asian IPNs have largely been intact (ref. Ando and Kimura 2012).
  - However, prolonged negative demand shocks would hurt IPNs.
  - Some movements of production sites from China to ASEAN and others are continuing.
- Concern on a collapse of international commercial policy discipline, particularly on medical or essential products, emerged, but it was solved within a few months.

# Machinery exports and imports by Japan: monthly, HS84-92

Figure 2 Japan's machinery trade by sectors: trade values

(Unit: millions JPYen)



Data: author' preparation.

Note: HS85excl is the case excluding HS851712.

Source: Ando and Kimura (forthcoming).

## 2. Prospects on the US-China confrontation

- The US stance against China is likely to continue in the Biden Administration.
  - From commercial policy issues to broader confrontation.
  - Expanded interpretation of “national security.”
  - However, some cooperation may be developed, such as in environment.
- Need to carefully watch how far economic “decoupling” would proceed.
  - In terms of industries/commodities, firm nationalities, geographical extension, and others.
- The Chinese diplomacy also becomes aggressive, not only for the US but also other countries, such as “wolf warrior” diplomacy and the Export Administration Act (Dec. 2020).
- Middle-power countries in-between would like to keep good economic relationships with both the US and China. The issue is how to avoid being forced to choose just one of them.

# 3. Turmoil in the international trading regime and mega-FTAs

- Turmoil under the US Trump Administration
  - Re-negotiations over FTAs (KORUS, NAFTA), Section 232 of the 1962 Trade Expansion Act, Section 301 of the 1974 Trade Act.
  - A part of retaliatory/counter-veiling/offsetting/safeguard measures by other countries is also likely to be inconsistent with the WTO policy discipline.
- Difficulties in the World Trade Organization (WTO)
  - The Appellate Body issue, weakening as a negotiating forum.
- The role of mega-FTAs
  - From the past
    - Further liberalization and new international rule making
  - Newly added
    - Reducing policy risks and stabilizing the international trading regime.
    - Formulating a pro-trade middle-power coalition for the coming G2 world.



# Japan's mega-FTA strategy

- TPP (TPP12)
  - July 2013: participated in negotiation, Feb. 2016: signed, Jan. 2017: Japan concluded, the US walked away, not coming in effect.
- CPTPP (TPP11)
  - March 2018: signed, Dec. 2018: in effect (currently 7 countries are in effect).
  - Possibility of initiating accession negotiations with the UK and others.
- Japan-EU EPA
  - April 2013: initiated negotiation, July 2018: signed, Feb. 2019: in effect.
    - Ref. Recent EPA/FTA by EU: Korea (in effect in Dec. 2015), Canada (partially in effect in Sept. 2017), Singapore (in effect in Nov. 2019), Vietnam (in effect in Aug. 2020).
- Japan-US Trade Agreement, Japan-US Digital Trade Agreement
  - April 2019: started negotiation, Oct.: signed, Jan. 2020: in effect.
  - The former is supposed to be followed up by further negotiations.
- Japan-UK EPA
  - March 2020: Brexit, June: started negotiation, Oct.: signed, Jan. 1, 2021: in effect.
- Regional Comprehensive Economic Partnership (RCE) Agreement
  - Nov. 2012: announced to start negotiation, Nov. 2020: signed (without India).

# The contents of CPTPP

- Covers 500 million people, 13% of the world GDP
- Carry over most of the text of TPP except 22 suspended items (the half is related to IPR)
- Market access
  - Tariff removal: 99-100% except Japan (95%; agriculture!)
  - Services, investment: negative list method, ISDS
- Rule-making
  - Government procurement, IPR, competition
  - Novel elements (looking at China and others)
    - E-commerce
      - Basic principle: free flow of data, no data localization requirements (cf. EU: GDPR), prohibition of forced disclosure of source codes
      - Back-up policies needed
    - SOEs
      - Globalization of corporate activities and the leveling of the playing field
  - Global agenda
    - Labor (ILO Guideline+)
    - Environment (esp. fishery)
  - Regulatory practice, transparency and promptness in administrative procedure

# The contents of Japan-EU EPA

- Covers 640 million people, 28% of the world GDP
- Market access
  - Tariff removal
    - Japan: 94% (ag. 82%, manu. 100%); EU: 99%
  - Services, investment: negative-list method
  - Movement of natural persons
    - GATS+ including investors, contractual service suppliers and independent professionals, short-term business visitors, family members...
- Rule-making
  - “Nontariff barriers”: automobiles and auto parts, ...
  - E-commerce
    - No tariffs, prohibition of forced disclosure of source codes, electronic recognition/signature, ...
    - GDPR: separate negotiation. “Adequate level of protection” in Jan. 2019.
  - Government procurement: WTO-GPA+ (re. railways)
  - SOEs: non-discrimination, commercial consideration
  - IPR
    - Geographical indication: EU 210 items, Japan 56 items (based on laws newly introduced)
  - Dispute settlements on investment: separate negotiation
  - Trade and sustainable development
    - Pursue ratification of the fundamental ILO Conventions and other ILO Conventions
      - e.g., ILO 105: abolition of forced labour convention, 111: Discrimination (employment and occupation) convention
  - Regulatory cooperation
    - “Animal welfare”

# The contents of Japan-UK EPA

- Mostly following the contents of the Japan-EU EPA. The transit period of Brexit will be over at the end of 2020. This EPA will become the first EPA of the UK with a major country.
- Market access
  - Tariff removal: Japan: 94%, the UK: 99% (in terms of the number of tariff lines). Some additional commitments to the Japan-EU EPA.
    - Manu.: 100% on both sides.
  - Services, investment: negative-list method. Some additional commitments.
- Rule-making: some deepening
  - E-commerce
    - Free flow of data, no data localization requirement.
    - Prohibition of forced disclosure of algorithm, too.

# The contents of RCEP

- Covering 30% of the world population and GDP, 28% of the world trade (46% of Japan's trade)
- Market access
  - Tariff removal: overall 91% (in terms of the number of tariff lines, including items with gradual reduction) .
    - Japan: 86% for China, 81% for Korea. For Japan: ASEAN Member States (AMS), Aus., NZ 86-100%, China 86%, Korea 83%.
    - Japan's agricultural, forestry, fishery products
      - Five major items (rice, wheat, beef and pork, dairy products, sugar) all excluded. For AMS and others 61% (82% in CPTPP)., for China 56%, for Korea 49%.
    - Japan's manufactured goods
      - For AMS 98.5%->99.1%, for China 47% -> 98%, for Korea 47% -> 93%.
    - Other countries for Japan on manufactured goods
      - 14 countries total 92%. China 8% -> 86%, Korea 19% -> 92%.
  - Services: mixture of countries with positive lists and those with negative lists. The former is subject to negotiation.
  - Investment: NT, MFN. Prohibition of loyalty regulations and forced technology transfer requirements. For ISDS and others, negotiations will be initiated within two years after the agreement in effect.
- Rule-making
  - Text: 20 chapters, 17 appendices. Comprehensive coverage.
  - The following is of interest, showing a starting point of future negotiations for trying to involve China in international rules.
    - 11. Intellectual property (TRIPS+)
    - 12. Electronic commerce (no imposition of tariffs on cross-border electronic transmissions; free flow of data and no data localization requirement subject to public policy, national security, and other considerations; electronic signature, and others)
    - 16. Government procurement (transparency, cooperation, review)
- Entry into force and others
  - Ratification/acceptance/approval by 6 AMS and 3 other non-ASEAN signatories; in effect after 60 days.
  - General review after 5 years.
  - After 18 months, open for accession by any state or separate customs territory.

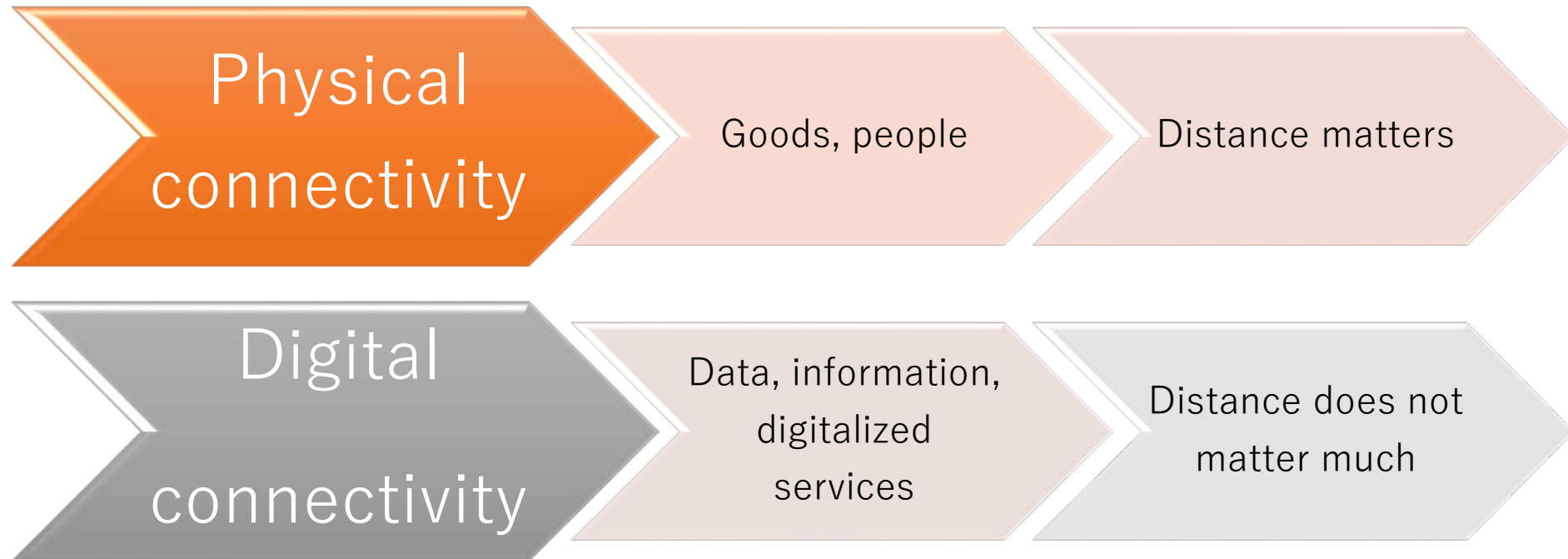
# Significance of RCEP

- Three characteristics
  - “Economic” agreement
  - Covering the whole area of “Factory Asia”
  - ASEAN’s initiative
- Level of trade liberalization
  - Almost equivalent to FTAs in East Asia in the past. Unusual to have the asymmetric tariff removal structure.
  - Japan-Korea and Japan-China are connected for the first time by an FTA. Certain levels of economic effects will come.
- Exit of India
  - Cannot cover the whole extended East Asia.
  - Japan, together with Australia and India, will initiate the Supply Chain Resilience Initiative (SCRI) and try to involve ASEAN.
- Some ambiguity in its significance with the US-China confrontation and others.
  - China’s “wolf warrior” diplomacy against Australia and others.
  - Uncertain to expand communication channels with China by RCEP for constructive dialogues.
- If the decoupling would be limited in scope, RCEP would be interpreted as a trial by middle power countries to continue good economic relationships with both the US and China.

## 4. Information and communications technology (ICT)

- The introduction of ICT is being accelerated in both developed and developing countries under the COVID-19 pandemic.
- In developing countries, in particular, the usage of CT (internet, smart phones) assisted by IT (such as machine learning) is expanding and deepening.
  - India, Cambodia, and others start introducing e-ID and making government services drastically efficient.
  - Korea, Taiwan, and others are effectively utilizing e-ID for infection monitoring.
  - Need trust for the government and the code of conduct by the government.
- To avoid “reshoring” and expand the involvement in IPNs, developing countries need to introduce and expand the usage of IT (robot and others) and CT (ref. Obashi and Kimura 2020).
- The growth of cross-border services outsourcing (the third unbundling (Baldwin 2016)) is accelerated as a novel form of international division of labor.
- Homework is the avoidance of digital divide and the establishment of policy system for data flows and data-related businesses (Chen, et al. 2019; 木村 2019).

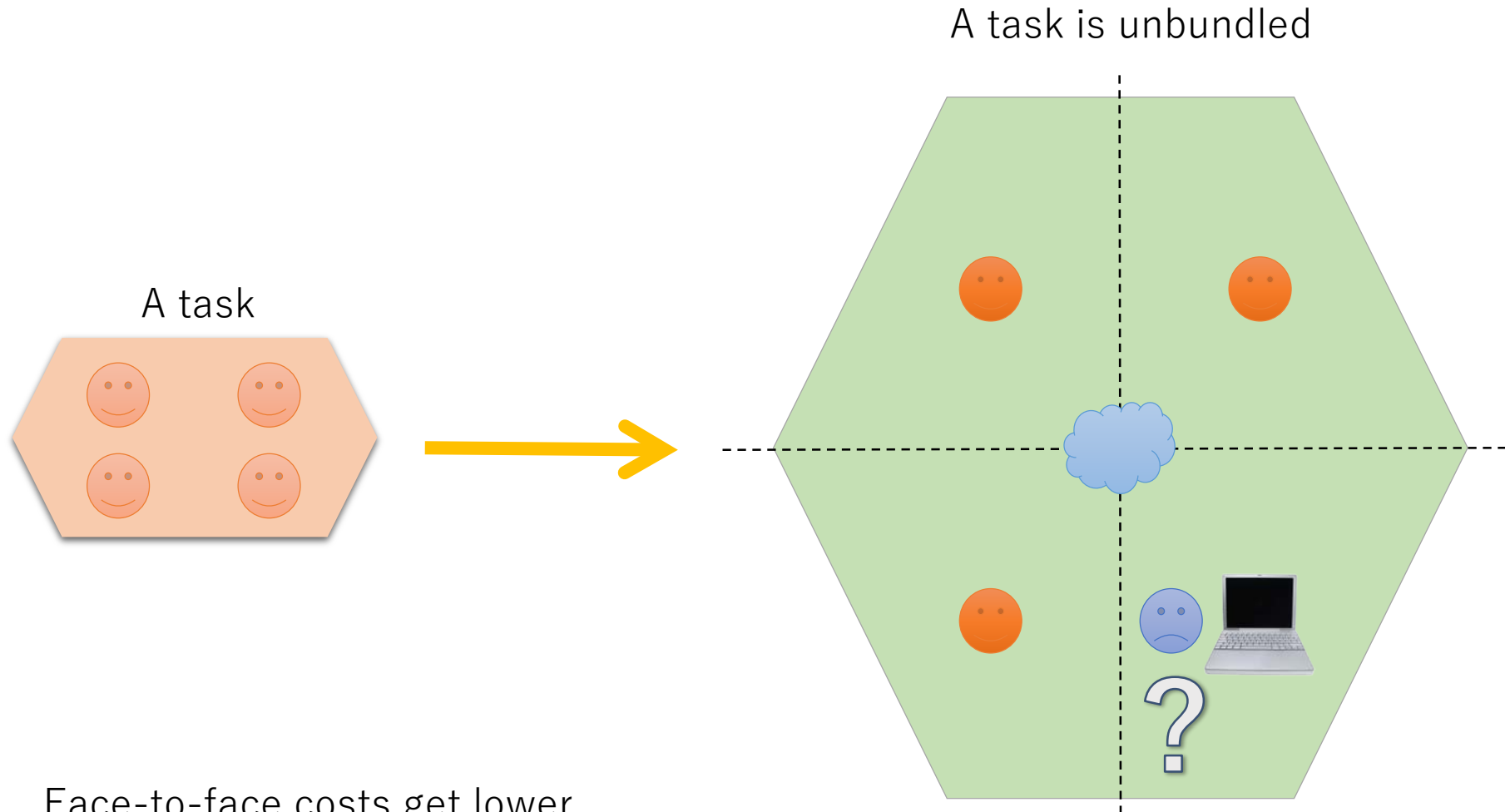
# Differences between physical and digital connectivity



Source: The author.



# The third unbundling

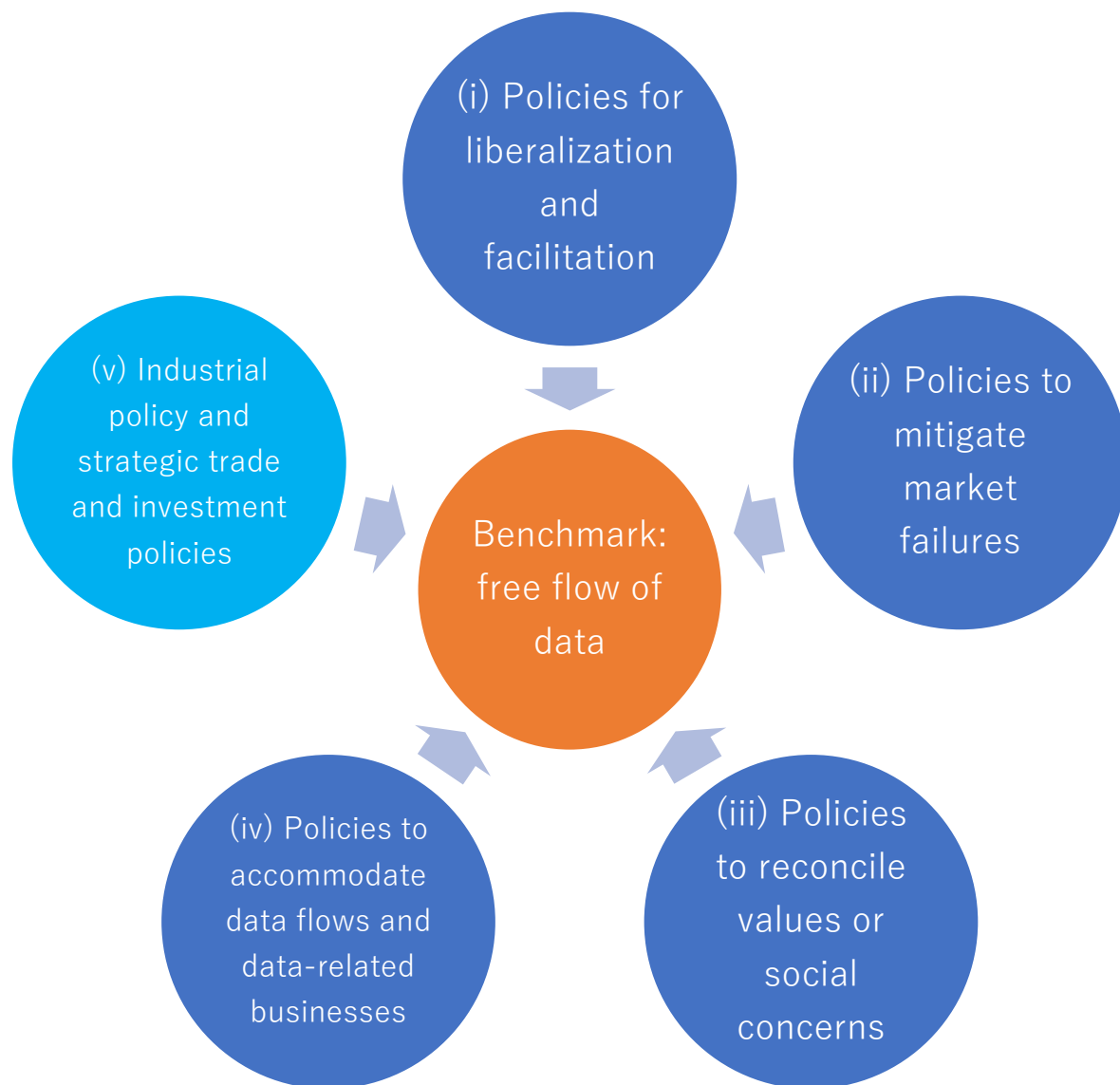


Face-to-face costs get lower.

A task can be unbundled; person-to-person matching becomes easier.

Source: The author.

# Free flow of data as a benchmark and supporting policies (Chen, et al. 2019)



- (i) Policies for further liberalization and facilitation  
Non-discrimination for digital content, customs duties on electronic transmissions, customs duties on parcels, Electronic authentication and signatures
- (ii) Policies to correct or mitigate market failures  
**Competition policy**, consumer protection, IPR protection
- (iii) Policies to reconcile values or social concerns with economic efficiency  
**Data and privacy protection, cybersecurity**, other general exceptions
- (iv) Policies to accommodate data flows and data-related businesses in the domestic policy regime  
**Taxation**, e-payments/fintech/other industrial regulations, AI, **information disclosure of firms and statistics, due process for government access to privacy/industry data**
- (v) Industrial policy and strategic trade and investment policies

# 5. Conclusion

- Year 2021 will come with four issues: COVID-19, the US-China confrontation, weakening of rule-based trading regime and mega-FTAs, and digital transformation.
- The rule-based trading regime is crucial for the prosperity of East Asia and Asia-Pacific regions.
- We must try to convince the US and China for the importance of the rule-based trading regime.
- To preserve the rule-based trading regime, middle-power countries located between the US and China must deepen the mega-FTA strategy and make effort for the WTO reform.

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