

U.S. Asia Pacific Council

# Washington Report

## Age-Old Domestic Supports, China's Rise May Affect Japan's Regional Economic Pursuits

Prof. Edward J. Lincoln

*When Japanese Prime Minister Naoto Kan visits Washington, D.C. in a few months, the spotlight likely will shine on the anticipated roll-out of a new "vision" for the U.S.-Japan security relationship. But as Foreign Minister Seiji Maehara pointed out during a brief visit to Washington in early January, the continued evolution of the bilateral alliance also will depend on robust economic relations. Prof. Edward Lincoln of New York University considers domestic and regional developments that may challenge some of Tokyo's economic aspirations.*

**USAPC:** Tokyo indicated at the conclusion of the APEC Leaders Meeting in Japan November 2010 that Japan initially would participate as an observer in the Trans-Pacific Partnership (TPP) talks before formally deciding to participate. Will Japan's agricultural interests ultimately impede its participation in the TPP?

**Lincoln:** I find it very sad that as we begin 2011, the Japanese government still has trouble dealing with the agricultural sector. The U.S. government and academic experts have been battering away on this issue for some 26 years.

During that period of time, Japan's agricultural sector has not done well. It continues to lose people, and the fewer and fewer remaining farmers have become older and older. I was told recently that the average age of a Japanese farmer is 65 years old. Their kids have been moving to urban centers because they do not want to be farmers. This is because farming is not a very good business in Japan due, in part, to the fact that farms remain very small.

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## House Republicans Will Press For Timely KORUS Approval, Economic Reforms From Beijing

Rep. Dave Camp (R., Michigan), the new chairman of the House Ways and Means Committee, served notice January 18 that he will press for early approval of pending free trade agreements (FTA) with Colombia, Panama, and South Korea. "Trade agreements are a sure-fire way to support US jobs and boost economic growth by creating new markets for US goods and services, particularly at a time when unemployment is nearly ten percent," Camp said in announcing a hearing on January 25 aimed at expediting both congressional and administration action on these pending FTAs. The White House has yet to submit the three accords to Congress for approval.

**KORUS Ratification**—In particular, Rep. Kevin Brady (R., Texas), chair of the Ways and Means Trade Subcommittee, indicated that he and Chairman Camp want to secure congressional approval of the U.S.-Korea Free Trade Agreement (KORUS) within the first six months of 2011. This timetable is in sync with that of the White House: US Trade Representative Ron Kirk established a July 1 target date for ratification of KORUS. Delays beyond that date potentially could cost US exporters a large share of the Korean

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News and analysis from  
Washington, DC about key issues  
in US-Asia Pacific Relations

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### Washington Report

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## Lincoln Interview

They are so small that many farmers use rototillers to till their fields. They don't ride tractors and let the machine do the work. Farming in Japan therefore is a far more physical job than in the United States. It's no wonder that young people don't want to go into this.

But if the Japanese government doesn't do something in the coming decade, there no longer will be an agricultural sector in Japan. Tokyo needs to pursue radical reform of its agricultural sector involving a combination of two elements: (1) placing Japanese farmers under international competitive pressure, and (2) pursuing a new policy that makes the sale and transfer of agricultural land much easier in order to grow the size of farms.

The Japanese government should have pursued these policy changes about 40 years ago. As labor costs increased, this logically would have led to the creation of bigger farms. But this didn't really happen. There has been a slight increase in the size of farms, but nothing substantial because the Japanese government has been reluctant for political reasons to implement these kinds of reforms.

To be sure, Japan has opened up certain product areas in agriculture. Japan is not a particularly good place to grow wheat, for example, so for many years Japan has imported virtually all of its wheat, corn, and soybeans. More recently, there has been a big increase in the import of vegetables and certain kinds of fruit, particularly from China.

But the Japanese still do not import rice—not with a 600 percent tariff on it! There still needs to be progress on agriculture. I find it very sad that the Japanese government has yet to undertake these reforms, and once again, Tokyo is allowing agriculture to trip up its participation in the TPP. This should not be happening.

**USAPC:** Japan has been a regional and global economic power and regards itself as such. But, in addition to the TPP initiative, Korea, Australia, and others have been pursuing a plethora of free trade agreements (FTAs). Is Japan falling behind in Asia?

**Lincoln:** Part of the problem may be that the Japanese government does not appear to regard its inability to participate in TPP as being "left behind." Since about 2000, the policy of the Japanese government has been to conclude bilateral, sub-regional, and regional FTAs. To date, I believe they have concluded close to a dozen of these FTAs.

But the quality of Japan's FTAs leaves a lot to be desired. For example, agriculture is excluded. Japan can get away with that in negotiating a bilateral agreement because it is a big country and most of its FTAs are with smaller countries. Tokyo has more weight in those negotiations than it would, say, in the

TPP process or talks aimed at concluding the Free Trade Area of the Asia Pacific (FTAAP) envisioned by APEC.

And it's not just agriculture that gets a pass. There are other non-agricultural products that are excluded as well as very weak agreements on services trade. These are not particularly strong FTAs. But Japan has concluded them and the count has gone up over the years. The Japanese government therefore can maintain, "Oh yes, we've concluded many FTAs with other countries. We're not being left out." But certainly Japan is being left out of quality FTAs.

**USAPC:** One commentator depicted Japan's participation in TPP, in effect, as a U.S.-Japan FTA because Tokyo would have to meet the U.S. standards. So, in view of your observation of Tokyo's track record on its own FTAs, at this stage Japanese officials apparently don't feel there is any great loss in not entering into the TPP process or de facto FTA negotiations with Washington.

**Lincoln:** Yes. Tokyo is not ready for what the United States wants in an FTA—and never has been.

**USAPC:** Yet another observer described Tokyo's decision to participate as an observer in the TPP process as a significant change in Japan's trade policy. But it sounds like you would disagree.

**Lincoln:** There is always the possibility that the Japanese government could surprise us. Tokyo has said it would try to make a decision about whether to formally enter the TPP talks by the summer of 2011.

Prime Minister Kan has said the time is ripe for Japan to break out of its shell, deal with the agricultural issue, and participate in trade liberalizing negotiations like the

TPP. But there are other cabinet officials who have been speaking out against those kinds of reforms. So who knows where the Japanese government is headed.

**USAPC:** So Prime Minister Kan not only is fighting traditional Liberal Democratic Party (LDP)-aligned agricultural interests but also members of his own Democratic Party of Japan (DPJ)?

**Lincoln:** Yes. In recent years, the DPJ discovered that Japanese rural voters appeared willing to abandon the LDP, so the Democrats actively courted their vote. Consequently, the DPJ now finds itself proposing a policy that is not all that different from what the former ruling LDP had advocated, that is, providing subsidies to farmers. This would be the DPJ's way of saying, "We'll give you a subsidy so you won't be hurt when we open up to international trade."

Unfortunately, it appears that this subsidy would be tied to production levels. Ideally, the government would tell a farmer, "We'll give you an income subsidy, so whether you produce vegetables or rice or not, your livelihood and your income will be protected somewhat."

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Tokyo is allowing agriculture to trip up its participation in the TPP

But if the government tied a farmer's subsidy, say, to every kilo of rice he produced, then the government simply would be encouraging the farmer to stay in highly inefficient rice production rather than creating conditions more conducive to market opening. That's not a good way to go.

**USAPC:** Let's continue this discussion about domestic politics. During the early months of former Prime Minister Yukio Hatoyama's administration in the fall of 2009, there were reports that the political appointees of the newly ruling DPJ and the long-time government bureaucrats did not work together effectively. Has that dynamic changed as the DPJ has gained a bit more leadership experience?

**Lincoln:** I'm not sure. You are correct that when the DPJ first entered office, one of its major campaign themes was to shift power from the bureaucracy to the politicians.

Many people have been making that intellectual proposition for the last 20 years. They have proposed that while a strong bureaucracy may have been good for Japan when it was a developing country and the policy issues were largely technical, now that Japan is a major developed country, the issues confronting the nation shouldn't be decided by bureaucrats. That is because the issues are fundamentally political, related to the allocation of resources or the promotion of various kinds of activities. It is logical to argue that there should be such a transition in power.

In reality, though, it is very difficult to accomplish that transition. If the system has a strong bureaucracy and weak politicians, then the politicians, indeed, are weak. They don't possess the sort of policy skills that we typically associate with members of the US Congress.

While we have our share of less-than-competent politicians in Congress, we also have a group of very impressive lawmakers who spend a great deal of time examining real policy questions in a way that very few Japanese politicians do. So, for starters, that situation must be remedied in order to implement the transition in power.

At least initially, it was not clear to me that there were many DPJ members who were inclined to delve deeply into policy. So on the one hand, the DPJ announced plans to take power over policy making, but on the other hand, the Democrats did not explain clearly to bureaucrats how that would change the rules of the game. The bureaucrats didn't know how to play by these new rules and they had—and continue to have—contempt for politicians because the politicians generally don't know the issues.

It's hard to say to what extent this dynamic has improved. It

has settled down at least a little owing, in part, to indications from Prime Minister Kan that he is willing to go half-way back to the former system to enable bureaucrats to play more of a lead role in policy making. But will that last? We don't know.

When I was in Tokyo during the week of December 13, everyone was telling me that Prime Minister Kan was not going to last more than a few months. The political scuttlebutt was that the DPJ would force Kan to resign after the regular budget is passed in late March 2011.

I found that rather distressing because my read on Kan is that he's at least somewhat better than former Prime Minister Yukio Hatoyama. Hatoyama, to me, typified the Japanese politician—he had plenty of ideas, but no policy sense.

So if Kan is forced out and replaced by someone from the more "hopeful, intellectual" side of the DPJ who doesn't have a lot of policy sense, then once again we could see more confrontation between the politicians and the bureaucrats. That could have important ramifications for U.S.-Japan relations going forward.

**USAPC:** Throughout the global economic crisis, Japan was in the midst of political upheaval that ultimately propelled the DPJ and Prime Ministers Hatoyama and Kan to power.

How did those political changes affect the government's ability to respond to the crisis? Or, was Japan better prepared to weather the storm owing to reforms instituted following its earlier banking crisis?

**Lincoln:** In one sense, Japan was better prepared, but the numbers indicated that, in reality, Japan got hit by the recession even worse than the United States. The U.S. economy shrank by a little over 3 percent from peak to trough, while the Japanese economy shrank by 5 percent. In terms of a decline in GDP, this was by far the worst recession Japan has experienced since the end of World War II.

But by the same token, I think you can argue that the Japanese were somewhat better prepared because the nature of this recession was different in Japan than it was in the United States. In the United States, the recession was driven by a 1990s Japanese-like collapse of the stock market and the real estate market, with consequent reverberations in the financial sector and ultimately in the so-called real sector of the economy.

That did not happen in Japan. In the summer of 2008, the Japanese seemed pretty confident that, at worst, they would have a very mild recession. Their optimism stemmed

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## Lincoln Interview

from the fact that Japanese financial institutions didn't buy American toxic assets, unlike the European banks. They thought it unlikely that a severe recession would transfer from the United States to Japan.

What did happen—and was totally unexpected—was a collapse in international trade. The U.S. economy fell by 3 percent. Imports decreased roughly 30 percent, peak to trough, from roughly the beginning of 2008 to early 2009. That's also true for world trade, which decreased by about 30 percent during that same one-year period.

But Japan's exports decreased by about 50 percent. That is colossal, almost like the Great Depression. You'd think that if the U.S. economy shrank by 3 or 4 percent, then imports would shrink by roughly that amount. No one can quite figure out why this happened.

For U.S. trade, the predominant explanation seems to revolve around trade finance. When financial markets froze up in the fall of 2008, financing for international trade was hit particularly hard. That contributed, in part, to the sharp decrease in U.S. trade, according to this argument.

But Japan's financial institutions were in very good shape to provide trade financing. So I think Japan was hit by something rather different, which actually may have been self-induced.

Japanese companies, particularly the auto and electronics companies, saw inventory at their American subsidiaries rising rapidly in the summer and fall of 2008. In addition, the pundit analysis in the fall of 2008 included a fair amount of speculation that we were headed into the second Great Depression.

I think that frightened Japanese companies. And when a company is frightened, it doesn't want to see an inventory build-up. So many Japanese companies responded by cutting shipments primarily to the United States and secondarily to Europe. So, for example, Toyota Motor Company shut down factories for several weeks in early 2009 to try to get inventories back under control. The analysis hasn't been done yet, but I think what I just described will be borne out by data.

That being the case, Japan's recovery was relatively quick. Japanese exports and global trade bounced back, not to pre-recession levels, but they did rebound. The Japanese economy returned to growth in 2009. The level of growth hasn't been as strong as we'd like to see in light of the nature of its recession. Recovery from an inventory-driven recession tends to be more V-shaped than U-shaped.

But there are other reasons for Japan's weaker-than-

expected growth. The U.S. and European economies are not recovering very quickly, which would limit Japan's export growth. In addition, the yen has strengthened against other currencies over the past three years. That has taken some of the edge off of Japan's price competitiveness during this recessionary period.

**USAPC:** With respect to currency valuation, the United States has been pressuring China doggedly to reform its currency policy on grounds that it is fueling the bilateral economic imbalance. Japan also has experienced some negative economic repercussions from China's currency policy. How would you compare Tokyo's handling of this matter with Washington's?

**Lincoln:** Basically, the Japanese government isn't doing anything partly because it is genuinely conflicted by this issue—and partly because I think Tokyo would rather leave this up to Washington. "Let the United States be the bad guy on this issue," may be the view of Japanese officials.

But underneath that, I think the Japanese are conflicted because over the past eight or nine years there has been a fairly aggressive level of investment by Japanese firms in

China. Much of that investment, as is true for a fair amount of other foreign direct investment flowing into China, is for final assembly of products for export around the world.

So it's not clear that the Japanese would benefit from a stronger Chinese yuan. The weaker yuan makes the price of the final assembled goods more competitive in the global marketplace. I think the Japanese government has been getting mixed signals from the business community about whether they really care about this issue.

**USAPC:** You mentioned that the yen has been strengthening over the past three years. Why is that happening, and do you see Tokyo intervening to brake the trend?

**Lincoln:** Let's go back a little. The yen was extraordinarily strong in the mid-1990s. In 1995, the nominal yen-dollar rate peaked at Y80/\$1.00, and then fell to Y122/\$1.00 by 2007. It now is back to around Y83/\$1.00. That gives the appearance of wide changes, with the yen back close to its historic high.

The weakening was particularly noticeable during 2000 to 2007. But when I say the exchange rate weakened, I'm not only referring to the dollar-yen exchange rate. Rather, I am referring to the real effective exchange rate. This is the rate that matters for international trade because it is a broad measure of how price-competitive a country's exports are and how price-competitive imports into that country are.

It is an index number that is an average of the exchange rate against all currencies with which the country trades, weighted

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# US Lawmakers Express Optimism Following US-China Trade Talks

The 21st U.S.-China Joint Commission on Commerce and Trade (JCCT) meeting on December 14-15 in Washington resulted in several noteworthy promises by China to address US concerns about its failure to protect and enforce intellectual property rights (IPR) and its controversial “indigenous innovation” policies. Although this biannual dialogue received virtually no major US media coverage, the potential significance of this outcome was not lost on leading members of Congress.

“[The] joint US-China trade talks resulted in important action [that will] increase American exports and result in more good-paying American jobs,” Senate Finance Committee Chairman Mas Baucus (D., Montana) said December 16. Ranking Finance Member Charles Grassley (R, Iowa) concurred, expressing “cautious optimism” about the developments on intellectual property enforcement and government procurement.

In the run-up to the JCCT meeting, Baucus and Grassley sent a letter to Chinese Vice Premier Wang Qishan co-signed by 30 bipartisan senators. The letter called on China to provide better IPR protection and enforcement, to pursue domestic innovation without “explicitly or implicitly” discriminating against US companies, and to remove its ban on certain imports of US beef.

Nearly 30 members of the House Ways and Means Committee pursued a complementary letter-writing strategy, urging US Commerce Secretary Gary Locke and US Trade Representative Ron Kirk to achieve measurable commitments from Beijing at the JCCT. “We urge the administration to measure progress on greater US market access into China and

protection of US [IPR] by objective criteria, [which] should include commercially meaningful metrics,” the House lawmakers wrote.

Pressure from Congress can serve as useful leverage in bilateral economic discussions. However, experts have warned that China’s promises at the JCCT are not binding commitments. As U.S. lawmakers underscored to President Hu Jintao during his state visit on January 19 (see article on page six), they will be monitoring carefully whether Beijing follows through on its promises of reform.

Following are highlights of the [JCCT outcome](#):

- China agreed to increase the purchase and use of legal software;
- China will take steps to (1) eradicate the piracy of electronic journals, (2) implement more effective rules for addressing Internet piracy, and (3) crack down on landlords who rent space to counterfeiters in China;
- China no longer will discriminate in government procurement decisions based on where the intellectual property component of the products was developed;
- China committed to revise a major equipment catalog and not to use it to discriminate against foreign suppliers or provide prohibited subsidies; and
- Although talks on beef market access were inconclusive, the two countries signed seven new agreements covering agricultural collaboration, soybean exports, statistics, and promotion of investment in the United States. ♦

## OFFICIAL WASHINGTON

In each issue, **Washington Report** will provide the names and contact information for selected executive branch officials with jurisdiction over economic, political, and security issues important to US-Asia Pacific relations. This issue focuses on pertinent personnel from the U.S. Department of State.

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## Approval Of KORUS, Economic Reforms From Beijing

market given the likelihood that the EU-Korea FTA also will enter into force in early July, Amb. Kirk warned on January 13.

**China Currency Policy**—Brady also made clear that legislation aimed at pressuring China to revalue the *renminbi* will not be on the Trade Subcommittee's agenda for 2011. The subcommittee chair said his panel would consider "in a comprehensive manner" policy prescriptions aimed at rebalancing US-China economic relations and redressing bilateral trade disputes, he said.

This will include close oversight of Beijing's efforts to follow-through on promises it made at the December 2010 meeting of the Joint Committee on Commerce and Trade (see article on page five) to crack down on intellectual property theft and discontinue policies favoring indigenous development of technology, among other issues. Brady also has urged the administration to resume negotiations aimed at concluding a Bilateral Investment Treaty with China, contending that "our foreign competitors already are ahead of us on this."

**President Hu's State Visit**—Brady's comments nevertheless did not deter some US lawmakers from using the occasion of Chinese President Hu Jintao's state visit on January 19 to reintroduce a currency bill. The "[Currency Exchange Rate Oversight Reform Act of 2011](#)," introduced on January 17 by Senators Robert Casey (D., Pennsylvania), Charles Schumer (D., New York), and Debbie Stabenow (D., Michigan), would provide less flexibility to the Treasury Department in citing countries as "currency manipulators" as well as impose stiff penalties on designated countries.

**Emerging Bipartisan Consensus on China**—Insiders are skeptical that the currency bill will advance very far in the 112th Congress. However, they do foresee greater bipartisan support for a more forceful US response—not only on trade and economic issues, but also on political, diplomatic, and security matters.

At a special briefing on China called by House Foreign Affairs Committee Chair Ileana Ros-Lehtinen (R., Florida) on January 19, more than half of the 18 members of both parties

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### CONGRESSIONAL WATCH

#### US-China Economic and Security Review Commission's 2010 Report to Congress

—Although issued on November 17, 2010, the Commission's [eighth statutorily mandated report](#) to Congress, which analyzes the national security implications of U.S.-China economic relations, undoubtedly will inform debate on Capitol Hill in 2011 about this complex bilateral relationship.

The Commission made 45 policy recommendations to Congress pertaining to (1) the bilateral trade and economic relationship, (2) the development of China's military capabilities, (3) China's activities in Asia, (4) China's green and alternative energy policies, and (5) China's regulation of Internet use and "information control."

Key recommendations include:

1. Congress should urge the administration to further pressure China to revalue

its currency by (a) working with U.S. trading partners to bring to bear on China the enforcement provisions of all relevant international institutions and (b) using the unilateral tools available to Washington to encourage China to shift its economy to more consumption-driven growth.

2. Congress should examine the efficacy of the current US trade tools to address China's market access barriers and, as necessary, develop new tools.
3. Congress should direct the US Treasury to account fully for US government debt held by foreign governments.
4. Congress should require the Defense Department to report on the adequacy of US military capacity to withstand a Chinese assault on regional bases.

5. If the United States is to compete successfully in green technology manufacturing, Congress should examine whether US programs ensure an adequate response to China's strategic promotion of the green technology sector.
6. Congress should request that the administration periodically issue a single report about the volume and seriousness of attacks on federal information systems.

#### Vietnam Human Rights

**Sanctions Act**—On January 5, the first day of the 112th Congress, Rep. Ed Royce (R., California) wasted no time in introducing this bill. It would impose sanctions on Vietnamese government officials who the US president determines "are complicit in human rights abuses committed against nationals of Vietnam or their family members, regardless of whether such abuses occurred in

Vietnam." This follows up Royce's resolution calling on the State Department to relist Vietnam as a "Country of Particular Concern" for violations of religious freedoms. That resolution passed the House late in the 111th Congress.

Royce's early leadership on this issue may be a harbinger of more aggressive advocacy of human rights protections by the new Republican majority in the House. The California Republican, who serves on the Congressional Caucus on Vietnam and the House Human Rights Caucus, also is a senior member of the House Foreign Affairs Committee. Importantly, Rep. Ileana Ros-Lehtinen (R., Florida), the new Foreign Affairs Committee chairperson, also is a staunch proponent of human rights protections. This increases the likelihood of Royce's legislation being reported by the committee and voted on by the full House.

**ASIA PACIFIC ECONOMIC COOPERATION (APEC) FORUM:**

**APEC Symposium and Informal Senior Officials' Meeting –**

On December 8-9, the East-West Center in Honolulu, Hawaii served as the setting for the APEC Symposium and Informal Senior Officials' Meeting. The purpose of the APEC Symposium was to expose senior representatives from the 21 APEC member economies to the views of outside experts on various issues APEC may consider in the years to come. In general, both of these gatherings were aimed at introducing Senior Officials to U.S. priorities for 2011, its host year.

Specifically, Amb. Kurt Tong, US Senior Official for APEC, said that Washington will pursue a very "results-oriented approach" with respect to three main objectives: (1) strengthening regional economic integration and expanding trade;

(2) promoting green growth; and (3) advancing "regulatory convergence," a term that refers to a systematic process aimed at bringing regulations and standards in different economies into closer alignment.

Concerning the first objective, **Tong said** that the United States hopes to secure ratification of the U.S.-Korea Free Trade Agreement as well as make substantial progress, if not conclude, the Trans-Pacific Partnership agreement in time for the November APEC Leaders' Meeting in Honolulu.

**KEY MEETINGS & EVENTS: JANUARY—FEBRUARY 2011:**

- Amb. Stephen Bosworth, US Special Representative for North Korea Policy, accompanied by Amb. Sung Kim, US Special Envoy for Six-Party Talks, traveled to Seoul, South Korea, Beijing, China, and Tokyo, Japan

to explore next steps on the Korean Peninsula with senior government officials, January 3-7.

- Chinese Foreign Minister Yang Jiechi held talks with Secretary of State Hillary Clinton, Washington, DC, January 3-7.
- Japanese Foreign Minister Seiji Maehara held talks with Secretary Clinton and others, Washington, DC, January 6-7.
- US Defense Secretary Robert Gates held talks with Chinese Defense Minister Liang Guanglie, Beijing, January 9-12
- US Assistant Secretary of State for East Asian and Pacific Affairs Kurt Campbell furthered preparations for Chinese President Hu Jintao's upcoming US visit, Beijing, China, January 9-11.
- H.E. Muhyiddin bin Mohamed

Yassin, Malaysian Deputy Prime Minister and Minister of Education, held talks with Secretary Clinton, Washington, DC, January 14.

- Secretary Gates held talks with Japan Defense Minister Toshimi Kitazawa in Tokyo and South Korean Defense Minister Kim Kwan-jin in Seoul on January 13 and January 14, respectively.
- President Obama hosted Chinese President Hu for a State visit, Washington, DC, January 19.
- President Obama will deliver the 2011 State of the Union address, Washington, DC, January 25.
- Amb. Kurt Tong, US Senior Official for APEC, and Ms. Wendy Cutler, Assistant US Trade Representative for Japan, Korea, and APEC Affairs, will attend the first Senior Officials' Meeting, Washington, DC, February 28-March 13.

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**Lincoln Interview**

by the share of trade with each of these countries around the world, and adjusted for a differential in inflation between the home country and each of these countries. It's a fairly complicated calculation, but it gives you a very broad picture of what's happening to the price of one country's products versus the price of products in the rest of the world.

So on that basis, the yen peaked in 1995 and then fell to a low level in 2007. From 2000 to 2007, this real effective exchange rate was below the 30-year-average. But that low level was instrumental in creating very strong export growth. It was export growth that brought Japan out of its "lost decade."

This time around, the yen has rebounded from that low point in 2007 to just a little bit above the average. It is not real strong, but compared to where the yen was in 2007, it has strengthened in value.

Unfortunately, when many people think about the exchange rate, they tend to think of the dollar-yen value in the spot market today, versus last year or the year before. But that rate doesn't adjust for the difference in inflation and neither does it adjust for the fact that Japan trades with a lot of countries,

many of whose currencies are not tied to the dollar. You get a very misleading picture of how strong the yen is by just focusing on the dollar-yen rate.

To put it in simple terms: for the past 15 years Japan has had mild deflation, running between 0.5 percent and 1 percent. The United States has had a modest positive inflation of between 1 percent and 2 percent. Thus, during this 15-year period, the price of Japanese products actually has decreased while the price of U.S. products has increased. At any given yen-dollar rate, Japanese products have been more price competitive.

But as I said, the tendency of many people is to focus just on the yen-dollar rate at any given moment. That's what was happening in Japan during the summer and fall of 2010. There were expressions of anxiety about the fact that this nominal yen-dollar rate would get back up to its peak of 1995. These concerns eventually caused the Japanese government to intervene in September 2010 in a pretty substantial way for a day or two. It was a surprising and large intervention. Japanese Finance Minister Yoshihiko Noda then said that Tokyo would

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## Lincoln Interview

consider doing it again.

I found that a little odd. Minister Noda attended the G-20 Finance Minister's meeting in October 2010 in South Korea, where the ministers issued a statement pledging not to manipulate currency values for trade gains. Noda endorsed the statement but then returned to Tokyo and announced that Japan would keep its options open. I find that rather contradictory.

The fact is, however, that Tokyo has not intervened since

then, perhaps because the yen did not test the Y80/\$1.00 limit. In addition, though, U.S. Treasury Secretary Timothy Geithner may have laid down the law to Minister Noda at the G-20 Finance Ministers meeting, saying something to the effect that such action would be particularly unhelpful in light of U.S.-led efforts to pressure China to allow the yuan to appreciate. In any event, I hope that message was delivered in fairly strong terms to the Japanese government.

**USAPC:** You mentioned earlier that Japanese business may not necessarily welcome efforts by the U.S. and Japanese govern-

### REGULATORY UPDATE

In addition to using the bilateral Joint Commission on Commerce on Trade (JCCT) to press China on its unfair trading practices, the Obama administration has taken the following regulatory actions aimed at redressing certain Chinese policies:

#### **“Surge” of Chinese Passenger Vehicle and Light Truck Tire Imports**

—On December 13, 2010, a World Trade Organization (WTO) dispute settlement panel upheld the Obama administration's decision in September 2009 to impose tariffs of up to 35 percent on automobile and light truck tire imports from China.

Beijing had challenged the US action on grounds that it violated the transitional safeguard mechanism included in China's Protocol of Accession to the WTO. The WTO panel rejected China's claims, finding that the United States acted consistently with its WTO obligations. Both sides have the right to appeal the panel's findings to the WTO Appellate Body within 60 days.

#### **Chinese Subsidies for Wind Power Equipment Manufacturers**

—On December 22, the United States requested consultations with China under the WTO dispute settlement process concerning special subsidies Beijing allegedly provides Chinese

wind power manufacturers.

Under the Special Fund for Wind Power Manufacturing program, China awards grants to Chinese companies that appear to be contingent on their use of domestic-made parts and components rather than foreign-made elements. The Office of the U.S. Trade Representative has estimated that grants provided under this program since 2008 could amount to several hundred million dollars.

This action arose from an investigation USTR initiated on October 15, 2010 under Section 301 of the Trade Act of 1974. This investigation addressed alleged subsidies, export restrictions on rare earth minerals, discrimination against foreign companies and imported goods, and other support provided by the Chinese government to promote its “green technologies” industries. All of these actions “cause serious prejudice to US interests,” according to the petitioner, the United Steelworkers (USW).

Under Section 301, USTR could take as long as 90 days to thoroughly examine and verify the USW's claims. It then was obliged to request formal consultations with the Chinese government under WTO auspices.

There has been some progress in the interim. At the meetings of the US-China Joint Commission

on Commerce and Trade (JCCT) on December 14-15 (see article in this issue), China agreed to modify its criteria for approval of new wind power projects. It eliminated the requirement that foreign companies have prior experience supplying large-scale wind power projects in China; Beijing now will recognize prior experience elsewhere. Chinese officials also reconfirmed a commitment made at the 2009 JCCT that the government had eliminated local content requirements in the wind power sector.

As part of the Section 301 consultation process, China further clarified that it had terminated two other subsidy programs identified by the USW—the Export Research and Development Fund and the Ride the Wind program. Along with the case filed on December 22, “these steps effectively address a substantial portion of the claims in the USW's petition,” according to USTR.

If after 60 days, Beijing and Washington do not reach a mutually agreed solution about the subsidies allegedly provided via the Special Fund for Wind Power Manufacturing program, the United States may request the formation of a WTO dispute settlement panel to hear the case.

#### **2010 USTR Report to Congress on China's WTO Compliance**

—As required by law, USTR presented to Congress on December 23 this [annual report](#), which highlights the status of China's ongoing efforts to satisfy commitments it made when it acceded to the WTO on December 11, 2001.

USTR acknowledged that China's WTO membership has provided ongoing benefits to the United States in the form of dramatically increased bilateral trade and the jobs and business income resulting from such economic activity. However, 2010 saw the “prevalence of interventionist policies and practices, coupled with the large role of state-owned enterprises in China's economy, [which] continued to generate concerns among US stakeholders,” the report states.

USTR noted that December 2010 meeting of the JCCT produced “concrete results” that address several of these concerns (see article in this issue). However, several areas continue to cause concern for the United States in terms of China's adherence to its WTO commitments. These include protection of intellectual property rights, industrial policies, trading rights and distribution services, agriculture, services, and transparency.



ments to pressure China to reform its currency policy. However, I'm wondering whether China's recent embargo on rare earth mineral exports to Japan has had the opposite effect and caused greater wariness about doing deals with China.

**Lincoln:** Yes, I think that episode has had a somewhat chilling effect on attitudes about doing business with China. Based on casual observation, I've actually found Japanese business to be more wary of China as a place to locate production and do business than American business. I think that has intensified particularly since China imposed the embargo on rare-earth mineral exports to Japan.

Over the last five years, I've listened to Japanese businessmen say they are absolutely convinced that they get mistreated more than other foreign companies in China. For example, last year there were strikes at foreign factories in China where workers were demanding higher wages. Well, guess which factories had the strikes—Japanese factories. These incidents cause Japanese business to be wary.

The flap concerning the rare-earth mineral embargo was particularly egregious. The timing of it was highly suspicious, coming as it did shortly after the Japanese Coast Guard arrested the captain of a Chinese fishing vessel operating in the waters off the Senkaku Islands. However, we cannot rule out coincidence.

The Chinese government announced a couple of years ago that it planned to reduce foreign shipments of rare earth minerals because greater quantities were needed at home. And they indicated that shipments would be reduced by 40 percent in 2010. Everyone knew the cut was coming. But to actually halt shipments was a surprise.

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## Approval Of KORUS, Economic Reforms From Beijing

who attended expressed alarm about the extent to which China's unfair trading practices and intellectual property theft have harmed Americans. Rep. Don Manzullo (R., Illinois), chairman of the Subcommittee on Asia, the Pacific, and the Global Environment, called on the administration and Congress to "hold China responsible" for violating international trade laws. "[China] is in fact capable of stopping violators when it is in [China's] interests to do so," he said.

Chairman Ros-Lehtinen agreed that the American people no longer should be expected to "[bear] the brunt of China's mercantile trade policies." But she seemed to be even more disturbed by China's human rights track record. "Does a responsible stakeholder refer to the Nobel Peace

You can't rule out other factors. There apparently has been rising concern in the Chinese government about unauthorized, illegal exports of rare-earth minerals. Perhaps the Japanese were buying through an unauthorized source, so the ban was a way of cracking down on the illegal exports. Maybe word went out to the provincial level that they had better check the export documents and find out whether the mines and processing firms actually were authorized to export rare-earth minerals. I offer this simply as an alternative explanation for Beijing's action.

But the fact that shipments suddenly stopped a week or so after the fishing boat incident was so curiously coincidental.

I think this episode has worried the Japanese government as well as our own government. It has undermined the perception of the reliability of China as a full participant in open markets.

And, of course, in open markets, it shouldn't be the Chinese government that establishes a quota for the export of rare-earth minerals. It should be the market that determines the outcome.

Importantly, the rare-earth mineral embargo appears to have had political ramifications. The embargo—combined with China's unwillingness to openly criticize and sanction North Korea for its sinking of a South Korean naval vessel in March 2010 and its shelling later in 2010 of South Korea's Yeonpyeong island—seems to have really cooled the pro-China stance favored by the DPJ when the party first gained power 16 months ago. China's actions appear to be driving the ruling party back toward the United States. ♦

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Prize Committee as a 'bunch of clowns' for awarding such an honor to a distinguished Chinese human rights advocate," she asked rhetorically. Importantly, several of her colleagues prefaced unrelated lines of questioning with a condemnation of China's human rights protections, in one instance even questioning the appropriateness of a State dinner for President Hu.

The creation and protection of US jobs will continue to dominate US lawmakers' consideration of US-China policy. But the new Republican-led House also will broaden its critique—and possibly target legislation—to address sensitive political, diplomatic, and security issues that the administration likely would prefer to manage without a lot of inflammatory rhetoric from Capitol Hill. ♦



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