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“FTA in East Asia and Agenda for Regional Cooperation”

By

Dr. Yoshiko Kojo

Professor of International Relations

Department of International Relations, University of Tokyo

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The Potential of Free Trade Agreements to Enhance Regional Cooperation in East Asia

FTA in East Asia and Agenda for Regional Cooperation

Yoshiko Kojo

Professor of International Relations

Department of International Relations, University of Tokyo

Introduction

There have been three waves of the development of bilateral and regional customs unions and free trade agreements since the end of the World War II. Now we are in the middle of the third wave. The first wave was recognized in the 1950s mainly in Western Europe. The European Coal and Steel Community (ECSC), the origin of the EEC, was an example. Following the Western European trend, regional trade agreements were reached mainly in Latin America and Africa. However, the West European case was the only successful one. The second wave started in the latter half of the 1980s. In Western Europe, the Single European Act and the Maastricht Treaty were agreed upon to create the European Union (EU) with a single European market and monetary union. In North America, the North American Free Trade Agreement (NAFTA) incorporated Mexico into the pre-existing U.S.-Canada Free Trade Agreement. In the Asia-Pacific region, APEC was established in 1989. The third wave is notable in the recent emergence of many bilateral and regional trade agreements. Many FTAs were concluded in recent years and are now under negotiation.

Why have a number of countries sought to conclude FTAs in recent years? Are there any characteristics of the recent proliferation of FTAs in East Asia? Does the

proliferation of FTAs contribute to the enhancement of the regional community? This paper aims to answer these questions. Before examining these questions, the next section will describe the characteristics of the recent proliferation of FTAs.

The Recent Proliferation of FTAs

The bilateral and regional trade deals increased in number and speed in recent years. Some 250 RTAs (Regional Trade Agreements) have been notified to the GATT/WTO up to December 2002. Out of the 250, 130 were notified after January 1995. Over 170 RTAs are currently in force; an additional 70 are estimated to be operational although not yet notified. According to the WTO, by the end of 2005, if RTAs reportedly planned or already under negotiation are concluded, the total number of RTAs in force might well approach as many as 300.¹

Geographically, there are two kinds of FTAs. One is the FTA across regions such as EU-Mexico, US-Jordan, New Zealand-Singapore, Japan-Mexico, and the other is the FTA within the region with geographical proximity such as the Free Trade Area of the Americas (FTAA), the ASEAN+3, and the EU. The former type sometimes includes strategic concerns apparent in such FTAs as US-Jordan and US-Israel. In East Asia, compared to regional economic arrangements in Europe and North America, it is generally argued that there is much less regional institutionalization in East Asia, although there are regional frameworks such as ASEAN and the Asia-Pacific Economic Cooperation (APEC).² However, recently we can notice the proliferation of FTAs as well as in other regions. FTAs such as Japan-Singapore and Singapore-Australia were concluded, and more than ten FTAs such as ASEAN-China, ASEAN-Japan, Japan-Mexico, Australia-Thailand, Japan-Thailand were proposed and are under study or negotiation (Figure 1. 2).

As for the content of FTA, FTA has been allowed to establish under the Article XXIV of the GATT. Although almost all FTAs include trade liberalization, their contents vary widely. Some cover liberalization of capital transfer and service trade, others include protection of intellectual property rights. As far as they comply with the

¹ WTO (http://www.wto.org/english/tratop_e/region_e/region_negoti_e.htm)

² Grieco, Joseph M. (1999), 'Realism and Regionalism: American Power and German and Japanese Institutional Strategies During and After the Cold War,' in Ethan B. Kapstein and Michael Mastanduno (eds), *Unipolar Politics*, Columbia University Press, New York: 1999, pp. 319-353, Katzenstein, Peter J. (1997), 'Introduction: Asian Regionalism in Comparative Perspective,' in Peter J. Katzenstein and Takashi Shiraiishi, *Network Power: Japan and Asia*, Cornell University Press, Ithaca, pp. 1-44.

principle of non-discrimination of the Article XXIV of the GATT, countries can design FTAs at their own discretion. It is easier for countries to utilize FTAs to their own purpose compared to the multilateral agreements such as the WTO. As a result, we might see various kinds of FTAs, which vary in level and scope of liberalization.

Why Do Countries Seek to Conclude FTAs? : The Case of Japan

There are mainly two objectives for FTA formation: economic and political objectives. Of course, countries that pursue FTA formation recognize the economic benefits from liberalization of trade and service. However, it seems that countries pursue FTA formation not only for economic reasons but also for political reasons.

For example, why did Japan come to show its interest in an FTA in the late 1990s? Japan's policy change to pursue FTA, even though it regards multilateral liberalization may be the best way to its welfare, affected other countries' perceptions on FTAs in East Asia. According to the Ministry of Foreign Affairs, there are economic political/diplomatic reasons for FTAs. As for economic reasons, "FTAs 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 friction becoming political issues, and help expand and harmonize existing trade-related regulations and systems." As for political/diplomatic reasons, "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

Actually, the Japanese government has been hesitant to participate in regional economic arrangements in the postwar period, in contrast to its supportive attitude towards global frameworks since it joined the IMF and the GATT in the 1950s. However, in the late 1990s and early 2000s, the Japanese government seemed to take a new policy orientation in trade and international finance such as its emphasis on "multi-layered trade policy" and its proposal of the regional monetary fund to deal with

³ MOFA, Japan's FTA Strategy (Summary), October 2002
(<http://www.mofa.go.jp/policy/economy/fta/strategy0210.html>).

financial crisis.⁴

It is generally argued that Japan's increasing economic transactions such as trade and direct investment with East Asia after the mid-1980s can explain the interest in formulation of an FTA. It is no doubt that increasing economic transactions with East Asian countries prompted the Japanese government to pay attention to regional bilateral framework. Japanese businesses that expanded activities across borders in East Asia also supported the government's commitment to a regional framework. However, economic explanation cannot fully account for Japan's pro-active attitude; for example, in the late 1990s, after the Asian financial crisis, Japan's direct investment in Asia and trade with Asia declined.

There are three political factors to explain Japan's policy change besides increasing economic transactions. The first factor is the stability of global economic frameworks such as the GATT/WTO and the IMF. Since Japan has relied on export-led economic growth, global economic frameworks have been regarded as essential for Japan's economy to eliminate barriers to foreign markets, and a stable international monetary system as necessary to conduct trade smoothly. Moreover, Japan has been one of the most eager supporters of a multilateral global framework, and until the late 1980s, it had never committed to a single regional or bilateral FTA.

However, since the 1970s, global economic frameworks showed frequent instability and cast skepticism for their future role. In the late 1980s, the GATT Uruguay Round stalled, due to conflicting interests between the United States on the one hand and the EC and Japan on the other on agricultural products, and a new international financial system was not agreed to either. In the late 1990s, the WTO Ministerial Conference failed to reach agreement, and the IMF could not solve the Asian financial crisis effectively. Instability in the global economic framework prompted the Japanese government to seek alternative frameworks that Japan can rely on for securing stable foreign economic relations.

The second factor is the situation of Japan-U.S. relations. Good economic relations with the United States have been crucial for Japan's economy. Since the 1980s, however, conflicts between these two countries increased. The main cause of Japan-U.S. economic friction was U.S. domestic complaints over its large trade deficit with Japan and Japan's large current account surplus. The U.S. government put pressure on the Japanese government to adjust Japan's current account surplus by reducing the trade

⁴ MITI (2000), *White Paper on International Trade 2000*, Okurasho Insatsukyoku, Tokyo

surplus with the United States by opening its markets, deregulating capital control, and expanding domestic demand. When the bilateral economic negotiations became more tense, Japan was likely to seek alternative or supplemental economic ties with other countries to avoid over-dependence on the United States.

The third factor is the perceptions of East Asian countries on Japan's role in establishing regional frameworks. Even in the late-1980s, East Asian countries were skeptical about Japan's assertive role due to their WWII experiences. On the Japanese side, the Japanese government and business were well aware of such skeptical feelings in the region and while the Japanese government became more interested in regional frameworks such as APEC than ever before, lingering skepticism restrained their behavior.

East Asian countries became more positive toward Japan's role in the region in the late 1990s after the Asian financial crisis. The crisis made East Asian countries seek Japanese leadership in preventing future regional financial crises. In the case of FTAs, it was Japan who was approached to consider seriously the FTA proposals of Singapore and South Korea. Moreover, China's increasing interest in regional frameworks after it joined the WTO prompted the Japanese government to move further toward a regional framework. It can be concluded that three factors explain Japan's more assertive policy position on regional frameworks in the late 1990s than in the previous period.

Political Aspects of the Proliferation of FTAs in East Asia

There are two important political aspects of the proliferation of FTAs in East Asia. First, although there are various reasons behind each country's motives for an FTA, one crucial reason common to almost all countries in East Asia is that they do not want to be left out of other countries' moves for FTA. This reason is most likely to explain the rapid proliferation of FTAs in East Asia. Since the Early Voluntary Sectoral Liberalization (EVSL) failed in the negotiation of the APEC, the expectation of the leading role of the APEC in liberalizing trade and investment in East Asia has been degraded. Along with the stalemate in the WTO, countries in this region came to fear missing the vehicle for liberalization. Since the fear of being left out is the most essential motive for many countries in the region, they tend to propose establishment of FTAs with other countries without being well prepared and having a specific purpose. This means that although there are many proposals for FTAs, at this moment it is not clear that what kind of FTA is desirable in East Asia.

Second, there has been no country to take leadership role in coordinating the increasing number of FTAs in East Asia. Leadership here means the initiative of designing an FTA to promote liberalization in a wider scope and implementing the code of liberalization. Bigger countries such as Japan and China seemed not to take this kind of leadership role until now, unlike the United States in the Americas and France and Germany in the EU. China proposed an FTA with ASEAN in November 2000 and concluded the Framework Agreement on ASEAN-China Comprehensive Economic Cooperation in November 2002. China wants to hedge the risk of liberalization within the framework of the WTO by promoting regional economic relations. However, the content of the proposed FTA is still under negotiation. Japan concluded the Japan-Singapore Economic Partnership Agreement and proposed an economic partnership agreement with ASEAN in January 2002. In October 2003, Japan also concluded the Framework Agreement for Comprehensive Economic Partnership between ASEAN and Japan. However, there have been few attempts from both China and Japan to utilize the ASEAN+3 framework to promote a free trade area in the region. Japan's proactive attitude toward FTA with ASEAN was reactive to China's behavior toward ASEAN.

These two political aspects restrained the proliferation of FTAs from constructing a regional community.

Agenda for Regional Cooperation

Whether the formation of FTAs will facilitate regional cooperation in East Asia will depend on how countries in the region manage at least the following three problems.

First, although there is an increase in the number of FTAs, as described before, there is no leadership to coordinate them and no leading idea to make them to contribute to regional community. There is also some diversification in the level and scope of liberalization among countries. This diversification makes the creation of a regional community difficult, as was seen in AFT. The region needs a leadership role and a common idea regarding the regional community.

The second problem is how to manage the relations between FTAs and multilateral frameworks such as APEC and the WTO. Do countries consider an FTA complementary or as an alternative to a multilateral framework? If they consider the FTA alternative to the multilateral framework, unlike the EU, there will be low

possibility to construct regional community in this region. Moreover, as some economists point out, the increase in the number of FTAs does not simply lead to a more liberalized world, due to the so-called “spaghetti bowl effects.”⁵ In order to avoid this problem, it is necessary for countries to commit themselves to APEC and the WTO principle and facilitate the process of them.

Third, there is no consensus in each country domestically on how much and what kind of liberalization should be realized. For example, in Japan, sensitive sectors such as the agricultural sector opposes liberalizing the market of agricultural products. This opposition in domestic politics made the Japan-Mexico FTA negotiation fail. In order to create a regional community, it needs to make FTAs less discriminatory. Less discrimination might put a burden on the sensitive sector. Therefore, the political will of the government to overcome the domestic opposition is necessary for creation of a regional community. Otherwise, the negotiation will be hard to be agreed upon due to the existence of sensitive sectors.

Japan’s Role

As for the role of Japan in an international economic order, since the late 1980s, in particular in the late 1990s, the Japanese government has tried to play a leading role in a multi-layered international economy. However, Japan is hesitant to translate its economic power resources into an assertive political leadership so far in formulating a regional framework such as APEC and AMF. It is no doubt that Japan is a major player in formulating an international economic order, but its policy has been restricted not only by international but also domestic constraints. International constraints come from the United States and East Asian countries. As described before, it seems difficult for Japan to play an assertive role without a consensus from both the United States and East Asian countries. For example, East Asian countries are not so interested in the internationalization of the yen. Keizai Doyukai, one of major industrial associations, reported that “there are even suspicions that Japan is attempting to shift the entire exchange risk to its trading partners, under the disguise of internationalizing the yen.” The Japanese government has to struggle with these perceptions.¹

Domestic constraints come from political commitments to the protection of sensitive sectors such as agriculture from economic globalization. In particular, Japan’s

⁵ Jagdish Bhagwati, and Panagariya, Arvind (1996), “Preferential Trading Areas and Multilateralism: Strangers, Friends, or Foes?” in Jagdish Bhagwati and Arvind Panagariya, eds., *The Economics of Preferential Trade Agreements*, Washington, D.C.: American Enterprise Institute.

reluctance to open the agricultural sector has limited its bargaining power in APEC as well as in the WTO, and will be an obstacle to concluding FTAs with other developing countries.

In the early 2000s, the Japanese government began to more seriously consider regional and bilateral frameworks to strengthen the international economic order as well as increase Japan's welfare. Whether these frameworks can reinforce each other to make the WTO negotiation in favorable to the region will depend on how much bilateral and multilateral cooperation among countries in East Asia can be achieved. Japan's preference for gradual institutionalization could be a way of facilitating cooperation. Whether this approach is successful or not also depends on the Japanese government's ability of adjusting domestic opposition from sensitive sectors.

ⁱ Keizai Doyukai, "A Private-sector Perspective on the Internationalization of the Yen: A Study on Japanese and Asian Stability and Growth," May 2000.

Table 1
Number of FTAs

Year	Western Europe, Middle East, Mediterranean	Central & Eastern Europe, Russia, CIS	Sub-Saharan Africa	North & South Americas	Asia and Pacific	Across regions	Total
1955-1959	1						1
1960-1964	1			1			2
1965-1969						1	1
1970-1974	5			1		2	8
1975-1979	3				2		5
1980-1984	1			1	2		4
1985-1989				1		2	3
1990-1994	18	7	1	2	3		31
1995-1999	30	25	1	2	1	1	60
2000-	17	10	2	2	4	5	40
Total	76	42	4	10	12	11	155

Source: JETRO based on WTO figures

Figure 1
Source: METi

< Main Regional FTAs/EPAs >

