

Japanese FTA Policy in Asia Pacific: Current Situation and Perspectives

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Introduction

It would hardly be an exaggeration to say that free trade has long been a universal human dream. Since time immemorial every merchant wished to sell his goods in distant lands on the same terms as he did in his hometown. On the other hand it is hard to imagine a customer wholeheartedly embracing import duties levied on his/her favorites among goods of foreign origin.

Japan's trade policy in general and free trade policy in particular (in modern times) has traditionally been focused on multilateral negotiations and dispute resolution mechanisms, the main exclusion being its contentious bilateral past with the United States. The rules of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) have provided Tokyo an ability to interact with its trade partners on an equal basis. Given its global trade interests, and historic legacy with

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Asian countries, particularly Korea and China, reliance on the multilateral system has helped promote Japan's trade interests.¹

However, since the advent of the new Millennium, Japan has considerably shifted its course. Of course, it continued pursuing negotiations in the WTO framework, and, to a lesser degree, in the framework of APEC but — what is most salient - it has started to increasingly seek bilateral Free Trade Agreements (FTAs) and Economic Partnership Agreements (EPAs) with Asia-Pacific nations. The Koizumi era (2001-2006) will be remembered as the start of pro-FTA foreign policy.

Theoretically, there is some distinction between ETAs and FTAs. An FTA is an agreement between two countries or a country and a regional grouping aiming at the elimination or reduction of tariffs and other trade barriers. An EPA is supposed to go further by also attempting to facilitate the free movement of manpower and capital among the partners to an agreement, etc. Sometimes, these non-traditional alliances are called “new-age” FTAs, an expression used by Singapore's former Prime Minister Goh Chok Tong to describe his country's agreement with Japan.² As a practical matter, officials at Japan's Ministry of Economy, Trade, and Industry (METI) acknowledge that there is little difference between an FTA and EPA. METI, however, prefers the EPA label based on the view that it does less to provoke domestic political opposition than the “free trade” supporters.³ Therefore, in the case of Japan both terms can be used in turn.

While the pursuit of FTAs is occurring worldwide, Japan — until

1 Pekkanen, Saadia M., “The Politics of Japan's WTO Strategies,” *Orbis*, Winter 2004pp. 135-147.

2 Watanabe, Yorizumi, “Free Trade Agreements and Japan's Trade Strategy”, *Japan Review of International Affairs*, Winter 2002, p.283.

3 Interview with Norio Nakazawa, METI Counselor for Regional Cooperation, June 28, 2005.

recently - was slower than others; it was even labeled as “defensive” and “weak” at the US Congress hearings.⁴ Surprisingly, by 2006 this country had only two acting agreements. The United States has an extensive FTA policy and agenda, and has agreements in effect with three Asian-Pacific countries — Singapore, Chile and Australia, to say nothing about NAFTA. Europe has been pursuing a similar course for years. China and six most advanced ASEAN nations (Thailand, Malaysia, Indonesia, Philippines, Singapore, and Brunei) are in the process of establishing an FTA by 2010. A small Chile has inked free-trade accords with three dozens of nations worldwide. Now Japan is trying to catch up.⁵

Economists continue to disagree about the merits of negotiating FTAs on the grounds that the — possibly unintended - discrimination of non-participants may undermine the multilateral trading system while others believe that FTAs promote multilateral deals in the long run. The concern is that FTAs could lead to a “spaghetti bowl” of overlapping conflicting trading partnerships each with its own set of rules at the expense of a more unified and non-discriminatory set of multilateral rules.

Nowadays, the domestic support in Japan for an FTA policy appears strong. Prime Minister Koizumi, especially during his second term was firmly behind the approach, as well as the ruling LDP-Komeito coalition. The Democratic Party, the major opposition force, supports the general thrust of the policy, though some party members maintain that first the world’s trading superpowers - the United States and China - should be addressed as prospective FTA partners.⁶

4 Katz, Richard. Testimony before the US House International Relations subcommittee on Asia and the Pacific, April 20, 2005.

5 Schott, Jeffrey J. “Free Trade Agreements: Boon or Bane of the World Trading System?” In Bergsten, C. Fred., *The United States and the World Economy*, Washington: Institute for International Economics, 2005.

6 Interview with Kenzo Fujisue, Upper House Diet Member, Democratic Party, June 23, 2005.

Surely, the US approach to the matter is decisively important. Given its own aggressive FTA policy, the United States is hardly in a position to criticize Japan's new policy orientation. But it has considerable concern in whether Japan's policy evolves in a manner that is supportive of U.S. interests in Asia - which include promoting a stable balance of power and insuring that U.S. trade and investment interests are not infringed in the region.⁷

Japan's new pro-FTA policy has been motivated by a combination of economic and political objectives. The most important ones entail avoidance of becoming isolated as other major trading countries actively pursue FTAs, energizing domestic economic activity, and promoting Japanese influence in Asia.⁸

Japan's concern about the possible emergence of protectionist economic blocs in the Americas and in Europe goes back to the 1980s and the early 1990s. Actually Japan's fear of the world splitting into rival trading blocs was instigated by the unhappy GATT Uruguay round. Then, the United States entered into the North America Free Trade Agreement (NAFTA) and announced plans to create a Free Trade Area of the Americas. In addition, the specter of "fortress Europe" loomed on the horizon.

In 1999 the collapse of multilateral trade negotiations at the WTO Ministerial conference in Seattle shook Japanese confidence in the future of multilateralism. Seven years later (2006) the Doha round of global trade negotiations equally proved to be a failure and to the same effect. On the regional (Asia Pacific) level little, if any, progress could seen in

7 CRS Report RL 32688, China-Southeast Asia Relations: Trends, Issues, and Implications for the United States, by Bruce Vaughn.

8 Hatakeyama, Noboru. "Japan's Movement toward FTAs," Speech delivered at the Institute for International Economics, Washington, D.C., May 8, 2003.

the implementation of APEC Bogor declaration which committed developed and developing member-states of APEC to complete trade and investment liberalization by 2010 and 2020 respectively. China's decision in 2001 to negotiate an FTA with ASEAN as a body was also a seminal event, providing more ammunition for those in Japan that were advocating a change of policy course in favor of bilateral agreements.

The case for developing an FTA policy was also driven by Asian economic trends and opportunities. METI officials see East Asia as the fastest growing region in the world and a region that is increasingly vital to Japan's economic future.⁹ FTAs and EPAs are viewed as, perhaps, the only way to deepen economic ties with East Asia and facilitate a new division of labor. The experience of the European Union has demonstrated that, as institutional integration develops, so too does intra-regional division of labor that leads to a more effective production network and to more efficient industrial structures. Nowadays, METI maintains that, if so, both individual parties to an FTA, as well as the region as a whole, can enjoy more robust economic growth powered by an expansion of foreign trade.

Reform-minded METI officials also hope that an aggressive FTA-EPA policy will serve as a force for promoting domestic agricultural reforms. By entering into negotiations with trading partners that continue to demand liberalization of Japan's protected farm sector, it is hoped that domestic support for policy towards agriculture's transition to a less protected environment would increase.

Finally, relevant decision makers see FTAs providing Japan with

9 METI projects that East Asia's share of world GDP (without Japan) will increase to 16% by 2020, up from 5% in 1990, with the shares accounted for by Japan, the United States, and Europe all dropping. East Asia's economic growth is also projected to average 5.5% between 2010-2020, compared to 0.5% for Japan, 1.4% for the United States, and 1.5% for Western Europe.

varied political and diplomatic advantages. These ranges from increasing Japan's bargaining power in WTO negotiations to helping Japan better compete with China for influence in Asia. Under the view that FTAs symbolize special relationships based on political trust, Japan hopes to bolster its diplomatic influence on a range of political and security issues.¹⁰

1. FTAs in Asia-Pacific region

The Asia-Pacific may be the world's largest economic trans-region, accounting for around half of world trade and output, but up until the late 1990s it was host to a relatively few FTAs by regional comparison. In 1997 it accounted for only seven of the 72 free trade agreements that had been signed globally by that date with only a handful of other FTA projects under consideration. Moreover, there was no operational FTA in East Asia at this time. Matters changed dramatically after the 1997/98 East Asian financial crisis and the WTO's Seattle Ministerial Meeting debacle of 1999.

By the end of 2002 a total of 19 new free trade agreements had been signed within the Asia-Pacific and another 26 FTA projects were in different stages of development, i.e. officially proposed, feasibility studied or being negotiated. By December 2005 the total number of Asia-Pacific FTAs had doubled to 38 with another 29 projects in development. The most notable agreements signed in the new Millennium have been :

- ASEAN — China FTA (ACFTA)
- United States — Singapore FTA (USSFTA)
- Australia — United States FTA (AUSFTA)
- Chile - United States FTA (CUSFTA)

10 Interview with Isamu Ueda, Lower House Diet Member, Komeito Party, June 23, 2005.

- Japan — Singapore Economic Partnership Agreement (JSEPA)
- Japan — Malaysia FTA (JMFTA)
- Japan — Mexico Economic Partnership Agreement (JMEPA)
- The Philippines — Japan FTA (PJFTA)
- South Korea — Chile FTA (KCFTA)
- Thailand — Australia FTA (TAFTA)
- China's 'Closer Economic Partnership Agreements' (CEPAs) with Hong Kong and Macau which looks like the embryo of the "Greater China" concept
- China-Chile FTA (CCFTA)
- Trans-Pacific Strategic Economic Partnership Agreement (TPSEPA, a quadrilateral FTA between Singapore, New Zealand, Chile and Brunei).

Perhaps even more significant FTAs are to come. The United States announced the commencement of negotiating agreements with South Korea and Malaysia. Japan has a number of FTAs lined up to sign with Thailand and Indonesia, and is trying — with great pains - to negotiate an FTA with South Korea. China is currently negotiating agreements with Australia and New Zealand. These are largely bilateral FTAs but there are ideas and plans for larger regional arrangements, such as the Free Trade Area of the Americas project being championed by the United States, as well a long discussed idea for creating an East Asia Free Trade Agreement which is traced back to Malaysian leader Mahathir Mohamad's proposal of EAEG (1991). The ASEAN member states continue to implement their ASEAN Free Trade Agreement (AFTA), and within the Asia-Pacific Economic Co-operation (APEC) forum the 'Bogor Goals' of establishing a free trade and investment zone across the whole trans-region remains, at least verbally, a core objective of the organization.

The intensification of FTA activity in the Asia-Pacific is significant

both in regional and global terms. Whereas the region only accounted for a tenth of all FTAs around the world in 1997, by 2005 it accounted for a quarter of the global total (38 out of 153 agreements worldwide). The new FTA trend in the Asia-Pacific has also brought about important changes to the macro-structure of international economic relations in the region.

FTAs have become a centerpiece of trade policy for most key Asia-Pacific states, and in many cases have further exposed the linkages between domestic politics and international trade, especially concerning sensitive industry issues such as agriculture. Furthermore, FTAs have the potential to significantly affect trade and investment flows within the Asia-Pacific not only by removing economic barriers between nations but also through how these agreements can shape the region's commercial regulatory environment. The intensification of FTA activity in the Asia-Pacific can have significant implications for other regions. Other regions and regional powers (e.g. the EU, Mercosur) would be concerned if the Asia-Pacific FTA trend disadvantages their commercial interests, through trade diversion and other adverse effects. But it is the impact of the Asia-Pacific FTA trend upon the WTO and the multilateral trade system that deserves particular attention.

FTAs and the WTO

To put it simply, a free trade agreement is an undertaking by signatory parties to remove (or strongly reduce) the trade barriers that have existed between them. Although considerable heterogeneity exists in terms of an agreement's scope, content and underlying philosophy, all FTAs are preferential in nature because only the signatory parties are conferred the trade and other commercial policy advantages embodied in the FTA. Hence, they incur *de facto* discrimination against other trade partners in the process. For example, in AUSFTA the United States has grant-

ed Australian farmers improved market access to its agricultural product markets. This places New Zealand's farmers at a relative disadvantage to their Australian counterparts because the former still face high trade barriers when exporting to the United States. The same situation applies to other trade partners of the US that have not signed an FTA with the country. Moreover, free trade agreements add further complexity to the already complex international trade system by introducing bespoke rules between FTA partners that are essentially derogations from the multilateral trade system. The so called 'spaghetti bowl' of differentiated rules of origin, tariff liberalization schedules, customs procedures, and preferential concessions in various other areas of commercial regulation (e.g. in investment, intellectual property rights, market operating licenses, sanitary and phytosanitary rules) being created by an expanding number of FTAs in the Asia-Pacific and elsewhere is an increasing cause for concern for the WTO, which is supposed to uphold and further develop a multilateral system of nondiscriminatory trade relations. Although the WTO has rules on FTAs, most acknowledge that these are outdated and weak. In essence, these rules stipulate that:

- FTA parties should not raise trade barriers against non-members.
- The main substance of the agreement should be implemented within 10 years.
- 'Substantially all trade' must be covered by the agreement, meaning that FTA parties should not be allowed to protect too many industry sectors from FTA liberalization.
- More favorable treatment may be conferred, however, to developing countries through partial scope or non-reciprocal arrangements (the so called 'Enabling Clause').

These rules were to be re-examined by the Doha Round's Negotiating Group on Rules (NGR). The NGR talks commenced in 2002

and most attention on FTAs has focused on the ‘substantially all trade’ issue (Article XXIV, clause 8 b). Some WTO members like Australia have proposed that a quantitative definition be introduced to this rule, for example 90 or 95 percent trade between the FTA parties concerned, but others such as the United States and the European Union have resisted this because it would seriously restrict their ability to exempt agricultural sectors and other sensitive industries from agreements they wish to sign. Permitting countries to continue protecting these sectors even under FTA agreements limits the production efficiency benefits yielded from *trade creation* (discussed later) and, moreover, sets a bad precedent for multi-lateral negotiations at the WTO. Very little progress has been achieved in the NGR talks on this crucial issue, and a substantive upgrading of this rule has not been agreed upon. In plain words, the further growth of FTA activity has not been restricted.

Such unfavorable developments have given rise to the new taste for bilateral FTA. Governmental initiatives aimed at promoting trade and cooperation outside frameworks of WTO and APEC have mushroomed throughout the whole of the Pacific Rim. So far, bilateral negotiations on the elimination of tariff and non-tariff barriers have involved the US, South Korea, China, ASEAN member states and ASEAN as a body, Japan, China, Chile, Mexico, etc.

Indeed, the most effective check on FTA proliferation would be a comprehensively concluded Doha Round itself. This is because further progress on multilateral trade liberalization diminishes the marginal gains yielded from trade partners signing FTAs. For example, if the Doha Round could lead to the average tariff rate on industrial products falling from 4 percent to 2 percent, then the trade liberalization ‘value-added’ offered by FTAs in this respect would be effectively halved, and bilateral agreements’ attractiveness would fade. It was expected, however, that if no agreement

is reached (or a weak Doha Round agreement emerges) then countries may consequently develop a stronger predilection for signing FTAs. This is what made signing a Doha Round, based on multilateral equity, so important. As it became clear in August 2006, more than five years of commerce liberalization talks collapsed with no timetable for completing the round.

It is worth reminding the fact that the last time free-trade bilateralism had become a defining feature of the world trade system was the 1930s. The structures of trade preferentialism created in that process led to a period of adversarial international economic relations that, shall we say, may have even contributed the global wide conflict that followed.

During his term in office, WTO Director-General Supachai Panitchpakdi became ever more critical of the growing FTA trend, and highlighted developments in the Asia-Pacific of particular worry given this is where the greatest spurt of FTA activity has occurred in recent years. At the end of his tenure, a 2005 report commissioned by the WTO expressed concern about the intensification of FTA activity globally, stating that it was creating confusion in the world trading system, with complex and inconsistent rules of origin, costly administrative rules, and opportunities for corruption.¹¹ Reports published by the IMF and World Bank around the same time came to similar conclusions about the potential dangers that FTAs posed to the multilateral trading system.¹² Then, how do supporters of FTAs present their case ?

Below we are trying to assess three main arguments that advocates

11 World Trade Organization / WTO (2005), *The Future of the WTO: Addressing Institutional Challenges in the New Millennium*, WTO Secretariat, Geneva.

12 Feridhanusetyawan, T. (2005) 'Preferential Trade Agreements in the Asia-Pacific Region', *IMF Working Paper Series*, WP/05/149, International Monetary Fund, Washington DC.

World Bank (2005) *Global Economic Prospects 2005: Trade, Regionalism and Development*, World Bank, Washington, D.C.

of FTAs often use to “sell” Free Trade Agreements, in other words to convince others of the virtues and usefulness of trading pacts of such kind. We shall draw upon examples from the Asia-Pacific to illustrate points made.

Trade creation

According to traditional theories on trade integration, trade creation occurs when liberalization arising from a free trade agreement allows more efficient FTA-based producers to expand their own share of the FTA’s markets at the expense of their less efficient neighboring rivals. This process leads to greater productive efficiencies being captured, lower consumer prices and a greater specialization in the FTA partners’ comparative advantages. There is, though, the question of how these welfare gains are distributed amongst FTA parties. For example, more developed FTA partners may be able to extract a far greater proportion of the welfare gains than lesser-developed FTA partners. In bilateral FTAs, the stronger partner can have the power to influence the terms of FTA trade more in its own favor, an outcome that is far less likely in multilateral trade agreements where the power of stronger countries is circumscribed by the multilateral collective, and where laws are “stable, predictable, understandable and nondiscriminatory”¹³ Moreover, trade creation gains are offset by the welfare costs of *trade diversion*. Trade diversion arises when non-member country producers — who offer a more competitively priced product than producers within the FTA area — are subsequently disadvantaged by relative tariff changes incurred by the FTA’s ‘internalized’ liberalization that is not matched by similar ‘externalized’ liberalization vis a vis non-members. In this scenario, relatively less efficient producers located with-

13 “Japan Must Act amid Trade Talk Rubble”, *The Japan Times*, August 21, 2006, p.15

in the FTA area are able to expand production at the expense of more efficient non-member located producers which can hardly be called a fair practice.

Obtaining verifiable evidence of the net welfare effects of FTAs is difficult. There has been, though, much reported concern of the trade diversion effects of Asia-Pacific FTAs both within and outside the region. For example, South Korean tire manufacturers complained in 2005 that their export sales in the Mexican market had fallen drastically as a result of the Japan—Mexico FTA. In June 2003, the Philippines called upon South Korea itself to narrow the tariff differential between imports of copper cathodes from its own producers and those from Chile during the South Korea—Chile FTA (KCFTA) negotiations. South Korea's import tariff on Chilean copper products was scheduled for phasing out by 2009 under the KCFTA, and in the meantime Philippine producers were faced with a 5 percent 'most favored nation' tariff. German car manufacturers expressed concern about similar trade diversion effects from an anticipated Japan—Thailand FTA, Japan being Asia's largest producer and Thailand Southeast Asia's largest producer of autos. We should finally make the point that trade diversion should not in theory arise from multilateral trade liberalization because no one trade partner is conferred a preferential tariff advantage by this process.

'WTO plus' FTAs

Supporters of FTAs often point to the positive contributions that agreements can make to advance certain technical policy elements of the WTO agenda. The idea here is that provisions in so called 'WTO plus' free trade agreements can provide state-of-the-art templates on which particular technical aspects of a subsequent multilateral trade agreement can be based. These especially relate to more sophisticated areas of commercial

regulation (e.g. intellectual property rights, or IPR) and therefore of greater interest to developed economies. The US and Singapore in particular made much of promoting the supposed ‘WTO plus’ nature of their FTA, signed in 2003. However, as previously noted, FTAs also bring greater trade rule complexity and structured preferentialism to the international economic system. Furthermore, the advanced ‘WTO plus’ provisions of certain FTAs have limited use and application to most developing countries because they simply lack the national capacities to accommodate the more sophisticated elements of commercial regulation as promoted by developed countries. The Asia-Pacific’s lesser-developed economies (e.g. Cambodia, Laos, Papua New Guinea) lack the fundamental capacity to sign reciprocal FTAs and even middle order developing countries such as the Philippines, Indonesia and Vietnam admit that they face serious capacity constraints when negotiating FTAs with more developed trade partners. The developing countries lack sufficient enough technocratic resources (i.e. trade negotiators and analysts) to engage effectively in WTO negotiations, let alone a spread of bilateral FTA projects. Their institutional frameworks (e.g. legal, socio-cultural) are also often inadequate to accommodate various policy-related commitments incorporated into more demanding FTAs.

Taking the example of the Philippines, a report published by the Philippine Institute for Development Studies¹⁴ argued that owing to the country’s weak technocratic and institutional frameworks, it had appeared more of a passive negotiator or participant in its FTA projects. Not only did the country suffer from having only a small pool of sufficiently skilled and technically trained FTA negotiators but also public regulations on

14 Erlinda M. Medalla, Dorothea C. Lazaro. (2004) Exploring the Philippine FTA Policy Options. Philippine Institute for Development Studies (PIDS)/Philippines. Issue 2004-19.

issues such as IPR and quarantine lacked the robustness demanded by more developed FTA partner countries, like the US, Japan and Australia. It was earlier implied that in bilateral FTA negotiations greater scope exists for the stronger party to force its regulatory demands upon the weaker (often developing country) party. Furthermore, in a bilateral FTA there may be no 'development' dimension at all, with no commitment made on behalf of a developed country partner to tackle directly the development challenges of the developing country partner. The US, for example, seems only to be interested in market access matters in its approach to FTAs, which is in some contrast to Japan's 'economic partnership agreement' model that is based on a more cooperative and developmental philosophy. More crucially, the WTO framework has formalized provisions that aim to strengthen its developing country members' trade capacity potential. Further fortification of these provisions as more directly addressing the trade capacity needs of developing countries was expected in the course of Doha Development Round. It is in realizing this objective, rather than realizing FTA projects, that the time and effort of WTO members should be focused.

Competitive Liberalization

The idea of 'competitive liberalization' is closely associated with the US's free trade agreement policy, especially under the United States Trade Representative (USTR) Robert Zoellick, who served in this office from 2001 to 2005. Its principles and philosophy have been adopted by other pro-free trade Asia-Pacific countries, especially when defending the use of FTAs in the face of criticism from those advocating a multilateral approach only in advancing trade liberalization. In essence, competitive liberalization relates to how the pursuit of FTAs with certain trade partners can compel others to join in a gradually widening trade liberalization process at the

bilateral, regional or multilateral level. Competitive liberalization works on the principle that it becomes more imperative for recalcitrant trade liberalizers to sign bigger trade deals that will help neutralize the trade diversionary effects of FTAs signed by 'pro-free trade' countries. An often cited example of competitive liberalization in action was the US's support for enhancing APEC's trade liberalization objectives (i.e. the Bogor Goals project) during the late months of 1993 that was allegedly designed to pressure the EU into coming to a final agreement on agriculture during a critical phase in finalizing Uruguay Round negotiations. The specific rationale here was that, for non-APEC members, new multilateral free trade agreements would help offset the negative externalities generated by the creation of a Pacific free trade zone.

However, the competitive liberalization dynamic can also work in converse fashion to the above. For example, if a growing number of Asia-Pacific countries have secured free market access to large trade partner markets (e.g. the US, China) through bilateral FTAs then the incentives to pursue a multilateral deal at the WTO can diminish. This is because the marginal benefits offered by a concluded WTO round lessen owing to its trade liberalization gains only affecting a much reduced proportion of country's total exports that do not enjoy FTA treatment. Of course, larger trade partners like the US wishing to conclude a WTO deal may offer those smaller countries opposing a WTO deal a bilateral free trade agreement as a pay-off, but there is no evidence of this ever occurring. In addition to the problem of diminished net trade liberalization gains caused by intensifying FTA activity there are also significant politico-economic risks attached to pursuing a competitive liberalization strategy. Propagating a trade diplomacy culture whereby a critical mass of FTAs is designed to bring about more FTAs, based on the defensive and reactive motive of mitigating the negative impacts of other agreements, is more likely to breed a form of

competitive bilateralism where each country seeks a preferential market access advantage over others. This may lead to more antagonist trade relations between states rather than the co-operative economic diplomacy required to forge regional and multilateral trade deals. The scramble between Japan and China to sign FTAs with other East Asian countries, and particularly with the ASEAN group, has, for example, reportedly heightened tensions in the Sino-Japanese relationship. Competition between ASEAN member states to sign the best bilateral FTA deals with key trade partners outside Southeast Asia has also raised tensions within the regional group. Singapore, and to a lesser extent Thailand, have prescribed to the competitive liberalization approach as politically articulated in their ‘pathfinding’ bilateral FTAs with the US, Japan, Australia, New Zealand and others as a means to catalyze Southeast Asia’s trade liberalization both within the region and with extra-regional FTA partners. Malaysia, Indonesia and the Philippines have been somewhat critical of this approach, stating that Singapore and Thailand were putting their own national interests ahead of ASEAN-led regional community-building, although subsequently initiated bilateral FTA policies of their own to seek the same market access preferences enjoyed by Singapore and Thailand.

Competitive liberalization is also closely related to the matter of competing FTA models (i.e. the holistic approach to FTA formation) and modalities (i.e. particular aspects of that approach, such as the preferred rules of origin regime) between the world’s most influential trading powers. As stated earlier, free trade agreements are heterogeneous: they vary significantly in terms of their nature, content and underlying philosophy. They also shape the regulatory framework in which international trade and business occurs. As Robert Zoellick commented¹⁵ in 2002, “each [FTA]

15 Op-Ed, *New York Times*, 14 April 2002.

agreement made without us may set new rules for intellectual property, emerging high-tech sectors, agriculture standards, customs procedures or countless other areas of the modern, integrated global economy — rules that will be made without taking account of American interests”.

The Asia-Pacific’s most influential trading states — the US, Japan and China — take notably different approaches to constructing their FTAs. Hub-and-spoke patterns of ‘FTA families’ with powerful trading states at the head of these families may fracture the international trading system into quasi trade blocs. Furthermore, it is not just a question of whether free trade is beneficial or not, rather *what kind of free trade* is being established and how are its benefits being distributed. Under FTAs, we are more likely to end up with a particular brand of free trade that better suits more powerful trade partners. Although many argue that the WTO agenda remains primarily determined by American and European interests, there is still much greater scope for developing countries to influence the nature and progression of global free trade through the WTO than through bilateral FTAs with the big trading powers.

The international trading system is really at a critical juncture. The intensification of bilateral FTA activity over recent years, and particularly in the Asia-Pacific where most of it has been concentrated, has already undermined the incentive structure for concluding a new global trade deal through the WTO. Furthermore, the Asia-Pacific FTA trend has created new layers of structured preferentialism into the international trading system and played more to the interests of more powerful trading states. Developing countries especially need a good quality, development capacity focused comprehensive accord to be realized, certainly more than being signed up to a number of FTAs that are skewed against their interests as highlighted above.

2. Japan's official view on perspectives on Asia-Pacific FTAs

In October 2002 in the wake of the first ever Japan's free-trade agreement (with Singapore) the national FTA strategy was adopted by Economic Affairs Bureau, Ministry of Foreign Affairs (MOFA).¹⁶ This policy document was widely interpreted as a reaction to ASEAN+China FTA (ACFTA) that had turned to be "a source of irritation to Japan, unable to formulate an effective external economic policy in the midst of a prolonged recession".¹⁷ The later developments have shown that the Government as a rule has been following the MOFA guidelines. Below we provide summary of the document.

1. Why Free Trade Agreements ?

(1) Amid the advance of economic globalization, it is important to maintain and strengthen the free trade system. While the World Trade Organization continues to play an important role in this effort, free trade agreements (FTAs) offer a means of strengthening partnerships in areas not covered by the WTO and achieving liberalization beyond levels attainable under the WTO. Thus, entering into FTAs is a highly useful way of broadening the scope of Japan's economic relationships with other countries.

(2) The European Union and the United States have pursued policies oriented both toward negotiations under the WTO and the creation of large-scale regional trade frameworks. The current round of WTO negotiations could be the last multilateral trade negotiations prior to the creation

16 Japan's Ministry of Foreign Affairs, *Japan's FTA Strategy*, October 2002. Found at [<http://www.mofa.go.jp/policy/economy/fta/strategy0210.html>].

17 Ohashi, Hideo. "China's External Economic Policy and Relations with Japan", *Japan Review of International Affairs*, Spring 2003, p.18.

of these large-scale integrated regional frameworks. It is necessary for Japan as well to address not only WTO negotiations but also FTA trends in strengthening its economic relationships with other countries.

2. Specific advantages of promoting free trade agreements

(1) Economic advantages

FTAs/EPAs lead to the expansion of import and export markets, the conversion to more efficient industrial structures, and the improvement of the competitive environment. In addition, FTAs help reduce the likelihood of economic frictions becoming political issues, and help expand and harmonize existing trade-related regulations and systems.

(2) Political and diplomatic advantages

FTAs increase Japan's bargaining power in WTO negotiations, and the results of FTA negotiations could influence and speed up WTO negotiations. The deepening of economic interdependence gives rise to a sense of political trust among countries that are parties to these agreements, expanding Japan's global diplomatic influence and interests.

3. Points to bear in mind in promoting free trade agreements

(1) Conformity with WTO agreements

Three points must be ascertained. First, the duties and other regulations of commerce should not be higher or more restrictive than the corresponding duties and other regulations of commerce prior to the formation of the FTA. Second, they must eliminate duties and other restrictive regulations of commerce with respect to substantially all the trade. Third, they must ensure completion of regional trade agreements (RTAs) within a 10-year period, at least in principle. The reference to "substantially all the trade" implies that countries must achieve a standard of liberalization that compares favorably to international standards in terms of trade vol-

ume (based on the figures reported, the NAFTA average is 99%, while the average for the FTA between Mexico and the EU is 97%).

(2) Impact on domestic industries

Japan cannot secure the advantages of FTAs without enduring some pain arising from the opening of its markets, but this should be regarded as a process that is necessary for raising the level of Japan's industrial structures. Unavoidable issues will emerge concerning various areas of regulatory control, including movement of natural persons, as well as the opening of markets and the implementation of structural reforms in the agricultural sector. With due respect for political sensitivities, unless we take a stance linking FTAs to internal economic reforms, Japan will not succeed in making them a means of improving the international competitiveness of Japan as a whole.

***4. The type of free trade agreement Japan is aiming for
(what to negotiate)***

(1) Comprehensiveness, flexibility, selectivity

At present one option would be to base future agreements on Economic Partnership Agreement (EPA) with Singapore, but Japan should maintain flexibility and explore the possibility of taking a "Singapore-plus" or "Singapore-minus" approach. It may be possible to have specific areas (such as investment and services) agreed in advance or to conclude an economic partnership agreement limited to covering such areas.

(2) Matters for consideration in realizing the Japan-ASEAN Comprehensive Economic Partnership

In order to ensure that such partnership is comparable to economic integration in other regions, it should offer the greatest possible liberalization in a broad range of areas.

(3) Possibility of utilizing FTAs to assist developing countries

Conclusion of FTAs with developing countries could also serve as a political device for promoting economic development in these countries, including those in Africa.

5. Strategic priorities for free trade agreements

(1) Criteria for judgment

These include (a) economic criteria, (b) geographic criteria, (c) political and diplomatic criteria, (d) feasibility criteria, and (e) time-related criteria.

(2) Japan's FTA strategy-specific matters for consideration

Japan's major trading partners are East Asia, North America, and Europe, three regions that account for 80% of Japan's trade. In comparison to FTAs with the countries of North America and Europe, which are all industrialized countries, FTAs with East Asia will produce the greatest additional benefits through further liberalization. As is apparent from the simple average figures for tariff rates (the United States, 3.6%; the European Union, 4.1%; China, 10%; Malaysia, 14.5%; the Republic of Korea, 16.1%; the Philippines, 25.6%; and Indonesia, 37.5%) that East Asia, the region where Japanese products account for the highest percentage of trade, has the highest tariffs. Liberalization of trade with East Asia will help facilitate the activities of Japanese businesses, which are facing competition from ASEAN and China and which, in many cases, have shifted their production bases to locations in East Asia.

When promoting FTAs, Japan must pay attention to securing political and economic stability within the larger context of the construction of a regional system. Priority should be given to concluding FTAs with countries and regions where, despite close economic relationships, relatively high trade barriers exist that pose obstacles to the expansion of Japan's

economy. From this standpoint, East Asia is the region with the most promising counterparts for negotiations, and in light of the feasibility criteria and political and diplomatic criteria cited above, the Republic of Korea and ASEAN are the most likely partners for negotiations.

At the same time, an FTA with Mexico should be concluded expeditiously where Japanese businesses have to pay relatively high tariffs, in comparison to those of NAFTA and the European Union that have already concluded FTAs with Mexico.

(a) Economic partnership in East Asia revolving around Japan, the Republic of Korea, and China, plus ASEAN

To begin with, Japan should pursue FTAs with the Republic of Korea and ASEAN, and, based on these foundations, efforts should be made over the mid to long-term to conclude FTAs with other countries and regions in East Asia, including China.

Republic of Korea: In view of Korea's political importance, wide-ranging contacts between respective citizens, deep relationship of economic interdependence, and joint proposals by business leaders in both countries for a comprehensive EPA or FTA, negotiations should begin as soon as possible after the new administration of the Republic of Korea takes office in February, 2003.¹⁸ Discussions should be started on a common vision for economic relationships in East Asia revolving around Japan, China, and the Republic of Korea.

ASEAN: While our aim is to ultimately strengthen an economic partnership with ASEAN as a whole, we should, to begin with, rapidly make efforts in creating bilateral economic partnerships individually, based on the framework of the Japan-Singapore economic partnership agreement, with major ASEAN member states (including Thailand, the

18 Administration of the newly elected President Roh Moo Hyun.

Philippines, Malaysia and Indonesia) that have expressed a positive interest in concluding a bilateral FTA with Japan. Taking into account the progress of bilateral agreements, we should start a process of expanding those agreements to the one between Japan and ASEAN as a whole.

China: While the possibilities for an FTA could be considered from the standpoint of ultimately working out economic partnership in East Asia centering on Japan, China, and the Republic of Korea, plus ASEAN, for the present we should continue to closely monitor China's fulfillment of WTO obligations, trends in China's economy, the status of overall relations between Japan and China, and progress in the new round of WTO negotiations as well as in negotiations on concluding FTAs among other countries in Asia before determining our policy.

Hong Kong: In the context of the ongoing process of expanding the relationship of economic interdependence between Japan and China, the possibility of concluding an FTA with Hong Kong should not be excluded.

Taiwan: Taiwan is a separate customs territory under the WTO Agreement, and while the possibility of concluding an FTA with a WTO member is theoretically and technically a potential subject for consideration, Taiwan's tariff rates are already low, so tariff reductions achieved through an FTA would not produce major benefits for both sides. It would be more appropriate to consider strengthening economic relations in specific relevant areas.

Australia and New Zealand: While the handling of agricultural products is a sensitive issue in relation to these two countries, Japan shares many common values and interests with them. Australia, in particular, is a major supplier of natural resources to Japan. One useful approach would be to proceed in two stages as jointly proposed by business circles of both countries, i.e. pursuing economic partnership in areas of mutual interest over the short term while attending to the longer-term

task of concluding a comprehensive FTA.

(b) Preliminary considerations regarding other countries and regions

Chile: In light of Chile's tariff structure, its volume of trade with Japan, and its major exports to Japan, the conclusion of an economic partnership agreement or FTA with Chile could be considered a mid to long-term task, rather than an urgent task of the highest importance.

Mercosur: This customs union is a driving force for economic integration in Latin America, and we must pay attention to its movement toward a Free Trade Area of the Americas and negotiations on concluding an FTA with the European Union.

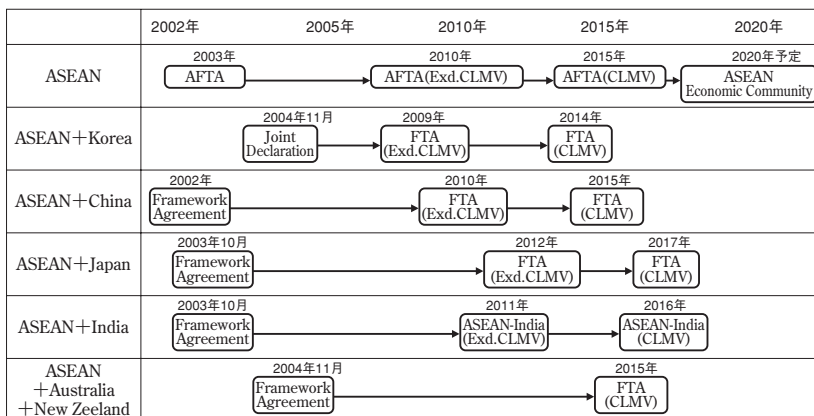
Russia: Any comprehensive move to strengthen economic relations, such as through an FTA, would be considered after the strengthening of relations through realization of individual projects.

South Asia: We should continue to explore the best approach to partnership while watching to see how India is integrated into the international economy.

Africa: While it is theoretically possible to employ FTAs as a means of assisting developing countries, we must also consider whether or not there would be any advantages for Japanese businesses.

North America and the European Union: The conclusion of an FTA with either would be a very difficult task in light of issues such as the handling of agricultural, forestry, and marine products. An FTA between Japan and the United States would bring about a major trade conversion effect. For the present it will be beneficial to strengthen the bilateral relationship through formulating frameworks in specific areas (such as mutual recognition) and promoting dialogues in such areas as regulatory reforms.

Below we provide FTAs schedule in East Asia prepared by MOFA and JETRO (figure 1).



CLMV=Cambodia, Laos, Myanmar and Vietnam

Source: MOFA and JETRO

Figure 1. FTA schedule in East Asia

3. Current situation of Japanese FTA policy

Japan has been late in joining the world practice of bilateral trade agreements. Until the latter half of the 1990s, the government relied mostly on multilateral negotiations as a means of opening up foreign markets to Japanese corporate interests. However, Japan is increasingly suffering the loss of market shares that FTAs between other countries produce. Because of NAFTA, for example, Japan felt an acute need for its own treaty with Mexico so that its products benefit from the same tariff levels on the Mexican market as those coming in from the United States. Japan concluded its first bilateral free trade agreement in 2000 with Singapore. In March 2004, it finalized discussions on an FTA with Mexico.

Until recently, Japan has been focusing its bilateral negotiating agenda on a few countries around the Asia-Pacific: Singapore (signed in 2000), Mexico (signed in 2004), Malaysia (signed in 2005), the Philippines (signed in 2006), Thailand (finalized but endangered by military coup in

September 2006), South Korea (under negotiation) and, slowly but carefully, ASEAN as a whole (expected to be inked by 2010). China and India are also on the agenda. Anyway, the Japanese government is getting frustrated with the slow pace of talks with neighbors in Asia. There have also been growing concerns about upcoming trade disadvantages for Japanese firms in Latin America due to the possible FTAA and the impending EU-MERCOSUR pact. Early in 2005, Japan started exploring possible talks with both Switzerland and Australia while in 2006 with Chile and Gulf states (as an entity).

The deals put forward by Japan are called “Economic Partnership Agreements” (EPAs), as the government holds that the term “free trade agreement” does not capture the broader integration of economic and social policies that these treaties aim to achieve between the partner countries. But these EPAs as a rule are similar in coverage to a typical FTA from the US, New Zealand or the EU.

Three regions - Asia, North America, and Europe - account for 80% of Japan’s total trade. Given that the simple average tariff rates imposed by the US and the EU are low, the government of Japan placed priority on negotiating FTAs with countries in East Asia.¹⁹ Not only do East Asian countries impose the highest trade barriers against Japanese exports, they also account for the highest and most dynamic share of Japan’s trade, thereby providing the greatest additional opportunities for expanding Japan’s economy via cuts in both foreign and domestic trade barriers.²⁰

As shown in **Table 1**, 11 East Asian countries and territories (China, South Korea, Taiwan, Hong Kong, Thailand, Singapore, Malaysia,

19 According to WTO data, Japan’s simple average tariff rate is now around 6.3%.

20 Japan’s Ministry of Foreign Affairs, *Japan’s FTA Strategy*, October 2002. Found at [<http://www.mofa.go.jp/policy/economy/fta/strategy0210.html>].

Australia, the Philippines, Indonesia, and Vietnam) purchased nearly 50% of Japan's total exports in 2004, up from 33% in 1998. Similarly, Japan is receiving a growing share of its imports from the same countries as well.

Table 1. Japan's Top Export Markets, 1998, 2000, 2002, and 2004 (% share)

Country	1998	2000	2002	2004
United States	30.53	29.73	28.51	22.45
China	5.18	6.33	9.59	13.07
South Korea	3.97	6.41	6.87	7.82
Taiwan	6.60	7.50	6.30	7.43
Hong Kong	5.81	5.67	6.10	6.26
Thailand	2.41	2.84	3.17	3.58
Germany	4.92	4.17	3.39	3.35
Singapore	3.81	4.35	3.40	3.13
United Kingdom	3.76	3.10	2.87	2.65
Netherlands	2.80	2.63	2.54	2.37
Malaysia	2.41	2.90	2.64	2.22
Australia	2.07	1.79	2.0	2.09
Philippines	1.87	2.14	2.03	1.70
Indonesia	1.11	1.58	1.50	1.60
France	1.60	1.56	1.47	1.48
Canada	1.63	1.56	1.76	1.35
Belgium	1.16	1.09	1.10	1.23
Italy	1.10	1.21	1.07	1.14
Panama	1.57	1.35	1.10	1.07
Mexico	1.09	1.09	0.90	0.92
Spain	0.68	0.67	0.63	0.36
United Arab Emirates	0.74	0.53	0.71	0.32
Saudi Arabia	0.73	0.64	0.90	0.65
Vietnam	0.34	0.4	0.51	0.56
Russia	—	—	0.23	0.55

Source: *World Trade Atlas*.

As shown in **Table 2**, the above mentioned exporters supplied Japan with 47.86% of its imports in 2004, up from 39.59% in 1998. Accordingly, in developing its FTA strategy, the Government of Japan placed the highest priority on negotiating FTAs with the Republic of Korea and the four largest ASEAN member states (Thailand, the Philippines, Malaysia, and Indonesia). An FTA with Mexico, now in effect, was also made a priority due to the relatively high tariffs Japanese companies faced compared to those companies from the United States, Canada, and European Union. The latter enjoy duty free treatment for the most part due to NAFTA (1994) and the EU-Mexican FTA (2000). After achieving FTAs with priority countries, the Government of Japan views China and Australia as the next most promising candidate partners.²¹

21 “Government Adopts FTA Policy Focusing on Partners in Asia,” *The Japan Times*, December 22, 2004.

Table 2. Japan's Top Suppliers of Imports, 1998, 2000, 2002, and 2004 (% share)

Country	1998	2000	2002	2004
China	13.22	14.52	18.31	20.73
United States	23.89	19.01	17.21	13.73
South Korea	4.32	5.39	4.59	4.84
Australia	4.64	3.90	4.15	4.27
Indonesia	3.87	4.31	4.21	4.11
Saudi Arabia	2.56	3.74	3.45	4.06
United Arab Emirates	2.98	3.91	3.44	4.03
Germany	3.82	3.35	3.68	3.75
Taiwan	3.65	4.72	4.02	3.67
Malaysia	3.10	3.82	3.31	3.10
Thailand	2.91	2.79	3.11	3.10
Canada	2.73	2.29	2.12	1.85
France	2.05	1.69	1.94	1.84
Iran	0.87	1.41	1.41	1.82
Philippines	1.58	1.90	1.93	1.81
Qatar	1.00	1.54	1.56	1.73
Italy	1.82	1.40	1.61	1.52
United Kingdom	2.09	1.73	1.60	1.46
Singapore	1.68	1.69	1.48	1.38
Kuwait	0.84	1.31	1.25	1.26
Russia	1.04	1.21	0.97	1.25
Switzerland	1.08	0.86	0.98	1.06
South Africa	0.83	0.79	0.86	1.01
Chile	0.85	0.75	0.64	0.92
Vietnam	0.62	0.70	0.75	0.85

Source: *World Trade Atlas*.

Since Japan launched its first FTA negotiation with Singapore in 2000, progress has been hampered by the government's defensive agricultural position. While some liberalization has been achieved, the amount so far has been greatly constrained by an inability to offer major reductions in its most protected crops - rice, beef, starches, wheat, and dairy - and to

open up its borders to foreign labor. Some critics have argued that Japan, following a course of least resistance, could end up with numerous watered down FTAs that neither harm nor energize the Japanese economy. According to this view, the FTAs with the largest benefits for Japan, such as those with Australia, China, and South Korea, are most desirable, but also most politically challenging and most likely to fail.²²

A short synopsis of the main features and significance of Japan's FTA policy follows. The trade agreements are divided into four categories:

- (1) those already entered into force;
- (2) those waiting for implementation;
- (3) those under negotiation; and
- (4) those that are in the pipeline or under consideration.

FTAs Entered Into Force — Singapore and Mexico

Japan's close political and economic ties with ***Singapore*** made this city-state a near perfect match for Japan's earliest FTA. Since the early 1970s, Japan has consistently been one of Singapore's top three trade partners and number one investor country. Out of nearly 5000 multinational corporations with operations in Singapore, over 1700 are Japanese firms. Since 2000, the amount of Japanese investment has topped 14 billion USD. Because the two economies were already liberally open to trade in most products, the FTA concentrated mostly on investment and opening up of sectors, such as services, finance, information technology, and transportation. The fact is that Singapore does not export agricultural commodities, which allowed Japan to dodge its most sensitive trade issue and gain easy internal support for the agreement.

The Japan-Singapore Economic Partnership Agreement (JSEPA)

22 "Japan Settles for 'Low-Risk, Low-Return' FTA Goals," *The Japan Times*, April 22, 2005.

was entered into force in November 2002. Tariffs were eliminated on 98% of the merchandise trade between the two countries, and further liberalization took place in services and investment. Given that there is virtually no agricultural trade between the two countries, and tariffs were already very low, it reportedly was a very easy FTA to conclude.

According to one report, other than some increase in imports of Japanese beer, Singapore has experienced no major changes from the FTA. The minimal impact may be due to the fact that tariffs were low to begin with and some chemical products, in which Singapore companies have a competitive edge, were excluded from the agreement. From Japan's perspective, the significance of this initial FTA seems to be good learning experience for its negotiators in how to negotiate an FTA.²³

Most importantly, agreement with Singapore marked a turning point in Japan's foreign trade policy: the start of the multilayered approach that includes regionalism in its field of vision as well as multilateralism.²⁴

First of all, Japan expected its accord with **Mexico** to "provide a bridgehead into NAFTA markets". Their FTA/EPA was signed in September 2004 and it went into effect in April 2005. Under the agreement (formally called an EPA), tariffs on 90% of goods that account for 96% in total trade value will be phased out by 2015, making 98% of exports from Japan and 87% of imports from Mexico duty free. Previously, only 16% of Japanese exports received duty-free treatment from Mexico, whereas 70% of Mexican exports entered duty free.²⁵

From Japan's perspective, the agreement helps eliminate the disadvantages its companies have incurred in competing against North

23 "Singapore, Thailand Reap FTA Rewards," *The Nikkei Weekly*, May 30, 2005.

24 Ohashi, Hideo, op. cit., p.30.

25 "FTA with Mexico Paves Way for Talks with Asian Nations," *The Nikkei Weekly*, March 15, 2004.

American and European firms since NAFTA went into effect in 1994 and the EU-Mexican FTA went into effect in 2000. Facing an average Mexican tariff of 16%, Japan saw its share of Mexican imports drop sharply, from 6.1% in 1994 to 3.7% in 2000.²⁶

Japan's automotive, electronic and steel companies are expected to benefit the most. The ETA offers a new tariff-free export quota for Japanese cars, in addition to the existing quota of about 30,000. The duty-free quota will make up 5% of the Mexican market in the first year and the quotas will be expanded before being completely lifted by 2011. With the abolition of the tariffs, exports of Japanese-finished cars are expected to double in the next few years. Steel tariffs are also supposed to be eliminated over a 10-year period.²⁷

The agreement is notable for Japan's agreement to reduce some protection of agricultural products. While the details remain sketchy, Japan reportedly cut tariffs on a variety of products such as pork, orange juice, fresh oranges, beef and poultry although these commodities will still be regulated by quotas. (Actual tariff rates are to be negotiated two years after the FTA's implementation). Yet, the value of Mexico's agricultural products exempt from import tariffs will still be less than 50% of its total agricultural exports to Japan.²⁸ Furthermore, Mexico supplies only 1% of Japan's total imports of agricultural products, suggesting that the limited liberalization will not pose much of a threat to Japanese producers nor be a precedent for other FTAs.²⁹ Anyway, within the first year after the accord's implementation bilateral trade increased by 37.1 percent while

26 Ministry of Foreign Affairs, Promotion of Economic Partnership Agreements (EPAs) and Free Trade Agreements (FTAs), p. 35.

27 "With Mexico FTA set, Japan turns toward Asia," *The Japan Times*, March 12, 2004.

28 "FTA with Mexico Paves Way for Talks with Asian Nations," *The Nikkei Weekly*, March 15, 2004.

29 "Mexico Expects Bonanza in FTA with Japan," *The Nikkei Weekly*, March 28, 2005.

Japan's direct investment in Mexico grew by as much as 234.1 percent.

FTAs Agreed in Principle (Waiting for Implementation)

Negotiations with **Malaysia** began in January 2004 and a basic EPA agreement was reached in May 2005. The two governments confirmed the agreement in principle on major elements of the Japan-Malaysia EPA negotiations at the East Asian Summit held in Kuala Lumpur. Though lowering of tariffs in regards to steel, automobiles, and plywood were the most difficult points in the negotiating process, an agreement has been reached that targeted a 10 year plan to gradual phase-out of Malaysian tariffs on Japanese exports in the steel and automobile sectors.

The two sides signed the agreement in December 2005, putting it into effect in 2006. One estimate is that the agreement will increase Japan's gross domestic product by 0.08% in real terms and boost Malaysia's real GDP by 5.07%.³⁰ The FTA will eliminate or strongly reduce tariffs on industrial goods by 2015. Of particular interest to Japan, Malaysia has agreed to immediately remove tariffs on all parts imported for local car production (used for the so-called breakdown format, under which components are imported to Malaysia for assembling). Customs duties on most finished vehicles (i.e. large cars that do not compete with Malaysian cars) and other car parts will be gradually removed by 2010.

Japanese automakers that manufacture locally can cut production costs if tariffs on auto parts from Japan are removed. Tariffs on small vehicles which compete with Malaysia's Proton "national car" will be abolished in stages by 2015. The grace period is designed to shield the market for small Malaysian-made autos, like those produced by Proton Holdings, from outside competition for five years. National car Proton and privately

30 "Japan-Malaysia FTA Gets Chiefs' Approval," *The Japan Times*, May 26, 2005.

manufactured Perodua have more than 70% of the market in Malaysia. Malaysia also agreed to eliminate tariffs on essentially all steel products within 10 years.³¹

Toyota Motor Corp. is re-strategizing its position in Malaysia to take advantage of free trade agreements (FTAs) signed between the countries in the region.³² Senior managing director Akira Okabe said the world's second largest car manufacturer saw potential not just in assembling cars in the country but also in sourcing and supplying of parts. Okabe said Malaysia was a significant market for the company although it had its regional manufacturing hub in Thailand. "Maybe this year or next year, we will have sales volume exceeding 100,000 units, which is not so small! In Thailand, we produce above 200,000 units (a year) because (we) export to the Middle East and regional countries" he said.

Japan for its part will eliminate tariffs on selective farm and fishery products within 10 years, with immediate abolishment of tariffs on such products as mangoes, durians, papayas, okra, shrimp, prawns, jellyfish, and cocoa. The tariff on margarine will be lowered from 29.8% to 25% in five years, and up to 1,000 tons of bananas will be duty free immediately. Tariffs on all forestry products except plywood, which is one of Malaysia's top exports to Japan, will also be eliminated immediately. But sensitive products such as rice, wheat, barley, dairy, beef, pork, starches, and fishery items under import quota are excluded from liberalization.³³

Negotiations with the *Philippines* began in February 2004 while the final document was signed by Prime Minister Koizumi and President Arroyo in September 2006 in Helsinki. For Manila it is the first free trade

31 Joint Press Statement: "Japan-Malaysia Economic Partnership Agreement," found at [<http://www.mofa.go.jp/region/asia-paci/malaysia/joint0505.html>].

32 "Toyota plans to tap regional FTAs." *The Star, Kuala Lumpur*, February 21, 2006

33 "Japan-Malaysia FTA Gets Chiefs' Approval," *The Japan Times*, May 26, 2005.

agreement ever. The agreement, which covers investment, trade in services, customs procedures, intellectual property, and competition policy, is expected to become effective by the end of 2006.³⁴

One of the major issues during negotiations was the admittance of Philippine labor resources into Japan, which was a major stumbling block to finalizing the agreement. While the Philippine Government insisted on the admittance of lawyers, health workers, and nurses, Japan was obviously reluctant towards any kind of fast increase in foreign workers at home. Finally, it was agreed upon that Japan would accept one thousand workers (400 nurses and 600 caregivers) who would have to pass Japanese language examination. The first group of Filipino workers will be allowed to come to Japan in the beginning of fiscal 2007. The deal is considered to be path breaking as it might open the door to manpower from other countries such as Thailand and Indonesia that have asked Japan to accept chefs and some other professionals.³⁵

A key bargain in the agreement calls for the Philippines to lower its tariffs on most steel products and autos by 2010 in exchange for lower Japanese tariffs on pineapples and bananas, farm products that do not compete with domestic produce. Bananas are not grown in Japan and pineapples are only grown in a small area of Okinawa. For the most part, Japan negotiated not to open its market further to sensitive agricultural products such as rice, wheat, barley, designated dairy products, beef, pork, starches and selective fishery products. Liberalization of Japan's protection of raw cane sugar will be reconsidered after the agreement has been in effect for four years.

In the autumn of 2006, the basic accord on free trade has also been

34 "EPA Deal Makes Philippines Third Free Trade Partner," *The Nikkei Weekly*, December 6, 2004.

35 "FTA to Let in 1,000 Filipino nurses, caregivers", *The Japan Times*, September 13, 2006

reached with **Chile** whereby tariffs on 92 percent of both countries' exports will be abolished over ten years. Japan's mass-media observed that that the country's agreement with Chile was reached much quicker than with the other FTA partners.

FTAs Under Negotiation —Republic of Korea, Thailand, and Indonesia

As shown in tables 1 and 2, **South Korea** is Japan's third trading partner both in terms of export and import. An FTA with this nation would be a great advantage to Japanese exports, especially in regards to auto parts and industrial machinery sectors. The recent joint Japanese-Korean research has shown that free-trade accord between the two nations would be the most important FTA in the region, second only to the desired but problematic tripartite China-Korea-Japan trading pact (CKJFTA)³⁶ However, bilateral negotiations which began in December 2003 soon came to be stalled. The two sides initially planned to submit liberalization offers by January 2005, but both countries developed reservations. Reportedly, Japan expressed reluctance to abolish tariffs on agricultural and marine products, while South Korea hesitated to cut tariffs on industrial goods, particularly those that could affect its auto sector. South Korean officials are also worried that an FTA could exacerbate its large trade deficit with Japan. Prospects for more flexible negotiating positions were not helped by a recent WTO case that Korea filed against Japan's import quotas for dried laver seaweed. Though Korea does not export this marine product in great quantities reportedly it took a hard line on "seaweed problem" to symbolize its protest over Japan's refusal to negotiate

36 Izawa, Kazuhoro and Kim Bonggil. "East Asian Free Trade Agreement: Strategic Aspects for Japan", in C.Y.Ahn et al. (eds), *East Asian Economic Regionalism*, Dordrecht: Springer, 2005.

“seriously” on agricultural issues in general.³⁷

Japan is actively working for an FTA negotiation, but the Korean government has not been very keen to enhance the policy dialogue, at least in the eyes of the Japanese. After holding six meetings, the talks were stalled by the Korean Government’s strong desire to exempt automobiles from the tariff cuts, which is currently at 8 per cent. South Korea fears a possible influx of Japanese cars would cause great damage to its domestic automobile industry.

The halt in free trade talks has, in addition, political roots. According to Seoul’s minister of commerce, the “reason behind stalling may not be only in differences of views among industries, but also broader historical issue”. To be more specific, the official referred to tensions over history, including Prime Minister Koizumi’s visits to Yasukuni Shrine in Tokyo,³⁸ as well as a row over an island in the Sea of Japan. Meanwhile, South Korea announced the start of FTA talks with the United States with the prospect to conclude them by March 2007. If so, Japan could become an obvious loser in the FTA race in the APR. Perhaps, ascension of Shinzo Abe to premiership in Japan will help move the solution of the problem into motion.

Japan’s negotiation with **Thailand**, Japan’s largest trading partner in ASEAN and the place where about 3,000 Japanese companies operate, began in February 2004. Trade matters on agriculture were agreed first, and then issues relating to steel, auto parts, services, and investments were discussed. Thailand’s extremely high automobile tariff of 80 per cent will be gradually lowered by 5 per cent each year for cars above 3000cc until it reaches 60 per cent in 2010. It has been agreed at that time that the

37 “FTA Talks with Seoul Deserve Fresh Start,” *The Nikkei Weekly*, March 7, 2005.

38 “Historical Tensions Blocking FTA Deal: Seoul,” *The Japan Times*, May 28, 2006, p.8

Japanese and Thai governments will then renegotiate how the further liberalization of automobiles will proceed. The Japanese Government has expressed a desire for the total elimination of automobile tariffs in 2010. Thailand will gain an elimination of tariffs for vegetables, fruits, cooked chicken, processed shrimp, stark, textiles, and jewelry exports to Japan.

Agreement with Thailand has proved difficult due in large part to agriculture. Thailand was initially so eager to achieve the accord that it was ready to exclude both countries' farm sector. As a result, it was agreed that rice - long considered the main obstacle in the negotiations - would not be subject to tariff cuts. Later, Thai stance stiffened so that Bangkok demanded elimination of Japan's tariffs on chicken, sugar, starch and forestry and fisheries products. Thailand also wants Japan to accept more chefs and spa specialists, especially after Filipino professionals were allowed to join Japan's labor market. Japan's demands on Thailand center on autos and steel. Cuts on Thai auto tariffs have been complicated by heavy Japanese foreign direct investment in the Thai auto sector (Japanese companies control over 80% of the production, sales, and exports of autos in Thailand).

Japan had planned to sign the pact in mid-October 2006 but the military coup in Thailand resulting in ouster of Prime Minister Thaksin Shinawatra have thrown it into doubt. According to the Japanese mass media, because Thaksin was the propelling force in brokering the FTA and is thought to be too "soft" in the negotiations, the accord may be reviewed by the new government.

Japan and *Indonesia* agreed in June 2005 to launch FTA/EPA negotiations and a joint group was set up to study its impact on both economies. Round of negotiations are supposed to take place every two months. Currently the framework for the negotiations is nearly complete, and both parties expect to be able to start substantive talks on various

areas including market access, investment, trade in services, personnel transfer, energy, intellectual property rights and bilateral economic cooperation. Japan is seen to be particularly interested in the development of energy resources in order to gain access to coveted Indonesian oil deposits. Both sides have expressed a strong desire to complete a deal within two years.

Indonesia, which is a major provider of crude oil, coal, and natural gas to Japan, hopes to see the agreement facilitate a large-scale increase in Japanese foreign investment. Japan's agricultural protection, along with Indonesia's protection of its auto and steel sectors, are likely to be divisive issues.

Other FTA Candidates

Japan is considering FTA/EPA negotiations with a number of other countries, including Australia, China, India, Taiwan and Switzerland. In addition, after concluding agreements with Malaysia, the Philippines and Thailand (these three counterparts account for about 75% of Japan's trade with ASEAN), Japan hopes to expand those agreements (including the one with Singapore) to **ASEAN** as a whole. The objectives of the ASEAN-Japan Comprehensive Economic Partnership (AJCEP) were agreed at ASEAN summit in Bali in 2003.

The first meeting among all the countries was held in Tokyo in April 2005. There appeared several points of contention, especially in regards to how an FTA with ASEAN would be related to bilateral FTA negotiations and how the rules of origin would be defined. When the two sides met for a ministerial meeting in September 2005, there was no leeway on either side to overcome these issues. The representatives from ASEAN strongly lobbied in Japan to drop its plans to push forward concrete trade negotiations for a broad ASEAN agreement until all the individual bilateral FTAs have

been concluded. The ASEAN ministers also expressed their disappointment at the slow pace and lack of progress in the meetings with Japan.

Meanwhile, Japan has started preliminary negotiations with Cambodia, Laos, Myanmar, Vietnam, and Brunei independently, and plans to eventually link them together into one larger ASEAN FTA. The two sides aim at full trade liberalization by 2012, which is behind the China-ASEAN agreement for 2010 and the South Korea-ASEAN agreement set for 2009.

The failure of the WTO Doha round has spurred Japan's interest for an even broader multinational tariff-free accord in the Asia-Pacific. In 2006 both the then Chief Cabinet Secretary (the future Prime Minister) Shinzo Abe and METI head Toshihiro Nikai called for a pan-Asian FTA that unlike ASEAN-China FTA would also involve India, Australia and New Zealand. Obviously, the proposed pact looks like APEC minus the Americas and Russia. The proposed East Asian Economic Partnership Agreement involving 16 nations could form a market larger than NAFTA or the EU, covering 3 billion people. Its combined gross domestic product (GDP) would be 9.1 trillion USD, one quarter of the global figure, according to 2004 data.³⁹

Proposed participants' reaction to the new initiative has been ambiguous. New Zealand, for example, has given a strong backing to the idea with the view that it "would be a huge spur ... to get the Doha round of global talks back on track"⁴⁰ However, Southeast Asian nations' reaction so far has been more cautious as they expect from Tokyo in the first place the completion of free-trade negotiation with ASEAN itself.

Australia is an important trading partner for Japan and a key supplier of Japan's oil, coal, iron ore, and natural gas. A feasibility study on

39 "Japanese Govt to Propose Big Asian Free-trade Zone", *AFX News Limited*, April 4, 2006.

40 "Kiwis Voice Strong Support to pan-Asia FTA Idea", *The Japan Times*, August 5, 2006, p.8

the impacts of FTA/EPA has been initiated, where Japan has finally agreed to include agriculture. Japan's growing interest towards Australia for importing natural resources could help move the process along. However, Australia's large agricultural sector and its desire to gain further entrance to Japan's market will almost certainly prove to be a difficult sticking point in to overcome. Japanese agriculture industry also fears that countries like Canada may follow, if Japan imports more agricultural commodities from Australia under the free trade agreement.

Two years of FTA discussions, however, have not progressed far reportedly due to Japan's resistance to open its market to more beef, rice, and dairy products from Australia. While a high-level agreement was made in April 2005 to continue discussing the feasibility of an FTA, most observers think that Australia will not enter into negotiations if agriculture is not on the table. In effectively downplaying the prospects for this FTA, Prime Minister Koizumi noted that an FTA with Australia that included beef would have an adverse effect on relations with the United States.⁴¹

While many Japanese officials are intrigued by the possibility of negotiating an FTA with **China**, the consensus is that it is much too early to move forward. For the present, Japan wants to monitor China's fulfillment of WTO obligations, the status of its state-owned sectors, and progress in Doha Round of multilateral negotiations.⁴²

For Japan, China is the most important economic partner in Asia and — since fiscal 2002 — in the world. According to a 2005 Mizuho Research Institute study, 37.5 per cent of the Japanese companies that were surveyed chose China as the most desirable FTA partner, which was the highest, followed by the United States (18.7 per cent). China also

41 "Japan, Australia Mull FTA," *The Japan Times*, April 21, 2005.

42 Interview with Ichita Yamamoto, Upper House Diet Member, Liberal Democratic Party, June 23, 2005.

appears to show a great deal of interest for an FTA with Japan in order to boost its exports. The Japanese market is seen as having great potential for Chinese agricultural exports. However, pressure from Japanese agricultural as well as Chinese high-tech firms fearing competition makes progress towards an FTA politically very difficult. Questions concerning faithful compliance from the Chinese government in regards to intellectual property and service sector commitments are also an issue.

While the Japanese corporations, especially those from the manufacturing sector, for the most part appear ready and even eager for an FTA with China, there are still many forces at work preventing Japan from moving forward toward on negotiations. The first of such factors is Japan's desire not to even begin talks about an FTA with China until the tri-lateral investment treaty including South Korea is successfully concluded. This treaty is set to replace bilateral investing treaties that are currently operating between the three countries.

Another problem relates to Japanese resistance to a potential flood of Chinese agricultural products into its market. While many experts point out the fact that increasing demand for agricultural products within China and the advantage of high quality Japanese food products such as rice would offset much of the pain from liberalization, there still remains a great deal of fear in this area. The Japanese Government also must undertake more research into what possibilities a China FTA would entail. There is also a great deal of discussion of how to deal with China's intellectual property problems and WTO commitments, and whether issues such as these should be tethered to bilateral free trade negotiations. Lastly, the recent icy political relationship between Japan and China in Koizumi era has not helped encourage a spirit of cooperation.

India: A joint study group to assess the prospects and impacts of EPA has been set up, and the first two meetings were successfully held in

New Delhi and Tokyo in 2005. The group was expected to submit a report to the two governments within a year. The two sides have spoken positively about the possibility for an FTA. It is important that India-Japan EPA will boost Japan's direct investment in India. On the trade front, export of Indian mangoes has been one of the main issues. Besides, India's iron-ore export contract with Japan ends in 2006, which could prompt further efforts towards bilateral discussions at that time. The double-taxation issue for Indian software exports to Japan will be settled soon.

Switzerland is what one Japanese trade official calls a good pipeline project. An attractive feature of this prospective negotiation is that the Swiss do not want to liberalize agriculture so there would be no major impediment to a negotiation. Lacking much liberalizing content, such an agreement would have mostly geopolitical merit.⁴³

Challenges to Advancing FTA/EPA Negotiations

Japan's ability to promote its economic interests through an aggressive FTA/EPA policy is constrained by protection of its agricultural sector and rigid immigration policies. While the FTA/EPA negotiations themselves provide pressures for more open policies, the ministries charged with these portfolios (those of Agriculture and Justice, respectively) have not yet advanced effective reform policies that would make a substantial difference.

Agriculture accounts for only 1.3% of Japan's GDP and 4.6% of its total employment, but remains heavily supported and protected from import competition. According to the OECD, support to producers as a percent of gross receipts was 58% in 2002-04, down from 61% in 1986-1988, but still almost twice the OECD average. Rice, wheat, other grains, meat,

43 Interview with Norio Nakazawa, METI Counselor for Regional Cooperation, June 28, 2005.

sugars, and dairy are the most heavily supported commodities. Tariff-rate quotas are employed to shield these commodities from international competition, resulting in food prices that in Tokyo are on average 130% higher than the rest of the world.⁴⁴

Most Japanese acting and prospective free trade accords do not cover farm products which considerably weaken their importance. Yorizumi Watanabe, the scholar and official who, perhaps, knows the situation around FTAs better than anyone in Japan writes: “When convenient sectors are included and inconvenient ones (i.e. agriculture) are excluded, you wind up with a bad FTA producing distortions in two ways, first through discrimination in relations with outside countries and second through discrimination between sectors within the free trade area. The two kinds of distortions have a negative impact on the economic well-being of the countries concerned and of the whole world”.⁴⁵

Many in Japan believe that excessive support for agricultural protection will disappear over time. They cite the declining share of the population engaged in agriculture and the high percentage of farmers (60%) who are over 65 years old and who derive the majority of their income from non-agricultural activities. In the process, the hold of the agricultural lobby is said to be slipping as evidenced by the slippage of the LDP in the 2004 Upper House election.⁴⁶ The LDP derives most of its support from rural areas, in part, due to Japan’s disproportionate electoral districting system; each rural vote is worth an estimated 2 urban votes.⁴⁷

44 *OECD (2005)*, “Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005.”

45 Watanabe, Yorizumi, *op.cit.*, p.292. Y. Watanabe is the deputy director-general of the Economic Affairs Bureau, Ministry of Foreign Affairs.

46 Although the LDP largely held its own in the vote — it lost one seat, to bring its total in the 245-seat Upper House to 115 - the election was largely seen as a significant setback for the LDP because the Democratic Party of Japan (DPJ) won 12 new seats to bring it to 82 seats.

47 CRS Issue Brief IB97004, *Japan-U.S. Relations: Issues for Congress*, by Mark Manyin (Coordinator).

However, policy reforms to help move Japan away from considerable agricultural protection have been slow to materialize. While the Ministry of Agriculture, Forestry, and Fisheries has released papers that have raised the idea that Japan should stop wasting resources on crops that can be imported more cheaply, little follow-up has occurred. These reports advocate consideration of policies that would increase competition in the sector by encouraging new entrants and providing direct compensation to farmers through tax incentives in lieu of price controls and high tariffs.⁴⁸ In large measure, this is due to opposition from influential members of the LDP's "farm tribe." The farm lobby in Japan is strongly nationalistic, and politicians who put nutrition products, particularly rice, on the bargaining table, risk their careers much. In the absence of a substantive reform plan to make Japan's farm sector more efficient, agriculture is bound to continue to be a major stumbling block for concluding economically meaningful FTAs/EPAs.

Among industrial nations, Japan maintains the tightest **immigration** policy towards accepting foreign workers and remains extremely cautious about changing course. Obviously, the possible massive influx of Chinese workers cultivate anti-immigration feelings in Japan's society. However, due to a declining birthrate and an aging workforce, Japan's decision-makers are under increased pressure to accept more foreign workers to keep the economy from stagnating. The demands of FTA negotiating partners such as the Philippines and Thailand to liberalize Japan's labor market prohibitions have brought added pressures and debate about a more open door policy.⁴⁹

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A 1999 government employment plan called for Japan to promote foreign employment in "specialized and technical areas," but a "careful

48 Fujisue, Kenzo and Koike, Masanari, "Opening Up, Reluctantly," *Far Eastern Economic Review*, April 2005.

49 "Foreign Workers at the Gate," *The Japan Times*, August 23, 2004.

approach based on national consensus” towards manual workers. Despite the needs in certain sectors to accept more foreign workers, such as nurses and care providers, public support is lacking. Concerns about increased crime rates, the social costs of accepting more foreigners, and an adverse impact on Japanese homogeneity tend to dominate, along with the resistance of labor unions. In addition, neither the LDP nor the Democratic Party stand clearly in favor of liberalizing immigration.⁵⁰

The significance of the immigration issue transcends the problems it creates for Japan reaching closure on FTA negotiations with its Asian partners, such as Thailand and the Philippines. The continuation of exclusionary immigration policies may also undercut Japan’s ambition to play a leading role in a more integrated and interdependent Asian economy.

Conclusion

So far, Japan’s FTA policy has been mainly defensive and relatively weak, low-risk and low-return. If this course persists, it may have varied effects on other countries interests. In this connection, the American attitude to the problem is of great importance. A recent testimony at the US House of Representatives Subcommittee on Asia and the Pacific by one of the leading experts on Japan, the editor-in-chief of “The Oriental Economist Report” Richard Katz is helpful in understanding the US approach. Katz argued that on the one hand, Tokyo’s current FTA policy is likely to provide a positive, yet small, boost to increasing Japan’s role in the political economy of East Asia. It is also likely to be favorable to Japan-US bilateral trade ties as other Asian trading partners, instead of the

50 Fujisu, Kenzo and Masanari Koike, “Opening Up, Reluctantly,” *Far Eastern Economic Review*, April 2005, p.39.

United States, pressure Japan to open its agricultural market further. There are also concerns that a defensive and weak FTA policy pursued by Japan could allow China to play a more dominant role in the Asian economy - perhaps even creating an exclusionary Asian trading bloc.

More than a decade ago, there was concern in the world that Japan was an economic threat because its economy was too strong. Subsequently, U.S. policymakers have come to believe that Japan is more of a problem when its economy is weak. A lackluster growth performance of Japan not only affects U.S.-Japan trade and financial ties adversely, but also undermines growth of the East Asian economy. Meanwhile, an economically strong Japan is needed to serve as a counterweight to a rising China.⁵¹

Despite regaining a good deal of financial stability in recent years, Japan's economy remains weak. With growth projections of no more than 1.3-1.6% over the next five years, Japan will not be in a position to play much of a locomotive role either for the United States or the region. This assessment is not likely to be altered by the estimated weak impact of Japan's FTA policy on economic growth. Lagging China in FTAs with Asian countries, as well in other trade and investment linkages, Japan currently cannot be said to be moving rapidly to establish itself as a credible counterweight to a rising China.⁵²

The reduction in bilateral tensions has been accompanied by Japan's FTA negotiating partners replacing the United States as demanders of agricultural trade liberalization. To the extent that these pressures lead to cuts in Japan's agricultural protection or agricultural reform proposals, this will be helpful to U.S. agricultural interests not only in bilateral context, but also in the context of the multilateral negotiation. Unfortunately, slow movement or progress along these lines is occurring.

51 Katz, Richard. Testimony before the US House of Representatives International Relations Subcommittee on Asia and the Pacific, April 20, 2005.

52 Ibid.

At the same time, Japan's FTAs could diminish the benefits that the United States has obtained from its own FTAs. Japan's accords with Mexico and Singapore are cases in point, moving Japan towards an equal footing with these trading partners.

Although proposals have been made in the past for negotiation of an FTA between Japan and the United States, Japan's reluctance to reduce its agricultural protection has proved a formidable stumbling block. Nothing has changed in recent years to alter that calculation, but concerns have been raised that the respective FTA policy of the two sides could allow the bilateral economic relationship to drift and weaken as Japan engages increasingly with its Asian neighbors and the U.S. seeks new partnerships throughout the world. One consequence could be lost economic opportunities for the two largest economies in the world, as well as a weakening of political and security cooperation. In this context, one former US trade negotiator has proposed consideration of what he calls a "Comprehensive Economic Initiative" (CEI) between Japan and the United States. The CEI is seen as a way for Japan and the United States (both governments and private sector representatives) to consider actions to promote trade, investment, financial flows, and deregulation, and to harmonize standards and coordinate competition policy.⁵³

China has been much more aggressive than either Japan or the United States in negotiating FTAs. Beijing has concluded a partial FTA with ASEAN ahead of Japan and South Korea.⁵⁴ China has also opened its

53 See interview with Glen S. Fukushima, in *The Asahi Shimbun/International Herald Tribune*, June 28, 2004.

54 The China-ASEAN pact took effect on July 1, 2005. The agreement is less than comprehensive, with only 40% of goods subject to a reduction in tariffs to 5% or less. The accord will seek to broaden the range of goods to 60% of imports within two years, but the agreement has also incorporated many exceptions for sensitive products. See "Japan needs trade pact with Asean," *The Yomiuri Shimbun*, July 19, 2005.

tropical farm products to Thailand in a partial FTA, and has also agreed to start FTA negotiations with Singapore, Australia, and New Zealand. China's long-term goal may be to form the center of an East Asian trade bloc.⁵⁵

Given that the United States has a limited FTA agenda with Asian countries (FTAs in place with Singapore and Australia and talks contemplated with only South Korea), an East Asian trade bloc could have the potential for substantial discrimination against U.S. exports.

Also worrisome from the US standpoint is the possibility of a Japan-China FTA. Much of Japan's private sector reportedly is enthusiastic about such a deal.⁵⁶ A Japanese government-sponsored study found that a China FTA could boost Japan's GDP by 0.5%, the most among any potential partner country or region.⁵⁷ While many big obstacles stand in the way of a Japan-China FTA, the possibility should give pause for thought to U.S. policymakers. Some observers opine that the United States would actively work to deter Japan from entering into an FTA with China.⁵⁸

At the same time, China's aggressive FTA policy is said to be used by Tokyo's opposing FTA negotiators for negotiating advantage. Trade negotiators representing ASEAN, for example, reportedly have played this "China card" by telling Japan that China is more forthcoming and willing to negotiate an FTA than Japan.⁵⁹ Presumably, this kind of gamesmanship could nudge Japan to take more aggressive and trade liberalizing FTA positions.

55 Mastel, Greg. "How China Threatens America," *The International Economy*, Spring 2005.

56 "Many Unlikely Voices back FTA with China," *The Nikkei Weekly*, July 5, 2004.

57 "China Deal Could Boost Japan's GDP 0.5%," *The Nikkei Weekly*, January 11, 2005.

58 "Japan, U.S. Set for Game of Diplomacy on FTA," *The Nikkei Weekly*, June 7, 2004.

59 Japan Settles for Low-Risk, Low Return FTA Goals," *The Japan Times*, April 22, 2005.