JAPAN NEWS

U.S. Treasury Secretary Presses Japan

By IAN TALLEY

Nov. 12, 2013 2:48 a.m. ET

TOKYO—U.S. Treasury Secretary Jacob Lew on Tuesday pressed Japan's prime minister to deliver on the final plank of his government's promised growth strategy, wary of a potential stall in efforts that could jeopardize America's own economic prospects.

But the Secretary's message was partially undercut as Prime Minister Shinzo Abe and his finance minister took the Secretary to task for Washington's own budgetary problems.

U.S. Treasury Secretary Jacob Lew shakes hands with Japanese Finance Minister Taro Aso prior to a meeting in Tokyo. *Bloomberg News*

"We are hopeful in the future these uncertainties over the fiscal issues will be resolved by the administration and the U.S. congress," Mr. Abe said.

Analysts say Washington's budget battles have undermined the U.S. leverage in economic talks. The budget fights forced a government shutdown and risked stalling an already anemic global recovery as lawmakers threatened to push the U.S. into default.

"We believe conditions surrounding the U.S. debt ceiling issue haven't improved much from October as the deals made at that time were just to push back the problem," Finance Minister Taro Aso told reporters after his meeting with Mr. Lew.

Amid the debt fights, the Obama administration is counting on a revived Japanese economy and a new regional trade deal called the Trans-Pacific Partnership to boost American exports and give the anemic U.S. economic recovery a much-needed jolt.

But there is some concern in the U.S., especially among auto makers, that the weak yen that has been a result of a large-scale monetary easing program is putting U.S. competitors at a disadvantage.

"While we welcome an end to deflation, to achieve sustained success Japan needs to strengthen domestic demand growth, avoid reliance on exports and continue to respect…commitments not to target exchange rates," Mr. Lew said in a commentary in The Wall Street Journal ahead of the meetings.

With the euro zone barely pulling itself out of a deep recession and emerging markets from Asia to Latin America slowing, Japan's recent spurt of growth has been a bright spot in the global economy. The prospect of Japan signing on to the TPP, along with around a dozen other nations, fueled hopes of major new export opportunities. Officials also think a high-caliber deal could also encourage China to accelerate its own economic liberalization.

But fears that Tokyo wouldn't be able to deliver the prime minister's risky, yet potentially high-reward strategy have mounted in recent weeks.

In a separate meeting, Japan's economy minister affirmed a year-end target for reaching a TPP trade deal. Still, he underscored the challenges ahead, highlighting political sensitivity over the five key agricultural products which Japan seeks to protect,

"I mentioned how the U.S. may not be fully understanding how significant a political issue the five agricultural products are," Akira Amari said.

The Japanese government want to exempt five farming areas: rice, wheat, sugar, dairy products and beef and pork from the requirement under the pact to eliminate all tariffs.

Mr. Abe is undertaking an aggressive three-part strategy to light a fire under the long-stagnant Japanese economy. The first two arrows of the so-called "Abenomics" program have been relatively easy and appeared to have worked: using cheap cash from the central bank and government coffers to spur near-term growth.

The prime minister is finding it difficult to push through the third: fundamental changes to the economy that will allow for more competition and sustain long-term expansion.

"Secretary Lew expressed our hope that Japan remains committed to the third arrow of reform," a Treasury spokeswoman said after the meetings. Mr. Lew "emphasized how critical it is that the Abe administration succeed in implementing effective measures that work through domestic demand to raise growth."

Although Japan agreed in July to enter the TPP trade talks, the lack of tangible structural economic changes is raising concerns about Mr. Abe's commitment and ability to deliver. The government's recent backing away from deregulation of the online pharmaceuticals industry—one of several service sectors whose heavy regulation prevents competition and new products—is fueling U.S. worries of an Abenomics stall.

Tokyo has attempted deregulation before, but vested interests have managed to block reforms. The pharmaceuticals failure has U.S. officials wondering if this time is any different.

"There are signs that the third arrow isn't happening," said Eswar Prasad, a Cornell University economist and Asia expert. "If that's so, it's very likely that Japan will go back to an even greater reliance on the first two arrows, on monetary policy in particular," he said. Even greater monetary easing would likely help push the yen lower. The Japanese currency is already down 20% from the highs seen late last year before Mr. Abe took office.

Another emerging fear is that Mr. Abe's deepest political ambition isn't an economic revival, but rather a normalization of the country's military status. Amid tensions with historical nemesis China over disputed island territories, Mr. Abe said in an interview last month that he envisioned Japan taking a more assertive role in countering Chinese power in the region.

But U.S. officials are encouraging Tokyo to prioritize the economy, taking advantage of the strong political mandate Japanese voters gave to Abenomics when they launched the prime minister into leadership and gave his party power over both houses of parliament.

If Mr. Abe's grand project fails, the consequences could be far worse than lost export opportunities. Economists warn that the country's mountain of debt could not only collapse Japan's economy, but send financial shockwaves around the world.

Still, Washington is convinced there are huge efficiency gains to be gleaned from deregulation of the service sectors and boosting the labor force participation rate, primarily of women.

—Alexander Martin and Takashi Mochizuki contributed to this article

Write to Ian Talley at ian.talley@wsj.com