

Japan Needs the TPP

by Jeffrey W. Hornung

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Prime Minister Noda Yoshihiko has chosen to confront his country's powerful agricultural sector and the politicians that represent it and push for Japan's entrance into the Trans-Pacific Partnership (TPP). Given its broader economic interests, there is no question that Japan needs the TPP.

The TPP began in 2006 as a Free Trade Agreement (FTA) among four countries. Today it consists of nine countries negotiating the terms of the agreement, including the United States. Its aim is to eliminate all tariffs within 10 years and create a free trade zone of the Asia-Pacific region. On the sidelines of this month's APEC meeting in Honolulu, TPP members will decide on the broad outlines of an agreement as a step toward creating detailed rules.

While Noda has indicated his interest in having Japan join, strong political forces within his own party oppose him. Despite the enormous political challenges, it is essential that Noda commit to Japan's participation.

First, given the countries currently negotiating the TPP as well as others interested in joining, the TPP has the potential to become an Asia-Pacific FTA. Regional economies are today's engine of global economic growth. Current TPP members already represent 26 percent of global GDP and 17 percent of global trade. Because the shares of both are expected to grow, especially as more economies join, the increased importance of TPP means that the rules and systems established by TPP members will likely set the global standard much the same way decisions at Bretton Woods set the rules for commercial and financial relations last century. Japan cannot miss participating in this rule-making process.

Japan also needs the TPP because its paucity of FTAs/Economic Partnership Agreements (EPAs) relative to other nations has translated into a declining competitiveness for Japanese firms. For example, Japan conducts 18 percent of its trade with countries it has a FTA/EPA. South Korea is double that at 36 percent and is looking to increase this, negotiating with economies that it conducts an additional 25 percent of trade. Tokyo lags here too, at 19 percent. As a result, Japanese firms have to compete with others under unfavorable terms in other markets. Passage of the South Korea-US FTA exemplifies this point as it gives an edge to South Korean firms in industries that Japanese firms once led, such as automobiles. If Japan does not join the TPP, Japanese

firms will face trade discrimination not only in the US, but in all other TPP economies.

Third, Japan faces severe demographic challenges. Japan has both a shrinking and an aging society. By 2050, its population is expected to shrink by nearly 32 million people, resulting in approximately 95 million Japanese. At the same time, the percentage of its population aged 65 years or older is expected to grow. In 2010, it was 23 percent but by 2050 it is expected to be 39.6 percent. Given this demographic forecast, Japanese firms solely targeting domestic consumers will face tremendous difficulties. For growth, they require open access to overseas markets that are big and/or growing. The TPP provides firms with this market access.

Finally, Japan needs the TPP to reform its agricultural sector. The sector suffers from three problems. First, it is inefficient, dominated by small plots. Commercial farms managed an average of 1.96 hectares in 2010. Because small plots result in higher costs, Japanese goods cannot compete with cheaper imports, leading to highly protected agricultural goods. The most well-known example is the 778 percent tariff imposed on imported rice to protect Japanese rice. Second, Japanese farmers are old and getting older. In 2005, the average age was 63.4. In 2010, this increased to 65.8. This year, 61 percent of farmers are 65 years or older. Third, the number of farmers in Japan is shrinking. In 2005 there were 3.2 million farmers. This shrunk to 2.6 million this year. All these factors mean that it is unlikely that the sector will enjoy future growth without meaningful reforms.

But Japan's farmers are powerful, and have been the key to electoral victories for both the Liberal Democratic Party and the ruling Democratic Party of Japan (DPJ). The interest in protecting those voters has made it difficult for reform-minded politicians to succeed. The TPP is key to this objective. Under the TPP as it is currently envisioned, tariffs would be eliminated, forcing Japanese farmers to compete on an equal footing with foreign counterparts. To succeed, they have to more efficiently allocate the factors of production and shift production to larger plots (i.e. 20-30 hectares). Many farmers will lose their livelihoods, but the smaller agricultural sector that will remain will be stronger and more capable of competing with foreign counterparts both in Japan and abroad.

The DPJ has never been considered pro-business, but failure to join the TPP means the DPJ will be cast as not only anti-business, but incapable of understanding the country's broader economic interests. The agriculture sector and the political actors that protect it are strong, but joining the TPP is essential to sustained Japanese economic prowess and long-term growth.

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