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An East Asian Spontaneous Economic Activity Space and the RTA/FTA Architecture: Does Japan Take a Right Way ?

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Introduction

Most of East Asia countries have taken so-called dual track approach that mix export-oriented policy with import-substituting policy. The import-substituting policies or protective domestic industry policies are revealed in the high applied tariffs of the East Asia countries. Meanwhile, the export-oriented policy has provided tax incentives to export industries, which had led to an expansion of extra-regional trade, as well as intra-regional trade, and eventually led to a de facto economic integration although tariffs still remain. To put it differently, the mixture of export oriented policy and import-substituting policy has developed a de facto economic integration in trade under protective high tariff, while political issues has impeded a de jure integration, or formal integration, or institutional integration in East Asia.

This paper aims to clarify characteristics of East Asia's de facto regional integration, and its de jure integration modality, and evaluates the regional trade arrangements (RTA)/free trade are (FTA) strategy of Japan. The first section sees the intra-regional trade by region, and advocates that East Asia has formed a spontaneous geographical space for economic activity. The second section discusses modality of the East Asia's de jure integration, implication of sub-regional cooperation such as ASEAN and the Northeast Asia, and focuses on enlargement of East Asia. The third section evaluates the FTA strategy of Japan. It introduces the FTA strategy of three influential Ministries and asserts that RTAs/FTAs are used as a diplomatic tool. The last section advocates that a good management of RTA/FTA is necessary for East Asia.

1 An East Asian Spontaneous Economic Activity Space

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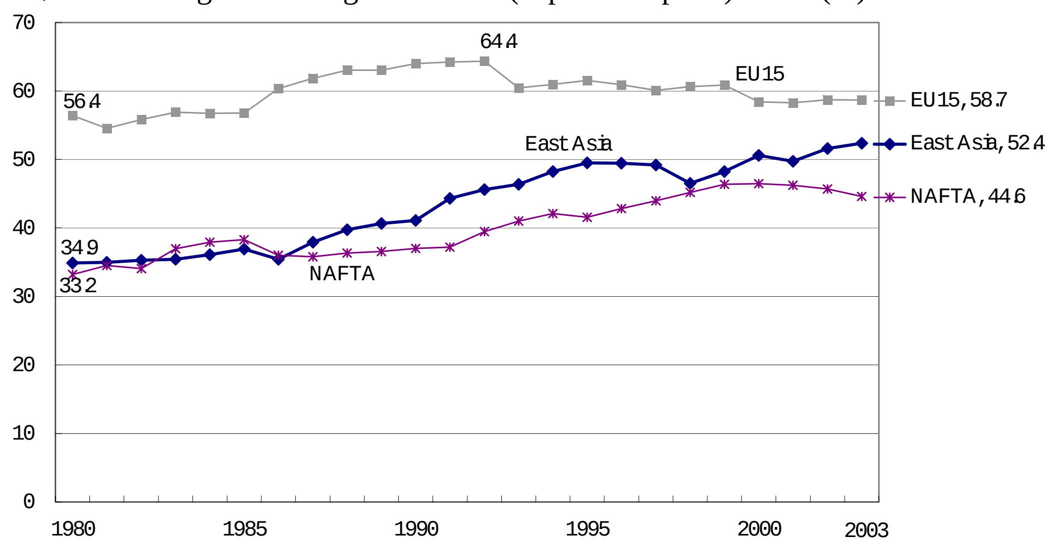
1. A Rise of Intra-regional Trade

Recently, East Asia has expanded the intra-regional trade, and the intra-regional trade share rose from 34.9% in 1980 to 52.4% in 2003 (see Fig. 1). This figure exceeds that of NAFTA (44.6%), although less that of the European Union (58.7%). What the intra-regional trade amounted to more than half of East Asia's total trade implies that East Asia has been shaping a spontaneous economic activity space. Despite borders, East Asian wide economic activity has intensified, and the East Asia economies have been integrated into a regional economy. To put it another way, the East Asia economies have been integrated and a de facto economic integration has advanced. Now, we had better pay attention to a region and not individual state, as space economics suggests.

Fig 1. Intra-regional Trade (exports+Imports) Share (%)



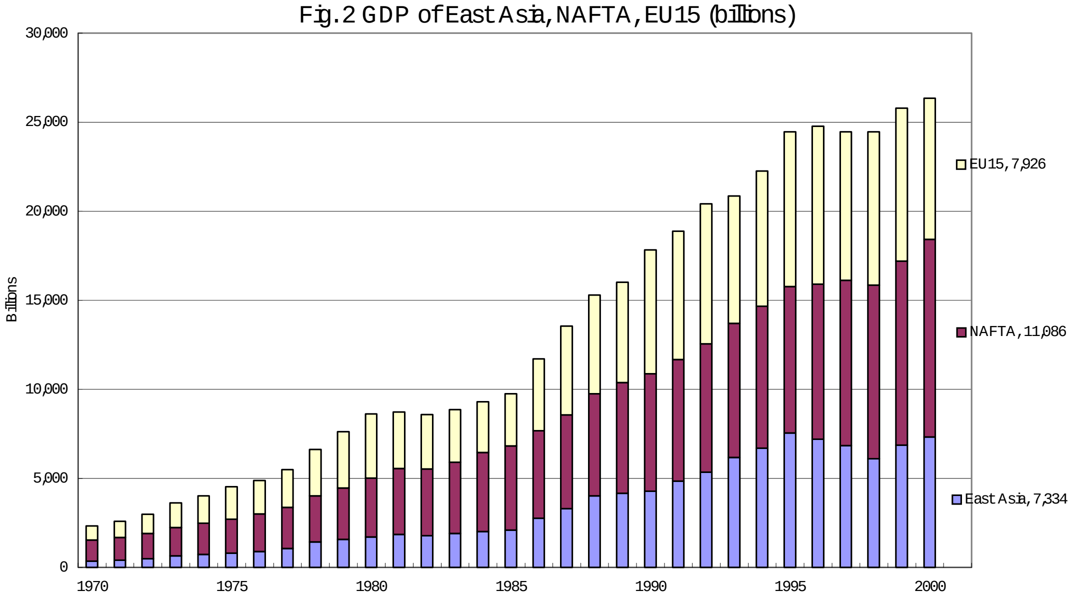
Note: East Asia consists of ASEAN10, China, Japan, Hong Kong, South Korea, and Taiwan.
Source: United Nation, Comtrade for EU15 and NAFTA, , Direction of Trade, 2004, CD-ROM, and Council for Economic Planning and Development, Republic of China, Taiwan Statistical Data Book, 2004 for Taiwan.

2. Economic Size Does Matter

What does matter for transnational economic activity including international trade？ Newton's law of gravity seems to be applied to trade between countries: The trade between the two countries tends to be proportional to their economic size, and inversely proportional to the distance between countries (Krugman 2004). Simply saying, economic size and geographical distance do matter (Krugman 1991a, and 1991b).

If the two economies are large, then the trade between countries tends to be large. As well, an economy grows fast, and then the trade with the country tends to grow fast. Indeed, East Asia economy grew faster than other regions such as the European Union and NAFTA in the last three decades (see Fig. 2), which led not only to raise the intra-regional trade share but also decrease the intra-regional trade of NAFTA and EU. According to the gravity framework, supposing other conditions constant, the more the East Asia's economy grows compared to other regions, the more East Asia's intra-regional trade against its extra-regional trade expands. Similarly, the more the East Asia's economy grows compared to other regions such as NAFTA and EU, the more international trade of NAFTA and EU with East Asia expands. In other words, the faster economic growth of East Asia has expanded international trade of NAFTA and EU with East Asia, compared to international trade with other regions. This led a decline of intra-regional trade of NAFTA and EU, with a rise of the intra-regional trade of East Asia.

Fig.2 GDP of East Asia, NAFTA, EU15 (billions)



Source: Alan Heston, Robert Summers and Bettina Aten, Penn World Table Version 6.1, Center for International Comparisons at the University of Pennsylvania (CICUP), October 2002.
Notes: Note: East Asia includes China, Indonesia, the Republic of Korea, Malaysia, the Philippines, Singapore, Thailand and Taiwan.

The gravity framework implies that the rise of China has led an expansion of trade of with China. China has grown at high economic growth rate, 9.1 percent for the last decade (1994-2004). First, due to geographical close distance, trading partners of East Asia have increased trade with China, which has contributed to an expansion of East Asia's intra-regional trade. East Asia benefits most from the rise of China. Second, due to the China's high economic growth, large economies such as the United States, Japan, France and German have expanded trade with China. It is because between large economies international trade would be large.

3. Geographical Distance Does Matter

More importantly, in the context of the RTAs/FTAs architecture in East Asia, geographical distance does matter for transnational economic activity. In the gravity model, if the geographical distance between the two countries is short (long), the trade between them tends to be large (small).

Why geographical distance does matter? There is an answer in that transporting goods to ten thousands miles distance takes cost more than one hundreds miles distance (Krugman 2004). This example implies that geographical distance does matter because transportation cost differs according to geographical distance.

Therefore, other factor being equal, trade between neighboring economies would be large, compared to trade with far distant countries, and trade within a region would be large. When borders barriers, or transportation costs for economic activity across countries, are reduced to the level of other regions, intra-regional trade share rises. A region becomes very important in globalization where transportation cost is reduced.

4. Reduction of Transportation Raises the Importance of Low Wage?

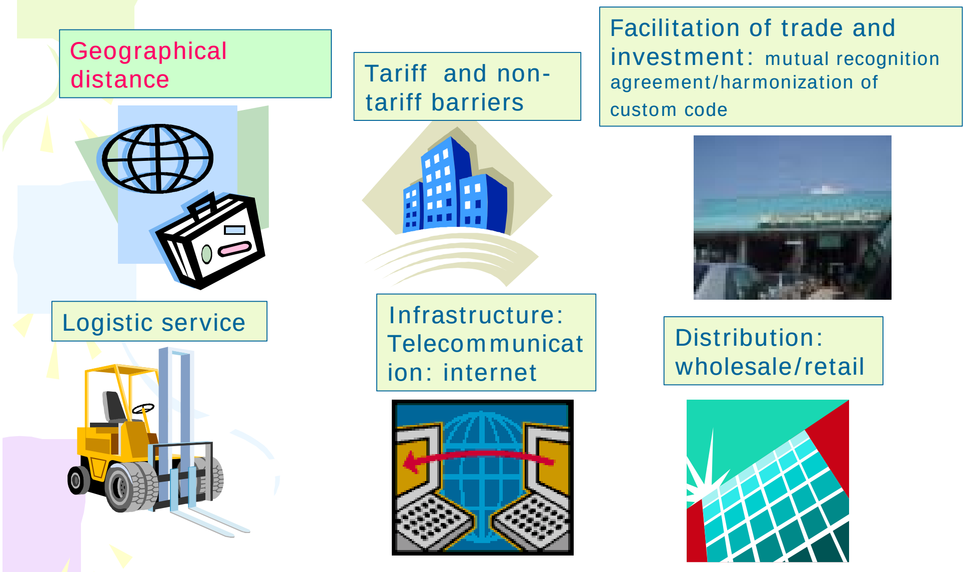
Reduction of transportation cost raises the importance of geographical close distance. A question rises. How has East Asia expanded the intra-regional trade so that it accounted for more than half of the total trade of East Asia. Krugman and Venables (1995) incorporated the concept of transportation costs to explain why manufacturing moves from the North to the South. Since the North offers a large market for intermediate goods and is a more attractive place to locate production of intermediate goods, it is a better place to produce final goods for a greater variation of intermediate goods. When transportation costs falls at first, the world economy will organize itself into an industrialized “core” and a de-industrialized “periphery,” because manufacturers in the North locate production in the North. But if transportation costs continue to fall, the importance of being close to markets (backward linkage) and suppliers (forward linkage) will decline. At that point, a low wage of advantage in the “periphery” will offset its disadvantage of being remote from markets and suppliers, and then manufacturers in the North will move out from the “core” to the “periphery”, converging income between the North and the South.

As transportation cost falls, low wages plays very important role. When wages rise in a country, firms move their production facilities to lower wage country. A new frontier emerges country after country.

5. What is Transportation?

What is transportation cost? Anderson and Wincoop (2004) defines transportation costs broadly defined as follows: transportation cots narrowly defined (freight costs and time costs) as follows, policy barriers (tariff and non-tariff barriers), information costs, contact enforcement cost, cost associated of different currencies, legal and regulatory costs, and local distribution costs. Transportation costs are determined by geographical distance, tariff and non-tariff barriers, facilitation of trade and investment, logistic service、 infrastructure including internet, and distribution, as shown in Diagram 1;

Diagram 1. Transportation Cost



Source: by author

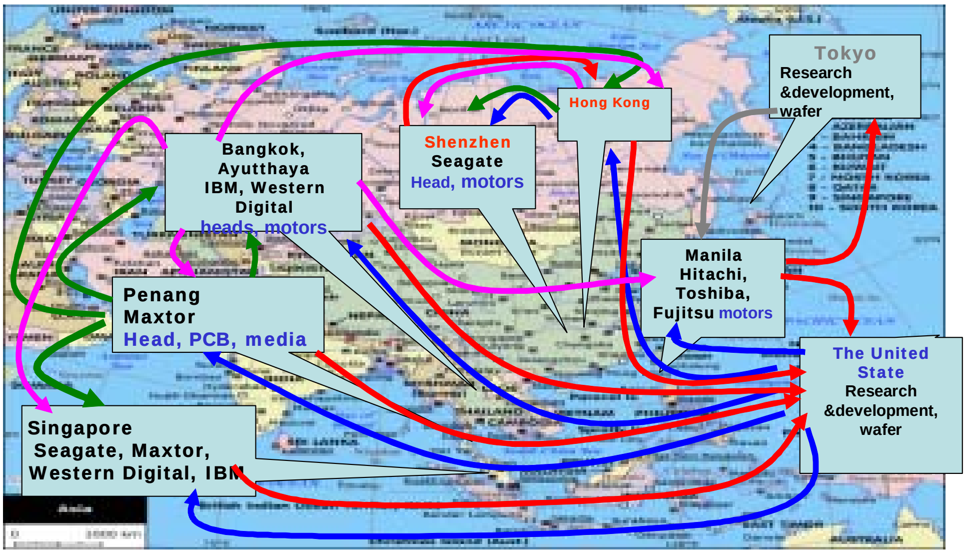
6. Increasing Returns to Scale

Why East Asia had had a large trade share with the United States, and why Japan had been a largest trade country for other East Asian countries within East Asia?

The Heckscher-Ohlin theorem explains the traditional international trade pattern well Countries trade according to comparative advantage. Assuming that the North produces manufactured goods and the South produces primary products including agricultural products, then the former exports manufactured goods, and the latter exports primary products. This reflects comparative advantages are different between the two sides.

At the present day, increasing returns to scale plays very important role, in addition to comparative advantage. Intel (central processing unit), Seagate (hard disc drive), Minebea (bearing), NIDEC (hard disc drive motor), Canon (printer and digital camera), and so on have located most of final assembling facilities in East Asia, in particular, ASEAN and China, because of low wages. Most of production processes are located there, and have formed industrial clusters. For instance, hard disc drive industry has concentrated in Singapore, Thailand, the Philippines, Malaysia, and China, and media components in Malaysia, motors and head in Thailand. Those component manufacturing processes are located near by component assembling process, and have formed industrial clusters. Industrial clusters have some kind of tree structures in the Asia-Pacific region. The United States and Japan participate in value chain of research and development, suppliers of basic material, and marketing in the world. Their production facilities are located in low wage countries and operated under large volume production in order to attain economy of scale, and thereby increasing returns to scale works there. Various components and parts are circulated across countries in the Asia-Pacific production network, realizing increasing returns to scale (see Diagram 2). Transportation cost to link international production network does matter.

Diagram 2 International Production and Distribution Network of a Hard Disc Drive



Source: by author.

2 Sub-regional Spaces and Cooperation in East Asia

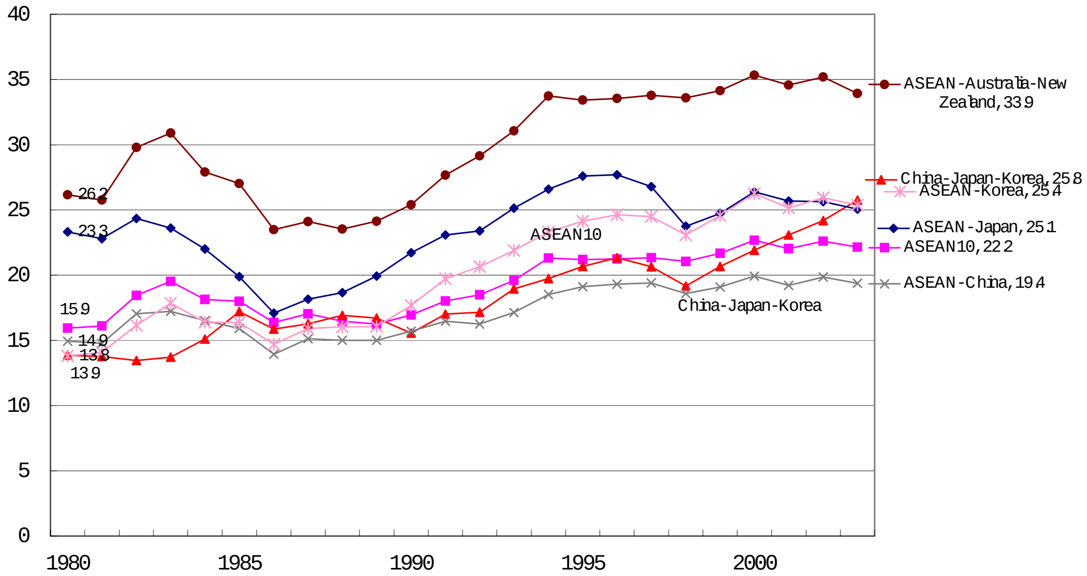
1. Sub-regional Spaces

East Asia's geographical space seems to be a spontaneous economic activity space, although borders still remain. How about ASEAN and the Northeast Asia (China, Japan and the Republic of Korea)? Are they regarded as spontaneous regions? An answer is that they are just sub-regions of East Asia, from the point of view of economic activity space.

Figure 3 shows the intra-sub-regional trade (exports and imports) share from 1980 to 2003. The intra- ASEAN trade share and the intra China-Japan-the Republic of Korea trade share do not dominate their regional trade, though they increased the intra-regional trade. The ASEAN trade share increased from 15.9% in 1980 to 22.2% in 2003, and China-Japan-the Republic of Korea increased remarkably from 13.9% to 25.8% in 2003. These figures indicate that both geographical spaces of ASEAN and the Northeast Asia are not self-organized regions, from the point of view of economic activity space, but just parts of a region, that is, sub-regions of East Asia.

In East Asia, RTAs/FTAs are going centering on ASEAN. ASEAN-China, ASEAN-Japan, ASEAN-the Republic of Korea, and ASEAN-Australia and New Zealand are concluded, or under negotiation, or agreed to the framework of RTAs/FTAs. To be more precise, in November 2004, ASEAN and China concluded to establish the ASEAN-China Free Trade Area (ACFTA) by 2010 for the original ASEAN six member states and China, and by 2015 for the newer ASEAN member states and China. ASEAN and Japan commenced negotiation the ASEAN-Japan Comprehensive Economic Partnership (CEP) in April 2005, and the details are described later. ASEAN-Australia and New Zealand is expected to start negotiation of the Closer Economic Partnership (CEP) in 2005. ASEAN and the Republic of Korea will follow the movements. In addition, several bilateral RTA/FTAs are enforced.

Fig. 3 Sub-regional Trade (exports+Imports) Share (%)



Note: East Asia consists of ASEAN10, China, Japan, Hong Kong, South Korea, and Taiwan.
Source: United Nation, Comtrade for EU15 and NAFTA, Direction of Trade, 2004, CD-ROM, and Council for Economic Planning and Development, Republic of China, Taiwan Statistical Data Book, 2004 for Taiwan.

But, those RTAs/FTAs centering on ASEAN cover too small space for economic activity. Only 19.4% of the total ASEAN-China trade in 2003 is directed to the ASEAN-China region. The figure is 25.1% for ASEAN-Japan, 23.4% for ASEAN-Korea, and 33.9% for ASEAN-Australia and New Zealand. About three fourth of them are directed to the rest of the world These facts indicate that those RTAs/FTAs covering areas are not enough space for economic activity.

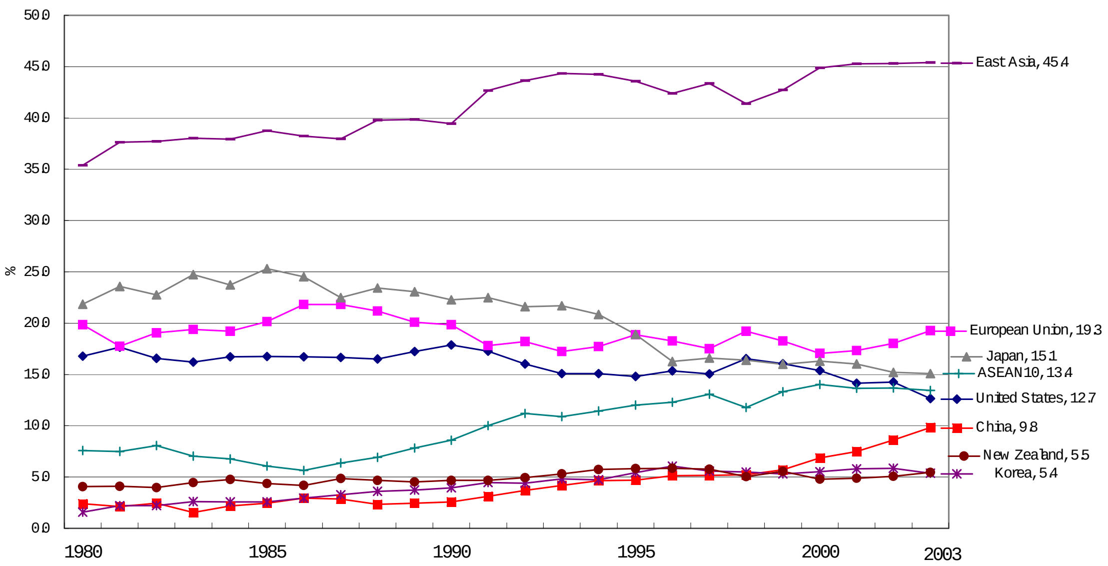
By contrast, more than half of trade of East Asia is directed to the region. East Asia may be a reasonable space for economic activity. The fact suggests that a spontaneous economic activity space needs a wide activity range. Fujita (2004) remarked that the East Asia’s geographical space is almost equivalent to the area from the South part of Canada, to the United Stats and Mexico, and flight time from California to New York is almost same with one from Tokyo to Singapore or Jakarta. A broad geographical space is necessary for economy to exchange products. It is probably because locations of industrialized cities are dispersed far away. In the world where transportation costs are enough low, firms locate production facilities far away from the existing large cities because of congestion cost or wage hikes (Fujita, Krugman and Venables, 1999). Actually, in the United States, a financial center (New York), a silicon valley (California), a automobile center (Detroit) are located at far away.

2. Enlargement of East Asia: Australia and New Zealand

East Asia including Taiwan and Hong Kong has formed a spontaneous economic activity spacer. Currently, however, the official framework of East Asia is the “10 + 3” (ASEAN 10, China, Japan and the Republic of Korea). The “10+3” geographical area provides enough space for business sector to locate facility and trade. However, considering the importance of role of Hong Kong and Taiwan, establishing a seamless East Asia including Hong Kong and Taiwan would commonly benefit to “10+3”.

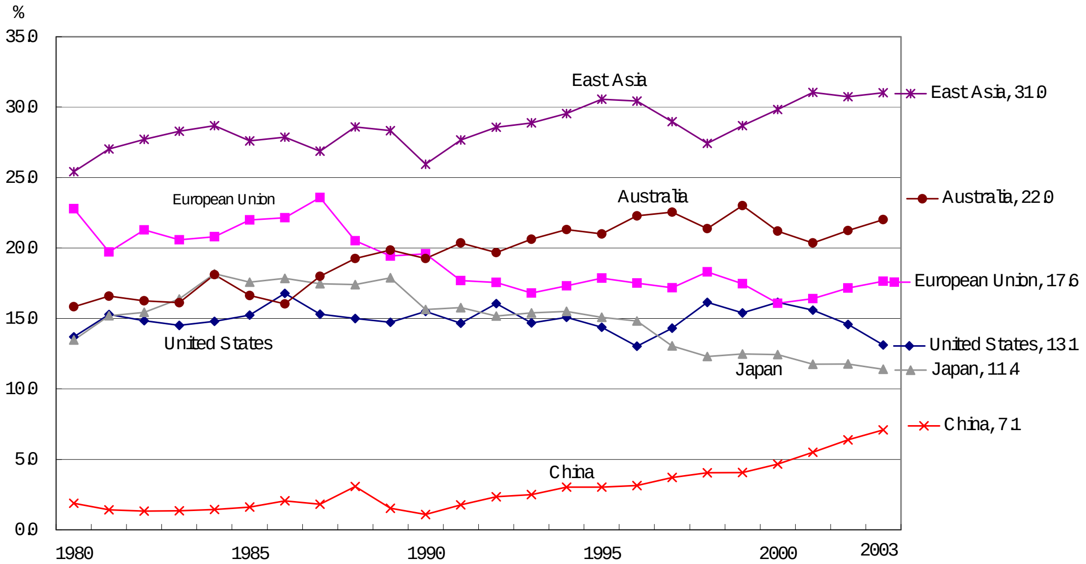
It should be noted that Australia and New Zealand economies have been integrated into East Asia economy. The trade share of Australia and New Zealand with East Asia amounted to 45% and 31% respectively in 2003. As for, New Zealand, the combined trade share with East Asia and Australia is 53.0%. As well, the trade share of Australia with East Asia including New Zealand is 50.9%. These figures suggest that East Asia had better enlarge the member including Australia and New Zealand, as well as Hong Kong and Taiwan, in the light of closer economic relation. Best of all, participation of Australia and New Zealand will be benefit to not only to Australia and New Zealand but also East Asia. The ASEAN+3 framework is just a political framework.

Fig.4 Trade Share of Australia with Partner Countries



Source: ,h],e Direction of Trade, 2004, CD-ROM.
Note: East Asia consists of ASEAN10, China, Japan, Hong Kong, South Korea, and Taiwan.

Fig 5. Trade Share of New Zealand with Partner Countries



Source: IMF, Direction of Trade, 2004, CD-ROM.
Note: East Asia consists of ASEAN10, China, Japan, Hong Kong, South Korea, and Taiwan.

3. Existing Barriers

Considering trade barriers in goods and service still remain high in East Asia, the RTAs/FTAs centering on ASEAN are justified. According to the tariff summary report 2004 compiled by the APEC Individual Action Plan, except Singapore and Hong Kong, the East Asia countries have applied high tariffs as follows: Simple average applied tariffs on all products are 18.5 percent, for Vietnam; 12.0 percent, for Thailand; 11.9 percent, for the Republic of Korea; 11.3 %, for China; 8.6 percent for Malaysia; 7.2 percent for Indonesia; 7.1 percent for Japan; and 7.1 percent for the Philippines.[1] These figures are higher than those of Australia (4.3 percent), Canada (3.9 percent), New Zealand (3.4 percent), and the United States (5.1 percent) (see Table 1).

The East Asian countries applied high tariffs not only on export products but also on domestic products. For example, Thailand applied high tariff on export products such as agricultural products, textile and clothing. Commonly, the East Asian countries applied high tariff on textile and apparel, reflecting the dual track approach that mixes export-oriented policy (tax incentive investment promotion policy) with protective domestic policy (high tariff).

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[1] MOFA (2002) and the WTO statistical database show different figures for 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%.

Table 1. Simple Average Applied Tariff rates by Products (2004, %)

	All Goods	Agriculture excluding Fish	Fish and Fish Products	Petroleum Oils	Wood, Pulp, Paper and Furniture	Textiles and Clothing	Leather, Rubber, Footwear and Travel	Metals	Chemical & Photographic Supplies	Transport Equipment	Non-Electric Machinery	Electric Machinery	Mineral Products, Precious Stones &	Manufactured Articles, n.e.s
Vietnam	18.5	27.7	27.7	16.8	15.7	37.3	18.7	9.4	7.2	13.9	7.2	13.3	13.6	14.1
Thailand	12.0	25.8	8.4	2.6	11.4	17.0	16.0	9.0	4.6	20.3	4.8	9.3	5.6	13.3
Korea	11.9	46.2	16.8	5.8	2.6	9.8	8.9	4.7	6.0	6.0	6.0	5.5	5.9	6.2
China	11.3	16.8	12.2	6.3	7.0	15.2	13.6	7.4	7.4	15.9	8.6	9.9	9.4	12.3
Malaysia	8.6	3.0	1.9	0.5	2.7	12.4	12.9	17.4	5.3	36.9	6.0	8.7	9.6	7.4
Indonesia	7.2	8.6	5.0	5.0	4.1	10.5	6.6	8.1	5.5	17.0	2.3	6.1	4.6	7.7
Japan	7.1	20.9	6.0	3.6	1.6	6.7	17.3	0.8	2.5	0.1	0.0	0.2	0.9	1.3
Philippines	7.1	7.9	8.4	2.9	6.4	11.4	6.6	5.4	4.9	17.0	2.5	4.5	5.1	4.8
the United States	5.1	9.8	2.0	2.5	1.1	9.6	7.0	2.1	3.8	2.6	1.3	2.0	3.7	3.2
Australia	4.3	1.4	0.0	0.0	3.8	12.8	6.9	3.4	1.9	5.3	3.4	3.2	1.7	2.0
Canada	3.9	4.0	1.4	3.1	1.6	9.0	5.6	1.9	2.9	5.2	1.7	2.4	2.0	3.1
New Zealand	3.4	2.1	0.6	1.3	1.3	7.8	6.2	3.0	1.5	5.3	3.7	3.6	1.7	3.0
Singapore	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	

Source: Tariff Summary Report 2004, APEC Electronic Individual Action Plan, http://www.apec-iap.org/

Barriers in service also are high in the East Asian countries. Service industry is a kind of import-substitution industry for the East Asian countries. They have not liberalized service sectors. Table 2 summarizes the number of GATS service sectors with commitment. Among 155 service sectors, the number GATS service sectors with commitment are only 47 sectors for Indonesia, and 51 sectors for the Philippines[2]. The countries/or regions that the number of GATS service sectors with commitments exceed more than 100 sectors are just Taiwan and Japan only.

These facts suggest that the sub-regional RTA/FTAs would contribute to eliminate trade barriers in goods and service sectors, and promote structural reforms. Therefore, hopefully, the sub-regional RTAs/FTAs cover not only liberalization of trade in goods as well as one in service. The RTAs/FTAs between developed country and developing country, such as ASEAN-Japan, ASEAN-the Republic of Korea, and ASEAN-Australia and New Zealand, will be establish free trade area under the Article XXIV of GATT and the Article V of GATS, which eliminate substantially all trade barriers in good and service respectively. On the contrary, the RTAs/FTAs between developing countries, such as ASEAN-China, are to be established under the so-called Enabling Clause of the GATT, which is expected to expand trade between developing countries.

2 The number of GATS service sectors with commitment tend to large those countries that have entered into the WTO in recent years, because examination are getting tigher.t

East Asia has formed a spontaneous economic activity space, but barriers in goods and service still remains. East Asia is expected to establish an East Asian wide RTA/FTA suitable for the spontaneous economic activity, and in future, de jure integration worthy to the de facto integration in trade is an issue to be challenged by East Asia. We are living in the world where economic activities are operated across countries, which need regional public goods to complement the business sector.

Table 2. Number of GATS Services Sectors with Commitments

Countries/Regions	Number of GATS Services Sectors with Commitments	Countries/Regions	Number of GATS Services Sectors with Commitments
Taiwan	123	Turkey	75
Switerland	117	Hong Kong	69
EU	115	Singapore	67
Norway	112	Argentine	65
Japan	110	Venezuela	64
the United States	110	Israel	62
Canada	105	Brazil	60
Australia	104	Columbia	58
Cambodia	95	the Philippines	51
the Republic of Korea	95	Indonesia	47
China	94	Pakistan	47
South Africa	91	Egypt	45
New Zealand	90	Chile	40
Thailand	75	India	37
Malasia	75	Macao	25
Mexico	75	Brunei	23

Source: WTO statistics database
(http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=).

3 EPA/FTA Strategy of Japan

1. MOFA , METI and MAFF

Now, we are ready for evaluating the FTA strategy of Japan. Three Ministers have determined the Economic Partnership Agreement (EPA)[3]/FTA strategy of Japan. They are the Ministry of Foreign Affairs (MOFA), the Ministry of Economy, Trade and Industry (METI) and the Ministry of Agriculture, Forestry and Fishery (MAFF). MAFF has affected the overall strategy of EPAs/FTAs in light of feasibility, the overall strategy of EPAs/FTAs, in particular, in identifying counterparts has been decided by the MOFA. The METI is in charge of many fields from liberalization of goods excluding

3 The Japanese government call FTA as EPA.

agricultural products and services, intellectual property right, facilitation measure such as mutual recognition, and cooperation in capacity building such as development of medium and small scale enterprises. The MAFF has really affected in identifying counterparts of the EPAs/FTAs, since there are several sensitive agricultural products.

Diplomatic Blue Book 2004 presents a view of MOFA that there is a growing need to promote Economic Partnership Agreement (EPA)[4] from the following points: (1) from the economic stand point, as a means of strengthening economic partnership beyond the levels attainable under the WTO and in areas not covered by the WTO; (2) from the security perspective, to boost economic benefits of developing economies, in order to reduce growing global disparities; (3) from the strategic view points in terms of international politics and diplomacy. MOFA uses EPA as a means of diplomatic strategy.

METI thinks as follows: (1) East Asia is undergoing astonishing economic development and developing a growing interdependent relationship with Japan; (2) to respond to the expected diminishing children issue; (18 years population of Japan decreased from 2 million in 1992 to 1.5 million in 2002); which has generated deflationary pressure on the Japanese economy; and (3) utilize the growth of the East Asian region by constructing of common systematic infrastructure in areas such as intellectual property systems, standards and conformity assessment system. METI intends to achieve a borderless business zone.

MAFF’ stance is passive responding to the Cabinet decision. Responding to the Cabinet Decision on 2003 Economic Perspective and Economic Policy that EPAs/FTAs are to be promoted[5], in June 2004, MAFF announced *Basic Stance for Agricultural Products* that considering (1) food safety, (2) food security, and (3) the ongoing structural reform, each agricultural product is to be liberalized flexibility. In November 2004, MAFF shows a view of promotion of the ongoing EPAs negotiation with the Asian countries in the area of agricultural products: (1) EPA will expand agricultural exports of Japan; (2) EPA will improve business environment and promote food business; (3) EPA will reduce poverty in East Asia; (4) EPA will contribute to preserve natural resource. The new guideline was responded to the Cabinet Decision on 2005 Economic Perspective and Economic Policy that the advancement of globalization, structural reform and foreign economic policy were coordinately to be progressed, and

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4 The Japanese government call FTA as EPA.

5 The Cabinet Decision on 2003 Economic Perspective and Economic Policy disclosed a government policy that mixes views of MOFA and METI: there is a growing need to consider a wide range of measures to promote free trade in a way that complements the WTO system, and that EPAs/FTAs are examples of such means. In order to activate the sluggish economy, EPAs/FTAs are to be promoted.

ultimate effort had to be made to conclude the ongoing bilateral EPAs/FTAs with the ASEAN countries and the EPAs with the whole ASEAN as much as possible.

In line with the coordination of the advancement of globalization, structural reform and foreign policy, the government is taking a new agricultural policy. The advisory group to the MOFF submitted a report in the mid-March 2005, which was approved as a new guideline of agricultural policy (2005-2015) by the Cabinet by the end of March 2005. The government will shift the emphasis on agricultural policy, from the traditional protection policy with high tariff, to a new policy that enhances competitiveness of Japan's agriculture, not relying on tariff. The new policy will be implemented in 2007/08 fiscal year. The Japan is going to implement the new agricultural policy to be matched with globalization. It will take several years until the agricultural sector enhances competitiveness.

2. A Counterpart List of EPAs/FTAs

MOFA (2002) shows criteria for judgment in promoting EPAs/FTAs. These include (a) economic criteria, (b) geographical criteria, (3) political and diplomatic criteria, (d) feasibility criteria, and (e) time-related criteria. MOFA (2002) reveals that the strategic priority should be given to concluding EPAs/FTAs with countries and regions where, despite close economic relationship, relatively high trade barriers exist that pose obstacles to the expansion of Japan's economy.

From this point, Japan places its top priority of EPA partner on East Asia centering on Japan, China, and the Republic of Korea, plus ASEAN. In light of the feasibility criteria and political and diplomatic criteria, the Republic of Korea and ASEAN are the top list of FTAs. China is dropped from the priority list.

In December 2004, the MOFA announced to study possibility of negotiation with other countries/regions, taking into account the progress of the on-going negotiations, as well as the importance of EPAs/FTAs to the Japanese economy (MOFA, 2004). In identifying countries/or regions to negotiate with, the government will take the following new criteria: (1) creation of international environment beneficial to Japan; (2) attainment of economic interests of Japan as a whole; and (3) situation of the partnership countries/regions and feasibility.

Taking into consideration of several points, the new strategy places the priority of the EPA/FTA counterparts on the enlarged East Asia including India and Oceania in stead of the ASEAN+3. The enlargement of the priority countries/or regions reflects the following recent situation.

Table 3. Criteria in Identifying Countries/or Regions to Negotiate with on EPA/FTA

1. Creation of international environment benefit to our country	
1.1	to facilitate community building and stablity and prosperity in East Asia
1.2	to strengthen Japan's economic power and to tackle political and diplomatic
1.3	to reinforce Japan's position at multilateral negotiations, including the WTO talks.
2. Attainment of economic interest of Japan as a whole	
2.1	to expand exports of industrial and agricultural pruducts, trade in service, and to improve the business environment of Japanese companies in operating in the partner countries/regions.
2.2	to stable imports of resources, safe and reliable food, and to diversify suppliers.
2.3	to promote Japan's economic and social structure reform.
2.4	to promote acceptance of profession or techinical workers, therby stimulating Japan's economy and society and promoting its further internationalization.
3. Situation of the partner countries/regions and feasibility to realize EPA/FTA	
3.1	whether or not both parties to consider difficulty to liberaliza sensitive products.
3.2	to cause friction or problems with other countries/regions. capability of implementing the commitments under the WTO and EPA/FTA.
3.3	whether or not FTA is the best means of economic partnership.

Source: Compiled by author, from "Best Policy toward Further Promotion of Economic Partnership Agreement (EPAs), Approved by the Council of Ministers on the Promotion of Economic Partnership in December 21, 2004.

First, the on-going negotiation with the Republic of Korea has deadlocked. The Republic of Korea has requested to make a concession more than 90% tariff lines of agricultural products, but Japan has offered concession tariff lines about 50% of agricultural products. Because of the wide gap between the request and offer by two sides, next round of negotiation has not set.

Second, Australia, one of the United State alliance states, has asked Japan to enhance economic relationship through FTA. Since the Bali terrorism in 2002, Australia and Japan has enhanced political relationship, and confirmed their same value in security and democracy. What Australia and Japan sent a military unit to Iraq in April 2005 in order to defend the Japans' Self-Defense Forces which has worked for reconstruction assistance there shows the close relationship between two countries. In April 2005, the two leaders received the government to government base joint study report to study merit and demerit of EPA/FTA between two countries, and agreed to start a feasibility study of EPA/FTA whether Australia and Japan can conclude the EPA/FTA to satisfy the Article XXIV of GATT which eliminates substantially all goods, because Japan has sensitive issue in agricultural products.

Third, Japan has enhanced the relationship with India. In April 2005, India and Japan agreed the Eight-fold Initiative for Strengthening Japan-India Global Partnership. Specifically saying, the two leaders directed the India-Japan Joint Study Group (JSG), which is to be launched by June 2005, to submit its report within a year, focusing on measures required for a comprehensive expansion of trade in goods, trade in services, investment flows and other areas of economic relations between the two countries. They also agreed to intend to realize an East Asian Community and work together to promote the vision of an Asian Economic Community.

It is apparent that the MOFA uses EPAs/FTAs as a diplomatic tool to enhance political and economic partnership, and to raise international position of Japan through creating international environment benefit to Japan.

3. Evaluation of the Enforced and Concluded FTAs

Evaluation of the EPAs/FTAs helps to understand the EPA/FTA strategy of Japan. Until now, Japan enforced the Japan-Singapore EPA in November 2002, and the EPA with Mexico enforced in April 2005. Japan and the Philippines reached at the basic agreement in November 2004. The negotiation with Malaysia, Thailand, and the Republic of Korea are going.

In April 2005, Japan commenced the EPA negotiation with Indonesia, and the whole ASEAN. Japan started to negotiate the issues covering the whole ASEAN such as the rule of origin with the whole ASEAN, but will enter bilateral negotiation on trade in good and service with individual countries of Cambodia, Laos, Myanmar, and Vietnam. Such bilateral and multilateral mixing approach may result in bad consequences that the EPA negotiation with some country will be late. In deed, negotiation with the Philippines was concluded, but ones with Thailand and Malaysia not.

Table 4. Time Lines of Japan's EPAs/FTAs

partners \ status	Joint Study	start of negotiation	last negotiation	concluded	enforcement
Singapore		Jan. 2001		Jan. 2002	Nov.2002
Mexico		Nov. 2002		Sep. 2004	Apr. 2005
The Republic of Korea	Oct. 2003	Dec. 2003	Nov-04		
Philippines	Dec.2003	Feb. 2004	Nov. 2004	Nov. 2004	
Malaysia	Dec.2003	Jan. 2004	Nov. 2004	@	
Thailand	Dec.2003	Feb. 2004	Dec. 2004		
Indonesia		Apr. 2005	Apr. 2005		
Whole ASEAN		Apr. 2005	Apr. 2005		
Australia	Apr. 2005, J.S. finished, starting F.S.				
India	Jun. 2005, starting J.S.				

Notes: J.S. and F.S. indicate government to government joint study and feasibility study respectivel
Source: Compiled by author.

How are the concluded EPAs/FTAs of Japan evaluated? Currently, the evaluation is possible for the EPA/FTA with Singapore and Mexico. The Japan-Singapore EPA makes the concession tariff list, and set the rule of origin for the listed items. The listed items cover 98.5% of the two-way trade. The list items offered by Japan cover 94% of the one way-trade, meanwhile the ones by Singapore cover 100%. As for liberalization in service, Japan makes a commitment to liberalize 134 sectors among all 155sectors, or 85% of all the sectors, while Singapore has liberalized 139 sectors, or 89% of all the sectors.

Noteworthy conclusion is the Japan-Mexico EPA. Japan makes the concession tariff list which liberalizes just 86%, 8000 items of all 9300 items, on the other hand, Mexico achieves 94%, 11130 items of 11800 items. Because of sensitive agricultural products, the concession tariff offered by Japan covers only 86% in tariff line, although more than 90% in import value of Japan from Mexico. Considering that the actual import value is realized under the defensive high tariff, achieving more than 90% in tariff line is desirable.

Japan and the Philippines reached at broad agreement, but details are still under negotiation. As for trade in goods, more than 90% of trades in terms of value are to be liberalized. The two countries also make commitments to liberalize more than the GATS offer.

As for liberalization of trade in goods, the concession tariff lines cover not so high for Japan, because of sensitive agricultural products. The sensitive agricultural product issue has made other negotiations difficult. For instance, in April 2005, Japan and Thailand concluded the negotiation for agricultural products in which Japan conceded for chicken, but rice and sugar. Since then, the two sides have entered the negotiation for manufactured products since then. Up to now, Thailand has not offered to liberalize automobile and steel, as Japan has not offered to liberalize agricultural products as Thailand requested. It is not likely that high level free trade area will be realized between Japan and Thailand. The FTAs between Japan and counterparts is not likely to establish full-fledged free trade areas, be just a kind of “win-win game” that satisfies the WTO minimum requirement.

Table 5. Summary of Commitment to Liberalization

	Commitment to liberalization			
	Goods		Service	
	Japan	Partner	Japan	Partner
Singapore	94% of trade value	100% of trade value	86% (13, 8/155)	89% (139/155)
Mexico	86% (8000 items/9300 items)	94% (11130 items /11800 items)	negative list	negative list
Philippines	more than 90% of trade value	more than 90% of trade value	GATS plus α	GATS plus α

Source: Comipled by author based on hearing from the Ministry of Foreign Affairs of Japar

4 A Good Management of RTA/FTA

Lastly, I would like to touch on a good management of RTA/FTA, replacing a conclusion and summary. In East Asia, there is lack of sense of a good management of RTA/FTA. We can learn much about it from the European Union (EU). Any EU accession state is not allowed to negotiate RTA/FTA with the external states, which has guaranteed that any member state in the EU community will not be excluded from the RTA/FTA with external states.

Japan has not learned from the EU experience. It is apparent that Japan has discriminated between countries in identifying counterparts of the EPAs/FTAs from feasibility and political reason. Japan will start a feasibility study, with Australia, following a joint study. On the other hand, Japan has refused to conduct a joint study with New Zealand, in spite of New Zealand’ repeated offers. The EPA/FTA with Australia will generate a large trade diversion effect from New Zealand to Australia. Japan has not shown intention to conduct joint study with China from feasibility and political reason. These facts indicate that Japan has entered into a RTA/FTA trap that discriminates between countries. A big country like Japan has to think a common benefit to all the countries in East Asia.

The discrimination may reflect the underestimation of importance and long-run effect of the East Asian wide RTA/FTA. First, the East Asian wide RTA/FTA nurtures mutual understanding between countries in the region and bring a base of peace and prosperity, through a common benefit from the integrated market and production area. Second, a common benefit and individual country benefit would be large than the estimated results obtained from the computed general equilibrium model (CGE). The CGE model does not incorporate the important two elements. One is a large number of Japanese firms are operating in China. The EPA with China would increase profit operating firms. The other is increasing returns to scale. The CGE model calculates only so-called state effects of trade creation and diversion effects. Reduction of barriers would expand trade and investment in the region through restructuring production facilities to consider increasing returns to scale effect.

As for a good management of EPAs, a balanced perspective of the ruling party, the Liberty Democratic Party LDP) is hoped. By the end of 2005, the LDP will make a policy statement on the East Asian Community which advocates the Community. The policy statement will push forward a talk with China and the Republic of Korea[6].

[6] The Foreign Policy Committee of the Liberty Democratic Party invited the Republic of Korea Ambassador to Japan on 20 April 2005, and People's Republic of China Ambassador to Japan on 27 April 2005, to hear views on the East Asian Community.

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