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# Japan's Growing Free Trade Network: Ahead of the Japan-US Free Trade Agreement

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# 1. Japan's strategy of international commercial policies

- Background
  - Importance of international production networks (IPNs)
  - Decline of the World Trade Organization (WTO) as a negotiating forum
  - Crisis of "rule-based world trading regime" with the US Trump administration
- To be a hub of mega FTAs network
  - Position itself at the frontier of further liberalization and international rule making.
  - Defend the rule-based trading regime as far as possible.
  - Keep room for expanding and deepening IPNs by reducing policy risks and uncertainty.

## 2. International production networks (IPNs) do not work with a lot of uncertainty

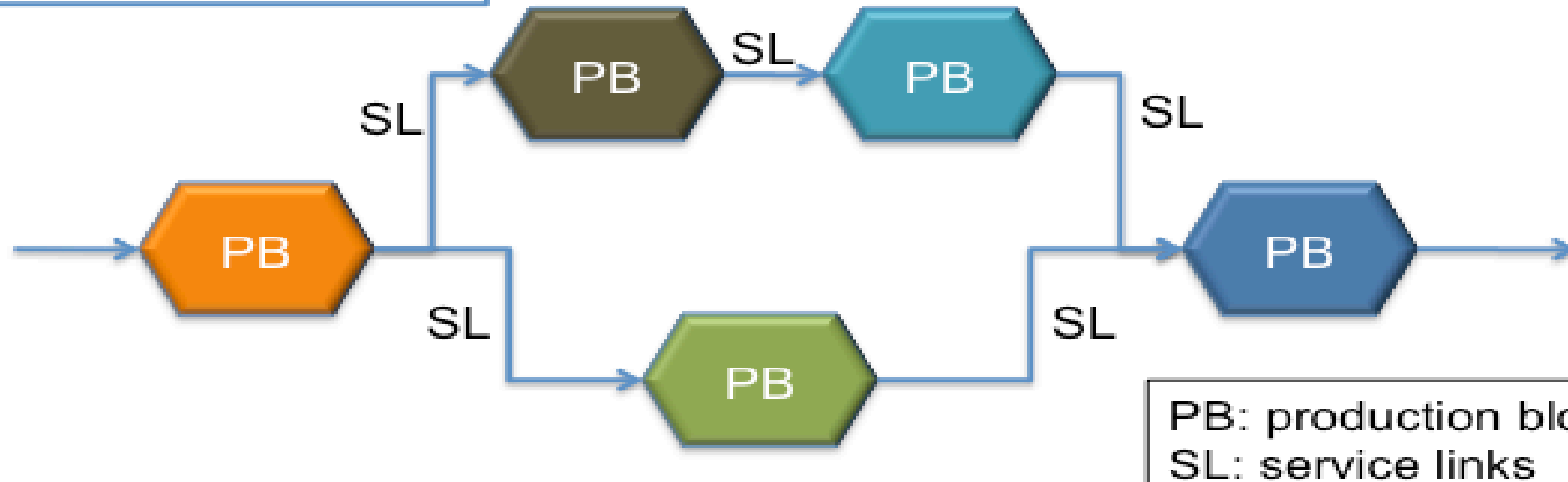
- Production blocks are connected with relation-specific transactions.
  - To prepare a back-up or reformulate networks, investment in the middle to long run perspectives is needed.
- There is still room for the expansion and deepening of IPNs
  - Cambodia, Laos, Myanmar
  - Indonesia, the Philippines, Vietnam
  - India
  - Even in the slow trade era (2011-2016), intra-East Asian network trade steadily grew.
- Effects of the US trade policy and the US-China trade war
  - Short run: possibility of positive trade diversion effects
  - Middle to long run: negative effects of the enhancement of uncertainties due to the crisis of the rule-based trading regime.

# The Fragmentation Theory a la Jones and Kierzkowski (1990)

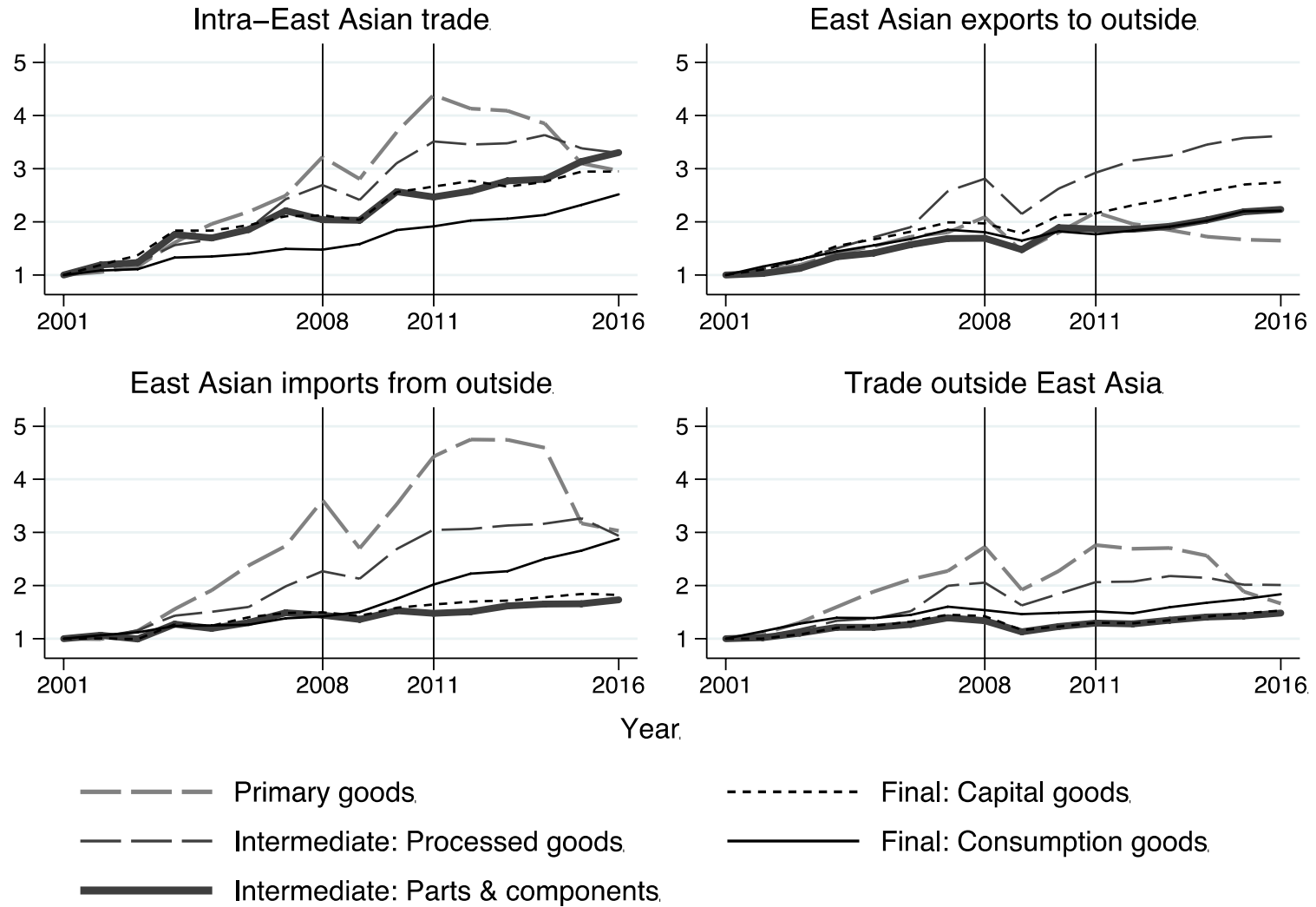
Before fragmentation



After fragmentation



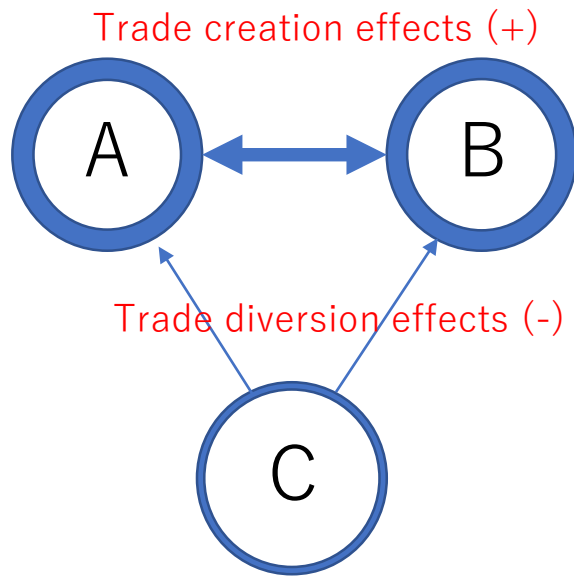
Parts & components trade, particularly intra-EA, grew even in the slow trade era (2011-2016)



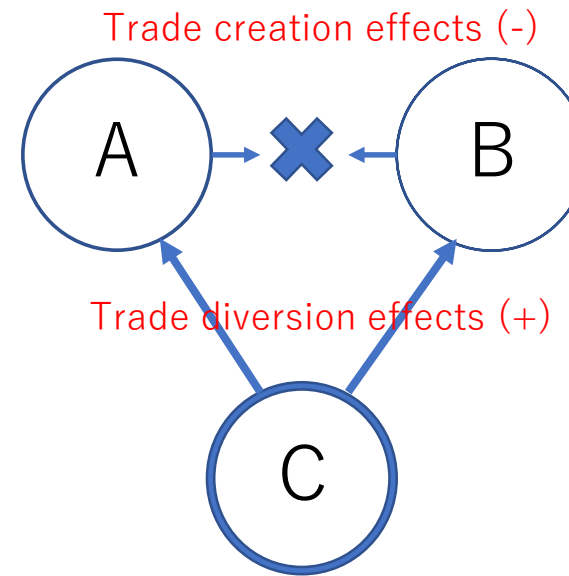
Source: Obashi and Kimura (2018).

# Economic effects of a regional trade agreement and a trade war on third countries

(a) Regional trade agreement



(b) Trade war



### 3. Withering WTO as a negotiating forum

- Since its establishment in 1995, negotiations for liberalization on built-in agenda (agriculture, non-agriculture market access, services) were wrecked, and little progress was made for new rule-making.
  - Exception: Information Technology Agreement (ITA), Trade Facilitation Agreement, and others
  - Some hope for plurilateral agreements, like-minded countries, multilateral with different speed, and others
- Regional trade agreements (FTAs, CUs) became major players for further liberalization and new rule-making.
- On the other hand, the demand for new rule-making has enhanced in twenty plus years.
  - How to incorporate newly developed economies, including China, into international rules?
    - Subsidy, government procurement, SOEs, and others.
  - Response to new technologies, particularly digital.
    - E-commerce, data flows, large platformers, and others.

# 4. Rule-based trading regime at risk

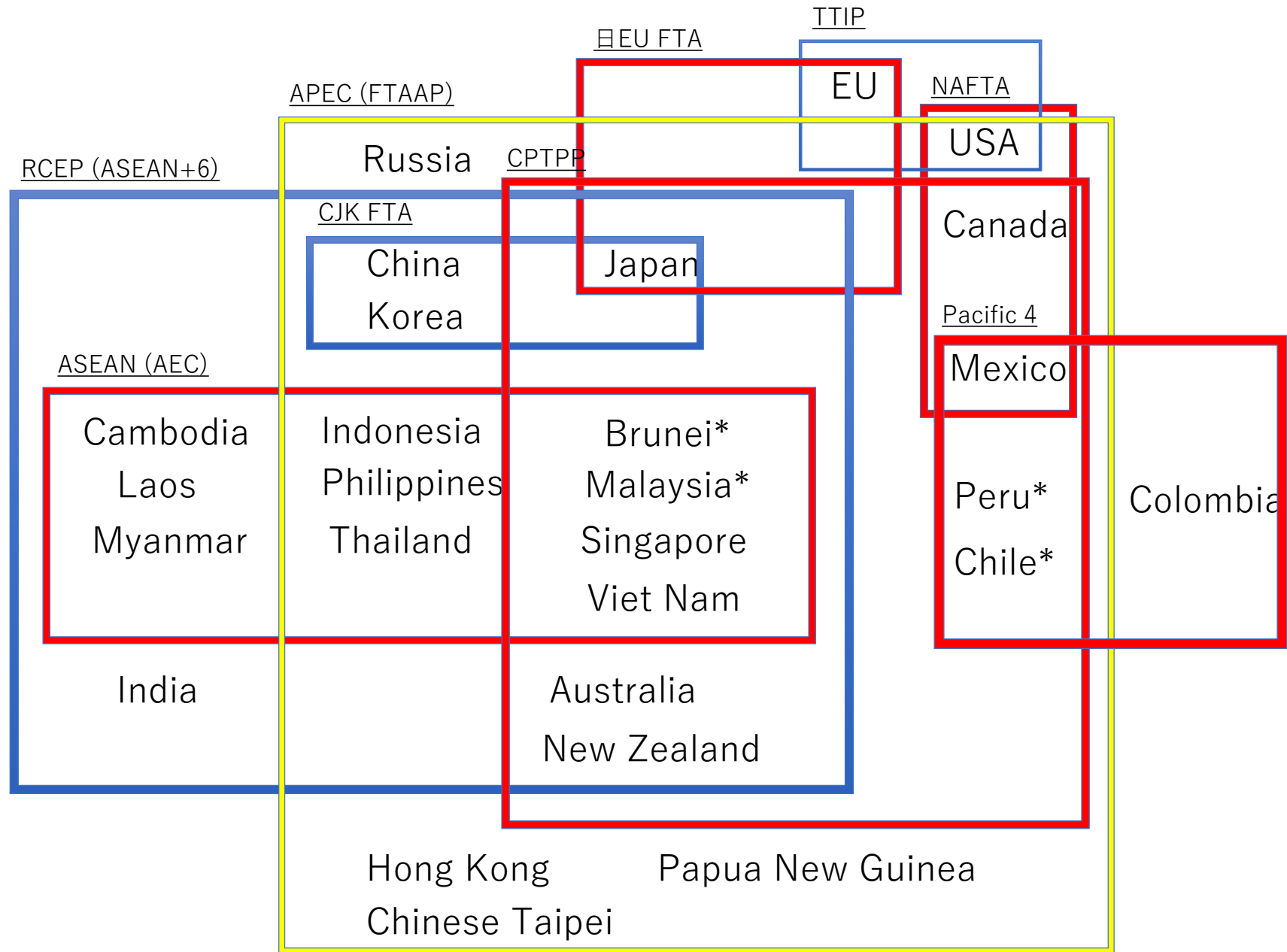
- Problematic trade policy under the US Trump Administration
  - Re-negotiation of FTAs (KORUS, NAFTA) includes elements of protectionism.
  - Section 232 of the Trade Expansion Act of 1962, Section 301 of the Trade Act of 1974 and related articles
  - Some of the retaliation/rebalancing measures and safeguards by other countries seem to be WTO inconsistent.
- Crisis of the WTO
  - Appellate Body issue, as a negotiating forum
- Populism and anti-globalization sentiment in some advanced economies.
- Rise of newly developed economies including China, criticism on the definition of “developing economies.”
- Delay in responding to new technologies.



# 5. The formation of mega-FTAs network

- Mega-FTAs for Japan: a series of negotiations started in 2013; acceleration against protectionism
  - Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP or TPP11)
    - July 2013: Japan joined neg. for TPP, Feb. 2016: TPP signed, Jan. 2017: the US walked out of TPP, Dec. 30, 2018: CPTPP in effect with 6 countries, Jan. 2019: Vietnam followed, others are supposed to follow.
  - Japan-EU EPA
    - April 2013: started neg., July 17, 2018: signed, Feb. 1, 2019: in effect.
  - Regional Comprehensive Economic Partnership (RCEP)
    - May 2013: started neg.
    - Important for keeping “ASEAN Centrality”
    - Negotiation, accelerated?
  - China-Japan-Korea FTA
    - March 2013: started neg.
    - Can it go ahead of RCEP neg.??
- Trade negotiation with the US
  - Japan, at the beginning, tried to narrow the scope and gain time.
  - Start negotiating “Trade Agreement on Goods” in Jan. 2019.
  - Key sectors: agriculture and automobiles
    - How to avoid dirty deals? Link to security issues??

# Proposed mega-FTAs in East Asia and Asia-Pacific



Note: \* means a country that does not ratify CPTPP yet as of July 2019.

Sources: The author.

# The contents of CPTPP

- Covers 500 million people, 13% of the world GDP
- Carry over most of the text of TPP except 22 suspended items (mostly minor except IPR)
- Market access
  - Tariff removal: 99-100% except Japan (95%; agriculture!)
  - Services, investment: negative list method, ISDS
- Rule-making
  - Government procurement, IPR, competition
  - Novel elements (looking at China and others)
    - E-commerce
      - Basic principle: free flow of data and no data localization requirements (cf. EU: GDPR)
      - Back-up policies needed
    - SOEs
      - Globalization of corporate activities and the leveling of the playing field
      - May need to reconsider disciplines on foreign aid in the future.
  - Global agenda
    - Labor (ILO Guideline+)
    - Environment (esp. fishery)
  - Regulatory practice, transparency and promptness in administrative procedure

# The contents of Japan-EU EPA

- Covers 640 million people, 28% of the world GDP
- Market access
  - Tariff removal
    - Japan: 94% (ag. 82%, manu. 100%); EU: 99%
  - Services, investment: negative-list method
  - Movement of natural persons
    - GATS+ including investors, contractual service suppliers and independent professionals, short-term business visitors, family members...
- Rule-making
  - “Nontariff barriers”: automobiles and auto parts, ...
  - E-commerce
    - No tariffs, prohibition of forced disclosure of source codes, electronic recognition/signature, ...
    - GDPR: separate negotiation (on-going)
  - Government procurement: WTO-GPA+ (re. railways)
  - SOEs: non-discrimination, commercial consideration
  - IPR
    - Geographical indication: EU 210 items, Japan 56 items (based on laws newly introduced)
  - Dispute settlements on investment: separate negotiation
  - Trade and sustainable development
    - Pursue ratification of the fundamental ILO Conventions and other ILO Conventions to ratify
      - e.g., ILO 105: abolition of forced labour convention, 111: Discrimination (employment and occupation) convention
  - Regulatory cooperation
    - “Animal welfare”

# RCEP and CJK FTA

- Regional Comprehensive Economic Partnership (RCEP)
  - ASEAN10 + 6 (CJK, Aus., NZ, and India)
  - Important to support East Asian production networks; to keep “ASEAN Centrality”
  - Negotiation goes on with high spirit this year.
  - It will be a living, continuously upgrading agreement.
- China-Japan-Korea FTA
  - Originally expected to lead the RCEP negotiation in terms of the timing and the contents.
  - Not much progress though.
  - The aggravation of Japan-Korea relationship would affect negatively.

# Japan-US trade negotiations

- The US hastens the neg. results. Became a “small negotiation.”
- Outline of the agreement will be disclosed soon.
- Checkpoints
  - Agriculture
    - Liberalization of major five items, close to the TPP concession?
  - Automobiles
    - Seems to slow down the pace of tariff removals on the US side than TPP.
    - Commitment of not using Section 232 of the Trade Expansion Act of 1962?
  - Exchange rate clause
    - Not to be included?
  - Poison clause
    - Not to be included?
  - WTO consistency
    - Meeting the criteria of tariff removal for “virtually all the trade”?
  - Any built-in commitment to expand the scope of further negotiations beyond trade in goods?

## 6. The role of mega FTAs network

- Establishing Japan's initiative in economic diplomacy
- Contribution to further liberalization and new international rule-making
- Secure room for expanding and deepening international production networks
- The formation of pro-trade coalition among middle power countries located between the US and China
- Defend rule-based trading regime

# 7. Conclusion

- Japan's mega-FTAs network strategy started with the Abe administration. Although it took for a while, it now gains steady progress.
- With head wind against free trade, the formation of pro-trade coalition by middle powers is meaningful.
- WTO reform (appellate body issue, as a negotiating forum) is important, but not easy.
- Mega-FTAs network may play an important role in partially complement the rule-based trading regime.