Japan: An Ardent Ally of ISDS, What Lies Beneath?

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In recent years, Japan has assumed a leadership role in shaping trade and investment policy initiatives within the Asian Pacific region. Its geopolitical position in recent trade and investment agreements – with important trading partners such as the EU, UK and Trans-Pacific countries – confirms Japan's (re)imagined policies which seek alignment with the core principles of liberal economic order. These agreements represent a key milestone in the international trade landscape, accounting for nearly 50% of the world GDP. Notably, Japan's activism in the realm of trade solidified its stance as a champion of trade and investment liberalization within the Pacific Rim region. Japan's activism also provided a critical counter narrative to its traditional stance which was largely shaped by protectionist policies.

Nevertheless, this article will argue that, despite Japan's involvement in forging core regional and international agreements, the existing archetype on which these landmark agreements are based call into question its commitment to rules-based openness and facilitation of trade and investment liberalizations.

This note will first highlight some of the features (or lack thereof) of the international agreements and demonstrate that they reveal traces of protectionism, suggesting that Japan might not have fully diverged from its traditional stance. Next, this note will provide a brief overview of Japan's approach towards reform efforts established by the Energy Charter Treaty (ECT) and UN Commission on International Trade (UNCITRAL) Working Group III. Finally, it will conclude by explaining possible incentives for Japan's continuous support of investor-State dispute settlement (ISDS) mechanisms.

I. The Rise of Japan's in Asia's Investment and Trade Landscape

From the end of the World War II until the early 1990s, Japan's international trade and investment policies were largely driven by strictly protectionist policies. Protectionist policies helped Japan gain significant surpluses which led to its emergence as a trade rival of major trading states such as the U.S. The stringent protection of domestic market and the relatively higher tariffs on exports in agricultural products and processed food significantly contributed to the success of Japan's economy in that era.

However, in the last decade, there was a paradigm shift and Japan became a leader in holding the line on the global trade order. Additionally, it forged the historic Economic Partnership Agreement with the EU and became the UK's first trading partner after Brexit by establishing the Comprehensive Economic Partnership Agreement (UK- Japan CEPA).

These comprehensive free trade agreements significantly affect world trade in the following ways.

These landmark agreements cover economic zones of two billion people representing 50% of the world GDP. This will help strengthen Japan's role in setting global trade standards, allowing it to assume a leadership role in global trade and investment policies. Moreover, these agreements expanded coverage to Japan's most sensitive market – agriculture – by removing tariffs from intermediate goods such as agricultural products (i.e. food and live animals). For instance, under the auspice of EU- Japan's Economic Partnership, both countries made a commitment to remove non-tariff barriers such as NTPs (Northern Territory Public Sector) in the following industries: food safety and health regulations, sanitary measures, and the automotive sector.

Furthermore, these agreements promote harmonization with the rule of law; they demonstrate commitment to free and rules-based trade. In doing so, they are committed to adhering to important global standards such as transparency and accountability in areas such as digital trade, data and e-commerce. For instance, the EU's and Japan's EPA made commitments to standardize regulations that hamper access to the car market by removing Japanese requirements of technical alternations. Similarly, the EU's and Japan's EPA include transparency rules for the number of subsidies allotted to the fishing industry.

Finally, these agreements were established during the era that was punctuated with growing resistance towards trade and investment liberalizations. This was evidenced by the strong public opposition encountered by countries such as Canada when they saw to enter into bilateral trade. The agreements between the EU and Japan proved to be an exception to the current trade which shows that trading partners are committed to economic integration. In fact, the objective of economic integration is echoed in the title and does not include the word "trade". This emphasizes the fact that the "Economic Partnership Agreement" goes beyond trade, as stated by EU Trade Commissioner, Cecilia Malmstrom, who said that the EPA should be "viewed as a strategic partnership including on many levels". This means that this agreement is designed to foster a deep international, economic integration; a wide range of activities including trade in services such as facilitating cross-border services with provisions on postal, telecommunication, and financial services.

While the success of the negotiations can be interpreted as a victory for free trade in times of rising protectionisms, the current structure of EPAs lacks important features that would help the parties involved achieve the high ambitions set by these agreements. Specifically, EPAs lack features that an effective investment or trade agreement possess, e.g., comprehensive and robust investment protection schemes and potent investor-state dispute mechanisms. The gaps created by these omissions has made these important instruments more analogous to ***accord de principle***, which, in turn, make the fate of investors too uncertain. In parallel, the absence of a robust investment mechanism rendered them as provisionally effective.

Although these agreements were intended to establish a potent international dispute settlement, the negotiation process took place during the time that the efficacy of Investor- State Dispute Settlement Mechanism has come into a sharp focus. Countries such as those in the EU expressed the need to introduce new standards to dispute resolution while refusing to include ISDS in their agreements. Conversely, Japan maintained positive attitudes toward ISDS and refused to accept the EU's proposal to include a different dispute mechanism. As a result, the agreements were concluded rather swiftly, and without compromise, despite important issues left at the negotiation table.

This was partly because including ISDS would have probably involved conceding greater access to Japan's politically sensitive sectors such as agricultural markets. This could have put Prime Minster Abe in a precarious position, as he was already facing backlash from rural voters for entering into bilateral agreements that introduced a new benchmark and provided greater concession of sensitive products in exchange for trade barriers. In addition, ISDS has received widespread approval by the Japanese Business Federal society. (The society claimed that ISDS contributed to economic growth.) This positive assessment of ISDS is also reflected in Japan's current position regarding the modernization of the ECT process. This will be explained in the following sections.

II Japan's Support of ISDS Mechanism

In both, the ECT modernization process and UNCITRAL's Working Group III reform process, Japan has retained a rather distinctive position. It has advocated for minimal changes either by proposing piecemeal solutions or by vetoing substantive reforms proposed by participating countries.

During the UNCITRAL discussions, Japan only pushed for incremental reforms aimed at securing an easy win regarding issues such as disclosure of third party funding and the code of conduct for arbitrators. In a statement that was submitted jointly with its trading partner, Chile, Japan firmly opposed wholesale reform to current reform negotiations, expressing doubts about the necessity of replacing the current ISDS with permanent investment courts. Japan's opposition met with criticism from various countries including those belonging to the EU. Some countries expressed concerns about the piecemeal approach

and how it could prevent the reform process from developing a pragmatic and principled approach to the problems that lie at the heart of ISDS.

In a similar vein, during the ongoing negotiation efforts concerning ECT modernization process, Japan strongly advocated for the reinforcement of investment protections in the ECT, repeatedly asserting that it is not necessary to amend current ECT provisions. The proposal that Japan rejected included an expansion of the "right to regulate" and changes to ISDS mechanisms.

Recently, Japan expressed great concern about the EU's plan for a multilateral investment court to replace the ISDS. Japan echoed its former position: modernizations should be minimal. The strong stance echoed by Japanese delegates prompted concerns from other delegates who thought that the negotiation process would not lead to concrete and substantive reforms. Unlike UNCITRAL's reform process, the ECT's reform process requires the unanimous vote of all its signatories. This is of note because Japan's position in the ECT is quite prominent. It is the ECT's largest donor and serves as the vice chair of the modernization negotiations.

It should go without saying that Japan's response to the EU wholesale reform did not sit well with EU delegates. In fact, they have issued a collective statement warning that the current treaty inhibits climate action and energy transition across Europe. Reportedly, 130 lawmakers in the European parliament issued a state warning that "The ECT is threatening the climate ambition of the EU domestically and internationally". EU lawmakers further stated that the EU should withdraw unless it can achieve a rewrite of the agreement that excludes protections for fossil fuel investors.

This begs the question: why does Japan continuously favor a system whose effectiveness has been called in to question by, both, developing, and developed countries? Some suggest that Japan's positive assessment of ISDS reflects the fact that Japan has had minimal involvement with ISDS, and has never been sued by foreign investors. The strong support for ISDS is also evident in the efforts taken to raise domestic awareness and understanding of ISDS throughout the business community.

There are other reasons why Japan maintains its traditional stance and lacks critical commitment to reduce its coal-fired activity. Some of these are

discussed below.

First, Japan has lagged behind global efforts to move away from coal-fired plants; it is the only advanced country that is still building coal-fired power plants, both, in Japan and overseas. As reported by the International Energy Agency, fossil fuel accounts for nearly 80% of Japan's energy supply. Furthermore, Japan heavily invests through its financial institutions and insurance companies in overseas coal-based power plants such as those found in India, Vietnam, Bangladesh, Chile and Morocco, all of which are in the process of acceding to ECT.

Second, Japan's inconsistent behavior towards trade liberalism was highlighted by the recent amendment of the foreign exchange and foreign trade Act of Japan which was implemented in 2019. The revision introduced rigid rules, requiring notices to be given to authorities when acquiring stakes within a given range. This requirement triggered concerns amongst those who believe that these rules will increase operating costs, thereby diminishing Japan's attractiveness as a destination for foreign investment. Nevertheless, such rules are visibly consistent with Japan's traditional stance which prioritizes protection from manufactured imports in the domestic market.

Conclusion:

In an era of interconnectedness, it appears that Japan's approach towards investment liberalization is rather detrimental. Its stance hinders important causes such as safeguarding the environment and related policies that are being pursued by, both, developed and developing countries. Furthermore, while Japan's approach towards trade and investment may not pose an immediate and significant threat to the entirety of global rules-based systems, it may cast a serious doubt on Japan's ability to take an active role on the global stage and to foster global rules-based system.

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