The Changing Role of Japan in the International Trade Regime: from a Rule-Follower to a Rule-Maker

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Abstract

Japan has changed its status from a rule-follower to a rule-maker in the international trade regime in the past 60 years. When Japan joined the GATT (General Agreement on Tariffs and Trade) in 1955, it had to follow the rules that were set by the existing member nations. As Japan expected that membership would contribute in promoting its international trade, it accepted the conditions and followed the existing rules which were favorable for member countries. Major countries, especially Western countries, took advantage of their bargaining position in their negotiations. However, after 30 years, Japan reached major country status, influencing the creation of rules in the international trade regime. This paper aims to clarify the factors and the process of Japan’s changing role by comparing the structure of the world economy in the past and the present.

Comments welcome!

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Introduction

Japan changed its status from being a rule-follower to a rule-maker in the international trade regime over the past 60 years. When Japan joined the General Agreement on Tariffs and Trade (GATT) in 1955 as a new member country, it had to follow the rules that were set by the existing member nations. However, as Japan increased its international influence due to its economic development, it became a member of the four major parties in the world economy consisting of the US, EU, Japan, and Canada, which were collectively known as the ‘quad’ (Baldwin, 2016, p.106; Drezner, 2006, p.94). “Embracing common liberal democratic norms and operating within interlocking multilateral institutions, the United States, Western Europe, and, later, Japan built an enduring postwar order” (Ikenberry, 2006, p.176). Japan is no longer just a rule-follower but a rule-maker in the international economic order.

Most previous studies that examine Japan’s emerging influence focus on cases of the international financial regime including IMF and World Bank (Ogata, 1989; Rapkin, Elston, & Strand, 1997), while less research focuses on Japan’s changing status in the international trade regime, GATT/WTO. As each state generally has a specific interest in international finance and trade, “it is necessary to provide some convincing explanations of why state behavior in finance has been so different from that in trade” (Helleiner, 1996, p.201). Taking into account Helleiner’s argument, this article analyzes how Japan has increased its influence in international trade rule setting in the GATT/WTO. Since Japan is a typical example of a country that has shifted its status from a rule-follower to a rule-maker, analyzing its case contributes to understanding the process of international rule making.

When comparing between the international financial regime and international trade regime, there are similarities and differences in terms of rule-making. One of the similarities is that there is a gap between economic development and international status in international economic institutions. Even when Japan achieved economic development, it could not easily upgrade its status in accordance with its economy because dominant members were reluctant to accept its growing influence. On the other hand, one of the differences is the voting system in the rule-making process within each regime. For example, the official votes of a member country within the international financial organizations are weighed according to GDP (IMF, 2016, p.10). Hence, the result is skewed in favor of powerful states (Büthe & Mattli, 2011, chap.2). In contrast to the IMF, it is difficult to evaluate a country’s influence in GATT/WTO due to the lack of a quota system. Instead,
GATT/WTO has a ‘one country, one vote’ principle. However, since decisions of GATT/WTO are generally weak, member countries do not always follow them. Furthermore, as there are non-governmental stakeholders that operate beyond national borders including multinational companies and international non-profit organizations, they affect the GATT/WTO rule-setting process. Identifying a country’s influence seems to be complicated because the more players there are, the more issues there are to discuss.

In order to clarify the complexity of trade issues, this paper analyzes how the trade regime has been developed and why governments have shifted their priorities in trade policies while dividing the post-WWII period into two phases, namely: from the late 1940s to the 1970s and from the 1980s until the present.

1. The Expansion of International Economic Rules

Currently, in the era of globalization, the business sector develops international networks for facilitating smooth flow of products, investment, technology, information, and people across national borders. In order to meet the demands of the business sector, governments broadened the scope of international trade rules to include trade, investment, services, and intellectual property (IP) which were never considered as trade policies before. Baldwin referred to the expansion of international businesses as the ‘trade-investment-services-IP nexus’ (Baldwin, 2015, p.41).

When the ‘trade-investment-services-IP nexus’ was developed, the business sector required harmonization of rules of different countries because facilitating international economic transactions would benefit it. However, the international harmonization of rules incurs enormous costs to the business sector when multiple rules are in conflict with one another. For instance, as a result of international harmonization, firms in a particular country may have to adjust their business to the newly implemented international rules that are in conflict with existing domestic rules (Büthe & Mattli, 2011, p.9). The wider the gap between the newly implemented international rule and the existing domestic rule, the higher the costs that will be incurred by the business sector to comply with the newly implemented international rule. In order to avoid these costs, the business sector lobbies the governments to turn the situation in its favor (Büthe & Mattli, 2011, p.4).

Table 1 shows four types of international harmonization, or international rule setting, which result
from the classification of rules according to two criteria. The first criterion is whether the international rule is through market competition or not. When a selection process is based on the market mechanism, the selection is referred to as ‘market-based’. On the other hand, when the selection is done through negotiations without competition, it is evaluated as “non-market based”. The second criterion is whether rule-setting is done by a public or private entity. Based on these two criteria, it is possible to understand the four types of international rule setting as shown in Table 1.

Table 1) Types of International Standard-Setting

<table>
<thead>
<tr>
<th>Selection Mechanism</th>
<th>Rule Setting</th>
<th>Public</th>
<th>Private</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-market Based</td>
<td>(I)</td>
<td>Rule-making in a focal International Agreement; International Organization; Transgovernmental Regulatory Collaboration e.g. IMF; GATT/WTO; ILO</td>
<td>(IV) Transnational focal standard-setting body e.g. ISO; IEC</td>
</tr>
<tr>
<td>Market Based</td>
<td>(II)</td>
<td>Competing standards and rules developed by/in national, regional, or minilateral public bodies e.g. Rules regarding food safety in different countries and institutions</td>
<td>(III) Competing standards by individual firms; consortia; competing transnational standard-setting bodies, usually they are <em>de facto</em> standards. e.g. Sony's Blu-ray format won over Toshiba's HD-DVD</td>
</tr>
</tbody>
</table>

Source) Büthe and Mattli (2011), modified by the author

Until the 1980s, governments focused on Type I, the public and non-market-based international rules. Most traditional international trade rules fall under Type I where governments and international organizations (IGOs) set rules with negotiations in order to promote smooth international transactions of goods and services that contribute to the stability of the global economy.
However, while the ‘trade-investment-services-IP nexus’ has developed in the era of globalization, the business sector and governments began to expand their focus to include other types of international rules that are shown in Table 1. Type II is public and market-based international rules as a result of international competition among public regulatory agencies. Type III entails rule-making by firms or other bodies competing, individually or in groups, to establish their preferred technologies or practices as the *de facto* standard through market dominance or other strategies. Type IV is private yet non-market based rules. When countries are faced with disadvantages that result from international rules of these four types, they occasionally blame the rules as ‘non-tariff barriers (NTB)’ that prohibit international trade.

In order to have favorable conditions, governments usually aim to become rule-makers regardless of their international status not only for the benefit of the private sector, but also for national interests. However, they have limited influence in the rule setting process of the private sector because the principle of the market economy discourages governmental intervention. Even if governments influence the rule setting process, not all countries can become rule-makers since powerful states, usually developed countries, take advantage of their power in the process (Drezner, 2007, p.132-3).

2. Governmental influence in international rule setting

Traditionally, when governments discuss international rule setting, they focus on Type I in Table 1 which requires governmental coordination. As Keohane (1988) suggested, “the rules of any institution will reflect the relative power positions of its actual and potential members” (p.387). In particular, a country's economic scale affects economic rule making process. For example, official votes within international financial organizations such as IMF and World Bank, are weighed by GDP or otherwise skewed in favor of powerful states (Büthe & Mattli, 2011, chap. 2).

However, even if a country achieves economic development, it cannot automatically increase its influence in accordance with its economy because dominant members are reluctant to accept its growing influence. Furthermore, as the established powers attempt to preserve the status quo that is advantageous to them, they tend to prevent the emergence of another country (Zangl, Heußner, & Lanzendörfer, 2016, p.172). On the other hand, when an emerging country has to increase its financial contribution to maintain the existing economic order, it becomes discontent
with the status quo that is not worth the cost. Therefore, the emerging country aims to upgrade its status in order to maintain favorable conditions that are worth its contribution.

For instance, Japan remained at the fifth rank for 20 years until 1990 despite it already being the second largest economy in the world. Increasing its status had “a symbolic significance beyond the numerical size of the votes” because Japanese authorities regarded it as “the struggle over the revision of the unequal treaties” since the 19th century (Ogata, 1989, p.18). As Japan was regarded as a developing country until the 1960s when the World Bank provided loans, examining the case of Japan can contribute to understanding the relationship between the established powers and an emerging country that is in transition from being a developing country.

Previous studies that analyze Japan’s emerging influence focus on cases of the international financial regime including the IMF and World Bank by utilizing statistical data (Ogata, 1989; Rapkin et al., 1997), while less research focuses on Japan’s changing status in the international trade regime, GATT/WTO. Therefore, this paper aims to examine Japan’s changing status in GATT/WTO after discussing its status in the IMF as a comparative analysis.

Regarding the IMF, member countries influence their votes by the quota based on a weighted average of GDP (weight of 50 percent), openness (30 percent), economic variability (15 percent), and international reserves (5 percent) (IMF, 2016, p.10). Such deviations from the one-country-one-vote principle have helped the US and European countries to dominate the rule-making process in the IMF (Drezner, 2007, pp.132-3). In order to understand the influential power of IMF member countries, it is helpful to analyze the IMF quota system.

Table 2 shows the development of Japan’s voting power in the IMF. It also implies that Japan has gradually increased its voting power since joining in the IMF. Changes involving voting rights are important formal indicators of shifting power relations (Ogata, 1989, p.19). Japan had the ninth largest share (2.8%) in the IMF when it became a member country in 1953, but it achieved the fifth largest share (4.25%) in 1970, the second largest share (6.10%) in 1990, and has continued at the second rank until now. Also, since the government of Japan sent one government official to serve as IMF vice president, it seems to be a rule-maker country in the organization. However, while Japan remained at the fifth rank for 20 years in spite of the second largest economy in the world, its government was discontent with the status. In the IMF-World Bank annual meeting in September 1980, the Financial Minister argued that “appropriate adjustments need to be made so that each member’s quota share
reflects its economic reality” (Green, 2001, p.233). Japan was discontent with the existing status quo because its economic scale and contribution to the world economy brought less than its expectation.

Table 2) IMF Quota Increase for Major Countries (% (Rank))

<table>
<thead>
<tr>
<th>Quota Increase</th>
<th>US  (1)</th>
<th>Japan (2)</th>
<th>Germany (3)</th>
<th>Britain (4)</th>
<th>France (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Quota (1945)</td>
<td>36.80</td>
<td>–</td>
<td>–</td>
<td>17.40</td>
<td>7.02</td>
</tr>
<tr>
<td>After Japan joined (1953)</td>
<td>31.48</td>
<td>2.86</td>
<td>3.78</td>
<td>14.88</td>
<td>6.00</td>
</tr>
<tr>
<td>Special quota increase (1960)</td>
<td>28.89</td>
<td>3.50</td>
<td>5.52</td>
<td>13.66</td>
<td>5.52</td>
</tr>
<tr>
<td>4th quota increase (1965)</td>
<td>24.52</td>
<td>3.44</td>
<td>5.70</td>
<td>11.59</td>
<td>4.68</td>
</tr>
<tr>
<td>5th quota increase (1970)</td>
<td>23.18</td>
<td>4.25</td>
<td>5.53</td>
<td>9.69</td>
<td>5.19</td>
</tr>
<tr>
<td>6th quota increase (1976)</td>
<td>21.55</td>
<td>4.28</td>
<td>5.56</td>
<td>7.50</td>
<td>4.92</td>
</tr>
<tr>
<td>7th quota increase (1978)</td>
<td>21.51</td>
<td>4.25</td>
<td>5.52</td>
<td>7.49</td>
<td>4.91</td>
</tr>
<tr>
<td>8th quota increase (1983)</td>
<td>19.90</td>
<td>4.69</td>
<td>6.00</td>
<td>6.88</td>
<td>4.98</td>
</tr>
<tr>
<td>9th quota increase (1990)</td>
<td>19.62</td>
<td>6.10</td>
<td>6.10</td>
<td>5.48</td>
<td>5.48</td>
</tr>
</tbody>
</table>

Source: IMF Annual Report, various years.

Japan's growing influence on the IMF and World Bank was suppressed despite its economic development due to the following factors: (1) procedural constraints of the IMF and World Bank, (2) lack of support from the dominant members for Japan's growing influence within the organizations, and (3) absence of crucial events affecting the global economy. However, once these conditions were met, Japan could increase its status in the international financial regime. Every time Japan increased its voting power and its influence in IMF in 1960, 1965, 1970, and 1990, the US had critical economic problems such as increase in trade deficit and loss of value of US dollars. Since these problems caused recession in the US, most countries decreased the volume of exports to the US. Fearing global economic instability, major countries required more financial contributions from Japan to maintain the international economic order, which resulted in revising the IMF vote system and permitting Japan to upgrade its status.
3. Japan as a Rule-follower in the Trade Regime

While Japan’s status was gradually upgraded in the financial institutions, it went back and forth between being a rule-follower and a rule-maker in the trade regime. Furthermore, Japan was occasionally regarded as a ‘rule-shaker’ when its rapid export expansion caused trade friction with other countries and disturbed the existing trade system. A position as a rule-shaker becomes a hurdle to a rule-maker. When a country succeeds in solving its problems, its abilities and power to create solutions can be recognized internationally. Then, the rule-shaker position becomes a stepping stone to being a rule-maker. In contrast, when a country fails in solving its problems, it loses opportunities to prove its abilities and power in solving its problems. In this case, the rule-shaker position is a stumbling block to becoming a rule-maker. Even if a country is regarded as a rule-shaker in the short term, it can possibly become a rule maker in the long term as long as it can solve its problems.

When Japan became a GATT member in 1955, it was required to follow the GATT rules. However, even when Japan became a GATT member, Western countries, including the United Kingdom, France, Australia, and New Zealand, refused to provide Japan MFN status that treated a foreign country equally to most favored nations.

As they worried that offering MFN status to Japan would trigger massive imports from Japan and threaten their domestic industries, they invoked Article 35 of the GATT which allowed members to suspend entry into regular relations with another member state under the GATT. This policy meant that Japan lost an opportunity to acquire equal treatments from other member nations and MFN status, which provides a country the most favorable trade conditions. The case of Japan was one of rare countries where Article 35 was applied among GATT members and “no country besides Japan has ever been so widely discriminated against in the GATT system” (Komiya & Ito, 1987, p.178).

Overcoming the unfair treatment of Japan was the foremost priority for the government of Japan. In order to improve Japan’s limited status for expanding exports, Japan advanced trade liberalization policies. This is because Western European countries pressured Japan to advance its trade liberalization and used Japan’s attitude to justify their discriminative policies toward Japan. In a series of trade negotiations, the ratio of trade liberalization was employed to evaluate how the government can best dilute its administrative control over foreign exchange allocation. The government adopted the "Trade and Foreign Exchange Liberalization Program" in 1960, and the "Trade and Foreign
Exchange Liberalization Promotion Program" in 1961 to achieve further trade liberalization. As a result of these prompt measures, the ratio of trade liberalization showed a sharp increase during the short period from 1960 through 1964 (Chart 1).

In contrast to Japan’s voting share in the IMF, the rate of Japan’s trade liberalization implied Japan’s commitment in the development of the trade regime when Japan was still a rule follower. However, the rising rate of trade liberalization in Japan did not contribute to growing Japan’s influence directly because it was an obligation of both IMF and GATT.

4. The Relationship between the Political Economy Background and Japan as a Rule-shaker

When Japan was a rule-follower, it was occasionally regarded as a rule-shaker that would disturb international trade rules and system since Japan’s rapid export expansion threatened other member countries. In order to prevent the international trade disorder, the Japanese government implemented “voluntary” export restraint (VER) measures in order to prevent a worsening of trade friction. If Japan
left the friction unsolved, it would decrease its export opportunities because other countries could impose severe restrictions on its goods. After the Japanese government decided to take steps to “promote a more orderly development of trade” in specific industries (Curzon & Curzon, 1976, p.260), it succeeded in showing its abilities and power to prevent the international trade disorder.

VER measures were developed in other industries such as the steel and automobile industries. Furthermore, it was implemented multilaterally because other exporters (Hong Kong and Taiwan) increased their textile exports rapidly after Japan’s VER worked well. Japan’s bilateral VER could no longer protect American industries. As domestic political pressure increased too much to ignore, the US government proposed to multilateralize and legalize VER under the GATT (Curzon & Curzon, 1976, p.259). Other countries also agreed to the US proposal in order to reduce further protectionist pressure internationally.

A series of VER measures were expected to avoid international trade disorder although they were against the free trade rules of GATT. Bhagwati mentioned multilateral VERs were “like getting the pope to preside over a pagan rite” (Bhagwati, 1989, p.11). It is important to consider that trade liberalization and VER were developed together since the late 1950s. The development of VER was a step for Western countries toward maintaining the international trade system while accommodating emerging economies. VER was a convenient policy tool for governments because they could show their pro-active attitude toward reducing trade friction. When establishing VER, Japan was a major negotiator country as a rule-shaker that could potentially disrupt the existing trade system. Japan’s rule-shaker position regarding VERs became a stepping stone to being a rule-maker later.

Tracing the political economy background reveals critical factors of why and how Japan shifted its status from a rule-follower to a rule-shaker, then to a rule-maker while dividing the post-WWII period into two phases, namely: from the late 1940s to the 1970s and from the 1980s until the present.

The first phase, from the late 1940s to the early 1970s, was based on the liberal international economic order under the Bretton Woods System (BWS). The BWS was established in order to stabilize the world economy after WWII by promoting international economic transactions that particularly required trade liberalization (Ikenberry, 2006, p. 179). However, domestic industries and labor groups hesitated to support the trade liberalization because it would increase imports and international competition. Generally speaking, trade liberalization focuses on the allocation of resources through free markets beyond national borders, whereas a democratic society affects
allocation of power through electoral votes within national borders (Blyth, 2016, p.172). Since domestic industries and labor groups influenced national elections under democracy, the founders of the BWS needed to find a balance between promoting trade liberalization and stabilizing domestic politics. Therefore, the BWS was based on a complex concept that pursued trade liberalization in principle, but also permitted governmental interventions to secure domestic stability if needed. Ruggie (1983) labelled this complex concept as ‘embedded liberalism.’

Under the BWS, GATT member countries focused on measures to control imports while promoting trade liberalization in the context of embedded liberalism. For example, when Japan became a GATT member in 1955, the US took the initiative to offer Japan favorable trade conditions such as lowering trade barriers. However, in spite of the US recommendation, Western European countries did not provide Japan the most favored nation treatment (MFN) since they considered negative domestic opinions that might increase imports from Japan. As a new member country, Japan needed to accept the unfavorable trade conditions and aimed to improve its own status.

During the first phase, Japan experienced its transition from a rule-follower to a rule-maker due to its economic development under the BWS. When Japan’s economy was unstable until the 1950s, Japan required the US economic and political support. In order to promote its export and economic development, Japan attempted to join the GATT, although Western European countries remained negative to accept its membership. On the other hand, the US supported Japan to become a member in the GATT because the US government considered that the stable economy of Japan contributed to its own interest in the Cold War era.

However, in the early 1960s, when the US faced an increasing trade deficit and economic downturn, the US ceased to offer favorable conditions to Japan because American industries and labor groups requested the government to protect domestic markets from other countries. Furthermore, since the US could no longer have economic dominance in the world, it demanded Japan to share the financial burden for maintaining the international economic order. While Japan gradually contributed to the stability of the international economic order, it began to increase its influence and gradually improved its status in the trade regime under the BWS in the first phases after WWII.

5. The Political and Economic Background of Japan as a Rule-maker in the Trade Regime
The second phase, from the 1980s to the 2000s, was under the Washington Consensus System (WCS) (Skidelsky, 2009, pp. 114-123). The WCS was based on neoliberalism that emphasized market economy, free trade, and few economic regulations. Hence, the dominant economic principle shifted from ‘embedded liberalism’ to ‘disembedded liberalism’, in which market forces were given a stronger role (Blyth, 2002, pp.119-23). The business sector aimed to develop international networks in order to facilitate the smooth flow of products, investment, technology, information, and people in the era of globalization. In order to meet the demands of the business sector, governments broadened the scope of international trade rules to include trade, investment, services, and intellectual property (IP) which were never considered as trade policies before. Baldwin referred the expansion of international businesses as the ‘trade-investment-services-IP nexus’ (Baldwin, 2015, p. 41).

In the previous section, we discussed the role of Japan in GATT during the BWS period. GATT was supported by the overwhelming economic strength of the United States after WW II. According to the hegemonic stability theory, the decline of the dominant country would cause instability of the international economic order including the trade regime. However, even when the dominant power of the US was starting to decline, the US still influenced the international trade rule-setting process while introducing new norms favorable to the country. While traditional trade rules were based on controlling cross-border measures that targeted transactions across national boundaries, new norms focus on measures within other country’s territory that is referred to as behind the border measures.

The turning point was the Uruguay Round (1986-94) where 123 countries participated in order to negotiate the establishment of the new trade regime, WTO. In the Uruguay Round, there were major achievements in the trade negotiations as follows: (1) agricultural trade and policies, (2) Trade in Services (GATS), (3) Intellectual Property Rights (TRIPS Agreement), and (4) International Investment (TRIMs Agreement). The latter three items (2 to 4) were new fields where the business sector required to the ‘trade-investment-services-IP nexus’ behind national borders.

Japan played a rule-maker part in the negotiation of the new fields because Japan’s business sector increased its foreign direct investment (FDI) all over the world and expanded its presence in the global economy. Japan’s growing influence resulted from not only its economic development but also its business sector presence in the world. Based on these two factors, Japan increased its international influence and a member of the four major parties in the world economy consisting of the US, EU, Japan, and Canada, which were collectively known as the ‘quad’ (Baldwin, 2016, p.106; Drezner, 2006,
p.94). Japan was not the only rule-maker but a group of rule-makers although it achieved upgrading its status that aimed before.

Conclusion

Currently, as Nye pointed out, “the openness that enables the United States to build networks, maintain institutions, and sustain alliances is itself under siege” (Nye, 2017, p.14). Therefore, “maintaining networks, working with other countries and international institutions, and helping establish norms to deal with new transnational issues are crucial” (Nye, 2017, p.16). Among transnational issues, this paper considers the development of the international trade regime that influences the global stability while focusing on the case of Japan.

International trade regime in the post-WWII have been operated within “a liberal rule-based order” that based on international rules regarding economic openness, reciprocity and shared decision-making (Ikenberry, 2006, pp.3-10). When the US and European countries cooperated to establish the international economic systems, they took the leadership in revising rules and had advantage over other countries. However, due to the rise of emerging countries, European countries and the US have been concerned that they would become rule-followers rather than rule-makers when emerging countries began to have international influence (Hamilton and Pelkmans, 2015, pp.2-3).

While the existing rule-makers holding dominant power, rule-follower countries tend to be discontent with the international rules because they have less profits than that of rule-maker countries. In particular, when emerging countries remain rule-followers that hold less power in establishing or revising rules, they are unsatisfied with the status quo because their economic contribution to the international economic order benefit them little. While emerging countries aim to upgrade their international status from rule-followers to rule-makers, dominant countries generally hesitate to permit such attempts for fear of losing influence.

On the other hand, dominant countries need to accept the rise of emerging countries as rule-makers if they need the engagement of emerging countries with the existing international rules in order to avoid international disorder. Japan was a typical example that changed its status from a rule-follower to a rule-maker in the international trade regime. Analyzing the case of Japan can contribute to understanding not only how a country increased its influence, but also why the international trade
system is needed to be revised for meeting the demands of the times.

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1 While referring to Büthe and Mattli (2011), we use the terms international rules and standards interchangeably.
2 The Bretton Woods era ended in the early 1970s when the US abandoned the US dollar's convertibility into gold in 1971 and when the first oil shock happened in 1973 (Skidelsky, 2009, p.115).