

## **An Evaluation of Japan's Recent Safeguards Actions**

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## 1. Introduction

In April 2001, Japan took its first step in implementing provisional safeguard measures under the Agreement on Safeguards against imports of Welsh onions, Shiitake mushrooms and Tatami mats. With certain exceptions, Japan has rarely resorted to such aggressive measures to this day, while subject to protectionist measures taken by other member countries of the World Trade Organization (WTO). The specific exceptions include the implementation of special safeguard (SSG) measures under the WTO Agreement on Agriculture. These measures may only be implemented against imports of agricultural products tariffed under the scope of the Uruguay Round negotiations. Japan has implemented the SSG measures 47 times so far against imports of rice, butter, milk, starch and other products (Table 1.1).<sup>1</sup>

**Table 1.1 Special safeguard (SSG) actions taken by Japan after the establishment of WTO**

	Number of SSG actions taken	Targeted products
1995	3	Starches, Whey, Milk powder
1996	5	Raw silk, Inulin, Milk powder, Buttermilk, Azuki Beans
1997	6	Meat of Swine, Raw silk, Evaporated milk, Inulin, Condensed milk, Milk and cream
1998	2	Condensed milk, Inulin
1999	6	Food preparations (containing natural milk), Wheat starch, Condensed milk, Starches, Milk powder, Inulin
2000	8	Peas, Food preparations (containing natural milk), Starches, Wheat flour, Butter, Inulin
2001	7	Buttermilk, Food preparations of flour, meal or starch, Other fats and oils derived from milk, Milk and cream, Manioc starch
2002	4	Buttermilk, Rice, Rice flour, Wheat preparation
2003	3	Beans, Food preparations containing starch
2004	3	Butter, Inulin, Corn starch
<b>Total</b>	<b>47</b>	

Source: Author's compilation from notifications (G/AG/N/JPN/\*) to WTO by Japan.

Upon implementing SSG measures, the Agreement on Agriculture unlike the Agreement on Safeguards does not require member countries to establish the existence of a causal link between increased imports of the product concerned and a serious injury to the domestic industry<sup>2</sup> or to disclose detailed results from relevant investigations.<sup>3</sup> Thus, while SSG measures were relatively easy to implement, the Government of Japan did not necessarily actively disclose such information to the public.

As seen above, it can be said that although Japan had frequently implemented SSG measures, it

<sup>1</sup> As of April 30.

<sup>2</sup> Article 4.2(b) of the Agreement on Safeguards.

<sup>3</sup> Article 3.1 of the Agreement on Safeguards.

is one of the major industrialized countries with relatively little to no experience in implementing other measures (Table 1.2).

**Table 1.2 Trade policy measures taken by major countries after the establishment of WTO**

		US	EU	Canada	Australia	Japan
Safeguard measures under the Agreement of Safeguards (-Dec. 2003)	Investigation initiated	11	2	1	1	1
	Provisional measures	0	2	0	0	1
	Definitive measures	6	1	0	0	0
Anti-Dumping measure (-Dec. 2002)	Investigation initiated	292	267	107	155	2
Countervailing Duty (-Jun. 2002)	Investigation initiated	120	58	24	13	0
Transitional Safeguards (TSG) under the Agreement on Textile and Clothing (-Dec. 2002)	Invocation	26	0	0	0	0

Source: METI [2004].

For example, the number of safeguard and anti-dumping measures implemented by Japan is considerably limited compared to other member countries. Moreover, Japan has never resorted to Countervailing Duties or Transitional Safeguard (TSG) measures under the Agreement on Textile and Clothing. The reasons for this include that i) Japan has remained relatively competitive for most industrial products and has not encountered circumstances requiring protection of domestic industries; ii) Japan has responded with SSG measures in dealing with agricultural products tariffed as a consequence of the Uruguay Round negotiations; and iii) agricultural products that were either tariffed or liberalized before the Uruguay Round negotiations included fresh foodstuffs that could not be readily traded due to constraints in transportation and preservation technologies.<sup>4</sup> However, due to new innovations in food transportation and preservation technologies and progress in “develop-and-import schemes” in agricultural business in Asian countries, a gradual increase in the number and variety of fresh agricultural imports was seen. There is no doubt that such changes in the trade environment did have an impact on the increased imports of these products subject to the provisional safeguard measures in 2001.

Incidentally, most of the trade issues covered by the Japanese media heretofore relate to either Japan’s import liberalization or protectionist measures taken against Japan by other countries. Therefore, while provisional in nature, the safeguard measures implemented by Japan for the first time drew great media attention, and furthermore helped raise the awareness of both consumers and

<sup>4</sup> The first and third factors were based on a speech given by Mr. Tamotsu Takase at the Research Institute of Aoyama Gakuin University on October 17, 2001.

importers on the negative impacts of “raising tariffs”. Moreover, as China’s retaliation against Japan’s safeguard measures caused further complications, a succession of events in 2001 also provided an opportunity for heated domestic discussions for the first time ever on questions such as “What is the national interest in trade policy?” and “How should we seek to strike a balance between the promotion of free trade and the protection of domestic industries?”

This paper seeks to first sort out the economic and political economy implications upon implementation of the safeguard measures, then to review and evaluate the provisional safeguard measures implemented by Japan in 2001, and the retaliation measures taken by China against Japan, and finally to consider the institutional issues and recommendations for the direction Japan should take in future trade remedy measures.

## **2. Theoretical Rationales for Safeguard Measures (Survey of Previous Studies)**

In this chapter, theoretical rationales for the implementation of safeguard measures and the existence of such rules are discussed from several viewpoints, along with a review of counterarguments against these views.

### **(1) Efficiency (Minimization of Social Adjustment Costs)**

According to conventional economics, if trade liberalization brings about an increase in imports in an economy, it is assumed that through the price mechanism, the factors of production such as labor and capital would eventually be optimally reallocated within or between industries. On the other hand, in a more dynamic view of the economy, factors of production would not be immediately reallocated in response to a change in the market environment. For example, if wage rigidities and other market failures exist, smooth adjustments would not be realized, resulting in a decrease in production volume or social adjustment costs, caused by the emergence of involuntary unemployment and/or idle capital.<sup>5</sup> Thus, the justification for avoiding a sudden increase in imports lies in preventing an undue expansion of social adjustment costs and in providing a temporary time period for domestic firms and workers to facilitate taking the necessary measures for adjustment within or between industries. However, can the safeguards be described as the first-best policy for the minimization of social adjustment costs?

The first-best policy to minimize social adjustment costs is to take domestic measures, such as granting subsidies for firms or retraining programs for workers to offset market failures that hamper smooth adjustments.<sup>6</sup> Safeguards in the form of tariff increases or quantitative restrictions would

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<sup>5</sup> Baldwin [1984] pp.590-595.

<sup>6</sup> On the other hand, if these domestic measures are to effectively function as tools to substitute the safeguard

raise prices of imported goods, deteriorate consumer welfare, and could eventually bring down the social welfare of a nation as a whole.

Furthermore, a number of views disfavor the implementation of safeguards from the standpoint of economic efficiency. First, while the Agreement on Safeguards limits time period of measures<sup>7</sup>, there is no guarantee that needed social adjustments are realized during the period of application. There are arguments that once import restrictions are introduced, the protection they provide tends to become permanent and that the implementation of the safeguard measures would inhibit self-innovative efforts by firms, thereby regressing in progress crucial for necessary adjustments.<sup>8</sup> Second, from the viewpoint of efficiency and equity, distinguishing the damages caused to domestic firms and workers by an “increase in imports” from damages by other factors such as recession or a change in consumer preferences, and providing the former with preferential remedies is called into question.<sup>9</sup> Third, it should not be forgotten that, while the Agreement on Safeguards prohibits retaliation against a WTO-consistent safeguard for the first three years that a safeguard measure is in effect, implementation of safeguards against a non-member country of WTO, implementation of WTO-inconsistent safeguards are associated with the risk of retaliation by an exporting country.

As seen above, the safeguard measures could bring a number of potential costs upon implementation. It has been suggested that one of the reasons safeguard measures are implemented instead of domestic measures despite this fact is that by passing on the cost of protecting an inefficient industry to foreign firms instead of taxpayers, it would be less likely to generate a “sense of inequality” at home, thus limiting political damage to politicians.<sup>10</sup>

## **(2) Political Safety Valve**

While a number of limitations and side effects exist for safeguard measures as a means to prevent expansion of adjustment costs, there is a view that in the long run, the existence and implementation of safeguard rules are essential in order to cope with protectionist pressures. Notably, this is an argument of a “political safety valve” function inherent in safeguard measures. This argument explains that when a country faces a drastic increase in imports as a consequence of trade liberalization, and an undermined domestic industry begins to feel the burden of adjustment costs, implementation of safeguards serves as a “safety valve” in containing an excessive rise in protectionist pressures.<sup>11</sup> In other words, the logic of this argument is that in the absence of a safety

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measures, there should be a domestic system in place under which these measures can be implemented at any time as an “emergency” tool in the event of a sharp increase in imports.

<sup>7</sup> Article 7 of the Agreement on Safeguards.

<sup>8</sup> See e.g. Lapham and Ware [2001]; Kohler and Moore [2001].

<sup>9</sup> Trebilcock and Howse [1999] p.232.

<sup>10</sup> ibid p.232; Kimura [2003] p.78.

<sup>11</sup> Jackson *et al* [1995] pp.601-602.

valve that works under transparent rules such as safeguards, it would be impossible to control the pressure when protecting domestic industries in the event of a drastic increase in imports and could thus lead to the execution of “gray area measures” such as Voluntary Export Restraint (VER).

### **(3) Public Choice Perspective**

Sykes [1991] maintains, from the perspective of public choice theory, that the existence of safeguard rules has the function of minimizing future political risks that politicians of an importer country face at the time of trade negotiations, thus promoting trade liberalization. According to public choice theory, the policy-making process in a democratic state does not necessarily guarantee the choice of an efficient policy, and politicians are expected to seek to maximize their own interests for the purpose of obtaining votes and monetary contributions. For this reason, the theory leads to a conclusion that in trade policy, the interests of special interest groups highly capable of lobbying activities and raising contributions tend to take precedence over the interests of unorganized entities such as consumers.

If safeguard rules did not exist and import-restrictive measures could not be taken even in the state of an emergency, politicians of an importing country could very well risk losing their support base after liberalizing their domestic market. However, if safeguard measures are available, it is possible for politicians to maintain leeway to gain political payoff by protecting an injured domestic industry by implementing safeguards even after liberalization. Needless to say, implementation of the safeguards entails the risk of retaliation by exporting countries as well as the risk of losing support from domestic industries affected by such retaliation. Thus, it would be reasonable for politicians in an importing country to implement safeguard measures only when the implementation of the safeguard measures is considered to bring a net gain in political payoff for them.

## **3. Japan’s Experience of Implementing Provisional Safeguards in 2001**

As previously described, Japan implemented provisional safeguard measures under the Agreement on Safeguards against imports of Welsh onions, Shiitake mushrooms and Tatami mats in April 2001. As a full investigation and actual implementation of the provisional safeguard measures under the Agreement on Safeguards were both firsts for Japan, there was major domestic controversy on the pros and cons of such trade measures. This chapter discusses the developments surrounding Japan’s implementation of the provisional safeguard measures, the corresponding retaliation by China, and then an evaluation of a series of relevant events.

## (1) Background and Contents of the Safeguard Measures

On December 22, 2000, the Government of Japan initiated a safeguard investigation according to Article 9 of the Customs Tariff Law (Table 3.1). Behind the rising momentum for the implementation of the safeguards were first of all, changes in the external environment as described at the introduction of this paper; that is, the innovation of food transportation, preservation technologies, progress in technological transfers and direct investment in agricultural business in Asian countries. As a result of these changes, imports of agricultural products formerly unfit for active trade increased, and the demand for protective measures from domestic producers increased accordingly. In addition, it should be noted that elections for the House of Representatives **were** scheduled to take place in July 2001. Viewed from the perspective of the aforementioned public choice theory, implementation of the safeguard measures appeared to be a perfect opportunity to garner election votes for politicians whose main support came from the agricultural sector. In fact, it was stipulated that the Research Commission on Trade in Agriculture, Forestry and Fishing Products of the Liberal Democratic Party (LDP) was the driving force behind the implementation of the provisional safeguard measures.<sup>12</sup>

**Table 3.1 Chronology of Japan's provisional safeguards and retaliation by China**

2000/12/22	<b>Initiation of investigation by the Government of Japan (GOJ) according to the Customs Tariff Law</b>
2001/3/23	Release of “evidence on the urgent necessity to take a provisional safeguard measures”
4/13	Consultation with China in Beijing (Vice-Minister level)
4/17	Cabinet decision on “The Cabinet Order Concerning the Imposition of the Provisional Emergency Duties on Welsh Onion etc., No. 167”
4/20	Notification to WTO
4/23	<b>Invocation of provisional safeguard measures (for 200 days)</b>
6/22	<b>Retaliation by China through imposing special custom duties (100%) on mobile and car phones, Air conditioners, and Automobiles imported from Japan</b>
7/3,4	Consultation with China in Beijing (Director General level)
7/29	<b>Election for the House of Representatives</b>
9/24	Consultation with China in Beijing (Director General level)
10/8	Meeting between Prime Minister Junichiro Koizumi and Prime Minister Zhu Rongji in Beijing
	Meeting between Prime Minister Junichiro Koizumi and President Jiang Zemin in Shanghai
10/31	Release of “summary of major index investigated by the government”
11/1	Consultation with China in Beijing (Director General level)
11/8	<b>Expiration of Japan's provisional safeguards</b>
11/22	Consultation with China in Beijing (Director General level)
12/11	China officially became a member of WTO
12/11	Consultation with China in Beijing (Minister level)
12/19	Consultation with China in Tokyo (Vice-Minister level)

<sup>12</sup> Suzuki [2003] p.104.

12/21	Consultation with China in Beijing (Minister level) ( <b>Conflict resolved, establishment of “Agricultural Products Trade Council” agreed</b> )
12/21	End of investigation by the GOJ
12/27	<b>Removal of special custom duties by China</b>

Source: METI's web site ([http://www.meti.go.jp/policy/trade\\_policy/safeguard/](http://www.meti.go.jp/policy/trade_policy/safeguard/)).

In March 2001, the government published “Evidence on the urgent necessity to take provisional safeguard measures against imports of Welsh onion, Shiitake mushroom and Tatami mats.” On the basis of the preliminary results of the investigation, Japan implemented the provisional safeguard measures (tariff-rate quotas) for a period of 200 days from April 23, and adopted the prohibitive secondary tariff rate for the three products (Table 3.2). The LDP won an overwhelming victory in the Upper House election in July, but the victory was generally ascribed to the “(Prime Minister) Koizumi boom,” thus it is highly unlikely that the implementation of the safeguards swayed the overall election outcome.<sup>13</sup>

**Table 3.2 Provisional safeguard measures taken by Japan in April 2001**

	<i>Trends in tariff rate</i>			Tariff for imports below quota	Tariff quota for 200 days	Secondary tariff for imports above quota
	1996	1998	2000			
Welsh onion	4.3%	3.7%	3.0%	3.0%	5,383 (MT)	256.0%
Shiitake mushroom	4.8%	4.5%	4.3%	4.3%	8,003 (MT)	266.0%
Tatami mats	6.9%	6.0%	6.0%	6.0%	7,949 (MT)	106.0%

Source: WTO (G/SG/N/7/JPN/1, G/SG/N/11/JPN/1, 25 April 2001).

## **(2) Results of the Investigation by the Government of Japan**

The following is an overview of the market situation for the three products Japan implemented provisional safeguard measures on (Tables 3.3-3.5). As the three tables indicate, imports of the three items clearly increased in the five preceding years, with the share of imports in the domestic market rising as well. Average domestic prices also declined, and domestic production and shipments dropped, except for Welsh onions. In its notification to the WTO on the basis of results from the government's investigations, Japan concluded that the “increase in imports caused serious damage to domestic industries” for all three products.<sup>14</sup> However, it must be noted that the methodology and conclusions of the government's investigations pose several statistical and interpretative problems.

<sup>13</sup> However, it is well worth noting that the LDP candidates elected had collected the most votes in Chiba Prefecture which had the largest number of Welsh onion producers in Japan in 2000, in Gunma Prefecture which produced the largest amount of fresh Shiitake mushrooms, and similarly in Kumamoto Prefecture which had the largest number of producers of Igusa rush used in Tatami mats. The results of the 2001 Upper House election were based on the Nihon Keizai Shimbun website. ([http://www.nikkei.co.jp/flash1/prompt\\_elected/index.html](http://www.nikkei.co.jp/flash1/prompt_elected/index.html))

<sup>14</sup> G/SG/N/7/JPN/1; G/SG/N/11/JPN/1

**Table 3.3 Results of the investigation by the Government of Japan (Welsh onion)**

	Unit	1996	1997	1998	1999	2000
Imports (a)	MT	1,504	1,471	6,802	21,197	37,375
	% change		-2.2%	362.4%	211.6%	76.3%
Domestic Shipping Volume (b)	MT	415,900	417,300	398,200	401,400	416,600
	% change		0.3%	-4.6%	0.8%	3.8%
Market share of imported onion (a/a+b)	%	0.4%	0.4%	1.7%	5.0%	8.2%
Total Supply (a+b)		417,404	418,771	405,002	422,597	453,975
Average price of domestic onion	yen/kg	252	278	340	300	222
Total labor hours	1,000 hours	50,772	46,438	43,244	37,810	34,130

Source: WTO (G/SG/N/7/JPN/1, G/SG/N/11/JPN/1, 25 April 2001).

**Table 3.4 Results of the investigation by the Government of Japan (Shiitake mushroom)**

	Unit	1996	1997	1998	1999	2000
Imports (a)	MT	24,394	26,028	31,396	31,628	42,057
	% change	-7.3%	6.7%	20.6%	0.7%	33.0%
Domestic Shipping Volume (b)	MT	75,157	74,782	74,217	70,511	67,224
	% change		-0.5%	-0.8%	-5.0%	-4.7%
Market share of imported Shiitake (a/a+b)	%	24.5%	25.8%	29.7%	31.0%	38.5%
Total Supply (a+b)		99,551	100,810	105,613	102,139	109,281
Average price of domestic Shiitake	yen/kg	1,079	1,041	980	949	915
Number of farms		50,772	46,438	43,244	37,810	34,130

Source: WTO (G/SG/N/7/JPN/1, G/SG/N/11/JPN/1, 25 April 2001)

**Table 3.5 Results of the investigation by the Government of Japan (Tatami mats)**

	Unit	1996	1997	1998	1999	2000
Imports (a)	1,000 sheets	11,369	8,628	10,344	13,569	20,300
	% change		-24.1%	19.9%	31.2%	49.6%
Domestic production (b)	1,000 sheets	26,937	25,088	21,302	15,923	13,872
	% change		-6.9%	-15.1%	-25.3%	-12.9%
Market share of imported Tatami (a/a+b)	%	29.7%	26.6%	32.7%	46.0%	59.4%
Total Supply (a+b)		38,306	33,716	31,646	29,492	34,172
Average price of domestic Tatami	yen/sheet	1,302	1,200	974	1,033	970
Number of farms		4,416	4,106	3,582	2,817	2,244

Source: WTO (G/SG/N/7/JPN/1, G/SG/N/11/JPN/1, 25 April 2001).

#### **(a) Welsh onions**

The average domestic price of Welsh onions in 2000 fell in comparison with the 1998 price, but

the average price for 1998 sharply rose because of a bad crop due to the impact of typhoons.<sup>15</sup> The 2000 price did not markedly decline (-11.9%) from the 1996 level. Domestic shipments almost leveled off from 1996, and shipments in 2000 actually rose over those in 1999. These facts leave the question open as to whether domestic industries actually faced a “serious injury” as defined in the Agreement on Safeguards, or were in a state of “a significant overall impairment in the position of a domestic industry”.<sup>16</sup>

Moreover, statistics for import volumes used in the government’s investigations were only for “fresh or chilled Welsh onions,” which showed extremely large import increase rates of 362.4% for 1998 and 211.6% for 1999. However, as Table 3.6 shows, the high import increases are partially due to the fact that the “frozen Welsh onions” which accounted for over 90% of all imported Welsh onions in 1995 had gradually been displaced by “fresh or chilled Welsh onions,” but the government’s investigations made no mention of these facts. The imports of all Welsh onions, or imports of fresh or chilled Welsh onions combined with imports of frozen Welsh onions, showed more moderate rates of increase than the increases provided in the government’s investigations.

**Table 3.6 Trends in imports of “Fresh or chilled onion” and “Frozen onion”**

	Unit	1995	1996	1997	1998	1999	2000
Fresh or chilled onion (a)	MT	475	1,505	1,475	6,807	21,278	37,411
	% change		217.1%	-2.0%	<b>361.4%</b>	<b>212.6%</b>	<b>75.8%</b>
Frozen onion (b)	MT	5,253	3,953	5,545	4,703	8,454	185
	% change		-24.7%	40.3%	<b>-15.2%</b>	<b>79.7%</b>	<b>-97.8%</b>
Total (a+b)	MT	5,727	5,458	7,020	11,510	29,732	37,596
	% change		-4.7%	28.6%	<b>64.0%</b>	<b>158.3%</b>	<b>26.5%</b>
Share of Frozen welsh onion (b/a+b)	%	91.7%	72.4%	79.0%	40.9%	28.4%	0.5%

Source: Plant Protection Station, *Statistics on plant quarantine*. (<http://www.pps.go.jp>).

Note: The number in the table above shows import volume of ex-quarantine.

### **(b) Shiitake mushrooms**

As for Shiitake mushrooms, there appears to be no apparent potential statistical problems. However, the rates of decline in domestic shipment volume in 2000 (-4.7% from 1999) and in the average domestic price (-3.6%) were not considerably large. Similar to the case of Welsh onions, it is open to question whether the domestic industry really faced a “serious injury” as defined in the Agreement.

### **(c) Tatami mats**

Out of the three products, the method and interpretation of the investigation for Tatami mats

<sup>15</sup> The Nihon Keizai Shimbun, morning edition, p.29, June 5, 1998.

<sup>16</sup> Article 4.1(a) of the Agreement on Safeguards.

poses the biggest question. Firstly, as Kimura [2003] pointed out, domestic shipments began to decline well before sharp increases in imports. The total supply, or the combined volume of domestic shipments and imports had also continued to decrease since 1996. When these two facts of the decline in total supply and a decline in prices are applied to the simple partial equilibrium model, it seems highly likely that the decline in domestic shipment volumes stemmed partially or fully from the drop in domestic demand with a downward shift in the domestic demand curve.<sup>17</sup> Therefore, the possibility cannot entirely be ruled out that recognition of an injury as a result of the government's investigation had deviated from the "non-attribution rule" of the Agreement on Safeguards that "when factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to increased imports."<sup>18</sup>

Furthermore, in the case of Tatami mats, a major scandal that shook the very basis of the credibility of the government's investigation came to light on November 15, after the completion of provisional safeguard measures. The Ministry of Finance acknowledged that the trade statistics used in the government's investigation were flawed.<sup>19</sup>

Normally, Tatami mats should be classified as an item in the category of "Products of plaiting materials of Igusa" (HS: 460191210). However, some customs offices prior to September 1999 classified and counted them as a separate item in the category of "Mats, matting and screens of Igusa" (HS: 460120010). All customs offices started following the correct classification beginning with the statistics for September 1999, but this resulted in a sharp increase in the apparent volume of Tatami mat imports from 1998 to 1999 (Table 3.7). The government used the inaccurate statistics in recognizing the "sharp increase in imports" and decided to implement the provisional safeguard measures. Although accurate statistics do not exist for the actual import volume of Tatami mats that should have been used in the investigation, when combining both import volumes of the two items miscategorized until 1999, the rate of increase in imports was actually negative for 1999 and very limited at 11.7% even for 2000.

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<sup>17</sup> Kelly [1988] p.192; Irwin [2003] p.19.

<sup>18</sup> Article 4.2(b) of the Agreement on Safeguards.

<sup>19</sup> The Asahi Shinbun, morning edition, p.1, November 16, 2001.

**Table 3.7 Statistical impact of a change in commodity classification in September 1999**

	Products of plaiting materials of Igusa (a)	Mats, matting and screens of Igusa (b)	Total (a+b)		Share of (a) (a/a+b)		
HS	460191210		460120010				
Unit	MT	% change	MT	% change	MT	% change	%
1995	23,471		14,687		38,158		61.5%
1996	19,327	-17.7%	19,504	32.8%	38,831	1.8%	49.8%
1997	14,668	-24.1%	19,862	1.8%	34,530	-11.1%	42.5%
1998	17,584	19.9%	19,767	-0.5%	37,352	8.2%	47.1%
1999	23,068	<b>31.2%</b>	14,215	<b>-28.1%</b>	37,282	<b>-0.2%</b>	<b>61.9%</b>
2000	34,510	<b>49.6%</b>	7,149	<b>-49.7%</b>	41,659	<b>11.7%</b>	<b>82.8%</b>

Source: Ministry of Finance, *Japan Exports & Imports: Commodity by Country*.

### (3) China's Retaliation on Imports from Japan and Resolution of the Conflict

For each of the three products for which Japan implemented the provisional safeguard measures, imports from China accounted for approximately 99% of Japan's imports in 2000.<sup>20</sup> The Chinese government requested Japan to immediately remove the safeguard measures, insisting that "Japan's action of implementing the safeguard measures only against products for which China has high import shares while there were also other products whose imports sharply increased, is discriminatory and violates the basic principles of the WTO," "the stagnation of Japanese agriculture has been caused by the inefficient industrial structure and the lack of competitiveness," and "the investigation by the Japanese government is arbitrary and its causality analysis is insufficient."<sup>21</sup> Subsequently, China implemented retaliatory measures on June 22, 2001 by imposing a special 100% custom duty on automobiles<sup>22</sup>, air conditioners (excluding parts thereof), and mobile and car phones imported from Japan, leading to a major trade dispute between Japan and China. Incidentally, at the time of this trade friction, major Japan-China economic organizations were chaired by top executives of an automaker (Toyota Corp.) an air conditioner manufacturer (Toshiba Corp.) and a mobile telephone maker (Matsushita Electric Industrial Co.).<sup>23</sup> There is speculation that China intentionally targeted these products in its retaliation to force Japan to withdraw the safeguard measures by effectively dividing public opinion in order to put pressure on the Japanese government.

The Japanese government rebutted that "China's retaliatory measures are in violation of both the

<sup>20</sup> In 2000, China commanded an import market share of 99.0% for Welsh onions, 99.8% for Shiitake mushrooms, and 99.9% for Tatami mats. The figure for Welsh onions is based on plant quarantine statistics (in terms of volume) of plant quarantine stations and that for Shiitake mushrooms and Tatami mats on trade statistics (in terms of prices) of the Ministry of Finance.

<sup>21</sup> The Chinese Ministry of Foreign Trade and Economic Cooperation, "Japan's Safeguard Measures Violate WTO Rules," the website of the Chinese Embassy in Japan (<http://www.china-embassy.or.jp/jpn/14015.html>).

<sup>22</sup> Passenger cars, buses, trucks, crane vehicles, and cement mixer trucks.

<sup>23</sup> At the time, the Japan-China Economic Association was headed by an executive adviser of Toshiba Corp., the Japan-China Investment Promotion Organization by an honorary chairman of Toyota Motor Corp., and the Japan-China Economic Relations and Trade Center by an executive adviser of Matsushita Electric Industrial Co. The Sankei Shimbun, Tokyo morning edition, p.7, June 20, 2001.

principles of most-favored-nation treatment under the Japan-China Trade Agreement and dispute settlement rules of the WTO,” apparently creating an extremely tense trade situation. However, since Japan was faced with the approaching deadline of the investigation and expiration of the provisional safeguard measures in October, and China was nearing the date of the accession to the WTO, the two countries held numerous rounds of consultations, and finally reached an agreement on December 21 to resolve the string of bilateral trade disputes. The agreements stipulated that i) Japan should avoid the implementation of the definitive safeguard measures; ii) China should suspend the retaliatory measures; and iii) a private-sector “Agricultural Products Trade Council” should be established in order to secure “orderly trade” between the two countries with the purpose of exchanging information on demand, the quality of products, production volumes and prices and also keeping track of production, demand and trade conditions<sup>24</sup>. While the purpose of newly established council is not to control trade volume, but to “exchange information” among “private entities”, there is a possibility that this scheme violates Article 11 of the Agreement on Safeguards, which prohibits voluntary export restraints (VER), orderly marketing arrangements, or any other similar measures, since government officials are also participating in this council and promoting “orderly trade.”<sup>25</sup>

#### **(4) Adjustment Assistance Program for the Relevant Industries**

As stated in Chapter 2, one of the factors justifying the implementation of the safeguard measures is its function of providing a temporary period of time to affected domestic firms and workers to smoothly take the necessary measures within and between industries to prevent an undue expansion of social adjustment costs. When the United States invokes safeguard measures under Section 201 of the Trade Act of 1974, it is common practice to correspondingly implement Trade Adjustment Assistance (TAA) programs also stipulated under the Act<sup>26</sup>, with the Department of Labor and the Department of Commerce providing adjustment assistance to workers and firms injured by increased imports. While Japan does not have a systematic trade adjustment assistance program, after the provisional safeguard measures were implemented in April 2001, the Subcommittee on Special Trade Measures of the Industrial Structure Council confirmed in its recommendation report that “definitive safeguard measures should be implemented concerning relevant products under the prospects that the adjustment of a domestic industry shall be carried out during a period of such implementation through the recovery of competitiveness by a domestic industry or in other forms.”<sup>27</sup> Following this report, the government in FY2002 provided a budget

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<sup>24</sup> Cabinet Secretariat “Memorandum between Japan and China on Trade Friction regarding Agricultural Products (long onions (*allium fistulosum*), fresh shiitake mushrooms, and rushes for tatami mats)” ([http://www.kantei.go.jp/foreign/policy/2001/1221memo\\_e.html](http://www.kantei.go.jp/foreign/policy/2001/1221memo_e.html))

<sup>25</sup> Kawase [2003] pp.530-531.

<sup>26</sup> See Figure 3.2.11 of METI [2002] p.150.

<sup>27</sup> Subcommittee on Special Trade Measures, Industrial Structure Council, “An Approach to Safeguard Measures

for structural adjustment measures<sup>28</sup>, including 65 billion yen for Welsh onions and other vegetables, 2.3 billion yen for Shiitake mushrooms, and 1.0 billion yen for Tatami mats. However, it should be noted that all these measures aimed to promote adjustment within related domestic industries, and not to encourage the shift of factors of production between industries.

#### **4. Evaluation**

In light of the developments reviewed so far, this chapter attempts to evaluate the provisional safeguard measures Japan implemented in 2001 from several viewpoints.

##### **(1) Efficiency (Minimization of Social Adjustment Costs)**

First of all, the following three points can be stipulated for evaluation from the standpoint of efficiency. First, if the basic principle is upheld that the first-best policy to encourage adjustments is to directly offset market failures hampering adjustments, then the implementation of safeguards that would weaken the welfare of consumers through higher prices of imports is undesirable, even if intended as provisional measures.

Second, even when there is theoretically room to justify the prevention of an undue expansion of social adjustment costs by the implementation of the safeguard measures, it is questionable if, due to the provisional nature of the measures, the benefit of minimizing the social adjustment costs actually exceeds the negative impact of the safeguard measures in such a short period of 200 days. Rather, it may even be possible that the provisional safeguard measures helped relevant industries raise excessive expectations on receiving continued protection, consequently delaying the essentially needed adjustments. Agricultural producers gathered in the capital of Tokyo for several months until trade disputes with China were resolved, in order to engage in massive rent-seeking activities asking for implementation of the definitive safeguard measures.<sup>29</sup>

Thirdly, China's retaliation brought on extremely large losses to Japan's export industries. Table 4.1 shows monthly figures of Japan's exports to China of mobile and car phones, air conditioners

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(May 9, 2001)" ([http://www.meti.go.jp/policy/trade\\_policy/safeguard/data/SG\\_sankoushin.pdf](http://www.meti.go.jp/policy/trade_policy/safeguard/data/SG_sankoushin.pdf)).

<sup>28</sup> The combined sum of budgets is calculated on the basis of materials provided by the Ministry of Agriculture, Forestry and Fisheries ("Structural Reform Measures for Vegetables," "Structural Reform Measures for Shiitake Mushrooms," and "Structural Reform Measures for Igusa and Tatami Mats") for submission to the Council on Customs, Tariff, Foreign Exchange and Other Transactions (Ministry of Finance, September 4, 2001). (<http://www.mof.go.jp/singikai/kanzegaita/siryou/kanb130904.htm>)

<sup>29</sup> It is likely that the provisional safeguard measures helped overly raise expectations on protection among entities other than those engaged in production of the three items subject to the provisional measures. For example, according to a questionnaire survey conducted by the Ministry of Agriculture, Forestry and Fisheries, a total of 1,395 local governments submitted comments seeking the implementation of safeguard measures in 2001 alone. Ministry of Agriculture, Forestry and Fisheries, "The Number of Comments Concerning the Implementation of Safeguard Measures on Agricultural, Forestry and Fisheries Products."

([http://www.maff.go.jp/sogo\\_shokuryo/sg\\_kanren/sg\\_011024.pdf](http://www.maff.go.jp/sogo_shokuryo/sg_kanren/sg_011024.pdf)).

and automobiles in 2001. In the exports of these products to China, there is a discrepancy of over 50 billion yen between the exports before and after China launched the retaliatory measures on June 22. While this discrepancy cannot be defined as the cost of China's retaliation since it does not consider seasonal fluctuation factors, the rapid growth trend of the Chinese economy, and other demand-side factors, there is no doubt that the retaliation came at an extremely large loss for Japan. For example, according to an estimate of the Japanese government, if a free trade agreement currently under negotiation between Japan and the Philippines is concluded, Japanese exports to the Philippines are expected to increase by about 0.19% (about 93.1 billion yen).<sup>30</sup> Hence, the loss of Japan's exports to China resulting from the retaliation is more than half the gain in exports expected to come from the conclusion of an FTA with the Philippines that is being negotiated at a massive administrative cost.

**Table 4.1 Japan's Exports of Mobile telephones, Air conditioner, and Automobiles to China in 2001**

	Mobile and car phones	Air conditioning machines (other than parts)	Motor cars, Buses, Trucks, Crane lorries, Concrete-mixer lorries	Total
Year 2001	Unit: Thousand JPY			
Jan.	1,125,925	63,299	5,719,831	6,909,055
Feb.	2,339,436	131,536	4,872,967	7,343,939
Mar.	2,404,506	360,249	7,876,606	10,641,361
Apr.	3,811,215	190,625	9,425,315	13,427,155
May.	2,747,747	156,921	10,669,227	13,573,895
Jun.	2,098,572	113,259	8,955,692	11,167,523
Jul.	902	55,289	2,477,262	2,533,453
Aug.	4,846	69,620	1,575,572	1,650,038
Sep.	836	133,773	3,168,324	3,302,933
Oct.	425	88,548	794,490	883,463
Nov.	32,023	47,037	1,160,053	1,239,113
Dec.	5,014	51,089	2,484,721	2,540,824
Jan. to Jun. (a)	14,527,401	1,015,889	47,519,638	63,062,928
July to Dec. (b)	44,046	445,356	11,660,422	12,149,824
(a - b)	<b>14,483,355</b>	<b>570,533</b>	<b>35,859,216</b>	<b>50,913,104</b>

Source: Ministry of Finance, *Japan Exports & Imports: Commodity by Country*.

Note: HS codes corresponding to the respective product above are following. Mobile and car phones: 852520500 and 852520600, Air conditioning machines (other than parts): 8415 minus 841590, Motor cars: 8703, Buses: 8702, Trucks: 8704, Crane lorries: 870510, Concrete-mixer lorries: 870540.

## (2) Political Safety Valve

Did the chain of events regarding safeguard measures serve as a “political safety valve” to mitigate the pressures for protective trade measures? I do not believe that domestic industries

<sup>30</sup> Impacts of Japan-Philippines FTA (%) are obtained from Table 6-A in Kawasaki [2003]. Impacts of FTA on export volumes (in terms of JPY) are calculated by the author with Japan's export volume in 2001 (49 trillion yen).

competing with imports appreciated the effectiveness of the safeguard rules through the implementation of the provisional safeguard measures. Rather, it is assumed that the people who had clamored for the protection from imports realized the user-unfriendliness of such a safeguard tool as well as a sense of anger and futility over Japan's eventual failure to implement the definitive safeguard measures. As a result of the spreading recognition, among domestic industries competing with imports, that safeguard measures are not something that can be readily implemented, the possibility cannot be denied that pressures opposing trade liberalization, or for further protection through the use of different tools may intensify in some industries in the future.

On the other hand, it is true that the recent chain of events and the extensive media coverage provided a majority of the Japanese people who previously took little interest in trade issues with an opportunity to realize and think about the costs of trade protectionism and potential risks of retaliation by trading partners (Table 4.2). It may very well be that the biggest gain for Japan from this case is that the silent majority, in other words, the true beneficiaries of free trade had an opportunity to seriously think about trade issues.

**Table 4.2 Number of articles relating safeguards in Nihon Keizai Shimbun**

1990	1991	1992	1993	1994	1995	1996
71	58	22	18	20	57	105
1997	1998	1999	2000	2001	2002	2003
51	15	25	41	551	482	252

Source: Author's calculation using *Nikkei Telecom 21* (<http://telecom21.nikkei.co.jp/nt21/service/>).

### **(3) Public Choice Perspective**

As previously mentioned, among the factors that influenced the decision to implement the provisional safeguard measures were the facts that the election of the House of Representatives was scheduled to take place about half a year after the initiation of the safeguard investigations, and that the Research Commission on Trade in Agriculture, Forestry and Fishing Products of the Liberal Democratic Party, which relies on votes by farmers, was the driving force behind the implementation of the provisional measures. Nevertheless, Japan ultimately did not implement the definitive measures, possibly for the following reasons. First, the cost of trade retaliation by China and the foreign policy cost of the deteriorated ties with China were simply too large to bear. Second, the Upper House election was over by the time the agreement was made to avoid implementation of the definitive safeguard measures, and on top of this, the Koizumi Cabinet which was enjoying high popularity in urban constituencies by upholding the theme of "structural reform," had a payoff structure quite different from that of the previous cabinets.<sup>31</sup>

<sup>31</sup> Kawase [2003] p.523.

As indicated by Table 1.2, the number of safeguard measures internationally implemented is quite limited relative to the numbers of anti-dumping measures or countervailing duties. The reasons for this may be that the administrative cost of investigations could be large, and that WTO panels and the Appellate Body adhere to the strict interpretation of the WTO agreements in examining the conditions for implementing safeguard measures, and have so far recognized WTO violations on the part of countries that invoked the safeguard measures in all the dispute settlement cases regarding safeguards<sup>32</sup>. Thus, the fact that safeguard measures are not a user-friendly tool would increase the future political risks confronting politicians who are backed by industries competing with imports. If the recent series of events did help Japanese politicians recognize that safeguard measures are a difficult tool to handle, it would mean nothing less than a decline in an important function of “lessening the political risk in trade liberalization policy” that safeguard measures are supposed to have<sup>33</sup>. It can thus be argued that it is imperative to consider measures that complement or substitute trade remedy measures as Japan continues to further promote free trade.

## **5. Conclusion (Future Policy Options for Japan)**

Safeguard measures used to be considered a useful tool to strike a balance between the promotion of free trade and responses to domestic political demands for trade protection. However, as discussed in the preceding chapter, given retaliation risks and rigid conditions for the justification of safeguard measures established in the WTO disputes settlement cases, it would be unrealistic for most WTO member countries to expect the flexible implementation of WTO-consistent safeguard measures. Therefore, Japan is likely to find itself in a “trilemma” situation where it cannot simultaneously resolve the problems of “promotion of trade liberalization,” “strict administration of safeguard measures,” and “responses to domestic political demands for protection”<sup>34</sup>. Finally, I would like to briefly touch on the potential of trade adjustment assistance (TAA) programs as a means of breaking through this trilemma in Japan.

In the United States, the necessity of TAA programs for firms and workers injured by increased imports was first recognized in 1954, and such programs were subsequently institutionalized in 1962<sup>35</sup>. In recent years, these programs have been adopted not only to complement safeguard measures but also utilized frequently as a stand-alone replacement for safeguard measures. Like safeguard measures, TAA programs which provide generous assistance to firms and workers injured particularly by increased imports have been subject to a barrage of criticism from the perspectives of efficiency and equity. At the same time however, these programs are valued for their perceived

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<sup>32</sup> Suzuki [2003] pp. 94-95.

<sup>33</sup> Kawase [2003] offers detailed discussions on the political function of safeguard measures and the demonstration of the decline of that function today.

<sup>34</sup> Kuno [forthcoming].

<sup>35</sup> Jackson *et al* [1995] p.661.

“political function” of mitigating pressure for protection and ensuring latitude in trade policy.<sup>36</sup> Moreover, in comparison with safeguard measures, TAA programs are known to have advantages, such as: they can directly influence market failures hampering adjustments without deteriorating consumer welfare, they can provide support to individual firms and workers in accordance with the extent of damage, they face little risk of retaliation by trading partners, and they do not carry the risk of WTO disputes over the legitimacy of their implementation.

Since Japan does not have institutionalized TAA programs, it has so far responded *ex post facto* under ad hoc budgets, as seen in “measures related to the Uruguay Round Agreement on Agriculture<sup>37</sup>” implemented after the conclusion of the Uruguay Round negotiations and “Structural adjustment-related measures” taken after the recent implementation of the provisional safeguard measures. However, in comparison with the U.S. system, several problems can be pointed out with the existing ways of such support in Japan.<sup>38</sup>

First of all, for TAA programs to function as a means to complement and substitute safeguard measures, laws and regulations as well as procedures are necessary for injured industries, firms, and workers to apply for assistance in a fair manner. However, such a system does not exist in Japan. Due to the absence of such a system, there is no established standard of procedures or qualifications for screening recipients. Instead, such determination is made through an extremely opaque and political process. It appears that even industries subject to assistance programs are selected with political considerations. It may be the price that has to be paid for trade liberalization, but recklessly spending taxpayers’ money for TAA programs in total absence of a qualification or screening process should be recognized as a serious problem. Moreover, most of the assistance programs in Japan aim at recovering the competitiveness of an injured domestic industry as a whole and do not aim to promote inter-industry adjustments for individual workers and firms. As a country that achieved economic growth by enjoying the benefits of free trade, Japan is expected to break through the trilemma situation by considering a possibility of introducing well-institutionalized trade adjustment assistance programs.

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<sup>36</sup> See e.g. Richardson [1982]; Aho and Bayard [1984]; Schoepfle [2000].

<sup>37</sup> The government earmarked a total budget of about 7,200 billion yen for these measures over a period of six years.

<sup>38</sup> See Kuno [forthcoming] for problems with the existing trade adjustment support programs in Japan.

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