The Role of Preferences in Japan's FTA Policy Formation in Asia on a Bilateral, Minilateral, and Region-wide Level

Does Japan Need a Region-wide Agreement?

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The candidate confirms that the work submitted is his/her own and that appropriate credit has been given where reference has been made to the work of others.

Abstract

Using Japan's existing free trade agreements (FTAs) this thesis analyses the country's current FTA policy by focusing on the formation of domestic preferences regarding bilateral, minilateral and proposed region-wide FTAs. The two-level game metaphor (Putnam 1988) is combined here with the international political economy (IPE) approach in order to analyse the complex interactions between various levels of factors influencing main actors' preferences. The two-level game model is used to separate the international and domestic levels of policy formation process and to conceptualise the latter as bargaining between various groups of actors (domestic negotiations). The thesis argues that preferences of discussed domestic groups together with the specific policy formation process are central to explaining Japan's FTA policy and its current impasse. The thesis conceptualises this policy as embedded in a broader economic and political environment, both on a national and an international level. Changes in this environment can affect actors' preferences and lead to changes in country's free trade agreements policy. This study analyses the added value of consecutive FTAs from the perspective of their main clients, as well as technical aspects of their harmonisation, multilateralisation or consolidation. It also discusses Japan's approach to overlapping FTA regulations. Therefore, the research is set within the overarching theoretical debate of multilateralising bilateralism which attempts to determine the feasibility of harmonising bilateral FTAs into broader agreements. The thesis focuses predominantly on the desirability of such harmonisation from the perspective of Japan's main actors. This study is based on in-depth interviews conducted in Tokyo in January 2009 and between March 2010 and December 2011.

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Dedication

This thesis is dedicated to my grandmother, Eugenia Jerzewska and in loving memory of my grandfather, Jozef Jerzewski. They have encouraged me every step of the way.

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List of Abbreviations

ABAC - APEC Business Advisory Council

ADB - Asian Development Bank

AFTA - ASEAN Free Trade Agreement

AJCEP - ASEAN-Japan Comprehensive Economic Partnership

APEC - Asia-Pacific Economic Cooperation

APT - ASEAN Plus Three

ASEAN - Association of Southeast Asian Nations

ASEAN+3 - ASEAN Plus China, Japan, and South Korea

ASEAN+6 - ASEAN Plus China, Japan, South Korea, India, Australia, and New Zealand

ASEM - Asia-Europe Meeting

ATIGA - ASEAN Trade in Goods Agreement

BIT - Bilateral Investment Treaty

CEO - Chief Executive Officer

CEP - Comprehensive Economic Partnership

CEPEA - Comprehensive Economic Partnership in East Asia

CEPT - Common Effective Preferential Tariff

CJK - China, Japan, and Korea

CJK FTA - China, Japan, and Korea Free Trade Agreement

CTC - Change in Tariff Classification

CU - Custom Union

DDG - Deputy Director-Generals

DPJ - Democratic Party of Japan

FDI - Foreign Direct Investment

EAFTA - East Asian Free Trade Area

EAS - East Asian Summit

EASG - East Asian Study Group

EAVG - East Asian Vision Group

EPA - Economic Partnership Agreement

ERIA - Economic Research Institute for ASEAN and East Asia

EU - European Union

FTA - Free Trade Agreement

FTAA - Free Trade Agreement of the Americas

FTAAP - Free Trade Area of the Asia-Pacific

GATS - General Agreement on Trade in Services

GATT - General Agreement on Tariffs and Trade

GDP - Gross Domestic Product

HS - Harmonised Commodity Description and Coding System

IDE - Institute of Developing Economies

IMF - International Monetary Fund

IPE - International Political Economy

IPR- Intellectual Property Rights

ITA - Information Technology Agreement

JAMA - Japan Automobile Manufacturers Association

JETRO - Japan External Trade Organisation

JCCI - Japan Chamber of Commerce and Industry

JMC - Japan Machinery Centre for Trade and Investment

JMEPA - Japan-Malaysia Economic Partnership Agreement

JPEPA - Japan-Philippines Economic Partnership Agreement

JPY - Japanese Yen

JSEPA - Japan-Singapore Economic Partnership Agreement

JTEPA - Japan-Thailand Economic Partnership Agreement

LCD -Liquid-crystal Display

LDP - Liberal Democratic Party

MAFF- Ministry of Agriculture, Forestry and Fisheries

METI - Ministry of Economy, Trade and Industry

MFN - Most Favoured Nation

MITI - Ministry of International Trade and Industry

MNC - Multinational Corporation

MOF- Ministry of Finance

MOFA - Ministry of Foreign Affairs

NAFTA - North American Free Trade Agreement

NIE - Newly Industrialised Economies

NTB - Non-tariff Barrier

ODA - Official Development Assistance

OECD - Organisation for Economic Co-operation and Development

OEP - Open Economy Politics

OMT - Office of the Minister for Trade

PAFTAD - Pacific Trade and Development Conference

PECS - Pan-European Cumulation System

PM - Prime Minister

PRC - Peoples' Republic of China

RIETI - Research Institute of Economy, Trade and Industry

RoO - Rules of Origin

RTA - Regional Trade Agreement

SME - Small- and Medium-sized Enterprise

TFAP - Trade Facilitation Action Plan

TPP - Trans-Pacific Partnership

TPSEPA - Trans-Pacific Strategic Economic Partnership Agreement

TRIM - Agreement on Trade-Related Investment Measures

TRIPS - Trade Related Aspects of Intellectual Property Rights

US - United States

USD - US Dollar

VC - Value-added Content

WTO - World Trade Organisation

Chapter 1
Introduction and Theoretical Framework

1.1 Introduction

Japan was the first Northeast Asian country to sign a free trade agreement (FTA). As of January 2012 it had 13 free trade agreements[1], including a minilateral agreement with Association of Southeast Asian Nations (the ASEAN-Japan Comprehensive Economic Partnership, AJCEP). In March 2010, Japan's trade volume with its FTAs partners approximated 15.9 percent of its total trade volume and a further 22.3 percent with prospective FTA partners (FTAs under negotiations)[2]. In addition, the country is participating in three coexisting frameworks with regional economic integration agenda including a possible negotiation of a regional FTA: ASEAN plus China, Japan and South Korea (ASEAN+3); ASEAN plus China, Japan, South Korea (hereafter Korea), India, Australia and New Zealand (ASEAN+6) and Asia-Pacific Economic Cooperation (APEC) forum. In November 2011, Japan has also announced its participation in the Trans-Pacific Partnership (TPP). Using Japan's existing FTAs this thesis explains the country's current FTA policy by looking at the formation of domestic preferences regarding bilateral, minilateral (the agreement with ASEAN) and proposed region-wide FTAs. The two-level game metaphor (Putnam 1988) is combined here with the international political economy (IPE) approach in order to analyse complex interactions between various levels of factors influencing main actors' preferences. The thesis argues that preferences of discussed domestic groups together with the specific policy formation process are central to explaining the country's FTA policy and its current impasse. It also provides new empirical evidence in multilateralising bilateralism debate and discusses Japan's approach to dealing with overlapping FTA regulations, as well as to future regional integration.

This is a qualitative study which focuses on preferences of selected domestic groups and their role in the FTA policy formation process. The thesis looks at domestic preferences for: 1) bilateral FTAs with East Asian states, although treaties with other countries are also discussed, 2) the AJCEP, and 3) proposed region-wide agreements. This study analyses the added value of consecutive FTAs from the perspective of their

[1] For a full list of Japan's FTAs see Appendix 1.
[2] Interview no. 9.

main clients as well as technical aspects of their harmonisation, multilateralisation or consolidation. Therefore, the research is set within the overarching theoretical debate of multilateralising bilateralism which attempts to determine the feasibility of harmonising bilateral FTAs into broader agreements[3]. The thesis focuses predominantly on the desirability of such harmonisation from the perspective of Japan's main actors which were chosen due to their direct or indirect involvement in the FTA policy formation process. This selection was based on a literature review and initial fieldwork research which involved interviews with Japanese scholars, FTA analysts and representatives of think-tanks. As a result, three (two main and one supporting) domestic groups were chosen. The first group is the government. The second group consists of strong domestic interest groups. This includes: 1) Japanese multinational corporations (MNCs) operating and manufacturing in East Asian countries, and 2) the agricultural sector. Finally, preferences of other domestic groups are also briefly discussed. They are: the service sector which demonstrates non-manufacturing sector's views, and labour unions[4]. The study focuses on over a decade of Japan's FTA policy. Although the country signed its first free trade agreement in 2002, the development of FTA policy can be traced back to 1998. This is the starting point of the analysis in Chapter 3. The end of 2010 and the APEC Summit in Yokohama mark the end of data collection and fieldwork research. Therefore, the thesis mentions developments which occurred beyond this point in time only when the situation has changed or an update was necessary.

The structure of the thesis is as follows. Chapter 1 provides an introduction and an outline of the study. It presents the subject of the research and questions it aims to answer. A short literature review lists the most relevant theoretical models and their application for this research. This is followed by an explanation of the approach to examining actors' preferences and a theoretical framework for the study. The chapter concludes with a description of the data collection process and limitations of the research. Chapter 2 introduces FTAs. It explains how they relate to other forms of market organisation and trade liberalisation. It also discusses barriers to trade such treaties remove, as well as other types of provisions they include. Having provided a brief overview of FTAs, the chapter introduces the multilateralising bilateralism debate and the 'spaghetti bowl' concept. Chapter 3 presents Japan's FTA policy to date. It discusses the preferences of Japan's ministries and domestic interest groups for bilateral FTAs with East Asian countries and an agreement with ASEAN. It also includes two

[3] The debate is described in detail in Chapter 2.
[4] The rationale for choosing the three groups will be discussed further in this chapter.

examples of Japan's 'failed' FTA negotiations. Chapter 4 discusses Japan's domestic actors' preferences for a region-wide FTA. It aims to establish which of the proposed region-wide schemes the interviewed groups would opt for and what are their broader preferences for Japan's future role in regional economic integration. Chapter 5 explains the role of domestic actors in the policy formation process. It describes how the preferences of domestic groups are aggregated by the ministries into FTA policy. It analyses: 1) communication channels between various groups and the ministries that represent them, 2) how the ministries involved in the FTA policy formation process aggregate this information and communicate with each other, 3) how the compromise between conflicting domestic preferences is made, and 4) how the Japanese side is represented during international FTA negotiations. Chapter 6 presents final conclusions.

1.2 Rationale for the Study

The number of free trade agreements increased rapidly in recent years. They have become a widely studied phenomenon and a prominent feature of the world trading system. Dent (2010a:50) calculates that the number of FTAs worldwide rose from 16 agreements in force in 1990, up to about 72 in 1997 and approximately 200 FTAs in force in 2008. To give a different example, in 2003, out of all WTO member states, only Macau and Mongolia were not participants of one or more regional trade agreements (Ravenhill 2005b:117). In 2009, Mongolia was the last country not to be a member of a trade agreement (Menon 2009). In June 2010, a first meeting of the Joint Study Group on Japan-Mongolia Economic Partnership (FTA) took place. According to WTO (WTOd[5]), in January 2012 there were 184 FTAs in force. Perhaps no other region has witnessed the proliferation of FTAs more than East Asia. It was a latecomer when it comes to FTAs: there were no free trade agreements before the financial crisis of 1997/98. In 2000, ASEAN's FTA (AFTA) was the only FTA in force in the region (Ravenhill 2010:178). In August 2010, there were 61 FTAs concluded in East Asia[6], of which 47 were signed and in effect, and 79 further FTAs were proposed or under negotiations (Kawai and Wignaraja 2011a:3). Thus, as argued by Kawai and Wignaraja (*ibidem*:1), "Asia has emerged at the forefront of global free trade agreement activity".

[5] The data comes from the WTO Regional Trade Agreements Gateway, last updated in January 2012. Available from: http://www.wto.org/english/tratop_e/region_e/region_e.htm.
[6] This is based on FTAs signed by ASEAN member and India.

This has been referred to as the new East Asian regionalism (e.g. Ravenhill 2010, Rajan 2005:217). Such agreements are "assuming more importance as a tool of commercial policy in Asia than ever before" (Kawai and Wignaraja 2011a:16).

As discussed earlier, Japan has signed 13 FTAs. The country FTA policy is particularly interesting for a number of reasons. First, it takes place on three separate levels: bilateral, minilateral and regional. This provides an opportunity to analyse Japan's approach to the coexistence of different levels of FTAs and its ideas for future harmonisation, multilateralisation or consolidation of such agreements. In particular, Japan's decision to include a flexibility clause in the agreement with ASEAN provides an insight into the government's vision of the future shape of regional integration in East Asia. As such, analysing Japan's FTA policy can provide new empirical evidence in the multilateralising bilateralism theoretical debate which will be discussed in detail in Chapter 2.

Second, Japan has "the strongest base of giant MNCs involved in production networks and supply chains throughout Asia" (Kawai and Wignaraja 2011a:4). For that reason, Japanese MNCs are highly interested in the progress of regional economic integration. The Japanese government has used FTA negotiations to provide a favourable business environment in East Asia. Japan's free trade treaties are on the crossroads between protectionist tendencies and internal and external pressure for higher international profile in the region. For that reason, the analysis of Japan's FTA policy requires including a variety of factors and actors, as well as developing suitable theoretical approach.

Third, Japan has traditionally perceived itself as being in between the East and the West (Rozman *et al.* 2007:1). Its special partnership with the US has historically made it difficult for Japan to commit to a regional framework excluding the US[7]. Its foreign policy was called passive and reactive (e.g. Calder 1988). Nonetheless, in recent years Japan has simultaneously participated in regional cooperation frameworks in East Asian and Asia-Pacific, as well as two coexisting plans for creating a regional FTA in East Asia: ASEAN+3 and ASEAN+6. Both proposed FTAs are at an early planning stage and there is no certainty if and when an East Asian trade agreement will become a reality. However, as will be discussed in Chapter 4, with the formation of the Trans-Pacific Partnership and the snowball effect this had amongst the APEC member states, Japan could no longer idly observe the development of regional economic integration. This thesis covers a particularly interesting period in Japan's regional and FTA policy: it

[7] This issue will be discussed further in Chapter 4.

focuses on the run up to the decision to participate in the TPP. It analyses how domestic and international factors have influenced the preferences of domestic interest groups and led the country to declare its participation in the TPP despite a strong opposition from the agricultural sector. Once negotiated, the TPP might turn out to be an agreement with the highest level of liberalisation Japan has signed so far. Its participation in the treaty might also help to sway other countries in the region by creating a momentum for the TPP in East Asia.

Finally, Japan's FTA policy is at an impasse resulting from conflicting domestic interests and strong opposition to further liberalisation[8]. Japan's decision to join the TPP could be viewed as the first step out of this impasse. However, it was made amidst strong protests from the agricultural sector. This is an interesting time for Japan's FTA policy. In the upcoming years the country will need to deal with domestic opposition to the treaty and develop a clear vision for regional integration while actively participating in the TPP negotiations and helping to shape the future agreement. As the thesis covers Japan's FTA policy from its inception up to the end of 2010, it provides a good overview of the situation and allows us to understand the circumstances surrounding Japan's decision to enter the TPP negotiations. It also demonstrates how the selected domestic actors view Japan's role in future regional economic integration.

1.3 Research Questions

Based on the issues discussed in the previous section, the overarching question of the research is: what type of a region-wide free trade agreement do Japan's main actors prefer and how has the country's FTA policy to date been influenced by these preferences? The initial fieldwork research and literature review led to a set of supporting sub-questions:

1) What kind of free trade agreements has Japan been signing so far and why? What preferences have shaped these agreements?
2) How have these preferences changed over time, from the early stages of Japan's FTA policy to 2010?
3) What added value could a prospective region-wide FTA have? Does Japan need a region-wide FTA or perhaps the current agreements provide a sufficient

[8] This issue will be discussed in Chapters 3 and 5.

response to the country's strategic goals?

4) Do bilateral, minilateral and region-wide FTAs fulfil the same strategic political and economic goals, or do they serve different purposes?
5) What were the reasons behind a decision to include a flexibility clause in the AJCEP? Does the flexible approach really provide a way out of the spaghetti bowl syndrome?
6) What type of factors (international, domestic, political or economic) shape actors preferences for FTAs?
7) Who and how formulates Japan's FTA policy? What are the communication channels between the domestic interest groups and the different parts of the government?
8) At what stage of the policy formation process is the domestic win-set of preferences formulated?
9) What characteristics of the policy formulation process have led to the current FTA policy impasse?

These questions were the basis for the research fieldwork and are discussed throughout the thesis. Question 1 and 2 relate to Chapter 3, while question 3 to Chapter 4. Questions 4 to 6 focus on more general issues and are discussed in both Chapter 3 and Chapter 4. Chapter 5 provides answers to questions 7 to 9.

1.4 Theoretical Perspective

1.4.1 The International Political Economy Field

The thesis takes an international political economy and therefore a multi-disciplinary approach to exploring the relationship between 'the state' (politics) and 'the market' (economics) both on the domestic and international level. One of the distinctive characteristics of IPE is that it considers the importance of "economic phenomena – for example, social classes, multinational corporations or world markets – as independent, intervening or dependent variables in the understanding of foreign policy, a role we also ascribe to 'politics'; for instance, intra-elite competition, ethnic rebellion, or the nature of political institutions" (Burton and Wurfel 1990:1). In other words, IPE implies that "the economics of trade cannot be separated from its political aspects" (Balaam and

Veseth 2001:111 cite Robert Kuttner). As a result, a strong emphasis is placed on economic factors and informal (non-governmental) ties between states. When it comes to East Asia, the IPE approach allows stressing the importance of economic interdependence in the region as a backdrop for the government-led regional economic cooperation initiatives such as a region-wide FTA. It also permits to focus on activities and preferences of important non-governmental or trans-national actors such as the agricultural lobby group and the MNCs.

Within the IPE field, this study touches upon the open economy politics (OEP) which focuses on the politics of international economic exchange. Lake (2008:763) explains that OEP discusses interests, institutions and bargaining:

> *"OEP begins with firms, sectors, or factors of production as the units of analysis, derives their interests over economic policy from each unit's position within the international economy, conceives of institutions as mechanisms that aggregate interests (with more or less bias) and condition the bargaining of competing societal interests, and, finally, introduces when necessary bargaining at the international level between states with different societally produced interests. Few theories give equal weight to all steps in this analysis".*

This research focuses on the first two stages: 1) how the domestic interest groups' preferences regarding FTA policy are shaped and communicated to the government, and 2) how the government transforms competing domestic interests into Japan's FTA policy. The focus on the preferences of domestic actors places this topic within the broad frame of liberal IPE theory. This part of IPE researches a wide range of actors and analyses the interplay between them. Moravcsik (1997:516) explains that according to liberal international relations theory "the relationship between states and the surrounding domestic and trans-national society in which they are embedded critically shapes state behaviour by influencing the social purposes underlying state preferences". This means that domestic situations impact states' preferences and influences the way they behave on the international stage. Therefore, economic integration is viewed as a bottom-to-top processes resulting from aggregated interests of domestic and trans-national actors: states' policy is influenced and shaped by these groups. Non-governmental actors, both individuals and groups, are considered to be important players. They "organise exchange and collective action to promote differentiated interests under constraints imposed by material scarcity, conflicting values, and variations in societal influence"

(Moravcsik 1997:516). Commercial liberalism, one of the variants of liberal theory, assumes that changes in the domestic distribution of profits from increased economic interdependence provide an incentive for domestic actors to impact state's policies. Moravcsik (1997:528) explains that "changes in the structure of the domestic and global economy alter the costs and benefits of trans-national economic exchange, creating pressure on domestic governments to facilitate or block such exchanges through appropriate foreign economic and security policies". Economic incentives from increased trade do not necessarily cause states to opt for trade liberalisation. Rather, their preferences depend on the distribution of gains from trade within the state. Positive or negative incentives from cross-border trade determine the preferences of domestic actors. Moravcsik (1997:528) concludes that "the greater the economic benefits for powerful private actors, the greater their incentive, other things being equal, to press governments to facilitate such transactions; the more costly the adjustment imposed by economic interchange, the more opposition is likely to arise".

1.4.2 Regionalisation, Multilateralism and Minilateralism

Several scholars make a clear distinction between the process of regionalism and regionalisation. Regionalisation is a bottom-up integration process led mainly by the private sector and caused by the increasing economic interdependence between states (Beeson and Yoshimatsu 2007:230). It is an informal process whereby increasing economic links do not result from a formal agreement or actions of an international organisation. Regionalism, as opposed to regionalisation, is a formal process of state-led initiatives towards regional integration involving international agreements and organisations with structure and aims. Dent (2008a:7) defines regionalisation as "micro-level processes that stem from regional concentration of interconnecting private or civil sector activities", such as increasing international trade between companies in a given region, and regionalism as "public policy initiatives, such as free trade agreement or other state-led projects of economic cooperation and integration that originate from inter-governmental dialogues and treaties". Hence regionalisation is a "societal-driven, bottom-up process" and regionalism is a "policy-driven, top-down process" (*ibidem*). Therefore, regionalisation occurs as an offset of increased economic interdependence between companies in the region and not as a result of a common identity or a bottom-up strategy of regionalisation.

This distinction seems particularly relevant when it comes to East Asia, as it has often been argued that the region has undergone a market-led integration. This means that whilst informal economic regionalisation has taken place over the years there has been little development in terms of institutional regional framework. For that reason, some scholars speak of the difference between *de facto* (regionalisation) and *de jure* (regionalism) economic integration in East Asia (Hiratsuka 2007, Hiratsuka and Kimura 2008) and the 'persistent discrepancy' in the progress of these two processes (Nicolas 2010). The official government initiatives lag behind the market-driven integration. Increased regionalisation and economic interdependence between the East Asian states results from several factors. One of them is the formation of vertically integrated production networks. Vertical integration of production networks, also known as internationalisation of production, production fragmentation or production sharing, occurs when companies move their labour-intensive stages of production abroad to less developed countries while the capital-intensive stages are done back in the home country where parts or intermediate goods are further processed. Hence the manufacturing stage of production occurs in the most cost-efficient location. In East Asia, the intra-industry trade in parts and components, resulting from production fragmentation, has not only increased the overall volume of intraregional trade but also strengthen the regional interdependence. Production sharing spread in the region is due to "the region's wide range of development levels, strong intraregional links, and capacity for organisational and technological change" (ADB 2008:18). Secondly, the Asian financial crisis of 1997/98 convinced the East Asian states of the need for a closer economic cooperation. According to a study by the Asian Development Bank (ADB 2008:5) the crisis has deepened the interdependence in Asia, as well as increased the macroeconomic links, cooperation in trade and finance, and strengthened the emerging Asian regionalism. The study also points out that the growth of macroeconomic interdependence following the financial crisis and the deepening trade and financial ties have made the region more sensitive to global and regional economic shocks. As the former Managing Director of the International Monetary Fund, Dominique Strauss-Kahn, concluded during a press conference in Tokyo the recent global economic crisis has proven that globalisation is not only an academic concept[9].

The thesis focuses on preferences of domestic actors and the aggregation of these preferences by the government and focuses on the process of regionalisation. However, it also discusses regionalism as analyses the policy formation process and FTAs:

[9] Press Conference at the Foreign Correspondents Club of Japan, Tokyo, 18 January 2010.

intergovernmental, international and state-led agreements. It can be argued that FTAs are a researched aspect of regionalism and increasing regionalisation is one of the factors behind them. In this thesis FTAs are examined in the context of regional economic integration and not a region-building process which exceeds the economic sphere and involves a region-wide identity. Hence the understanding of regionalism is limited here to state-led economic integration, in particular the proliferation of bilateral and minilateral FTAs.

In the thesis proliferation of bilateral FTAs is also discussed in the broader context of multilateralism. The term multilateralism can refer to politics, international trade and security relations. When it comes to international trade multilateralism most often refers to the multilateral trading system under the World Trade Organisation (WTO), the multilateral organisation primarily responsible for governing international trade. It can also refer to multilateralising of bilateral agreements which means making them accessible to a higher number of parties or it can signify broader FTAs including several states. Keohane (1990:731) defines multilateralism as "practice of coordinating national policies in groups of three or more states". Ruggie (1993:11) defines it as "institutional form that coordinates relations amongst three or more states on the basis of generalised principles of conduct: that is principles which specify appropriate conduct for a class of actions, without regard to the particularistic interests of the parties or the strategic exigencies". A multilateral organisation is a "separate and distinct type of institutionalised behaviour, defined by such generalised decision-making rules as voting or consensus procedures" (*ibidem*:14). The WTO is an example of such organisation and adopts a set of common rules, for example the most favoured nation (MFN) principle. To avoid confusion, this thesis refers to projects such as the ASEAN+3 or ASEAN+6 FTAs as region-wide FTAs and not regional multilateral agreements. For the same reason, the agreement between ASEAN and Japan is referred to as minilateral which means an FTA between a small subgroup of a larger entity, for example a subgroup of states within a region. This is similar to Kahler's (1993:296) explanation of minilateralism as "great power collaboration within multilateral institutions" and minilateral as meaning a subgroup within a larger group or organisation. An agreement between ASEAN and Japan or China could technically be called bilateral as it was concluded between two parties. Dent (2006:291) calls agreements between a bilateral state and a regional group, such as ASEAN, quasi-regional agreements[10]. However, in this thesis minilateralism signifies an agreement between three or more members but

[10] The typology and classification of FTAs will be further explained in Chapter 2.

still a subgroup of the region. It helps to differentiate these FTA from bilateral and region-wide treaties.

1.4.3 Theoretical Models and Their Application to the Study

1.4.3.1 Putnam's Two-Level Game Metaphor

Game theory, in particular John F. Nash's (1950) equilibrium and bargaining model, was introduced to international relations theory by, amongst others, Albert Hirshman, Robert O. Keohane, and Joseph Nye (Moravcsik 1997:523). It has then been further adapted by Robert D. Putnam (1988). Derived from game theory, the two-level game metaphor (Putnam 1988) is a political science model that can be applied to international negotiations taking place between liberal democracies and that seeks to connect the international sphere of factors with the domestic one. Putnam's initial framework was further developed in a collaborative multiple case study project (Evans *et al.* 1993). It argues that within any international negotiations process there are two games being played simultaneously by the countries' governments: 1) the international negotiations (game one), and 2) an attempt to find consensus and support at the domestic sphere (game two). Therefore, the government, referred to as the central government, negotiates each international agreement on two fronts. The two levels or games mutually influence each other. The domestic groups interact with the international environment in two ways: 1) by influencing their government and taking part in the domestic policy formation process, and 2) by interacting directly with international actors. The second option is particularly relevant when it comes to MNCs[11]. In order for negotiation to be concluded an agreement to be signed, a compromise, called a win-set, needs to be established on both the domestic and international fronts. A win-set is an acceptable result of negotiations for all actors on this level. This thesis defines Japan's FTA policy formation process as the domestic win-set. Therefore, the study focuses on level two of Putnam's game and how the conflicting preferences of domestic groups are transformed into a domestic consensus. The level two game might be compared to negotiating an agreement on the international front and then ratifying it on a domestic level. The US-Korea FTA can serve as an example. Although it has been signed in June 2007, it has only been ratified by both country's legislative bodies the second half of

[11] This issue will be discussed later in the chapter.

2011. This demonstrates the importance of domestic consensus for international agreements. As indicated in the following chapters of this thesis, in Japan the domestic win-set takes place before and during the international level of negotiations. As Putnam (1988:449) writes "the Japanese propensity for seeking the broadest possible domestic consensus before acting constricts the Japanese win-set, as contrasted with majoritarian political cultures". The preference for a consensus-based decision-making is deeply rooted in the Japanese culture and society. This is reflected in the term '*nemawashi*' which refers to the importance of an internal, informal consensus between all involved parties.

Criticising the two-level game theory, Jeffrey W. Knopf (1993) introduced a three-and-three level game metaphor. In his opinion, the two-level theory, although emphasises the interactions between the domestic and international levels of factors, offers few new observations. The author (*ibidem*) expands the two levels to three in order to allow for a division between allies and other parties in an analysis of security negotiations. Knopf (1993:600) also increased the number of the levels of domestic-international interactions to three: trans-governmental (government with government), trans-national (domestic actors with domestic actors) and cross-level (government with domestic actors). Each of these types of interactions impacts the outcome of the negotiations in a different way. The novelty of this approach is that domestic groups can initiate international negotiations. Knopf (*ibidem:*608) argues that domestic actors get involved in trans-national or cross-level interactions as they attempt to force a compromise between their position and what the leaders would otherwise consider to be a preferred solution.

Leonard Schoppa (1993) examines the impact of the US' pressure during the Japan-US Structural Impediments Initiative dialogue from 1989 on Japan's domestic politics and the market liberalisation concessions it made. Schoppa argued that the two-level approach needs to include system-level variables (international) as well as domestic-level variables as the realist, state-centric approach does not provide answers. His work focuses on a fragment of Putnam's model which he considers underdeveloped: synergistic strategies and the circumstances under which they are likely to produce positive results. Synergistic strategies are pursued by negotiators during international negotiations and are "aimed at reshaping politics in both their own and their counterparts' domestic arenas to make possible deals that would not have been possible in the absence of interaction between the two levels" (*ibidem*:353-354). Schoppa distinguishes two more synergistic strategies that have not been mentioned by Putnam:

participation expansion and alternative specification. Participant expansion occurs when the number of participants of international negotiation is increased at the domestic level. This can be done either by "expanding participation at the elite level or internationalising a previously domestic issue or by increasing the influence of the unorganised masses" (*ibidem*:374). Alternative specification strategy occurs when foreign pressure highlights "policy alternatives that may not be considered in absence of foreign involvement" (*ibidem*).

1.4.3.2 Domestic Interest Groups Models

Domestic interest groups models are of particular relevance to this thesis as such groups are one of the two main levels of analysis. Baldwin *et al.* (2007:4) explain that "the politically optimal structure of a bilateral FTA depends upon the comparative advantages of the two nations and the particular political strengths of various interest groups at the time the deal is signed". Interest groups politics models explain how a well organised small group can significantly impact state's decision-making process to its advantage. Gary S. Becker's (1983, 1985) work focuses on how interest groups compete for political influence. Becker (*ibidem*) applies economic modelling to the issue of special groups' politics and the competition between interest groups. According to Sutter (1995:128), there are three factors that determine how special interest groups impact national policies: 1) the amount of pressure the general interest generates, 2) the amount of pressure the special interests generate, and 3) how the pressure generated by each group translates into political influence (the marginal productivity of pressure). Becker (1985:336) discusses the 'compensation principle' and its usefulness in assessing if a particular policy is beneficial for the general public. If a discussed policy brings more benefits to one group than losses to another group, under the condition that access to political influence is equal for all groups, the group that gains from the policy would exert more political pressure and, in effect, their preferences would prevail. The group that gains may then compensate the losses of other groups. According to the logic of collective action, special interest groups given their small size, better organisation, and lack of free rider issue, are able to exert stronger political pressure than the remaining part of society (Sutter 1995:128). This is relevant to the analysis in Chapter 3 and helps to understand why the Japanese agricultural sector has the ability to block policies that could potentially be beneficial or welfare-increasing for the rest of the society. Domestic agricultural lobby groups in Japan have often been accused of slowing down FTA negotiations and pressuring the government to exclude sensitive products from market liberalisation. For example, the Japan-Australia FTA negotiations, which started in April 2007, have been making little progress due to the opposition of the Japanese agricultural sector. This body of work is particularly relevant to the discussion on 'failed' FTA cases in Chapter 3. Becker (1985:344 cites Olson 1982) writes that domestic interest groups are widely condemned for pursuing their personal interests and cites Olson, who claims that they are "responsible for sluggish growth and the eventual decline of nations". Becker (*ibidem*:344) further argues that "no policy that lowered social output would survive if all groups were equally large and skilful at producing political influence, for the opposition would always exert more influence than proponents".

Grossman's and Helpman's (2001, 2002) model of special interest groups' politics explains how such groups impact the policy formation process within democratic states and is also of relevance in the context of this thesis. They point out that there is no consensus regarding the definition of special interest groups: it can range from "any identifiable group of voters with similar preferences on a subset of policy issues" to "organisations that take political actions on behalf of a group of voters" (Grossman and Helpman 2001:1). In this thesis interest groups are represented by individual companies within the manufacturing sector, organisations representing their interests (business associations), and the agricultural cooperatives representing the interests of for the agricultural sector. Grossman and Helpman (2002:13) write that "when the policy makers enter a negotiation with preferences that have been shaped by domestic interest groups, the outcome in each sector reflects the relative political power of the industry groups in the two countries". In other words, "electorally-motivated politicians (...) seek to impose tariffs that satisfy the demands of industrial constituents while still generating enough welfare to garner the votes needed for re-election" (Kapstein 2006:5). This approach is similar to the understanding of the domestic win-set formation process adopted in this thesis. The state's preferences are being shaped by the preferences of domestic groups which have unequal access to political power. The agricultural sector and the MNCs are the two strongest domestic interest groups as indicated by the research fieldwork and have the potential to significantly influence Japan's FTA policy. Pekkanen (2003) discusses sectoral lobbying in Japan. Writing about the privileged sectors' influence on Japan's WTO strategy, Pekkanen (2003:285) mentions the powerful automobile and steel sectors and points out that between 1995 and 2000 the country's complaints under the WTO's dispute settlement system have been filed almost exclusively on behalf of these sectors. This demonstrates the importance of interest groups in shaping Japan's WTO strategy. Pekkanen (*ibidem*:289) also explains that domestic political influence "should also be reflected internationally, whether in a legalised multilateral forum or not". His paper mentions the channels used by influential sectors in communication with the government, such as industrial and business associations.

Thomas Schelling's (1960) work is a part of international bargaining literature which is nested within the two-level framework. Schelling conjecture[12] focuses on the domestic constraints of foreign policy and how it can provide states with a bargaining advantage in international negotiations. According to this theory, a domestic group that opposes a proposed agreement can improve the state's bargaining position (Hiscox 2005:78 cites Schelling 1960:28-9). In the context of FTA negotiations the Schelling conjecture means that the party which is constrained by a powerful domestic group can in effect obtain higher concessions and more favourable conditions than the party which is not. Ahmer Tarar (2001) questions the outcomes of the Schelling conjecture for the situation in which both sides are constrained and claims that in result of insufficient information both sides can end up being worst off. The Schelling conjecture might provide an explanation for Japan's ability to exclude an overwhelming majority of agricultural products from FTA negotiations.

1.4.3.3 Economic Incentives and Domestic Distribution of Gains from Trade

In models such as the ones presented in the previous section, preferences are closely linked to interests, mostly economic, resulting from changes in income or/and its distribution. They depend on how an FTA impacts the domestic distribution of gains and losses from trade. International trade changes the relative price of products the country exports and imports and hence impacts certain domestic groups (Krugman and Obstfeld 1997:56). An analysis of changes in the preferences is domain of the OEP making it a distinct approach within the IPE (Lake 2008:764).

David Ricardo's (1817) model assumes the existence of two states producing two goods and with one factor of production: labour. It argues that increased trade benefits all states as gains depend on comparative not absolute advantages. Therefore, even if

[12] It was named so by Milner (1997:68) (Tarar 2001:320).

state A produces all goods less efficiently and therefore more expensively than state B, it has a bigger comparative advantage in some of these goods. Hence the assumption is that if state A specialises in the production of goods where it has higher comparative advantages, international trade can be beneficial for both states A and B. Krugman and Obstfeld (1997:25) used the Ricardian model to explain that free trade benefits not only rich states and that it does not result from low wages in less advanced economies. However, the neo-mercantilists critique of the comparative advantages theory touches upon the problem of how international trade affects employment within a country, for example farmers who have lost business as a result of increased competition. Balaam and Veseth (2001:113) write:

> *"The national production structure generates goods for trade. Yet this structure reflects a distribution of national resources such that people are employed in different sectors of the economy. While comparative advantages are theoretically dynamic- that is, shift in a nation's resources and capabilities generate new opportunity costs, people employed in those industries are likely to resist moving into other occupations".*

The specific factors model is a variant of the Ricardian model. It has also been called the Ricardo-Viner model due to Jacob Viner's (1931) work on the specific factors model which was published in 1931 [13]. The specific factors model has three factors of production, labour, capital/prices and land, and two types of goods: manufactured goods produced using labour and capital, and agricultural goods produced using labour and land. The Heckscher-Ohlin model, developed in the 1930s, limits the number of factors to two, labour and capital, both considered to be mobile within the economy. The model which is also referred to as factor-proportion theory "emphasises the interplay between the proportions in which different factors of production are available in different countries and the proportions in which they are used in producing different goods" (Krugman and Obstfeld 1997:67). The specific factors model and the Heckscher-Ohlin model answer the question of who gains from trade in a similar way. In the former "trade benefits the factor that is specific to the export sector of each country but hurts the factor specific to the import-competing sectors with ambiguous effects on mobile factors" (*ibidem*:56). The latter concludes that owners of countries' abundant factors gain from trade, but owners of scarce factor lose (*ibidem*:77). Similarly, according to the

[13] Other scholars who have offered substantial input are Paul Samuelson and Ronald Jones.

Stolper-Samuelson model, which has been derived from the Heckscher-Ohlin model by Wolfgang Stolper and Paul Samuelson in 1941, international trade benefits those who own abundant factors of production within the economy and hurts the owners of scarce factors. As a result, the former will support market liberalisation while the latter will oppose it and support protectionist policies (Hiscox 2005:53). However, Hiscox (*ibidem*) also points out that the owners of factors of production and their employees often lobby together and that the factors of production are not as mobile between various domestic industries as assumed in the model. Nonetheless, we can apply these general assumptions to Japan and expect that the owners of scarce factor of production, land, will oppose to trade liberalisation. Indeed, as explained in detail in Chapter 3 the agricultural sector is against further market liberalisation as it expects to encounter significant losses as a result of increased international competition. Liberalisation of trade, according to the above models, would hurt farmers, the owners of land, a factor specific to import-competing sector and the scarce resource within the economy. Krugman and Obstfeld (1997:58) offer three reasons for liberalisation despite its effects on income distribution. First, these effects occur not only as a result of an increased international trade but also under other circumstances. Second, it makes more sense to compensate those who lose as a result of increased trade than to limit it. And third, those who lose from trade are usually better organised and represented than those who gain. For example, the farmers protest as they risk losing as a result of trade liberalisation, while consumers, who would gain, remain silent. The second point refers to the compensation principle and the third one to the special interest groups' politics models both of which were mentioned earlier in this chapter.

The above trade theory models have often been used in the IPE literature and the OEP in particular. For example, Peter Gourevitch's (1978) 'second image reversed' focuses on how the international-level factors impact the domestic sphere[14]. It argues that knowing a company's sector and its position along the factoral lines divide (abundant *versus* scarce factors of production) it is possible to deduct its preferences regarding trade liberalisation (Lake 2008:764 cites Gourevitch 1986). Ronald Rogowski's (2008) model is a part of the 'second image reversed' literature and analyses the implications of the Heckscher-Ohlin model for domestic politics. Rogowski (*ibidem*:823) writes that:

[14] Putnam criticises Gourevitch's framework as it presents only a 'partial equilibrium': how international factors impact the domestic level, when, in fact, both levels interact with each other and can become mutually entangled as a result of international negotiations (1988:430).

"Gains and losses from trade, and hence preferences over trade, will divide along factoral lines in the Heckscher-Ohlin and in the specific-factors models, abundant factors normally favouring, and scarce factors normally opposing, free movement of products and factors".

Such models point out to the fact that domestic preferences are affected by distribution of gains and losses from increased international trade resulting for example from signing of an FTA. Preferences of these groups matter for the states' trade policy.

1.5 Theoretical Framework of the Thesis

1.5.1 Plurality of Factors

This thesis applies selected elements of the models discussed in the previous section in order to provide an in-depth understanding of Japan's FTA policy formation. It combines Putnam's (1988) two-level game metaphor with using preferences as the central concept and the inclusion of four types of factors: domestic, international, political, and economic. Putnam's (1988) model was used to separate the international and domestic levels of the policy formation process and to conceptualise the latter as bargaining between various groups of actors (domestic negotiations). Factors such as the domestic distribution of gains from trade shape the domestic actors' preferences which, in turn, are a tool for understanding the underlying motivation behind Japan's FTA policy. The formation of this policy is understood here as interplay of preferences of the most influential groups of actors: the thesis demonstrates how an organised group with sufficient political representation can impact state's policy as explained by the special interest groups model.

This research assumes a plurality of domestic actors involved in the FTA policy formation process and the creation of a domestic win-set as well as the plurality of factors influencing their preferences. By their very nature FTAs are a meeting point for preferences of several groups of actors. For this reason, this research takes domestic and international, as well as economic and political factors into consideration in order to provide a clearer perspective on Japan's FTA policy choices. Therefore, it assumes that Japan's FTA policy and the motivation behind it cannot be explained solely by international-level analysis and trade liberalisation theories such as competitive liberalisation or the juggernaut effect (Baldwin 1994, 2004, 2006). The role of domestic factors and actors (e.g. conflicting interests of the ministries and their constituencies) needs to be included. Similarly, Japan's FTA policy cannot be analysed by focusing on political factors alone[15]. Thus, the study distinguishes four levels of factors: domestic political, domestic economic, international political, international economic. Incorporating the above mentioned levels of analysis improves the existing narrative of Japan's FTAs policy in East Asia. The IPE approach provides a link between the 'state' and the 'market'. The incorporation of domestic and international variables results from adopting Putnam's two-level game metaphor.

The need for including both the international- and domestic-level factors while analysing foreign economic policy was advocated by several scholars. Yoshimatsu (2003:111) argues:

> *"The international politics approach is useful in explaining broad policy outcomes across time in different countries, or general trends in the overall international economic system. Yet, it cannot account adequately for why a particular type of policy was adapted in a state. For instance, it provides no explanation if why one sector is protected from international competition while simultaneously other sectors are willingly opening their markets. The international politics perspective contains several problems in explaining Japan's external relations and policies".*

Angel (2001) also sees the need for both levels of factors, in particular while dealing with Japan's current foreign economic policy. The author (*ibidem*:5) comments on the traditional divide between the international and domestic levels of analysis:

> *"Globalisation has altered the interests and positions of domestic political actors and accelerated the shift in power from central governments into the hands of private actors. The new domestic coalition, in turn has affected the ways in which countries behave in the international arena. As a result, the traditional divide between the international and domestic realms has become empirically less accurate and theoretically less useful in the study of foreign policy".*

Dieter and Higgott (2003a:107) point out that "a state's foreign economic policy results

[15] More on the importance of economic factors in the next section.

at least as much from domestic factors as it does from international factors". Natasha Hamilton-Hart (2003) writes that both international and domestic factors contribute to the understanding of low level of regional cooperation in Asia and that neither of them provides a sufficient explanation. Krugman and Obstfeld (1997:6) claim that "conflicts of interest within nations are usually more important in determining trade policy than conflicts of interest between nations". Mikanagi (1996:23) argues that the study of Japan's trade policy should include state-level and society-level analysis. The former is an approach in which the state dictates the policy. The latter is an approach in which domestic interest groups compete for political influence and economic benefits and foreign policy results from the outcome of this internal struggle. Mikanagi (*ibidem*) writes that "studies on interest groups are important for understanding social input into policymaking, but exclusive focus on private actors will overlook important factors that affect the policymaking process".

1.5.2 Plurality of Actors

Understanding of the domestic policy formation process as bargaining or compromise between various domestic preferences indicates the importance of selecting the appropriate groups of actors. Therefore, the thesis focuses on both the governmental actors who formulate the domestic win-set according to Putnam's (1988) model and the influential domestic actors as indicated by the special interest groups model. Helen V. Milner (1997:33) writes that "when domestic actors share power over decision making and their policy preferences differ, treating the state as a unitary actor risks distorting our understanding of international relations". As mentioned in the previous section, Japan's current FTA policy could be construed as an end result of a dynamic process of consensus-building between main actors within the state. Hiscox (2005:72) explains that "there is really no such thing as the 'national interest' when it comes to foreign economic policy or, rather there is no one national interest, there are many". Moravcsik (1997:518) describes it in the following way: "government policy is therefore constrained by the underlying identities, interests, and power of individuals and groups (inside and outside the state apparatus) who constantly pressure the central decision makers to pursue policies consistent with their preferences". Similarly, the unit of analysis of this study are actors who are perceived as bundled groups of individuals, such as the ministries and sectors, connected by a similar interest (Lake 2008:763).

The first group of actors is the government. The term is used loosely to indicate the level of analysis and not to presume that the governmental actors represent a unified front[16]. The research assumes a plurality of actors on this level. The initial fieldwork indicated the importance of four main ministries in the FTA policy formation process: the Ministry of Economy, Trade and Industry (METI), the Ministry of Foreign Affairs (MOFA), the Ministry of Finance (MOF) and the Ministry of Agriculture, Forestry and Fisheries (MAFF). Preferences of these actors and the dynamic interplay between them are the main focus of analysis on this level. In her research on how the domestic structure of preferences impacts foreign policy Milner (1997:33) distinguishes two groups of actors: political actors and domestic interest groups. Political actors are divided into the executive and the legislative, both assumed to be unitary (*ibidem*:34). This thesis takes a slightly different approach. First, given the specific characteristics of the policy formation process the analysis focuses mainly on the four ministries and bureaucrats working for them. According to conducted fieldwork, preferences of other parts of the government, such as the Diet or the Prime Minister's Office, do not play an equally important role. Although the Prime Minister sets out the general course of action and oversees negotiations, he lacks sufficient political power to lead the negotiations. This will be discussed in detail in Chapter 5. Sato (2001:15) explains the importance of ministries in the domestic policy formation process in the following way:

> *"As economic diplomacy had receded from the control of the MOFA and the prime minister, ministerial interests have prevailed over national interests. (...) Within the jurisdiction of each ministry, policy formation may take the form of corporatist-style bureaucratic interest representation; elitist-style, bureaucratically imposed decision making, or the iron triangle, which includes the specialised senior LDP politicians (zoku)".*

Second, the thesis does not consider the preferences of the government or the ministries to be homogeneous. As the ministries do not represent the same constituencies, they do not have common preferences[17]. In addition, the Japanese ministries do not only represent their constituency and collect the preferences of domestic actors. They also shape and form the policy according to their own agenda and interests. This is

[16] The term 'government's preferences' is sometimes used in this thesis while referring to the overall sum of preferences of the governmental actors. In other words: the final domestic win-set.

[17] Milner (1997:36) uses the concept of a 'divided government' to indicate that the executive and the legislature representing different constituencies have varying preferences.

strengthened by the fact that policy is traditionally formed by bureaucrats who have an opportunity to develop a long-term policy vision and not the elected politicians. As a result, ministries cooperate closely with the interest groups they represent (Manger 2005:811). At the same time, internal ministerial preferences can develop. Sato (2001) uses what he calls the bureaucratic politics model to explain the formation of Japanese foreign economic policy on the domestic level. The domestic policy is dominated by an 'iron triangle', comprised of the ruling triad of politicians, mainly from the Liberal Democratic Party (LDP), bureaucracy and big businesses (Sato 2001, also Carpenter 2003:61)[18]. Their close cooperation, when it comes to the formation of Japan's policy, makes it difficult to implement changes in many aspects of domestic and foreign policy (Pempel 2006:43). Sato (2001) traces the internal process within this triad analysing how this system shapes the final outcome of the policy formation process and uses five cases to determine how it responds to foreign pressure. Sato (*ibidem*:14) points out that in the post-war period the ruling LDP focused on general, diplomatic policies while "the management of Japan's economic policy was left to the hands of bureaucrats in economic ministries, such as the Ministry of Finance and the Ministry of International Trade and Industry (MITI)[19]". Although Sato (*ibidem*) agrees that this situation has been slowly changing, this is another argument for focusing on ministries in analysing the FTA policy formation process.

The second group of actors are the powerful domestic interest groups. On this level the research discusses the preferences of Japan's manufacturing sector and the agricultural sector. As mentioned earlier in this chapter, the manufacturing sector is represented both by individual companies as well as business associations and industry associations. The agricultural sector is represented by agricultural cooperatives whose role will be discussed in detail in Chapters 3 and 5[20]. Soderbaum (2005:240) argues that several IPE theoretical approaches overemphasise the role of the state in the process of regional integration and that the increasing acknowledgement of the importance of non-state actors is a recent trend within the field. Therefore, higher emphasis should be placed on the relationship between governments and non-state actors in order to fully understand the nature of processes such as regionalism or globalisation[21]. This also corresponds with Putnam's two-level game metaphor. The thesis stresses the pivotal role of non-governmental actors and their impact on the state's policy.

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[18] This issue will be discussed in Chapter 3.
[19] MITI was renamed to METI in 2001.
[20] Due to difficulties with access individual farmers were not interviewed.
[21] This assumption is derived from liberal theory.

Focusing on the preferences of Japanese corporation, FTAs' main clients, is important for two reasons. First, it implies the presence of economic-level factors in the analysis, the importance of which has been mentioned in the previous section. Phillips (2005:23) argues that the phenomenon of globalisation and the increasing market integration occurs beyond the political control of states. Big corporations have become an important player in international relations (Cohn 2003:77). Strange (1988, 1997) advocates the importance of firms in the study of international relations and the weakness of the state-centred approach resulting from a diminution of national government's authority. She (1997:4) criticises the global economy models that "put undue emphasis on politics and on the role of governments and not enough on economics and the role of markets". Ravenhill (2005b:128) writes about the changing balance of power between the state and the companies resulting from the increased economic interdependence and globalisation:

> *"Potential foreign investors quickly voted with their feet when faced by governments that attempted to impose conditions on them: indeed, from the early 1980s onwards, the balance of bargaining power between investors and governments shifted dramatically so that investors were increasingly able to demand concessions from host governments on issues such as taxation, rather than accepting restriction on their activities".*

Increased economic interdependence and market-led integration in East Asia as well as the internationalisation of production networks, described earlier in this chapter, have rendered any analysis of Japan's FTA policy that does not include the position of MNCs and international-level economic factors, incomplete. Yoshimatsu (2003:90-91) argues that protecting their interests, in particular in the East Asian region, is one of the main strategic goals of Japan's foreign economic policy. This issue will be further discussed in Chapter 3. As the study focuses on the formation of domestic win-set, it discusses only Japanese multinational companies and their preferences regarding FTAs and does not include foreign MNCs operating in Japan.

Second, MNCs are by definition trans-national actors. Due to the nature of their operations MNCs interact with foreign domestic actors, governments, international organisations, and other trans-national groups. High level of vertical integration of Japanese production networks results in MNCs' preferences being shaped just as much by domestic situation as by economic developments outside the country. Therefore, MNCs have an innate interest in FTA policy and actively participate in the formation of the domestic win-set. In addition, their position in the international markets depends on their relative position versus that of foreign companies in the same sector. In this respect, in the context of this research they provide a counterbalance to the agricultural sector which in turn focuses on the domestic situation and whose preferences are shaped predominantly by domestic factors.

In Japan there are globally competitive sectors and those who still enjoy governmental protection and are threatened by the prospects of greater liberalisation. In general terms, the manufacturing and the agricultural sector represent a division for competitive (export-competing) sectors and the uncompetitive, highly protected (import-competing) ones. This dual structure of Japanese industry results in a tension when it comes to supporting or opposing a region-wide, or in fact, any FTA. The conducted fieldwork included in-depth research interviews with several Japanese multinational corporations. These were: a company in the electronics sector; two multinational corporation specialising, amongst others, in electronics and consumer products; two multinational corporations in the automobile and motorcycle sector, together with the Japan Automobile Manufacturers Association; a multinational corporation in the chemical fibres and textile sector; two member companies of the Japan Iron and Steel Federation; a multinational company in the heavy industries and machinery sector; and a multinational corporation whose operations range from life insurance or supplying of electricity, to aircraft, automobile and motors construction. The companies were selected due to the fact that they have production networks in East Asia or export final goods to this region. They utilise Japan's FTAs or could have potentially utilised but declined to do so, for example due to small preference margins. The selected companies provide a good sample of Japan's manufacturing industry as they represent four different sectors: automotive, electronics, textile and chemical, and iron and steel. Preferences of companies regarding FTAs can differ between sectors. While the electronic industry has global products, automobile companies produce for a segmented market, meaning that products vary from market to market and the size of the market is a crucial factor. Furthermore, the conducted fieldwork indicated that preferences can differ significantly between companies in the same sector depending on the location of their production network. The thesis focuses on the preferences of MNCs regarding Japan's past and present FTA policy and not the utilisation rates of these treaties[22]. It focuses on the qualitative evaluation of the existing agreements and attempts to establish what causes companies to take advantage of preferential tariffs under FTAs. Japan External Trade Organisation (JETRO) has done a substantial amount of research on the utilisation of FTAs based on the company's size and sector as well as difficulties in using such agreements. For example, it conducts an annual large sample survey of Japanese companies' international operations (JETRO 2010b).

The preferences of domestic interest groups opposing FTAs also need to be taken into account. As mentioned earlier in the chapter, this group includes the agricultural sector which is one of the strongest domestic special interest group and plays a crucial role in Japan's FTA policy (George Mulgan 2000:1). Its position regarding trade liberalisation will be explained in detail throughout the thesis. The stronger the opposition to trade liberalisation within the country, the bigger the incentives and domestic support required to conclude an FTA (Lake 2008:765 cites Cowhey 1993). Moravcsik (1997:532)[23] points out that strong domestic groups' pressure can explain policies such as protectionism, subsidisation, and other types of regulations, arguing that:

> *"Thus in the liberal view the creation and maintenance of regimes assuring free trade and monetary stability result not primarily from common threats to national security or appropriate international institutions, but from the ability of states to overcome domestic distributional conflicts in a way supportive of international cooperation".*

This type of balance between the pro- and anti-liberalisation forces was demonstrated during FTA negotiations with Korea and Australia, the 'failed' FTA cases. This will be further analysed in Chapter 3. The preferences of the agricultural sector were represented in the fieldwork by the agricultural cooperatives. These organisations play a special role in domestic politics. They have the capability to distort the policy formation process and exert political pressure on other domestic groups. Chapter 3 provides a brief explanation of their particular position on the domestic stage while Chapter 5 explains how the change of administration to the Democratic Party of Japan (DPJ) in 2009 shifted the domestic balance of power. In this thesis, the preferences of farmers and

[22] Utilisation rates signify to what extend the agreement is used by companies from member states. In other words, how much of the trade between FTA parties takes place under preferential tariffs.

[23] For more on this issue see Keohane and Milner 1996.

agricultural cooperatives representing them are often discussed together with the preferences of MAFF. The similarity of preferences regarding FTAs between the two groups is so strong that discussing them separately would lead to repetitions. The reasons for this similarity will also be discussed in Chapter 5.

The third group of respondents are the representatives of other domestic interest groups. The service sector, mainly the banking sector, represents the preferences of the non-manufacturing sectors. Labour unions are a domestic group which has only recently became aware of FTAs. The conducted fieldwork research included one of the two main national confederations of trade unions. These groups are less involved in the formation of FTAs policy. Their preferences on the subject are not as strong and their influence does not equal that of previous groups. The weak preferences regarding FTAs can be explained by the specific characteristics of labour unions in Japan. Together with life-time employment and seniority-oriented wage system, in-company or enterprise-based labour unions formed the 'three sacred treasures' of the country's management model in the post-war period. Labour unions proliferated after the enforcement of the Trade Union Law in 1945. Initially, they represented the interests of workers and in 1946 the electrical sector's trade union demanded introduction of a minimal wage system based on the costs of living (Nishinarita 1998:199). However, in the 1950s labour unions commenced a close collaboration with the corporations they were associated with. This was caused, amongst others, by two political cleansings conducted by the American occupation forces (Tsuda 1990:22). The first cleansing focused on people connected to the wartime regime and the second on people connected to the socialist movement. From the 1950s onwards labour unions were created within the corporations and united managers and workers of the same company. Their main function was to cooperate with and support the parent organisation. Bossak (1990:60) argues that this results in the low level of involvement of Japanese labour unions in political activity. These three groups were selected based on the initial fieldwork research and literature review. They provide a wide spectrum of interests and motivations. As will be demonstrated throughout the thesis, the first two groups are key players when it comes to Japan's FTA policy formation process. The preferences of the third group play a supporting role in this thesis and provide broader perspective on some of the discussed issues.

1.5.3 Preferences

1.5.3.1 Defining Preferences

Preferences of main actors are a core concept of this study. The thesis attempts to analyse the development of Japan's FTA policy through the prism of subjective preferences of the people who shape it. This has several implications, for example when it comes to the choice of actors and factors as well as the choice of data collection methods. These implications will be discussed in the following sections. What is meant by preferences is the optimal preferred outcome. In this thesis, the term is conceptualised as an overarching concept which encompasses actors' interests and motivation. The assumption, derived from liberal theory, that preferences of important domestic non-governmental players, such as interest groups, influence FTA policy formation process is the starting point of this research. Japan's FTA policy is hence viewed as an interplay between various domestic actors namely ministries influenced by strong lobby groups. The final outcome is a result of a consensus-building process, a compromise accomplished during this interplay which is referred to here as Putnam's domestic win-set (level two game). This consensus is then challenged by the constraints of the international environment and the preferences of other states (level one game).

Milner (1997:33) defines preferences of political actors or interest groups as "their most preferred policy – or their 'ideal point' – is that policy choice in the issue area that maximises their basic interests – that is, retaining political office or maximizing income". According to this understanding, the term is similar to 'interests' or 'motivation' and could to some extent be used interchangeably. However, the term 'interests' could be confused with economic or financial interests. As Kapstein (2006:12) argues that actors actions are not solely motivated by material interests:

> *"Experimental research shows that in many strategic interactions, agents do not pursue a strategy of maximizing their own short-term payoffs, as both microeconomics and much of international relations theory would predict, but instead demonstrate an "other-regarding" concern for the payoffs that each player receives (Frohlich, Oppenheimer and Kurki 2003; Orbell 2005)".*

The plurality of domestic actors causes the research to focus on preferences and not governmental or national FTA strategy. The thesis uses the term 'preferences' as the terms 'policy' or 'strategy' could be construed as only the official position of the main decision-making body: the government. According to this way of thinking, preferences precede strategy. As Milner (1997:33) puts it they are primordial. Samuels (2007:8) writes that in terms of strategy and foreign policy "most states have a mixed bag of preferences" and "they play defence and offense at the same time, seeking to preserve the status quo in some situations and upend it in others". Japan's official FTA strategy is only vaguely defined in MOFA's and METI's official documents. Yoshimatsu (2003:107) points out that "the government has not necessarily formulated cohesive and persistent policies towards ASEAN largely due to conflict between METI and MOFA over initiatives and methods of economic cooperation". Therefore, it seems more useful to analyse Japanese government's position in terms of the interplay of the main ministries' preferences than in terms of an overarching official strategy. Moreover, Japanese corporations with their own preferences and calculations do not necessarily follow the state's policy directions (Yoshimatsu 2003:107). Assuming the plurality of actors and focusing on preferences allows for a better understanding of motives and mechanisms leading to the formation of Japan's FTA policy.

Milner (1997:33) argues that "the structure of domestic preferences holds a key to understanding international cooperation". Aggarwal (2006:17) points out that "from a political standpoint, the motivation of actors provides a first cut into understanding the likelihood of pressures for change". In his paper, Moravcsik (1997:519) justifies the usage of term 'preferences' by an attempt to avoid confusion with national "strategies, tactics and policies". The author (*ibidem:513*) defines preferences as "the fundamental social purposes underlying the strategic calculations of governments". At each stage of the policy formation process domestic and international, economic and political factors impact the decisions and preferences of actors. They make an informed decision based on information obtained from these four levels of factors. At the same time, they do not have equal access to information and their position is also biased by personal situations (e.g. owners of scarce *versus* abundant resources within the economy) which results in differences of preferences. Putnam (1988:430) argues that there is a 'general equilibrium' between levels of factors whereby the domestic and international spheres interact simultaneously. The starting assumption of the research is that with the increased global and regional interdependence, advances in technology, and communication, domestic actors' preferences are influenced by the four types of factors, albeit unequally and not to the same degree. Following the same logic, preferences can change over time as a result of developments on the domestic and international fronts. The formulation of main actors' preferences is a dynamic process that results from the type of information the actors have in any given moment and the geopolitical situation on the international and domestic fronts. Therefore, while some preferences remain more or less constant, other can change over. For example, China's accession to the

WTO and subsequent interest in FTAs could have impacted the preferences of Japan's domestic actors regarding the country's regional trade policy[24]. This research discusses several levels of preferences depending on the source:

- Preferences of main groups of actors,
- State's preferences (a domestic win-set, a compromise of domestic preferences),
- Preferences of the negotiating partner (only occasionally mentioned in this thesis),

or on the topic:

- Preferences regarding bilateral FTAs
- Preferences regarding a minilateral FTA with ASEAN
- Preferences regarding a region-wide FTA.

There is one additional reason for the usage of the term 'preferences' in this research: it places the thesis in the context of the body of work on preferences of domestic groups and their impact on foreign policy discussed in this chapter (e.g. Milner 1997, Moravcsik 1997).

1.5.3.2 Relevant Studies on Preferences in East Asia

There have been previous studies using actors' preferences for explaining East Asian regional diplomacy, regional integration, and cooperation. Natasha Hamilton-Hart (2003) analyses constraints of regional cooperation in Asia and argues that this phenomenon can only be understood by including domestic level explanation and that the economic models, demonstrating national gains and losses from cooperation or trade, simply focus on the wrong questions. The author (*ibidem*:238) argues that "gains or losses need to be mapped against the interests of the groups which dominate policy". The same type of logic drives this thesis. Aggarwal (2006:16) demonstrates how the pay-offs from the initial bilateral agreement or trade arrangement and related preferences of main actors lead to the creation of a new agreement or modification of

[24] This issue will be discussed in Chapter 3.

the existing ones. According to his reasoning, the establishment of an FTA affects various groups within a state. There is a change in trade and investment flows. This, in turn, alters actors' preferences and may cause them to lobby for the modification of the agreement or establishing a new one.

Krauss (2003) analyses Japan's foreign economic policy and asks whether the shift from bilateralism (with the US) to multilateralism (for example under APEC) and then to what he calls multilateralism+ (simultaneous participation in the WTO rounds and various FTA projects), represents a deep change in the country's strategic goals. He uses the strategic interaction theory (Lake and Powell 1999) which includes the strategic environment level (action and information variables) and the actors' level (beliefs and preferences variables). Separating the actors' beliefs and preferences from the changes in the strategic environment, Krauss (2003) uses the example of two transitions in Japan's foreign economic policy: 1) years 1988-89 leading to the establishment of APEC, and 2) years 1999-2000 when Japan adopted FTAs as a tool of foreign trade policy. Krauss argues that there is continuity in the foreign economic goals and that the country's foreign policy and FTA strategy are aimed at achieving the same strategic objectives. Therefore, the author (*ibidem*:324) concludes by arguing that "both new initiatives were simply rational adjustments to the new strategic environment in the means used to continue to attain the same preferences, given beliefs at the time about US and Asian neighbours, information received, and range of actions available". Japan's bilateral FTAs in this understanding are new means or tools for obtaining old foreign economic policy goals. This resembles the functional approach mentioned earlier in this chapter. Building upon this framework, consecutive FTAs or types of FTAs could be used as units of analysis: bilateral FTAs, the minilateral one and the prospective region-wide FTA initiative. The question asked here would be what strategic objectives do different types of FTAs fulfil and how does a region-wide agreement fit with these objectives? If current FTAs fulfil similar objectives, does the proposed region-wide treaty serve the same purpose or are there other factors that make such agreement desirable? If Japan's efforts for a region-wide FTA fit with the country's strategic objectives behind bilateral FTAs then Krauss' 'old goals, new means' argument holds true. If Japan's strategic goals are constant and various forms of trade liberalisation arrangements are tools used to achieve them, it could be expected that the country will consistently demonstrate efforts for regional economic integration.

Yoshimatsu (2003) analyses how changes in the international environment, namely the 1997/98 Asian financial crisis, have influenced the preferences of the LDP and the

MOF and convinced them of a need for stronger regional integration and cooperation. His research adopts a domestic policy and actor-specific approach and focuses on the preferences and actions of state policy-makers. It does not discuss preferences and actions of non-governmental actors. Nonetheless, similarly to Yoshimatsu's (2003:112) work, this research also aims to "select specific actors and explore how and why their preferences and activities for East Asian affairs have evolved".

1.5.3.3 Forming Preferences - Actors' Preferences *versus* Overall State's Preferences

In his analysis of domestic sources of foreign economic policies, Hiscox (2005:51) combines both the economic and political factors. The author (*ibidem*): 1) identifies the preferences of important domestic groups, and 2) determines how the domestic political institutions aggregate these preferences and make policy-related decisions. He also points out that the actors' preferences are, in turn, dependent on how the domestic distribution of gains is affected by the government's policies. The thesis analyses both of these steps. The domestic win-set is created by the ministries as a result of aggregation of main actors' preferences. As Moravcsik (1997:518) explains while defining the assumptions of liberal IR theory "states (or other political institutions) represent some subset of domestic society, on the basis of whose interests state officials define state preferences and act purposively in world politics". As such, there is a difference between actors' preferences and their aggregated form: state's preferences. Influential domestic actors, such as interest groups, communicate their preferences to the appropriate ministry. The government in itself plays a role of Putnam's 'transmission belt', whereby it collects and represents preferences and interest of an appropriate group. As discussed earlier, the ministries do not only collect preferences but also shape the policy according to their own. Preferences of political actors and of interest groups can differ significantly. Milner (1997:60) argues that "whereas political actors' preferences for international cooperation are a function of electoral calculations, the preferences of societal groups depend on the distributional consequences of international agreements". They are often conflicting (e.g. protection versus liberalisation of tariffs), or competing (e.g. for investment in different regions). Furthermore, not all groups have an equal ability to exert political pressure. In the process of formulating state's preferences domestic preferences are distorted as a result of an unequal amount of representation available to particular groups. As demonstrated by Becker (1985) and Grossman and Helpman (2001 and 2002), interests of a well organised small group can skew the state's policy in the favour of that group. Moravcsik (1997:530) argues that "the precise policy of governments depends on which domestic groups are represented" and that "policy is biased in favour of the governing coalition or powerful domestic groups". The subject of this research is a democratic state where a democratic voting system and three branches of power ensure that the society is well represented. Nonetheless, no government offers universal or unbiased representation (Moravcsik 1997:518). Group's ability to exert political influence depends on their relative position within society, more than on their actual size. If powerful domestic groups have sufficient representation they are able to lobby for solutions that benefit them while passing the costs onto groups that would otherwise benefit from liberalisation (rent-seeking). An example of such well organised interest group in Japan is the agricultural sector.

As domestic interest groups attempt to influence the ministry that represents them, it could be argued that the final outcome is formulated through a process of dialogue or bargaining between the ministries representing the strongest groups (e.g. METI *versus* MOFA). This occurs in two steps: 1) communication between domestic groups and the ministry that represents them, and 2) communication and bargaining between the ministries and inter-ministerial competition or rivalry. As a result, a domestic win-set is formed. As indicated in Chapter 5, this can take place simultaneously to the international win-set which is the compromise formed during FTA negotiations between the domestic preferences and those of the foreign partner. Therefore, the ministries respond to the lobbying efforts from within an outside the country and are Putnam's transmission belt.

1.5.3.4 Liberalisation and Political Effort

IPE theory assumes that "openness is historically rare, politically problematic, and a phenomenon that needs to be explained" (Lake 2008:758). It attempts to determine under which political conditions states decide to open their markets. Similarly, in this research, actors' preferences for an increased market openness leading to a region-wide FTA could be construed as a dependent variable and economic and geopolitical factors as the independent, casual variables. The level of liberalisation of an FTA depends on its type, depth and scope of coverage. Bilateral, minilateral and regional trade agreements are consecutive levels of trade liberalisation agreements in terms of membership and not necessarily market openness.

There are several opinions on how the number of members influences the depth and scope of agreements. Wider treaties often do not include deep liberalisation issues which can make them easier to sign. Bilateral agreements, in particular these signed by Japan, often include provisions exceeding the WTO commitments. Therefore, there might be trade-offs between the number of members and the degree and scope of liberalisation. In Rajan's (2005:217) opinion a 'new regionalism', meaning a new type of regional trade agreements, is occurring in East Asia since the financial crisis of 1997/98. The author (*ibidem:*225) explains that "because of the depth of issue coverage, the new FTAs tend to be far smaller in initial membership than the older and existing FTAs, which had a preference for shallowness or narrowness in issue coverage but broadness in terms of membership". On the other hand, negotiating broader agreements requires political effort. Aggarwal (2006:4) writes:

> *"Each of these agreement types derives its advantages and disadvantages from tradeoffs between political and economic efficiency. For example, agreements among few states develop easily, but implicitly involve welfare losses due to trade diversion and marginalisation of weaker countries. Conversely, larger agreements maximise economies of scale by expanding markets, promoting broad-based trade liberalisation, and enabling global integration, but demand more political effort to negotiate".*

While negotiating a multilateral FTA, the state has far less control over the negotiation process. The higher the number of members, the more difficult it is to reach a compromise on conflicting issues and the more political effort is required on the side of each negotiating state. Similarly, the higher degree of liberalisation a country commits to, the more political effort is required to gain domestic support for the agreement (domestic win-set). There has to be sufficient expected gains from the treaty to provide an incentive for domestic actors. Therefore, for Japan to actively participate in a region-wide FTA there would need to be enough expected gains for the domestic actors to support the agreement and overcome domestic opposition. Based on an earlier discussion on the levels of factors and how they affect preferences, this could be portrayed in the following way:

Figure 1.1 Theoretical framework model

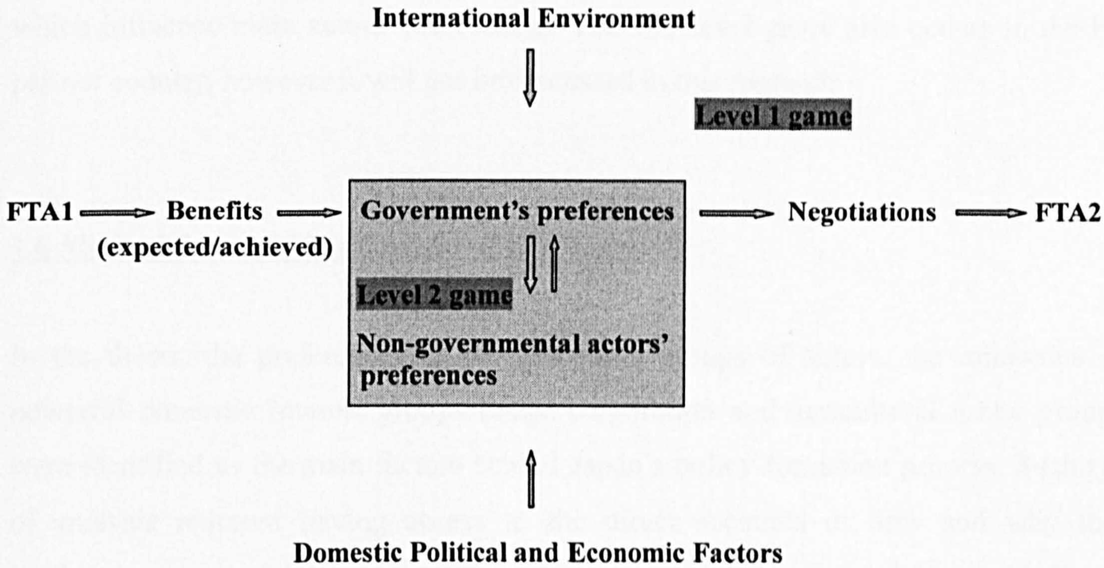

Figure 1 demonstrates the theoretical framework of the thesis. According to this framework, the thesis argues that the effects of existing treaties and the expected benefits and trade-offs of a planned FTA, as well as domestic and international-level factors, strongly influence the actors' preferences. All these factors help to shape domestic preferences which are the basis of the first win-set. The expected benefits from a bilateral trade agreement cause certain groups of actors to support the signing of an FTA. This is confronted with the domestic opposition (e.g. agricultural lobby) and influenced by the international situation (e.g. the increasing proliferation of bilateral trade treaties in the region and worldwide). The aggregated preferences regarding the type and scope of an FTA are the domestic win-set. This is later verified in the process of establishing the international win-set during bilateral negotiations when the preferences of the other party affect the final outcome. The two-level game would be conceptualised in the following way. The bureaucracy and the four ministries which play a crucial role in terms of FTA policy formation (METI, MOFA, MOF, and MAFF) correspond to Putnam's central government. On the domestic level there are several interest groups. However, the two most influential are the MNCs and the agricultural lobby group. The international and domestic levels interact and influence each other. In other words, both governmental and non-governmental actors communicate with international actors. This is similar to Knopf's (1993:600) three levels of domestic-international interactions discussed earlier in this chapter. The thesis assumes that Japan's domestic actors interact with the international environment and that these interactions help them form an opinion on FTAs and regional trade liberalisation. Hence cross-level and trans-national interactions are understood here as international factors which influence main actors' preferences. The two-level game also occurs in the FTA partner country, however it will not be discussed in this research.

1.6 Methodology and Limitations of the Research

In the thesis, the preferences of the two main groups of actors, the ministries and powerful domestic interest groups (large corporation and agricultural lobby groups), were identified as the main factors behind Japan's policy formation process. Such type of analysis required having access to the direct accounts of how and why these preferences were shaped. Hence the opinions and recollections of representatives of selected groups of actors were the cornerstone of the data collection process. It was imperative to obtain access to main stakeholders of Japan's FTA policy. The data collection process was based on in-depth, semi structured interviews. A total of 60 research interviews were conducted over two fieldwork trips[25]. The first fieldwork, conducted in February 2009, was an exploratory part of the data collection process and focused mainly on members of the academia, research think-tanks and governmental organisations. The second phase of interviews took place between April and December 2010. It focused on the representatives of the three selected target groups. Each of the interviews lasted one hour. The respondents were chosen based on a non-probability (non-representative) sample. This type of sampling was selected due to the difficulties with access to representatives of the three groups. In some instances snowball sampling was used as some of the respondents offered recommendations and contact details for their colleagues. One of the major issues of the data collection process was to obtain information from members of all three groups. On the other hand, in order to be able to discuss the position of ministries, MNCs or other groups it was crucial to interview appropriate people within these organisations. Therefore, the choice of respondents was based on how involved they were in FTA policy or how much knowledge they had on the subject. The fieldwork did not aim to obtain the highest number of interviewees from each target group. As actors' preferences are inherently subjective, careful selection of respondents can help to increase validity and reliability of the study. Where possible, respondent were chosen from amongst people who have been personally and

[25] For a complete list of interviewees see Appendix 2.

directly involved in the FTA policy formation process, on the internal (within the organisation), domestic or international levels. This was a particularly difficult task when it came to the third group. As a result, only one respondent of each group was interviewed. Based on the theoretical framework, the thesis focuses on presenting subjective preferences of respondents. Therefore, it gives a substantial amount of voice to respondents.

Data obtained from the interviews is supported by documents and additional statistical data. The preferences of the third selected group of actors (other domestic interest groups) provided additional information. They often played a supportive or illustrative role in the analysis or allowed to fill in the gaps where other types of data were unavailable. In addition, the thesis relied on governmental publications, political parties' manifestos, publications of business associations and companies, as well as internal documents. They were obtained from the organisations' web pages, various university and public libraries, and online collections. Triangulation of data sources and data collection methods increases reliability and validity of this research and allows for cross-checking of data (Yin 2003:92). Secondary data was also used. Organisations, such as the WTO and JETRO, or large think-tanks, such as the Institute of Developing Economies (IDE) and the Asian Development Bank Institute (ADBI), produce high quality research on FTAs, regional economic integration and several other topics. They are a good source of data, for example, on the subject of trade volume and FTA utilisation rates. They collect data directly from a large number of companies or organisations. JETRO's annual large sample survey has already been mentioned in this chapter. Several other JETRO's publications have also been used in this thesis. While JETRO and IDE were considered to be an important source of data and opinions, their preferences are not discussed in great detail as they do not play a direct role in the FTA policy formation process. They are not an independent interest group and have an indirect impact on the policy formation process by providing data for the government, companies and other groups. They are primary research-driven organisations. Therefore, although they are mentioned throughout the thesis, they are not discussed in Chapter 5 as a part of the policy formation process.

The theoretical framework of this research focuses on the main or most influential actors on the domestic scene and excludes other groups. The preferences of other ministries are not discussed. For example, the movement of people, included in FTAs with Indonesia and the Philippines, falls under the jurisdiction of the Ministry of Health, Labour and Welfare. However, the initial fieldwork research indicated that the four discussed ministries were the main political actors in the FTA policy formation process and due to the access limitations and time constraints the preferences of other ministries were excluded from the analysis. Similarly, the position of small- and medium-sized companies (SMEs) is not discussed in the thesis. This is caused mainly by difficulties with access. Preferences regarding FTAs of Japanese SMEs which export products to East Asian countries would have been an interesting addition to the research. However, the thesis presents only the preferences of multinational manufacturing corporations in four sectors. Other domestic groups, such as non-governmental organisation, are also excluded from the analysis. This is dictated by the fact that the thesis focuses on groups which participate in the formation of domestic win-set. As a result only the most influential interest groups and political actors were chosen. The literature review and the initial fieldwork indicated that preferences of other non-governmental organisations or interest groups, for example environmental organisations, have little impact on the domestic win-set. In short, the research does not focus on every domestic group that has an opinion or a preference regarding FTAs but on the most influential ones.

1.7 Conclusions

This research focuses on how actors' preferences determine the country's FTA policy. It looks into how, perhaps, the establishment of bilateral and minilateral FTAs affected Japan's region-wide FTA policy. It also identifies key determinants of Japan's free trade agreements policy to date, as well as the actors' opinions on how successful the past FTAs have been in fulfilling their objectives. The thesis focuses on main actors' preferences in explaining Japan's FTA policy and the relationship between bilateral, minilateral and region-wide FTAs. It makes an original contribution on three separate levels. First, it develops a theoretical framework based on Putnam's (1988) two game model, preferences, and the inclusion of four levels of factors: domestic political, international political, domestic economic and international economic. This allows us to conceptualise Japan's FTA policy as interplay of domestic actors' preferences and as being shaped by the domestic decision-making and policy formation processes. Second, it is based on new and comprehensive empirical data. The interviewees were often directly involved in FTAs negotiations on the domestic or international level, communicated the preferences of interest groups to the relevant ministry or *vice versa*, and had an in-depth knowledge of sectoral politics. Several of the interviewed senior managers were responsible for the FTA regulations within their companies and hence had an insight into the utilisation of Japan's trade treaties on a day-to-day basis. Third, the thesis provides evidence in the multilateralising bilateralism debate by analysing domestic actors' preferences. This level of analysis can be particularly useful in understanding the impasse of Japan's FTA policy as it explains the domestic conflict of interests which has led to the current outcome.

This chapter introduced the subject of the thesis and its main assumptions. It discussed where the research fits within the broader IPE field and presented theoretical models that are of relevance to the subject. It also provided a clarification of main terms. The second part of the chapter described the theoretical framework and justified the choice of actors and levels of factors used in the analysis. Finally, the chapter mentioned the data collection process and the limitations of the research. The theoretical assumptions discussed in this chapter will guide the analysis in Chapters 3, 4 and 5.

Chapter 2

Free Trade Agreements (FTAs) and the Effects of their Recent Proliferation

2.1 Introduction

This chapter introduces terms, concepts and academic debates that will provide a base for the analysis of Japan's domestic actors' preferences in the following three chapters. First, it presents FTAs: comparison with other types of market organisation, their economic effects, the type of barriers to trade they remove and provisions they might include. Secondly, the chapter discusses reasons for the proliferation of free trade agreements with particular attention paid to the East Asian region. It explains concepts such as isolation avoidance and competitive bilateralism that are highly relevant to the analysis of this thesis. Finally, the chapter presents an overview of the multilateralising bilateralism debate which provides a broader context for the analysis of the possible consolidation of various levels of Japan's FTA strategy (bilateral, minilateral, and regional). It discusses the problem of the spaghetti bowl effect and proposed ways to facilitate the harmonisation of existing agreements. The main question of the multilateralising bilateralism debate is what type of provisions and regulations FTAs should include in order to allow for their multilateralisation.

2.2 Overview of FTAs

2.2.1 FTAs and Types of Market Integration

The work of Jacob Viner (1950) and Béla Balassa has laid the foundations for the classification of stages of market integration. They are: preferential trade agreement, free trade agreement, customs union, common market, monetary union and complete economic integration. In addition, at some point between stages five and six, countries can introduce a fiscal union. They can also decide to enter into a political union. Preferential trade agreements, also referred to as partial scope agreements, offer preferential market access, by reducing tariffs on trade in goods. Free trade agreements offer preferential access to foreign markets by removing barriers to trade between members on reciprocal basis[26]. A member country is granted a reduction or exemption from the most favoured nation (MFN) tariffs offered to all trading partners. A country can be a member of several FTAs, as they do not establish common import tariffs. Rules of origin (RoO) are applied in order to prevent trade deflection which occurs when third-parties trans-ship their goods via an FTA member state and obtain the same level of preferential market access without fulfilling any reciprocal obligations. RoO establish the origin of a given good by checking it against the criteria that must be fulfilled in order for the good to be considered sufficiently locally produced by a FTA country when exporting to the FTA partner. Custom unions (CUs) differ from FTAs in that signatory parties adopt common tariffs on third country imports thus preventing countries becoming a member of multiple CUs. In addition to the above, a common market involves a free movement of labour and capital, higher level of interstate cooperation, and harmonisation of various regulations, procedures and policies. The last stage is a monetary union which implies "common currency and/or harmonisation of monetary, fiscal and social policies" (Ravenhill 2005b:118).

Free trade agreements are often referred to by other names. For example, they are sometimes called preferential trade agreements or PTAs (Feenstra and Taylor 2008:398). This, however, does not relate to preferential trade agreements as in the first stage of market integration discussed above. Instead, the name points to the preferential character of liberalisation under such treaties. Jagdish Bhagwati (2008) advocates the use of this term to highlight the difference between preferential trade and free trade resulting from multilateral or unilateral removal of tariffs. The author (*ibidem*:xi) stresses their discriminatory character and argues that they act "like termites" and "are eating away at the multilateral trading system relentlessly and progressively". The WTO uses the term regional trade agreements (RTA) as a generic name for CU's, FTAs and partial scope agreements. This can be explained by the fact that such treaties are within the jurisdiction of WTO's Committee on Regional Trade Agreements (Ravenhill 2005b:119)[27]. According to the WTO (WTOd[28]), in January 2012, there were 319 RTAs in force of which 90 percent were FTAs and partial scope agreements and ten percent were CUs. Although the two names are commonly used interchangeably, RTAs are not

[26] FTAs are a form of reciprocal liberalisation. Other types of liberalisation are non-reciprocal liberalization, such as unilateral removal of tariffs and not fully reciprocal bilateral agreements e.g. between developed and developing countries under the Enabling Clause.

[27] Despite the fact that the Committee was established in 1996, the WTO's rules on FTAs were formulated in earlier decades when the majority of trade agreements were regional and not bilateral.

[28] The data comes from the WTO Regional Trade Agreements Gateway, last updated in January 2012. Available from: http://www.wto.org/english/tratop_e/region_e/region_e.htm.

identical with FTAs. The phenomenon of the proliferation of bilateral FTAs is often brought up in the context of increasing regionalism. However, the growing number of FTAs does not necessarily imply a greater level of regional integration. For example, Dent (2006) has argued that the proliferation of FTAs in Asia Pacific should be brought up in the context of increasing regional bilateralism and not regionalism. Furthermore, neither FTAs nor CU's have to be regional. For example, Japan has signed agreements with Mexico, Chile and Switzerland.

Depending on the number of participants and their location FTAs can be classified in a different way. Aggarwal (2006:6) distinguishes the following modes of trade governance: 1) unilateral, 2) bilateral geographically concentrated (bilateral regionalism), 3) bilateral geographically dispersed (bilateral trans-regionalism), 4) minilateral geographically concentrated (regionalism), 5) minilateral geographically dispersed (trans-regionalism), and 6) multilateral (globalism, WTO). On the minilateral level he uses the examples of Association of Southeast Asian Nations (ASEAN) FTA (AFTA) and North American Free Trade Agreement (NAFTA) for geographically concentrated and Free Trade Agreement of the Americas (FTAA), for geographically dispersed. According to this classification both the ASEAN-Japan FTA as well as any possible future wider agreement in East Asia would be referred as minilateral which in the context of this research might cause confusion. Therefore, in this thesis planned wider regional agreements will be referred to as region-wide FTAs, as explained in Chapter 1. Other scholars developed different typologies. Dent (2010c:211-213) classifies FTAs in the Asia-Pacific region in the following way: 1) bilateral agreements between two states, 2) plurilateral FTAs between more than two states, 3) cross-regional agreements between states from different geographical regions, 4) quasi-regional FTAs between a state and a regional group such as ASEAN, and 5) regional or grand-regional agreements that include the majority of nations from one region or trans-regional agreements, for example an FTA between Asia-Pacific states. Ravenhill (2005b:120) distinguishes: 1) bilateral regional and trans-regional FTAs, 2) minilateral regional agreements (NAFTA), trans-regional agreements (Asia-Pacific Economic Cooperation, APEC) or interregional agreements (EU-MERCOUSUR), and 3) global liberalisation under the GATT/WTO. Aggarwal (2006:19-20) classifies the links between coexisting agreements and distinguishes:

- Nested agreements where lower-level agreements conform to broader ones (e.g. to the Article XXIV of the GATT); for example APEC's relationship with the

GATT/WTO

- Horizontal connections with a division of labour; FTAs including new issues exceeding the WTO's benchmark
- Overlapping agreements which may lead to conflict in the division of labour; the ASEAN-Japan FTA and Japan's FTAs with ASEAN members are an example of an overlapping agreement in terms of membership and subject.
- Independent agreements dealing with different issues therefore not connected.

2.2.2 FTAs and the WTO

The WTO allows for the creation of FTAs under conditions listed in the Article XXIV of the General Agreement on Tariffs and Trade (GATT) and Article V of the General Agreement on Trade in Services (GATS). FTAs should be notified to the WTO under the Article XXIV of GATT for trade in goods, Article V of the GATS for trade in services and under the Enabling Clause for agreements including developing countries. An FTA that includes both trade in goods and services will be notified under both Articles. As a result, if an agreement liberalises both trade in goods and services, it needs to be notified twice which leads to double-counting of several FTAs in WTO's statistics (Dent 2006:3). An agreement on trade in services is listed as an Economic Integration Agreement (EIA). For example, China and ASEAN were linked by an EIA in trade in services and by a partial-scope agreement[29] under the Enabling Clause in trade in goods before the ASEAN-China FTA entered into force in 2010.

The Article XXIV of the GATT (WTOc[30]) does not sufficiently clarify the relationship between the WTO and FTAs[31]. Although the WTO requires countries to notify an FTA under one of the articles, there is no mechanism in force that examines whether they are in fact consistent with the rules upheld by the organisation. Paragraph 8 of the Article XXIV explains that FTAs should liberalise 'substantially all trade' between two or more states. Under paragraph 5, FTA member states are required to liberalise trade within 'a reasonable length of time'. As the term 'reasonable length of time' has been criticised for being too vague, during the Uruguay Round of talks a

[29] This was the Early Harvest Package of the 2002 Framework Agreement on Comprehensive Economic Cooperation.
[30] WTO website Article XXIV, Available from: http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm#articleXXIV, Accessed December 2009.
[31] One of the aims of the Doha Declaration was the clarification of rules on FTAs (this has so far brought little results).

document entitled *'Understanding on the Interpretation of Article 24 of the General Agreement on Tariffs and Trade 1994'* (WTOe[32]) was published. It stated that the 'reasonable length of time' for reaching full liberalisation is up to ten years. If this is not achieved, an explanation should be provided to the WTO Council on Trade in Goods. The term 'substantially all trade' also requires additional clarification. As paragraph 8 does not entail any numerical quantifiers, it has been called the 'legal vacuum' of the Article XXIV. As Bhagwati (2008:22) writes:

> *"What did it mean to say that 'substantially all trade' must be covered- 60 percent trade, or 80 percent, or 90 percent? Would the reduction, at whatever percentage, have to be uniform and across the board, or could entire sectors, such as agriculture or high-tech, be left out?"*

As a result, an FTA can exempt a substantial amount of products from liberalisation and still be compatible with the WTO regulations[33]. Manger (2005:811) argues that in practice the Paragraph allows for an exclusion of ten or more percent of traded products. Dent (2006:39) mentions the WTO estimations which concluded that "that FTA coverage rarely falls below 50 percent, was usually higher than 75 percent but with most notified under Article XXIV having over an estimated 85 percent coverage".

2.2.3 Trade Liberalisation and Facilitation under FTAs

Free trade agreements have an effect on income distribution within a state and influence trade patterns. In simplified terms, exporting sectors profit from preferential market access while import-competing sectors lose in the result of higher competition[34]. Therefore, traditionally those who support liberalisation are the exporting companies who gain from increased market access and those who oppose are the import-competing companies who lose profit as a result of signing an FTA. Each FTA impacts a number of countries, such as FTA members, their trading partners and neighbours, and causes a complex set of results where the balance of gains, loses and trade-offs for all parties involved is sometimes hard to establish and foresee. In 1950, Viner (1950) published a

[32] WTO website Uruguay Round Agreement, Available from: http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm#articleXXIV, Accessed December 2009.
[33] The Japan-Singapore FTA, which excluded the majority of the agricultural sector, will be discussed in Chapter 3.
[34] This issue was discussed in Chapter 1.

book entitled *'The Customs Union Issue'* introducing concepts of trade diversion and trade creation effects. He was the first to argue that preferential agreements may potentially have welfare diminishing effects both for non-members and members alike[35]. The proportion of welfare improving and welfare diminishing effects of a bilateral or minilateral FTA depends greatly on the type of provisions it includes, as well as the depth and scope of liberalisation. Trade diversion and trade creation effects are static economic effects of FTAs. Trade creation (welfare improving) effects derive from the increases in trade amongst the member countries resulting from removing tariffs and other trade barriers. As a result "more efficiently produced imported goods replace less efficient domestically produced goods" (Rollo 2007:7) in the more open competitive market conditions established by the FTA. Trade diversion (welfare diminishing) effects occur when countries shift their supply sources from more efficient non-member countries' suppliers to a less efficient member country's ones as a result of the relative tariff preferences position now enjoyed by the latter over the former. Dynamic effects of FTAs include the economics of scale and increased competition and cooperation that occurs over the long-run, and not just from one-off 'static' tariff rate changes. Economies of scale result from the reduction of average costs of production which leads to achieving greater resource efficiency. In other words "the conditions for internal specialisation created within an FTA area will lead to cost efficiencies that in turn engender welfare gain" (Dent 2006:22).

FTAs can liberalise trade in goods, services and factors of production. They can adopt the WTO's threefold division for: 1) trade in goods under the GATT 2) trade in services under the GATS, and 3) rules on intellectual property rights under the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). An increasing number of FTAs includes liberalisation of services. Apart from the treaty with ASEAN, all Japan's FTAs had such provisions. Just as under the WTO, the liberalisation of trade in services under FTAs can be applied to:

- Mode 1 - movement of services across borders
- Mode 2 - movement across national borders of consumers/buyers
- Mode 3 - commercial presence, trade in capital
- Mode 4 - movement of natural persons

Furthermore, depending on member' preferences FTAs can remove various types of barriers to trade, as well as include provisions on cooperation in several domains and

[35] This is called Viner's Ambiguity (Baldwin et al. 2007:2).

trade and investment facilitation measures. FTAs liberalise trade by removing border and beyond-the-border barriers to trade. Border barriers are tariffs (fiscal) and non-tariff barriers (NTBs) to trade that a traded good, service or factor of production encounters on the border of a foreign state. NTBs can be defined as restrictions to trade that do not involve tariffs or quotas, for example custom clearance procedures or RoO (Martens 2009). Non-tariff barriers can also occur as beyond-the-border barriers to trade, for example technical regulations, product standards and phytosanitary measures, domestic regulations, such as environmental regulations or export subsidies which lower the price of goods, making it more attractive to foreign importers[36]. Trade facilitation and removal on non-tariff barriers has gradually become an increasingly important feature of many FTAs. Trade facilitation measures might include standardisation, allowing for an easier movement of people, and implementing e-commerce technology. For example, Japan's FTA with Singapore included two chapters on trade facilitation: Chapter 4 deals with customs procedures (for example simplification of customs procedures), and Chapter 5 with paperless trading (Nakagawa 2008:12). Other Japan's FTAs also include chapters on trade facilitation. As will be explained in Chapter 3 of this thesis, trade facilitation is an important part of Japanese companies' preferences for a region-wide FTA. Harmonisation of measures across borders under FTAs can mean provisions on commercial regulations and cooperation. Commercial regulations include rules on investment, intellectual property rights, government procurement, rules of origin and competition policy (Dent 2010a:52). Other examples are sector-specific provisions such as regulations of financial services or telecommunication sector.

Liberalisation of investment under the WTO is based on the same two principles as trade in goods and services: national treatment (treating one's own nationals and foreigners equally), and the MFN treatment (equal treatment for nationals of all trading partners in the WTO). Under FTAs, investment provisions can be divided into investment liberalisation and protection. Investment liberalisation includes pre-establishment national treatment, pre-establishment MFN treatment and prohibition of performance requirements (prior to the approval of investment) (JETRO 2009:129). Investment protection, on the other hand, takes form of post-establishment national treatment, post-establishment MFN treatment, compensation for expropriation, fair and equitable treatment, and state-investor conflict resolution procedures in the event of nationalisation. The last two elements are not covered by the WTO's regulations but can be found in FTAs (JETRO 2009:129). Investments facilitation includes procedures for

[36] For an extensive work on how to liberalise NTBs see Baldwin *et al.* 2007.

investment and provisions on intellectual property rights. Provisions on investment liberalisation under FTAs can be based on a broad definition of investment, covering the transfer of any assets or intellectual property or a narrow definition, limited to direct investments only (Kumar, United Nations 2007:11). In 2009, Japan had 24 investment agreements, of which 15 were bilateral investment treaties (BITs) and nine investment chapters in FTAs (JETRO 2009:129). The investment chapters are becoming a standard in Japanese FTAs[37]. If a BIT was signed prior to FTA negotiations, it is usually incorporated into the agreement as an investment chapter[38].

The WTO TRIPS Agreement sets minimum standards and rules on intellectual property protection rights (IPR). It adopts the national treatment and the MFN principles. FTAs often exceed the WTO level of regulations, for example by including TRIPS-plus or TRIM-plus (Agreement on Trade-Related Investment Measures). Apart from the Japan-Mexico FTA, Japan's agreements include a chapter on IPR, although they are limited to "enhancement or clarification" of TRIPS provisions (JETRO 2009:133). One exception is the agreement with Switzerland which has a high-level chapter on IPR (*ibidem*:134). Chapter 10 of the Japan-Singapore FTA includes comprehensive cooperation in IPR protection. Other TRIPs-plus provisions can be found in Chapter 9 of Japan's agreements with Malaysia, Chapters 10 of the Japan-Philippines FTA and the Japan-Thailand FTA, and Chapter 9 of the Indonesia-Japan FTA (Nakagawa 2008:14). Dent (2010a:67) explains that, in comparison with the US, Japan's approach to IPR under FTAs can be characterised by an emphasis on including more generalised and less defined rules, and also on IPR cooperation. Some FTAs include provisions on competition policy. Such provisions can also take form of bilateral antitrust agreements. Most of Japan's agreements have a chapter on policy and competition law (Nakagawa 2008:19, JETRO 2009:137). Japan-Switzerland FTA includes advanced competition policy provisions, similar to the antitrust agreements (JETRO 2009:137). In addition, FTAs can promote various types of cooperation for example cooperation in labour or environmental issues, industrial cooperation, technology, as well as regulatory cooperation e.g. mutual recognition agreements.

Lloyd (2008:16 cites Lawrence 1996) makes a distinction between 'shallow' and 'deep' integration under FTAs. 'Shallow' integration in that sense implies the elimination of tariffs and non-tariff border barriers to trade in goods, services and factors of production. 'Deep' integration occurs when beyond-the-border trade

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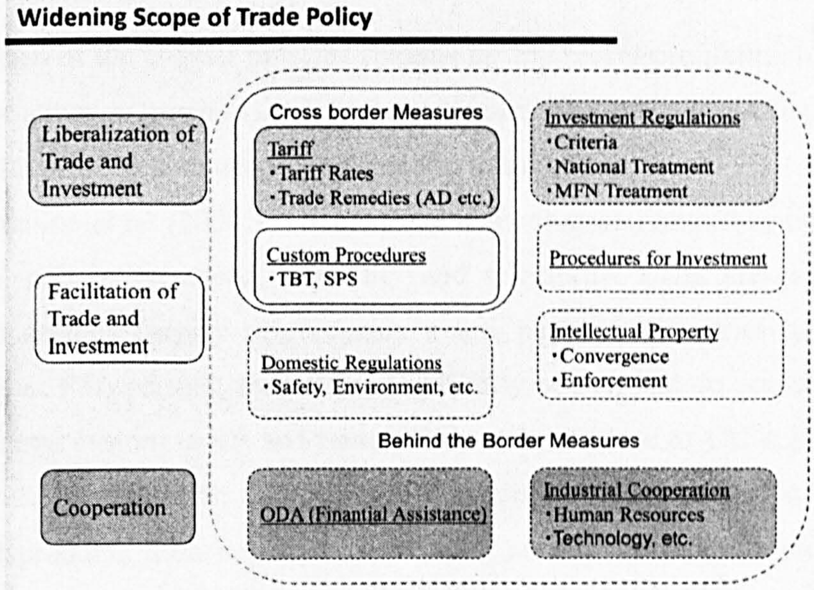
[37] Interview no. 40.
[38] Interview no. 57.

restrictions are eliminated. 'Broadband FTAs' is a generic name for FTAs including comprehensive commitments to liberalisation. They are also called WTO-plus agreements, as they include elements exceeding subjects covered by the GATT/WTO. They can include provisions on elimination of technical barriers to trade, labour and environment, increased cooperation and harmonisation of measures across borders. They often include 'Singapore issues', which were named so after the WTO Ministerial Conference in Singapore in 1996: transparency in government procurement, trade facilitation, investment and competition policy. Japan signs broadband FTAs and calls them economic partnership agreements (EPAs). EPAs aim to widen the scope of integration and ensure gradual harmonisation and facilitation of regional economic activities and economic cooperation (Kawai and Wignaraja 2007:6). Figure 2.1 demonstrates the wide scope of trade policy provisions under Japanese EPAs. Former Minister of Foreign Affairs, Taro Aso (MOFA 2006b), defined Japan's understanding of the two terms in the following way: while FTAs are "instruments which take up issues such as the lowering of tariffs during trade in goods and the elimination of restrictions on foreign investment during trade in services", EPAs "are based on the premise that from the perspective of economics, national borders no longer exist". From the beginning of Japan's FTA policy, the Japanese government argued that EPAs are complementary to the WTO trade liberalisation process as they can provide a model in terms of provisions on competition or investment policies, for which WTO has no rules (MOFA 2006c:6 and Urata 2003:106)[39]. Figure 2.2 shows main elements of Japan's FTAs.

[39] For more on the characteristics of EPAs see Chapter 3.

Figure 2.1 Scope of trade policy under Japanese EPAs



Source: METI, July 2010, Japan's EPA/FTA and Regional Economic Integration Policy. Obtained during interview no. 5

Figure 2.2 Main elements of Japan's EPAs

Main elements of Japan's EPA

		Trade in Goods			Trade in Services				Investment									
		Market access	ROO／TBT	Mutual recognition	Market access	National treatment	MFN treatment	Movement of natural persons	National treatment	MFN treatment	Performance requirement	State vs investor dispute settlement	Government procurement	Intellectual property	competition	Business environment	cooperation	Energy and mineral resources
ASEAN	Vietnam	o	o		o	o		o							o	o	o	
	Philippines	o		o	o	o	o	o	o	o	o			o	o	o	o	
	ASEAN	o	o														o	
	Brunei	o			o	o	o	o	o	o	o	o				o	o	o
	Indonesia	o			o	o	o	o	o	o	o	o		o	o	o	o	o
	Thailand	o		o	o	o	o	o	o	o	o	o		o	o	o	o	
	Malaysia	o	o		o	o	o	o	o	o	o	o		o	o	o	o	
	Singapore	o		o	o	o		o	o		o	o	o	o	o			
Latin America	Chile	o	o			o	o	o	o	o	o	o	o	o	o	o		
	Mexico	o	o			o	o	o	o	o	o	o	o		o	o	o	
Europe	Switzerland	o	o		o	o	o	o	o	o	o	o			o	o		

Source: MOFA, March 2010, Japan's FTA/EPA Current Status and Main Issues, p.16. Obtained during interview no. 9

2.3 Reasons for the Proliferation of FTAs

This section of the chapter presents reasons for the recent proliferation of FTAs, with a particular attention given to the East Asian region. The analysis in Chapters 3 and 4 will refer to the theoretical concepts explained in this section.

Fiorentino *et al.* (2006:15) name three main characteristics they consider to be key to FTAs' popularity: speed, flexibility and selectivity. FTAs are relatively quick to negotiate as they usually involve only a few partners. Countries have an option of choosing an FTA partner, are not geographically bound, and do not need to harmonise their external custom tariffs and trade policy as in the case of CU's. FTA members can also decide on the depth and scope of liberalisation. The possibility of excluding a group of products from negotiations provides an opportunity to avoid problematic or 'sensitive' issues. Kawai and Wignaraja (2007:7) list three main reasons behind the proliferation of FTAs in East Asia: 1) deepening of market-driven economic integration, 2) deepening of the European and North American economic integration, and 3) the experience of the East Asian financial crisis. Dent (2003:25) argues that for many Asian countries bilateral trade agreements may have the first and foremost strategic purposes. They can benefit a specific sector, provide access to natural resources, open a significant market or be a defensive or reactive FTA aiming to diminish the negative impact of other countries' FTAs.

2.3.1 Domestic Political Factors

Domestic political concerns play an important part in governments' FTA policy. Despite the fact that multilateral liberalisation can potentially bring more profits, Dieter and Higgott (2003b:445) argue that "good economic theory is often bad politics" and does not necessarily translate into political constituency. Governments may choose to pursue bilateral FTAs as they bring quick, visible and prestigious results – signing an international trade treaty. Bhagwati (2002:117) argues that states pursue their individual interests despite the fact that a coordinated multilateral solution would be better for all sides. Bilateral preferential trade agreements are easier to conclude than multilateral ones. As it was explained in Chapter 1, the higher the number of members, the more difficult it is to reach a compromise on conflicting issues and the more political effort is required on each side. This is partly due to the fact that the bargaining sides need to overcome the opposition of various domestic groups. As John Ravenhill (2005b:142) puts it:

> *"The political significance is that free trade agreements that provide partial liberalisation can provide exporters with what they want (access to foreign markets) while enabling governments to avoid tackling the problem of inefficient domestic industries. The result is a process of 'liberalisation without political pain".*

Dieter and Higgott (2003b:446) argue that bilateral FTAs create an 'illusion of control' over the process of market liberalisation and result from the "fear of being shut out of agreements in times of low trust in the multilateral trading system". They find this motivation particularly important when it comes to the East Asian region where FTAs are 'statements of sovereignty' creating a counterbalance to the limited control over the WTO negotiation process. Furthermore, FTAs are said to support and 'lock in' domestic economic reforms (Manger 2005:807). Bilateral trade agreements may be a way of directing foreign pressure (*gaiatsu*) in order to overcome domestic opposition to economic reforms, restructuring and market liberalisation. Dent (2006:51) argues that this is in particular relevant for countries such as Japan and Korea. By opening the economy to competition from other countries FTAs enhance the restructuring of uncompetitive sectors. In this respect they can be more effective than multilateral trade agreements, which according to some scholars is an important motivation behind governments' pursuit of FTAs (Urata 2003:98). This was also confirmed by Prime Minister Aso (MOFA 2006b). Urata (*ibidem*) points out that previously Japan was reforming its domestic structures using the US's pressure and international frameworks such as the WTO/GATT. This ceased to be the case in the middle of the 1990s due to the problems with the WTO/GATT negotiations as well as decreased pressure from the US to open up the Japanese market. As will be discussed in Chapter 5, without a strong political leadership, it is difficult to sign an FTA with a level of liberalisation sufficient to support domestic reforms.

2.3.2 International Political Factors

One of the most commonly mentioned reason for the proliferation of bilateral FTAs is the lack of substantial progress of the multilateral liberalisation process with the stalling of the Uruguay Round due to the disagreements over agriculture, failure of the WTO ministerial meetings in Seattle in 1999 and Cancun in 2003, and finally, problems with the successful finalisation of the Doha Round. Similarly, multilateral liberalisation under APEC and the 'open regionalism' it advocated did not bring expected results. The Bogor Goals from 1994 and the Osaka Action Agenda from 1995 have made little progress over the years. The Early Voluntary Sectoral Liberalisation, launched in 1997, has failed. Additionally, the fact that areas such as the Singapore issues are excluded from multilateral talks made FTAs a more attractive option for countries that consider these elements important (Fiorentino *et al.* 2006:26). For example, Japan and the EU insisted that issues of investment agreements, competition policy, transparency and trade facilitation (Singapore issues) be included in the Doha Development Agenda (Bhagwati 2005a:4). The lack of confidence in the multilateral trade liberalisation and global and regional institutions that govern it has led many states which have traditionally supported multilateralism to shift towards what is now being called a 'multi-track' approach. This means that while still participating in the WTO rounds they also pursue bilateral solutions. Dent (2006:41), referring in particular to the Asia-Pacific region, calls this a 'trade policy paradigm shift' from mercantilism, or neo-mercantilism, to liberalism. Bhagwati (2008:81) argues that this process, which he in turn calls 'second regionalism', started when the US decided to pursue bilateral agreements as opposed to the previous purely multilateral approach of the early 1980s. As he (Bhagwati 2008:81) explains, this was later called the 'competitive liberalisation' theory whereby FTAs were believed to help the multilateral trade liberalisation: the United States' pursuit of bilateral FTA would cause other states to seek similar agreements with the US and support liberalisation under the WTO[40]. Lack of progress of the multilateral liberalisation process and the US's and EU's pursuit of FTAs caused states, such as Japan, which for a long time have been adherent to the global, multilateral liberalisation under the WTO, to adopt a 'multi-track' approach. Ravenhill (2005b:131) in turn attributes the change in the United States' approach to bilateral FTAs in the 1980s to the impact of the European Community's Common Agricultural Policy as well as the slow progress of multilateral, global liberalisation.

Dent (2006:51) lists cooperative diplomacy as another reason for FTAs' popularity. It is a way in which states cooperate to manage increasing economic interdependence in

[40]This resulted more in the 'tit-for-tat' agreements especially in East Asia. Bhagwati (2008:86) disagrees with this reasoning and argues against Fred Bergsten's notion that FTAs can help advance the WTO negotiations. This will be discussed in detail later in the chapter together with the multilateralising bilateralism debate.

the region. Ravenhill (2005b:120) argues that regionalism (here regional bilateral or minilateral FTAs) can serve the purpose of "economic cooperation and confidence building" and that "in international relationships that have a history of conflict or where no tradition of partnership exists, cooperation on economic matters can be a core element in a process of confidence building". Furthermore, Ravenhill (*ibidem*) explains that both the European Union and ASEAN are examples of FTAs signed with a partial motivation of preventing possible future warfare (in the second case a war between Indonesia –Malaysia 1963-66). Secondly, Dent (2006:51) points out the importance of security considerations in Asia-Pacific and calls this type of factors security alliance diplomacy: the US-Australia FTA is an example of a treaty signed with such motivation. Terada (2006:6) stresses the strategic objectives and gives an example of Singapore, the first country in East Asia to have signed an FTA and one of the region's most active states in this respect. The author (*ibidem* cites Leifer 2000:26) argues that bilateral FTAs were a way to counterbalance the state's "innate vulnerability arising from its geopolitical circumstances wedged between big Islamic countries like Malaysia and Indonesia". Bilateral FTAs provided Singapore with a sense of economic and political security and stabilisation. Other types of security alliance diplomacy might include supporting one's allies (Manger 2005:806 cites Gowa and Mansfield 1993, Gowa 1995). This type of motivation can also include the 'new security agenda', meaning non-traditional security threats, such as environmental damage, illegal migration, organised crime, drug smuggling, and international terrorism (Ravenhill 2005b:122). FTAs can be a way of introducing regulations in this field.

Bilateral FTAs can be perceived as an insurance policy against trade disputes in the uncertain international environment (Manger 2005:807 cites Mansfield and Reinhardt 2003). In East Asia the financial crisis of 1997/98 provided an additional push in this direction. It convinced the East Asian states of a need for regional, economic security measures and led them to increase efforts in the field of financial integration, e.g. the Chiang Mai Initiative of bilateral currency swaps arrangements. It also caused them to seek an alternative to multilateral trade liberalisation. Unlike in Europe or North America, there were no free trade agreements in East Asia before the financial crisis. Dent (2006:50) argues that FTA 'catch up' was an important factor behind the popularity of bilateral trade agreements in the Asia-Pacific region. This is connected to another two factors he (*ibidem*:52) mentions: isolation avoidance and competitive bilateralism. Both of them were strongly reflected in the fieldwork research findings. Isolation avoidance means that states sign their own bilateral FTAs in order to avoid being 'left out' as a result of other countries' pursuit of such agreements. Several scholars wrote about this phenomenon under different names. Bhagwati (2008:45) calls this type of FTAs 'tit-for-tat' retaliatory agreements. Bilateral FTAs are understood here as 'defensive' or 'retaliatory' tools of trade policy. Bhagwati (2008:45) gives an example of regional FTA initiatives in East Asia, such as the ASEAN+1, ASEAN+3 or ASEAN+6, which excluded the US and were created after the US signed NAFTA and considered the Free Trade Agreement of the Americas excluding Asia. Terada (2006:25) provides another example of isolation avoidance in East Asia by arguing that Japan's FTA with Singapore and planned agreement with Korea has caused China to negotiate a free trade agreement with ASEAN. This, in turn, has led Japan's Prime Minister Junichiro Koizumi, to propose a similar FTA to ASEAN. According to Terada (2008:8), who quotes Katsuhiko Umehara former Director of the Ministry of Economy, Trade and Industry, Japan's agreement with Singapore convinced Malaysia and Indonesia , which were reluctant to join the FTA race, to reconsider their policy. While Japan was negotiating with Singapore, Malaysia spoke openly against such treaties. According to the former Malaysian Trade Minister, Rafidah Aziz (Terada 2006:11 cit Straits Times, 15 March 2001), Malaysia was "not interested in having bilateral FTAs with anybody". However, since then, the country has concluded agreements with, amongst others, Japan, Pakistan and Chile.

Competitive bilateralism rationale for the proliferation of FTAs is closely related to isolation avoidance. In this understanding FTAs "are a function of inter-state competition for economic and political influence" (Dent 2006:41). Bilateral or minilateral FTAs can change the regional balance of power, serve as bargaining tools or provide leverage in multilateral negotiations. Political competition can be explained as an awareness of regional balance of power and position vis-à-vis other countries and an idea of not being 'left behind'. Economic competition, discussed in detail in the next section, is related to the relative position of multinational companies (MNCs) on international markets and their response to foreign companies obtaining preferential market access under third-party FTAs. Ravenhill (2005c:3) points out that when APEC was established member states attempted to use the organisation to pressure the EU to compromise during the Uruguay Round of GATT. Ravenhill (2005b:129) calls this phenomenon bandwagoning or balancing and explains it as "the possibility that regionalism in one part of the world triggers regionalism elsewhere through 'demonstration', 'emulation', or 'contagion' effects". These two factors correspond to the neorealist approach which perceives regionalism as an extension of states' continuous struggle for power on the international stage. For example, it can occur when countries form alliances in order to counterbalance the position of other states and regional groupings, or when a "hegemon or 'stabiliser' state can stimulate the emergence of regional cooperation and regional institutions in a variety of ways, and indeed is necessary for this to happen" (Soderbaum 5002:224 cites Hurrell 1995:51-3, Waltz 1979; Gilpin 1987; Buzan 1991). Understanding of FTAs as defensive tools for offsetting the negative effects of economic integration between third parties is significant in the context of this thesis. According to research fieldwork, both isolation avoidance and competitive bilateralism play a pivotal role in Japan's FTA policy as will be discussed in Chapters 3 and 4.

2.3.3 Domestic Economic Factors

Dieter and Higgott (2003b:446) point out that the average level of tariffs and NTBs was successfully reduced by the GATT/WTO process and hence removal of traditional barriers to trade under FTAs does not offer as many gains as it used to. Richard Baldwin (2006:1474) explains proliferation of FTAs despite the falling MFN tariffs by the 'home market magnification' effect which means that "small advantages created by tariffs matter more when the overall level of protection is low". Baldwin's 'home market magnification' effect and the economies of scale are the basic economic reason for signing bilateral FTAs. Such agreements can also help to attract inward foreign direct investment (FDI). This can be an important motivation, particularly for smaller and less developed economies (Hufbauer and Schott 2007:25). Ravenhill (2005c:4) gives an example of a substantial increase of FDI in Mexico after the country has signed NAFTA in 1994. By contrast, Manger (2005:3) argues that FDI provide incentive for bilateral trade treaties: having invested abroad, MNCs want to secure their advantage in the local market. Hence the internationalisation of production networks can cause firms to opt for bilateral treaties. As developed countries usually have low tariffs on manufacturing parts and components, vertically integrated companies can import back intermediate goods quite cheaply from the countries that host labour-intensive stages of production. For Japan, these tariffs are often close to zero. However, exporting materials from the home country abroad can be more expensive as developing states often maintain high MFN tariffs (Manger 2005:810). Therefore, Manger (2005:810) argues that FTAs can be used as "commercial policy instruments to further the competitiveness of multinational firms". This understanding accentuates the restrictive and protective character of FTAs. From the perspective of foreign MNCs, it is desirable to sign a similar agreement to offset negative effects resulting from FTA members trading under preferential tariffs. MNCs are interested in the liberalisation of trade with countries where they manufacture goods or which are their target markets. Companies with vertically integrated production network are also deeply interested in provisions on investment, commercial regulation, movement of capital and labour, national treatment principle and administrative procedures, as FTAs including such elements facilitate operations within the network.

This type of motivation corresponds to functionalist school within the neoliberal approach to regionalism (Soderbaum 2005:226). It conceptualises regionalism as a tool for fulfilling certain functions. It can be defined as "technical and basic functional programmes and projects within clearly defined sectors, without challenging national sovereignty or disturbing existing power structures within each country" (*ibidem*). The notion of regionalism and FTAs in particular being pragmatic and functional is widely reflected in the thesis. The 'functional approach' as explained in Chapters 3 and 4, is a cornerstone of Japan's FTA policy and is expressed by signing agreements designed to correspond to specific interests of the manufacturing industry.

2.3.4 International Economic Factors

The economic equivalent of the 'tit-for-tat' motivation and isolation avoidance is Baldwin's (1993) 'domino effect' theory which is also closely related to the MNCs' point of view described in the previous section. One of the most obvious reasons for signing free trade agreements is to increase the trade creation effect and offset the trade diversion effect caused by third-party trade treaties. Proliferation of FTAs causes states which do not want to be left behind to sign treaties of their own to offset those signed by their competitors. Baldwin (1993, 2004) named this the 'domino effect'. Domino effect occurs when, as a result of country A signing an FTA, country B enters into FTA negotiations to offset the effects of the first agreement. Signing of an FTA is an 'idiosyncratic shock' for non-members: it changes the domestic, political equilibrium and the balance of pro- and anti-liberalisation forces and preferences within a country (Baldwin 2004:6). This means that the creation of one FTA promotes the formation of another by increasing the pro-liberalisation forces in a non-member state faster than the anti-liberalisation ones. In other words: FTAs beget further FTAs. Fearing discrimination, non-member state exporters express a greater support for preferential liberalisation. Recently, Baldwin and Jaimovich (2010) conducted a study based on the FTA database developed by Hufbauer and Schott in 2009. Their work provides new empirical evidence for the domino mechanism behind FTAs. They (*ibidem*) write that "the domino theory is not a 'primitive' explanation of why regionalism is spreading, but it explains how a few exogenous shocks could produce a cascade of political economy effects that makes it look like regionalism is spreading like a wildfire". On the other hand, Ravenhill (2010) rejects the notion that the proliferation of FTAs in East Asia results from an economic domino effects and points out that such agreements bring little economic gains to member states. This is caused by many factors, for example: excluding politically sensitive sectors, signing FTAs with relatively minor trading partners, and low preferential margins. According to the author (*ibidem*:196), low utilisation rates of the region's FTAs provide evidence against the economic domino effect. However, a recent Asian Development Bank Institute firm survey report (Kawai and Wignaraja 2011b:34) demonstrates that the utilisation rates of East Asian FTAs are higher than previously believed[41]. Similarly, Ravenhill (2010:179) argues against the notion that economic interdependence has caused the proliferation of trade treaties in the region after the financial crisis and explains that "rather than domestic economic actors being the primary driving force behind the new East Asian regionalism, my argument is that it has been a state led process, in which non-state actors were often marginalised". This means that, while increasing economic interdependence is undisputable, it did not, in his opinion, lead to the proliferation of FTAs in East Asia. Instead, Ravenhill (2010:199) argues that such agreements were "driven by a 'political domino effect', with governments' primary concern being their potential exclusion from a new dimension of regional economic diplomacy".

[41] According to the survey, 28 percent of 835 firms responding to the question on use of FTAs stated that they used preferences under free trade treaties. Dent (2010a:60 cites ADB 2008) mentions an earlier Asian Development Bank study which demonstrated that FTA utilisation rates across East Asia were around 10 percent.

2.4 Multilateralising Bilateralism Debate

2.4.1 Multilateralising the Spaghetti Bowl

This section presents an overview of the multilateralising bilateralism debate also referred to as multilateralising regionalism debate (e.g. Baldwin 2006)[42]. The question asked here is: in what way can bilateral agreements be harmonised into multilateral ones? Dent (2010a:50) points out that FTAs are heterogeneous in nature as they are formed from the politico-economic interactions of involved states. FTAs differ greatly in the types of barriers to trade they remove, implementation modalities and the range of other provisions and regulations they include. Such differences are at the heart of the multilateralising bilateralism debate as they make it difficult to harmonise and multilateralise FTAs. As Baldwin (2006:1451) puts it "global duty-free trade will require a multilateralisation of the world's existing and emerging regionalism". This section asks what type of provisions FTAs should include in order to maximise positive effects and allow for easier harmonisation. The debate is highly relevant in the context of this thesis. As Japan has already signed several bilateral FTAs and an agreement with ASEAN, any prospective regional FTA, whether in the Asia-Pacific or the East Asia region, will need to coexist and be harmonised with the existing treaties.

One of the principal drawbacks of the proliferation of FTAs is that it creates a spaghetti bowl effect or a 'maze of regulatory regimes' (Pauwelyn 2007:3). Both terms reflect the difficulties of coping with a multiple sets of trade rules which occur when one country is a party to several FTAs. With the proliferation of FTAs a dense network of agreements, tariffs, and rules is created. For companies this means increased costs and time spent on complying with different regulations and for the government: additional administrative costs of receiving and issuing certificates of origin. The multilateralising bilateralism debate can be derived from the spaghetti bowl debate, also known as the 'stumbling blocks versus building blocks' (stepping stones) debate. Both terms were coined by Bhagwati (1995) who named the regulatory maze of overlapping bilateral FTAs the spaghetti bowl effect and during Harry Johnson Lecture in London in the 1990 asked a question whether "FTA as stumbling blocks or building blocks" (Bhagwati 2002:118). The President of the Asian Development Bank, Haruhiko Kuroda, renamed the spaghetti bowl in the Asian region to the noodle bowl in 2006 (Kawai and

[42] See also papers presented at the 'Multilateralising Regionalism' conference, WTO, 10-12 September 2007, Geneva. Available from:
http://www.wto.org/english/tratop_e/region_e/conference_sept07_e.htm.

Wignaraja 2009:2). The main question of the spaghetti bowl debate is whether FTAs can lead to multilateral liberalisation. What is meant here is both 1) whether bilateral FTAs help regional economic integration, and 2) whether regional integration helps global trade liberalisation under the WTO. The first question is of relevance for this thesis as it asks how bilateral FTAs impact domestic actors' preferences for a region-wide agreement. Hence this section focuses on the first part of the question.

There is a disagreement in the subject literature regarding the impact of proliferating bilateral FTAs on the regional or global multilateral trade liberalisation. The stepping stone argument can be summarised in two points. First, FTAs provide incentives for other countries to seek liberalisation. This would respond to the competitive liberalisation theory which was discussed earlier in this chapter (Bergsten 1994, Baldwin 2004:5). This means that the proliferation of FTAs in one region causes other countries to sign further trade agreements to off-set the trade diversion effect of those already in existence. However, this can be done under bilateral arrangements and hence not further the regional or global liberalisation. The second argument is that these treaties support the multilateral trade negotiations under the WTO. According to the WTO (2005b), the popularity of deep integration elements in FTAs can lead to the inclusion of these elements in the multilateral trade negotiations. Therefore, FTAs can promote WTO-plus provisions and be stepping stones towards further regional or global liberalisation. This argument is supported by Brown and Stern (2011). In order for the WTO to adopt rules on deep liberalisation and regulatory cooperation there should be a "consensus on what the rules should be" resulting from "an extensive exchange of information, on analysis and on discussion among specialised national agencies" (*ibidem*:352). FTAs can facilitate such exchange of information and can help to develop a best practice model for this type of rules. Ravenhill (2005b:141) adds two further arguments supporting the stepping stone approach: FTAs help to prepare industries for global liberalisation by introducing increased competition and they increase profits of exporting sectors which are then in a better position to lobby for further liberalisation. Baldwin (2004:4) points out that states which have pushed for multilateral liberalisation since the II World War are also those who have pursued preferential, mainly regional, agreements. This viewpoint is conceptualised by the juggernaut mechanism theory (Baldwin 1994, 2004, 2006)[43]. The initial impulse for the juggernaut mechanism is bilateral or multilateral reciprocal tariff cutting which is supported by country's

[43] The concept of juggernaut mechanism is related to the domino effect theory described earlier in the chapter.

exporters who seek increased market access. Tariff liberalisation is implemented under FTA's phase-in schedules. During this time, exporting sectors in FTA-member countries, which expect to gain from tariff cuts, are upsized. The import-competing sectors are downsized. In Baldwin's opinion (*ibidem*), this strengthens the pro-liberalisation forces within nations and weakens anti-liberalisation ones. In this respect FTAs and the WTO are parts of the same liberalisation process. Furthermore, Baldwin *et al.* (2007:1) also argue that the internationalisation of production networks, which they refer to as production unbundling, creates incentives for the multilateralisation of FTAs. Multiple tariffs and RoO complicate operations of companies with vast international supply and production networks and create economic inefficiencies. This has "brought the spaghetti bowl effect to the point where it is no longer easy to manage and have increased support for multilateralisation of FTA network" (*ibidem*). Recently, Saggi and Yildiz (2011) used Nash's (1950) two game model to discuss the possible effects of the increasing number of bilateral FTAs on the multilateral trade liberalisation. They offer evidence in support of the stepping stone model and argue that under certain circumstances the mere possibility of signing an FTA by another state can provide an incentive to participate in multilateral trade liberalisation. As non-member states are discriminated against under bilateral FTAs, which is not the case under a multilateral agreement, "bilateralism can actually provide an impetus to multilateral trade liberalisation" (Saggi and Yildiz 2010:34). Li (2009:159) used gravity estimations to demonstrate that FTAs between countries with established vertical trade links have strong effects on these links. The author argues that "the deeper the integration between countries the larger the FTA impact on them" (*ibidem*:159). Vertical trade between countries previously engaged in production sharing is intensified as a result of a bilateral FTA. This provides an incentive for deeper integration on a broader level. Therefore, FTAs between countries with vertical specialisation can help to promote multilateral liberalisation.

Robert Z. Lawrence (1995:407) argues that regional trade agreements will be building blocks for global liberalisation through supporting countries' economic development and providing an incentive for further liberalisation by "creating demands for greater access to the block". In addition, he suggests that FTA member countries remain dependent on trade with non-members and hence such treaties cannot be viewed as protectionist stumbling blocks. In his article published in 1995, Lawrence (*ibidem*:408) mentioned contemporary concerns regarding the stumbling block effect of free trade agreements:

"A second concern is that Japan will spearhead a Southeast Asian bloc, principally by moving its manufacturing industry offshore. (...) As Japanese investment rises in other Southeast Asian countries, so goes this argument, Japan will obtain control over these rapidly growing markets, erecting invisible barriers that will make it difficult for other countries to penetrate. And acting though MITI, Japan supposedly will try to manage international specialisation in a manner which inhibits the free entry of firms and products from outside the region".

In reality, despite the internationalisation of production networks, Japan does not lead a closed regional block and Japanese companies are faced with several NTB in Southeast Asia, as will be further explained in Chapter 5. Instead, ASEAN has been playing an increasingly visible role in regional integration. The organisation developed the ASEAN+1 network of FTAs and has been actively participating in trans-regional activities, for example through the Asia-Europe Meeting.

On the other hand, Viner (1950), Bhagwati (2004) and Limao (2006) make a clear distinction between FTAs and free trade and mostly stress the negative effects of bilateral arrangements such as trade diversion. According to Bhagwati (2008:xi), FTAs are in fact stumbling blocks for global trade liberalisation as they are inherently discriminatory. The stumbling block argument points to the negative sides of FTAs: they divert political attention away from liberalisation under the WTO and cause countries to be less interested in multilateral rounds (Levy 1994). Preferential agreements are contrary to the MFN principle[44] and non-discriminatory spirit of the WTO. The stumbling block argument could be further explained by preferences of exporting industries. MNCs lobby for FTAs under which they obtain an advantage, a margin of preference, vis-à-vis their foreign competitors. Kapstein (2006:6) explains that "this is because industrial sectors make lumpy investments that are profitable only under given tariff schedules and will therefore organise and lobby to retain them". Rollo (2007:15) points out that those who gain from preferential agreements will oppose the reduction of MFN tariffs as this will limit their profits. In this way, FTAs create incentives for MNCs to resist greater multilateral or unilateral liberalisation. Limao (2006:157) points out that smaller reductions in MFN tariffs during the GATT/WTO rounds are a way of retaining

[44]MFN is one of four main principles on which the WTO is based. The other three being: the national treatment principle, transparency in trade policy and reciprocal liberalisation during multilateral negotiation rounds (Hufbauer 1990:67).

a higher preference margin under FTAs. Such tactics make other countries reluctant to cut their own tariffs and thus slows down the multilateral trade liberalisation. Similarly, Dent (2006), deploying his 'lattice regionalism' hypothesis, argues that proliferating bilateral FTAs do not help regional community-building process in the Asia-Pacific region. Analysing two counter-perspectives of 'region-convergent' and 'region-divergent' bilateralism the author (*ibidem*:255) discusses issues such as the noodle bowl, RoO regimes, competitive liberalisation, hubs, spokes, and contesting FTA models and argues that "the new bilateral FTA trend will mostly work against regional community-building in the Asia-Pacific through undermining the coherence and viability of existing regional organisations, intensifying inter-state rivalries, reinforcing power asymmetries and exacerbating the development divide in the region".

The main question of the multilateralising bilateralism debate is how to harmonise and multilateralise existing FTAs into broader treaties. Okamoto (2003:12) sees two general ways in which FTAs can be multilateralised. This could be done by increasing their membership and/or by making them less discriminatory for third parties and gradually applying FTA provisions to non-members. He (*ibidem*) points out that this can occur on three levels: 1) through international organisations, for example the WTO, 2) within a particular FTA, for example by including special clauses, and 3) on a unilateral level if states decide to apply same provisions to third parties. In Okamoto's (*ibidem*:14) opinion, the best results would be achieved by combining actions on all three levels. Hoekman and Winters (2007:4) see three ways of multilateralising bilateralism: 1) hegemonic multilateralisation where one country imposes its model on others, 2) convergence where the importance of harmonising regulations becomes visible as the traditional barriers to trade disappear, and 3) shifting of the political support for liberalisation as a result of third-party FTAs and a changing economic situation. Another way would be to include the non-partner MFN clause for trade in goods, similar to the one found in service agreements. It requires countries to automatically extend any further liberalisation to already existing FTA partners (Fink and Jansen 2007:2). Agreements on services are easier to harmonise as existing regulations are much less discriminatory than tariffs for manufactured goods. Origin is often determined by the location of production instead of ownership. A similar MNF clause exists in WTO's TRIPS Agreement and Pauwelyn (2007:31) mentions that using it for trade in goods under FTAs would be "a major boost to multilateralising regionalism". Unilateral liberalisation could be another solution to the spaghetti bowl problem if the concessions made in preferential agreement would be unilaterally extended to the multilateral level

(Fiorentino *et al.* 2006:26). Baldwin (2006:1471) points out that there are recent examples of unilateral tariff reduction, for example in East Asia, and refers to this phenomenon as the 'race-to-the bottom' unilateralism. Companies with vertically integrated production networks might support unilateral liberalisation of tariffs in order to facilitate import of intermediates and finished goods from manufacturing facilities located abroad.

On the other hand, Corning (2009) uses the example of overlapping FTAs between ASEAN members and Japan to explain the possible reconciliation of bilateralism and multilateralism which falls under the multilateralising bilateralism debate. He does this by comparing the technical aspects of the two types of agreements: tariff reductions, rules of origin and the WTO-plus provisions. Corning (2009:661) concludes that "the choices made in negotiating AJCEP suggest how difficult it will be in the short-term for economic regionalism in East Asia to move beyond functional cooperation" and points out that harmonising of the six ASEAN+1 FTAs would be an even more difficult task. Another way to facilitate multilateralisation of bilateral FTAs is to include high-level, 'deep liberalisation' provisions. Hongshik and Innwon (2007:783) argue that, as tariffs for manufacturing goods are already quite low, liberalisation based solely on tariff cuts will not bring enough benefits to start Baldwin's domino effect that would lead to the multilateralisation of trade liberalisation. On the other hand, according to the authors, comprehensive broadband FTAs do not aggravate the negative effects of the spaghetti bowl[45]. Hongshik and Innwon (2007:875) stress the importance of trade facilitation provisions and argue that in order to avoid the negative effects of the spaghetti bowl and to be stepping stones for multilateral liberalisation FTAs should: 1) be concluded between countries that have the highest potential for trade creation, 2) include provision or clauses on complying with the existing multilateral liberalisation initiatives, and 3) include 'deeper integration' elements. Gains obtained as a result of trade facilitation provisions allow states to trade more with non-FTA members and hence to minimalise the trade diversion effect (*ibidem*). Trade facilitation reduces trade costs which in turn increases gains from trade and attracts more FDI (*ibidem*:787 cites OECD 2005). In other words, FTAs involving WTO-plus elements are more welfare enhancing and are easier to multilateralise. Jong-Wha Lee and Innwon Park (2005:40) have also argued that including trade facilitation provisions in FTAs would help to reduce the spaghetti bowl effect in Asia while keeping with the spirit of APEC's guiding principle of open regionalism. This argument is strongly reflected in the findings of the fieldwork

[45] Ahn and Cheong (2007) also argue that the negative effects of the spaghetti bowl can be lessened.

research and the discussion on Japanese companies' preferences for FTAs described in Chapter 4.

Menon (2009:1395) assesses the four main solutions for dealing with the proliferation of bilateral FTAs in the Asia-Pacific region[46]. As discussed, these are: 1) consolidation into broader regional agreements, 2) multilateralisation of provisions under the existing FTAs, 3) harmonisation of MFN tariffs by bringing them down but not removing completely, and 4) liberalisation of RoO and dilution of their restrictive effects by introducing cumulation[47]. Multilateralisation, meaning offering the preferential treatment negotiated under FTAs to non-members, is considered to be the optimal solution (Menon 2009:1405). This would however need to be done on unilateral basis, which is a weak point of this proposal. Menon (2009:1396 and 1405) argues that consolidation is the least desirable option for two reasons: it is impractical and it does not remove the incentive of signing further bilateral treaties. It is possible that the existing FTAs would be kept after signing of an overlapping regional agreement, as was the case when Japan signed an FTA with ASEAN. Therefore, a consolidation of bilateral FTAs could aggravate the problem by creating of an additional level of regulations. Dent (2010c:240) discuses the reasons why convergence and harmonisation of bilateral FTAs in the Asia-Pacific will be difficult to achieve and argues that such agreements have made little contributions to a "more comprehensive regionalized integration and regional community-building processes". In his opinion, Asia-Pacific agreements may in time transformation into 'FTA-plus' agreements and focus on WTO-plus issues.

2.4.2 Multilateralising Rules of Origin

As they guard the discriminatory character of FTAs, rules of origin are one of the main elements of the spaghetti bowl and a major hindrance to the harmonisation and multilateralisation of agreements. If RoO are weak and non-discriminatory multilateralisation occurs almost automatically as this allows for the trans-shipment of goods (Baldwin *et al.* 2007:9). Gasiorek *et al.* (2007:3) identify two main negative effects of RoO: 1) they can be used as protectionist measures, as they create non-tariff barriers to trade, and 2) they strengthen the spaghetti bowl effect as each FTA uses a specific and complex set of RoO. Therefore Bhagwati (2008:66) claims that FTAs "they

[46] The author defines Asia-Pacific as comprising of member states of ASEAN, APEC and South Asia.
[47] This concept will be explained in the following section.

take away with one hand what they give with the other".

RoO are negotiated separately for every FTA depending on circumstances and preferences of agreeing parties and are attached to the main agreement in the form of a protocol. FTAs use RoO based on the Harmonised Commodity Description and Coding System (HS) of tariffs, an international classification system under the World Customs Organisation. The system was initially adopted by the Customs Cooperation Council in 1983. HS codes are composed of six digits that can be extended up to ten digits. The first two digits are called a chapter; the first four are called a heading; six digits are a subheading; and all eight or ten digits are called an item. FTAs use two levels of preferential RoO: product-specific (how RoO are applied to a given product) and sectoral (how they work in a broader context) (Estevadeordal *et al.* 2007:58). Product-specific rules have two categories: 1) wholly obtained, where the good is produced entirely in one country, and 2) substantial transformation, where the good needs to undergo a certain process in order to be considered originating from a given country. Substantial transformation may be of three types: 1) change in tariff classification (CTC) (change in the HS heading level), 2) minimum local value-added content (VC), and 3) required specific production process (SP) (Kawai and Wignaraja 2007:15). SP can be applied to a particular stage of production or a component. As for sectoral RoO there are two rules that need to be mentioned: *de minimis* and cumulation (Estevadeordal *et al.* 2007:59). *De minimis* rule allows for the maximum amount of materials from abroad to be used without affecting the local origin of the good. The second rule is cumulation. Cumulation means cumulating the added value of components from several countries while establishing the origin of a given good. It is a way of harmonising and relaxing RoO and lessening their negative impact on trade flows. Thanks to cumulation "products imported from other signatory nations and used in the manufacture of a finished product are considered to be products of the nation in which the finished product is manufactured" (JETRO 2009:108). It facilitates the movement of parts and components between factories of a vertically integrated company. Bilateral cumulation is used in all bilateral agreements and allows intermediates and materials originating from one country to be treated as local in the other country. Diagonal cumulation is used in multilateral FTAs where all partners are linked by the same type of RoO and allows cumulation of added value in all member countries while determining the origin of a given product (Gasiorek *et al.* 2007:9). The product does not change origin once it enters the FTA. Full cumulation can also be used in multilateral FTAs. It offers more flexibility as any transformation of a product not originating in an FTA member country that takes place within an FTA counts towards the domestic added value of that good (*ibidem*).

As one of the NTBs, RoO can have a negative effect on FTA members and third-parties. RoO were called 'tools of discrimination' by a senior US Treasury official during the NAFTA negotiations (Hufbauer and Schott 2007:37). They affect trade flows and increase the trade diversion effect. RoO can also indirectly determine which source of intermediate inputs the company uses. If, before an FTA was signed, a company used an international supplier the finished good might not comply with the RoO when the agreement is in force. In this case, the company can either continue to use the same supplier, not take advantage of preferential tariffs and pay custom duties while exporting to other FTA members, or change its source and increase its costs in order to be eligible for preferential treatment. Whether the company decides to opt for the preferential tariff or not depends on the difference between the costs of complying with RoO and the gains from the preferential margin of the new tariff.

The trade distorting nature of RoO can be offset by allowing a more flexible approach, such as cumulation or *de minimis* rule. Both diagonal and full cumulation are possible only when all FTA members use the same type of RoO as it was done in the case of the Pan-European Cumulation System (PECS)[48] introduced in 1997. When PECS was established all participating countries agreed on the same set of RoO. Allowing this type of diagonal cumulation in multilateral FTAs creates a sort of 'RoO custom union' with common external RoO (Baldwin *et al.* 2007:4). It reduces trade distortion within the FTA territory. Gasiorek *et al.* (2007:23) argue that for cumulation to be applied, even if FTA members retain different rules of origin, all existing RoO would need to be changed into the VC rule. Full cumulation with value-added tariffs could then be implemented. Value-added tariffs were introduced by Lloyd (Gasiorek *et al.* 2007:24 cites Lloyd 1993) and denote tariffs applied in direct proportion to the amount of intermediates originating in a non-member country. In other words, countries would pay tariffs depending on the proportion of non-member states' inputs to the price of the final good: if that proportion was 40 percent, 40 percent tariff would be applied. Baldwin *et al.* (2007:6) argue that setting MFN tariffs at zero for all countries is an alternative solution and would solve the problem of trade distortion caused by FTAs. This was done, for example, under the Information Technology Agreement (ITA) from 1997. The agreement signed by 29 information technology (IT) exporters lowered MFN tariffs on technological products to zero and made RoO unnecessary (Baldwin

[48] This was recently extended to the Pan-Euro-Mediterranean cumulation zone.

2006:1510). Brown and Stern (2011) point out that since the World War II developed countries have significantly lowered tariffs on a unilateral basis. As a result, the MFN tariff for many products is already at zero. If this trend persists, the maze of preferential tariffs and rules of origin will slowly become less important. Additionally, as RoO protect FTA members with higher MFN tariffs from products trans-shipped from members with lower MFN tariffs, RoO should only be applied in this direction: RoO do not need to be applied for importing products from an FTA member with a higher MFN (Gasiorek *et al.*2007:22). Estevadeordal *et al.* (2007:44-46) list possible future scenarios regarding RoO:

- Status quo with bipolarisation of RoO as the stronger economies or FTA hubs impose one RoO system
- Multilateralisation achieved by establishing RoO best practice or benchmark within the WTO framework
- Convergence, meaning the "unification of multiple overlapping existing FTAs into a single cumulation zone with a new, single list of rules of origin" (*ibidem*)
- Synchronised multilateralisation and convergence which the authors consider the optimal solution. It would allow for a formation of larger cumulation zones. Both processes would need to occur simultaneously as without simultaneous global liberalisation large cumulation zones tend to adopt more restrictive RoO.

They conclude that the formation of a large cumulation zones with strict RoO is the most likely scenario for the future[49]. Kawai and Wignaraja (2011a) consider rationalisation of RoO and facilitation of related administrative procedures to be one of the ways to lessen the negative effects of the spaghetti bowl. They argue that harmonisation of RoO, cumulation, and possibility to choose between the CTC and VA rules (referred to as co-equal rule[50]) can bring many benefits. Additionally, Kawai and Wignaraja (*ibidem*:9) advocate introducing best practices of RoO administration, such as the possibility of self-certification, training and assisting small- and medium-sized companies in applying for the certificate of origin, and computerising the application process. Conducted fieldwork research has confirmed these findings. Chapter 3 demonstrates that above-mentioned suggestions are the preferred solution for the Japanese industries.

[49] Chapter 3 discusses ways to harmonise RoO preferred by the Japanese MNCs.
[50] The co-equal rule will be discussed in Chapter 3.

2.5 Conclusions

This chapter aimed to provide a broader definition of FTAs: comparison with other types of market organisation, possible differences in depth and scope, and the relationship with the global multilateral trade liberalisation process under the WTO. It also presented an overview of the reasons for FTAs recent proliferation and terms which will be used to identify and explain preferences for bilateral, minilateral and region-wide FTAs in the following chapters. Finally, the chapter explained the spaghetti bowl concept and outlined the multilateralising bilateralism debate. Understanding the various types of barriers to trade FTAs remove, the advantages of such treaties, problems with their harmonisation, and the complexity of rules of origin, provides a necessary context for answering the research questions. In particular, the chapter offers a basis for discussion on two pivotal issues: 1) what would be the difficulties in harmonising various levels of FTAs in East Asia from Japan's perspective?; 2) how do those difficulties and the existing complex network of preferences and RoO influence domestic groups' preferences for a region-wide agreement? These questions will be answered in Chapters 3 and 4. Each of the proposed region-wide FTAs in the East Asian or the Asia-Pacific region coexists with a number of already functioning treaties. Japan's FTAs with ASEAN members coexist with an overarching ASEAN-Japan FTA. This provides a precedent that can serve as a possible solution in dealing with similar situations in the future. In order to sign broader agreements Japan must decide how to deal with the regulatory maze of overlapping treaties. Chapter 4 analyses the country's approach to coexisting agreements.

Chapter 3

Preferences Regarding Japan's Bilateral and Minilateral FTAs

3.1 Introduction

This chapter discusses Japan's bilateral FTA policy, as well as the ASEAN-Japan Comprehensive Economic Partnership (AJCEP). First, it provides a short and general overview of the post-war Japanese economic development, with particular attention given to the establishment of the international production networks of Japanese corporations and agricultural cooperatives as the main domestic interest groups involved in FTA policy. It discusses the circumstances under which the key industrial sectors developed. These are: the electronics and automotive sectors, the iron and steel sector, as well as the textile and chemical sector. The FTA preferences of these four sectors are discussed throughout the thesis. Secondly, the chapter analyses the factors behind Japan's interest in bilateral trade agreements and the initial stages of FTA policy formation. It presents governmental and industrial preferences regarding bilateral trade agreements, as well as the role played by competition with Korea and China. Thirdly, the 'failed' FTA negotiations with Korea and Australia illustrate the constraints of Japan's FTA policy. Fourthly, current issues of bilateral policy, such as Japan's interest in negotiations with the EU, are discussed. The chapter concludes with an analysis of domestic preferences regarding a minilateral FTA with Association of the Southeast Asian Nations (ASEAN) and its usefulness for Japanese industries. The analysis presented in the following parts of the thesis will draw heavily on the conclusions of this chapter.

3.2 A Short Overview of Japan's Post-1945 Economic Development

Following the peace treaty signed in San Francisco in 1951, the Yoshida Doctrine allowed Japan to focus its efforts on industrialisation and economic recovery, while relying on the US for military protection (Jansen 2000:703). Faced with the threat of communism in the region, the US promoted Japan's economic recovery (*ibidem*:727). Japan enjoyed access to the American market, as well as its technology and know-how, mainly in the electronics and machinery sectors (Bossak 1990:58). In addition, the civil war in Korea (1950-53) helped to boost the Japanese economy as the US purchased Japanese machinery and equipment (Beasley 1995:226). Those favourable external conditions were coupled with domestic policies. In 1949 the Ministry of International Trade and Industry (MITI hereafter referred to as the Ministry of Economy, Trade, and Industry, METI)[51] was established. It played a crucial role in Japan's post-war economic development. Until the 1970s it oversaw the realisation of the main national goal – rapid economic recovery and industrial growth (Mikanagi 1996:22). The economic recovery was to a great extent state-led and based on comprehensive national economic plans (Sheridan 1993:147). In 1955, the Liberal Democratic Party (LDP) was created. Until the 2009 election, the party enjoyed over half a century of almost uninterrupted power in government, which provided favourable conditions for long-term economic planning.

In the 1950s, Japan entered a period of fast economic growth, which reached a rate of 13.2 percent in 1960, causing the following decade to be frequently referred to as the 'economic miracle' (Bossak 1990:28). Throughout the 1960s, Japan's economy grew on average over 10 percent per year[52]. The LDP's government directed a substantial amount of Japan's budget toward investment (*ibidem*:29). During the 1960s and 1970s the domestic economic policy focused on "public works and public works' spending, which was 'the driving force of growth'" (DPJ 2010b:1). This was accompanied by various forms of government participation in economic activities. The high growth level was achieved by increasing exports, as well as the modernisation and the increasing competitiveness of the Japanese economy (Bliski 2003:5). The government started to promote exports in the 1950s. Since 1953, Japan has implemented special tax exemptions for large companies, which was supposed to facilitate economic expansion (Bossak 1990:105). Emerging and developing companies received support and protection against foreign companies from METI (Beasley 1995:247). In addition, special regulations and funding was available for companies in so called 'key industries'- the sectors which the government considered strategic. They were supported by a wide array of "industrial policies including subsidies, policy finance and active technology infusion from the western countries" (Yoshimatsu 2003:87). The government aimed to increase the productivity of these sectors by large-scale investment and modern technologies (Sheridan 1993:133). It offered subsidies and tax

[51] In 2001 MITI was reorganised into METI.

[52] Data taken from the Statistics Bureau's web page, Chapter 3 Economy, Ministry of Internal Affairs and Communications, Available from: http://www.stat.go.jp/english/data/handbook/c03cont.htm, Accessed January 2012.

encouragements for increasing the use of competitive technologies in order to promote competitiveness (Jansen 2000:729). In the first post-war decade, the government directed the majority of funds to the coal and steel industries in order to increase production (Sheridan 1993:137). In 1960, Prime Minister Hayato Ikeda's National Income Doubling Plan was implemented. It aimed to double the national income within ten years by, amongst other things, the promotion of exports, the control of imports, and support for the development of heavy industries and the chemical sector (Tsuda 1990:22). These sectors had "capital-intensive production methods which were dependent on modern technology" (Sheridan 1993:149). Other industries considered strategic were synthetic fibre manufacturing and textiles, the chemical sector including fertilisers, as well as petroleum refining, petrochemicals, industrial machinery, and the electrics and electrical machinery sectors (Sheridan 1993:133). Large-scale plants, producing high-grade steel, amongst other things, were established on the coasts of Japan and the country became the leader in shipbuilding (Jansen 2000:728). Increasing productivity was supported by the control of imports. While the Japanese economy expanded, first through exports and then from the 1970s onwards through the liberalisation of outward foreign direct investment (FDI), the domestic market was heavily protected, initially by tariffs and then increasingly by non-tariff barriers. Japanese importers supported domestic production and did not import products, which would compete with local ones (Jansen 2000:729). With the government's support, the financial sector, the banks in particular provided funds for certain companies despite their weak performance (Kima *et al.* 2004:7). Such "uncompetitive industries, i.e. domestic market orientated manufacturing and service industries, were allowed to survive by protection and subsidy" (Gyohten 2003). Pohl (2005:1 cites Katz 2002) mentions Katz's reference to the Japanese 'dual economy', with some sectors enjoying a high level of protectionism and regulation and at the same time little competition. The bubble economy is considered to have begun in 1986 (Bossak 1990:30). In the early 1990s the asset-price bubble burst commencing over a decade of economic slow-down, often referred to as the 'lost decade'.

In the post-war period, a close cooperation between Japanese corporations, the LDP and bureaucracy supported economic development. This is often referred to as the 'iron triangle' or 'the ruling triad' (Carpenter 2003:61). Such strong links between the private sector and the government date back to the Meiji era and the *zaibatsu* – family-run corporations centred on private banks (Tsuda 1990:19). They were dissolved after the World War II by the Supreme Commander of the Allied Powers (SCAP). Soon they re-emerged as *keiretsu* - groups of companies organised around banks, such as Mitsubishi, Mitsui, and Sumitomo. The *keiretsu* were first formed as a close connection between a business, a bank and other companies of a similar profile. These were horizontal *keirestsu*. In the late 1950s, such companies started to establish a network of suppliers and contractors and formed vertical *keiretsu* (Bossak 1990:25): for example, Toyota's cooperates with two companies manufacturing auto parts, Denso and Koito, which sell 100 percent of their products to Toyota regardless of price competitiveness (Bliski 2003:6). Such close connections were supported by cross-shareholding amongst big companies and banks, which approximated 70 percent in the 1990s (Drifte 1996:43). *Keiretsu* helped to control the quality of the products. The close links between the ruling triad were further strengthened by the practice of *amakudari* (descent from heaven). Upon retirement bureaucrats took up positions on companies' governing boards. Businesses gained access to information and preferential treatment in government contracts, while the ministries obtained some level of influence over the private sector. The bureaucrats also often ran for political positions. Mikuni (1998) argues that those links made it hard for Japan to reform its economy against the will of one of those parties. He explains that the financial system in Japan benefited well-connected companies, which enjoyed privileged tax rates. Mikanagi (1996:22) refers to the 'elitist model', where the power is concentrated within the ruling triad. In this model the bureaucrats, mainly from METI, made decisions on economic policies in consensus with and supported by the other two groups. Mikuni (1998) stresses that the Diet of Japan and politicians are not the source of the country's policy - their role is to "formalise what is decided by the bureaucracy". Chalmers Johnson (1995) calls this system the 'developmental state'. He particularly stresses the role played by METI bureaucrats and how they designed industrial policy to promote fast economic growth. The 'iron triangle' and the links between METI and corporations were reinforced by the system of 'administrative guidance'. In the 1960s, the Ministry used this informal practice as one of the main tools for implementing industrial policy. Under 'administrative guidance' the Ministry had the authority to issue directives, requests and suggestions to companies under its jurisdiction. Schaede (1995:301) explains that under the system "administrative agency acts within its scope of jurisdiction in order to induce specific behaviour with the aim of realizing an administrative goal through industry cooperation". Such communicates where not legally binding but relied on the "government-business relationship established since the 1930's, respect for the bureaucracy, the ministries' claim that they speak for the national interest, and various informal pressures that the ministries can bring to bear" (Johnson 1982:266). The companies which did not comply with METI's directions could expect to face retaliation (Schaede 1995, Johnson 1982). According to Johnson (1982:265) "the institution of administrative guidance has done more than any other Japanese practice to spread the belief around the world that the Japanese government-business relationship is based upon some underlying, possibly culturally derived, national mores that have no parallels in other countries". The example of 'administrative guidance' demonstrates the importance of unofficial and informal communication channels between corporations and the government. This subject will be explored further in Chapter 5.

Due to decreasing production costs and increasing productiveness, as well as a favourable exchange rate, in the years from 1955 to 1974 Japanese products became competitive in terms of price (Bossak 1990:37). This caused a persistent trade surplus. This surplus and Japan's particular industrial policy, which protected and supported companies in industries considered strategic, caused trade disputes with other countries, for example the US and the EU (Beasley 1995:265 and Bossak 1990:37). Throughout the 1960s and 1970s, the structure of Japanese exports changed. Textile and textile-related products, which gained competitiveness through the improvement of the production of synthetic materials, no longer dominated exports. In the 1970s they were "matched, and then far exceeded by the products of heavy industry, of which automobiles were an important part" (Jansen 2000:731). In this period Japan started to develop knowledge-intensive industries. Imuta (1994:585) points out that during the 1970s Japan's car output doubled and the country was the world's largest automobile producer. At the same time, it became a leading manufacturer of several knowledge-intensive electronic products such as TVs. The focus on high-tech industries was strengthened by the Plaza Accord of September 1985 and the realignment of the Yen (JPY) to the US dollar (USD). The dollar depreciated against the appreciating JPY, making Japanese products expensive in the American market. Companies in the labour-intensive industries were not able to enhance their productivity and hence lost competitiveness (Imuta 1994:583). As a result, technological development became a new source of competitiveness in international markets. Imuta (1994:584) writes that in "knowledge-intensive advanced technology industries (...) vigorous R&D and large-scale investment in state-of-the-art equipment raised labour productivity". In addition, after 1985, manufacturing goods in Japan was no longer profitable for many, especially labour-intensive industries. FDI, tightly regulated in post-war Japan, was gradually liberalised and Japanese companies started to move their production networks to other countries in the 1960s and 1970s. In the 1980s, in what was known as the second economic miracle after the fast economic growth of 1960s, the number of FDI increased rapidly (Beasley 1995:252).

Although Japanese companies, even today, prefer to manufacture core parts and components within Japan, they have continued to move their production base outside the country. Thus, they established vertically integrated production networks, through "breaking up the production process into various sub-processes and locating each process in a country or a region where the sub-process is conducted most efficiently through active foreign direct investment" (Urata 2008a:9). To do so, Japan initially targeted the newly industrialised economies (NIEs) - Hong Kong, Korea, Singapore, and Taiwan and then the selected ASEAN countries. Until 1993 Malaysia, Taiwan, Singapore and Thailand constituted two-thirds of all Japanese affiliates in Asia (Ernst 2000:83). Japanese companies have had many links with the rest of Asia and a strong presence in the region since the late 19th century. However, the great majority of Japanese FDI to Asia was not in the manufacturing sector: according to Mason (1996:19) there were nine manufacturing FDI projects in East Asia, of which four located in Thailand. The Japanese production networks established in the ASEAN countries were then extended to China in the late 1990s. The core of this network shifted from the NIEs to Thailand, Malaysia and Singapore in the following years. A large number of those companies were in the electronic and electrical appliance sectors, or the machinery and the automotive sectors. As these networks developed, Japanese companies became interested in improving the business infrastructure in host states, and the strengthening of ASEAN's economic integration, which would facilitate trading within the Association[53]. Balboa (2010:3) from the Philippine Institute for Development Studies explains that "the establishment of regional production networks and supply chains by multinational corporations (MNCs) (...) became known as 'Factory Asia' (Soesastro 2006)". A triangular trade has developed in several sectors: parts from Japan and newly industrialised economies (NIEs) are exported to China and ASEAN countries, from where, after assembly, they are exported to the US and Europe (Utara 2008:7).

In the rural areas the situation was different. The Japanese Central Union of Agricultural Cooperatives, *Nokyo*, also known as the *JA-Zenchu* (Japan Agricultural Cooperatives) emerged as one of the most powerful lobby groups in Japan (Kawagoe 1995:220). *JA-Zenchu* was established in the post-war era, during the US' occupation. Today, it has local branches in most villages and towns. The *JA-Zenchu's* Deputy-

[53] Interview no. 8.

General Manager explains that agricultural cooperatives are a specific domestic interest group, mainly because they do not only represent farmers but also own various businesses[54]. Aurelia George Mulgan (2001:2) explains that although the *JA-Zenchu* is not the only organisation that speaks for the farmers it "is the dominant farmers' group, with an almost universal farm membership and an all-encompassing role in the economic, social and political lives of farmers". In the rural areas the *JA-Zenchu* performs various types of services including banking and funeral services. Most farmers depend on these services. Cooperatives are exempt from Japanese anti-trust laws. For example, the share of fertilisers sold by *JA-Zenchu* amounts to almost 80 percent of the total fertilisers sold in Japan, making them the largest provider in the country[55]. After the Great Depression in 1929-39, the agricultural areas suffered an economic crisis. The Japanese government asked the Ministry of Agriculture to establish an agricultural cooperative in each town to sell products on behalf of the farmers but also, for example, to purchase fertilisers and machinery, lend money or keep money deposits[56].

Under the Food Control Law from 1942, local cooperatives were used to collect rice from farmers. Rice was distributed evenly to customers in order to control and protect prices. At the time, Japan suffered from a food shortage and the government wanted to prevent a situation where food would be sold on the black market at extremely high prices, available only to the rich[57]. In the post-1945 period, the agricultural cooperatives continued to gain privileges. As the majority of farmers grew rice, their operations were focused around its gathering and selling. In 1961, the Agricultural Basic Law was passed. It aimed to reduce the income gap between farmers and industry (Yamashita 2004). The food shortage was no longer an issue and the agricultural cooperatives asked the government to increase the price of rice. In the 1960s, the price of rice was artificially increased by 9 percent annually (Yamashita 2009:623), making it cheaper to produce rice part-time than to purchase it at a market price. The farmers' price was increased, while the consumers' price was maintained at a rate lower than the purchasing price. The difference was paid by taxpayers. The agricultural cooperatives profited from the increased price of rice. In the post-war era *JA-Zenchu* handled 95 percent of all rice transactions and set the prices for rice (Bullock 1997). Hence they were able to obtain higher margins in transactions and to sell fertilisers or machines at a higher price.

[54] Interview no. 23.
[55] Interview no. 11.
[56] *Ibidem.*
[57] *Ibidem.*

According to Bullock (1997), *JA-Zenchu* functions as a quasi-state *keiretsu*, with its own trading company, *Zenno* (National Federation of Agricultural Cooperative Associations), bank (*Norin Chukin*), and local branches. In 1991, *Zenno's* total sales "would put it about fifteenth on the Fortune 500 list, second in Japan only to Toyota and equal to Hitachi" (*ibidem*). There are around 2.6 million farmers in Japan, and a high percentage of them (about two-thirds) are 60-65 years old. According to a February 2010 survey (*Japan Press Weekly* 2010) the average age of those farmers is 65.8 years old. Over the last 40 years, the share of agriculture in Japan's overall GDP dropped from 9 to 1 percent, while food self-sufficiency dropped from 79 to 39 percent (Yamashita 2009:622). At the same time, the number of part-time farmers (households) rose from 30 to 70 percent and the number of farmers over 65 years old rose from 10 to 60 percent (*ibidem*). In the rice sector, in particular, many of the farmers work part-time. The number of farmers impacted the level of political pressure that cooperatives could exercise on the government. The links between the LDP and the rural areas are rooted in history. Dent (2006:83-84) explains that they originate from "an alliance formed with the daimyos, rural-based magnates who dominated much of the country from about the 11th to the 19th Century" and continued throughout the 20th Century. This results in a strong "sense of political obligation to the farmers" (*ibidem*). Therefore, the rural areas were the political support base behind the LDP. Part-time farmers were additional voters that agricultural cooperatives could offer to the LDP politicians to persuade them to influence the government to raise the prices or offer them bail-out money in the case of financial difficulties. In addition, due to the specific electoral system rural areas were overrepresented in the Diet as the "rapid industrialisation brought with it very large migration from countryside to city, and the reallocation of Diet seats lagged far behind the facts of demographic distribution" (Jansen 2000:721). The agriculture, fishery and forestry sectors, as well as smaller industries such as the footwear and leather products sectors are traditionally considered to be the most sensitive and are thus strongly protected (MOFA 2005:6). To protect these products Japan uses price support or border protection measures, such as import quotas. Kawagoe points out that trade in those products is controlled by semi-governmental monopolies (1995:220).

3.3 Japanese's Ministries Preferences for Bilateral FTAs

3.3.1 Japan's Shift from a Multilateral Trade Policy to a Multi-layered One

Japan was a latecomer when it came to FTAs. In the 1970s and 1980s Japan's foreign trade policy was focused around investment and exports to developed countries and trade imbalance frictions, mainly with the US. It escaped from this situation by embracing the newly established World Trade Organisation (WTO). In the 1990s, Japan's trade policy was concentrated around the organisation and the idea that rules on trade should be decided and implemented multilaterally[58]. Japan believed that "the renunciation of unilateral trade measures in the WTO Dispute Settlement is one of the most important rules of the WTO" (WTO 1999:273). This is because Japan suffered from other states' unilateral actions. For example, the US threatened to impose sanctions on Japan under Section 301 of the 1974 US Trade Act[59]. Section 301 allows the US to declare a country's trade practices unfair and to undertake unilateral action to retaliate against them. In the opinion of METI's Director, as the number of members increased Japan found it increasingly difficult to negotiate with the US under the WTO and endorse or pass new, favourable regulations within the organisation[60]. Nonetheless, by the mid-1990s, Japan still saw the open regionalism and trade liberalisation under the WTO or another forum based on the most favoured nation principles as an optimal solution (Terada 2007:11).

The Japan External Trade Organisation (JETRO 2009:108) assesses that Japan's FTA strategy can be traced back to the second half of 2000. A former advisor of Japan's permanent delegation to the Organisation for Economic Co-operation and Development (OECD) who is also a former Ministry of Foreign Affairs (MOFA) employee explains that the shift towards a multi-layered policy started in the late 1990s[61]. METI's former Vice-Minister for International Affairs, Hidehiro Konno (2009:21), quotes Kaoru Yosano, the Minister of International Trade and Industry, who in a speech entitled *'The Prospects and Challenges of Japanese Economy'* at the Yomiuri Conference on November 11, 1998, said:

"There are things called free trade agreements (FTAs), which are

[58] Interview no. 2.
[59] Interview no. 3.
[60] *Ibidem.*
[61] Interview no. 46.

adopted by many countries except Japan. It is great that the WTO was established but it will take some time to accomplish the global free trade. In the meantime I think Japan as an internationalised nation should come to grips with FTAs".

According to Konno (*ibidem*), this was the first official statement regarding FTAs by a Japanese government official and the beginning of a shift in foreign trade policy. He explains that there had been an internal debate on the subject of FTAs within METI in the second half of 1998. It included an "intensive study on the history, politics, and economics of the ongoing FTAs in Europe and North America, as well as in other developed and developing nations" in the summer of 1998 (Konno 2009:23). This is confirmed by Dent (2006:77) who points out that METI's (1998) *'White Paper on International Trade'* published in the first half of 1998 spoke of the dangers and negative effects of FTAs, for example the discrimination of non-members through non-tariff barriers such as rules of origin. Dent (*ibidem*) then explains that as a result of internal discussion later that year METI Trade Policy Bureau proposed to explore the idea of FTAs. Konno (2009:24) also recalls that it was METI, and in particular the Trade Policy Bureau, which, due to "internal research and self-reflection in the trade bureaucracy" initiated the policy shift. This is an important conclusion as, from then on, the Bureau continued to drive forward Japan's FTA policy. METI's (1999 Chapter 3:2) 1999*'White Paper on International Trade'* stressed the possible positive aspects of liberalisation under free trade agreements. Dent (2006:78) comments that this "marked an important turning point in Japan's trade policy". The country turned towards a two-track approach to trade liberalisation, known also as a multi-layered foreign trade policy, whereby it supported the progress of the WTO's Doha Round and pursued bilateral solutions at the same time.

In a document entitled *'Challenges for the Upcoming WTO Negotiations and Agenda for Future Japanese Trade Policy'* (1999:section 3) the Japan Business Federation (*Nippon Keidanren* hereafter *Keidanren)* reaffirmed the need to strengthen efforts for concluding bilateral agreements. The organisation (*ibidem*) considered FTAs important "in terms of the foreign business activities of Japanese companies" and, amongst others, their "potential to strengthen Japan's negotiating power in, for example, the upcoming WTO negotiations". According to Nakagawa (2008:8) this convinced METI that FTAs could be a beneficial supplement to liberalisation under the WTO. However, *Keidanren's* document was published a year after Minister Kaoru Yosano's speech and the debate within METI. The Ministry's *'White Paper on International Trade'* (2000a) mentioned the economic impact of FTAs in North America (NAFTA), Europe (EFTA and the EU), as well as ASEAN's FTA (AFTA) and the EU-Mexico bilateral FTA. Finally, the Ministry published *'The Economic Foundations of Japanese Trade Policy – Promoting a Multi-Layered Trade Policy'* (2000b). The document concluded that "regional integration involving Japan is in line with economic realities, while progress in other regions and economic analyses suggest that it would also offer economic profit" (*ibidem* Chapter 3:15). It listed concluded bilateral investment treaties (BITs) (8 in 2000) and bilateral FTAs, considered or under study (with Korea, Singapore, Mexico and Chile), as examples of such 'regional integration' in addition to Japan's participation in the Asia-Pacific Economic Cooperation (APEC). Therefore, the document advocated the establishment of a three-track trade liberalisation policy: 1) the WTO, multilateral layer; 2) regionalism, for example APEC; and 3) bilateral relations with the US, the EU and East Asia[62]. The Director for FTA Affairs at METI's Trade Policy Bureau believes that the shift was a gradual process resulting from observations of developments outside Japan[63]. He explains that since 2000 the Japanese government has increased the number of staff working on FTAs at the expense of those working on the WTO. In 2002, MOFA established an economic partnership agreement unit to deal with the increasing number of studied and planned FTAs (Toh 2007:1). In those early years, there was a slight difference of opinion between MOFA and METI regarding trade liberalisation policy. A Managing Director of the Japan Association of Corporate Executives (*Keizai Doyukai*[64]) explains that MOFA supported participation in the WTO rounds as the cornerstone of Japan's trade policy[65]. METI, on the other hand, wanted to explore the bilateral route. In time, MOFA changed its position due to the continuing lack of progress of the WTO process and the constant pressure from METI[66]. Konno (2009:24) recalls that METI was convinced that Japan should change its policy, which he described as being "passive bilaterally, regionally, as well as multilaterally" and start showing initiative in the FTA process.

In 2002, the Ministry of Foreign Affairs (2002) published its first official document regarding FTA policy, entitled *'Japan's FTA Strategy'*. It was drafted as a result of MOFA's internal discussion. Although representatives from the Ministry of Finance

[62] Kawai and Wignaraja (2007:6) refer to a three-track approach to liberalisation involving: 1) the WTO and trans-regional solutions such as APEC, 2) regional fora and 3) bilateral treaties.
[63] Interview no. 3.
[64] The organisation will be discussed in detail in Chapter 5.
[65] Interview no. 23.
[66] *Ibidem.*

attended the meeting, no consultations with other ministries have taken place. For that reason, the document has been referred to by some governmental officials and scholars as 'MOFA's FTA policy'[67] or even 'MOFA's agitating paper'[68]. It acknowledges the importance of strengthening the economic partnership with ASEAN and establishing FTAs with Association members. The document clearly explains why East Asia was the main focus of Japan's FTA policy: it was "the region where Japanese products account for the highest percentage of trade", which also "has the highest tariffs" (*ibidem*). Another MOFA document, *'Basic Policy towards Further Promotion of Economic Partnership Agreements (EPAs)'* (2004), was approved by the Council of Ministers on the Promotion of Economic Partnership. Drafted two months after the signing of Japan's second FTA, an agreement with Mexico, it aimed to formulate a general policy and principles for prospective trade agreements. According to the Director of MOFA's EPA/FTA Policy Division the purpose of this document was to explain the ideological premises behind Japan's FTAs[69]. However, the document merely outlined the direction of the strategy. Until November 2010, when the current government, the Democratic Party of Japan (DPJ) published *'Basic Policy on Comprehensive Economic Partnerships'* (2010a), the 2004 document was the government's only official document on FTA strategy[70]. This has caused some Japanese scholars to argue that the LDP party did not have clear preferences in relation to FTA strategy[71].

The initial evolution of Japan's FTA policy can be observed in the terminology used in official documents. METI's document promoting multi-layered policy (2000b), as well as MOFA's *'Japan's FTA Strategy'* (2002) spoke of FTAs. Later documents, such as the MOFA (2004) document, used the term Economic Partnership Agreements (EPA). This change denotes a forming commitment to a comprehensive approach to FTAs that exceeds trade liberalisation issues. As explained in Chapter 2 of this thesis, EPAs include WTO-plus elements and go beyond tariff elimination. This approach is consistent with Japan's efforts to include broad liberalisation issues in the WTO's negotiations[72].

The fieldwork indicates another important reason behind Japan's choice to name its FTAs as EPAs. In 2002, Japan's most favoured nation (MFN) tariffs on industrial goods

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[67] Interview no. 60.
[68] Interview no. 12.
[69] Interview no. 9.
[70] The 2010 document will be further discussed in Chapter 5.
[71] Interview no. 50.
[72] For example, Japan opted for an establishment of "a comprehensive agreement on investment" and considered the outcome of the round, the TRIMs Agreement, "to be inadequate" (Brooks *et al.* 2003 16-18).

were on average four percent and 41 percent of tariff lines were brought down to zero (Baldwin 2006:1457). As the manufacturing sector was already quite liberalised, the government was conscious of the fact that it had little to offer in terms of market access [73]. Instead, in exchange for lowering tariffs, Japan offered provisions on economic cooperation, support for small and medium size enterprises (SMEs), official development assistance (ODA), technical capacity building, and other kinds of assistance. It could be argued that Japan has been signing EPAs as way of increasing its bargaining power and attractiveness as an FTA partner – including comprehensive liberalisation provisions – to give the country more leverage in negotiations[74]. At the same time, bound tariff rates[75] for textiles and clothing were almost twice as high and for agricultural products almost seven times higher (Baldwin 2006:1457). They were considered to be sensitive sectors. MOFA's Director of the EPA/FTA Policy Division explains that from the beginning the government anticipated that Japan's FTAs would achieve a low level of liberalisation and that sensitive issues would not be included[76]. It considered making compromises in exceptional cases, for example to conclude negotiations at the final stage if a product was a deal-breaker. Yet, in the Director's view, Japan did not expect FTAs to cause a massive overhaul of its domestic policy. This is another important conclusion as, until 2010 when Japan considered joining the Trans-Pacific Partnership (TPP), the country had indeed not experienced such an overhaul. The Director for FTA Affairs at METI's Trade Policy Bureau explains that the government decided to sign EPAs before the agreement with Singapore was concluded[77]. According to his recollection, this was done for two reasons. First, it was caused by the anticipated inability to offer concessions in the agricultural sector. More importantly, the comprehensive scope of Japan's prospective FTAs was needed to improve the business environment in East Asian countries, which would be beneficial for Japanese companies. In METI's understanding, Japanese corporations would profit from trade agreements exceeding tariff liberalisation. Based on the concluded research (METI 2000b) the Ministry expected that provisions on the liberalisation of trade in services and investment would provide additional benefits. The document refers to a computable general equilibrium model analysis, which examined the economic effects of tariff reductions, the liberalisation of trade in services, as well as investment liberalisation and

[73] Interview no. 46 and 60.
[74] Interview no. 28.
[75] This is the maximum rate allowed by the WTO.
[76] Interview no. 9.
[77] Interview no. 3.

its impact. The comprehensive approach including all of the above aspects was found to bring vast economic benefits if applied by the WTO. The Ministry believed that the same would be true for FTAs. Having invested in East Asian countries, companies required an ability to transfer technology and their personnel, a stable investment environment and a strong intellectual property rights' (IPR) protection. According to METI's Director-General for International Trade Policy the government decided to call free trade agreements EPAs in order to stress their positive aspects, such as cooperation, rather than the liberalisation of tariffs, which might have caused protests from certain domestic groups[78]. From the Ministry of Finance's perspective, BITs were of more significance than FTAs[79]. Nonetheless, the Ministry supported taking a broader approach to FTAs. Japan's EPAs deal with investment protection and customs issues, both of which are of interest to the Ministry of Finance (MOF).

The four types of factors which help to explain the proliferation of FTAs in East Asia were described in detail in Chapter 2. Free trade agreements can promote bilateral trade, improve the FDI environment, or support domestic reforms (Urata 2010c). Arguably, competition with other states, both in terms of political influence and competitive advantage in foreign markets (international economic factors), was the driving force behind Japan's initial interest in FTAs and, as demonstrated in the following chapters, continues to impact the country's FTA policy. Chapter 2 referred to such inter-state politically or economically driven competition as isolation avoidance, retaliation, competitive liberalisation, and the domino effect. With the WTO's Doha Round making little progress, Japan's other option to keep up with global trends was to join the FTA trend. Isolation avoidance and the tit-for-tat factor, meaning signing of retaliatory agreements, were crucial in Japan's shift towards FTA policy. *Keizai Doyukai's* Managing Director explains that a series of meetings and discussions undertaken between 2000 and 2003 led the government to conclude that Japan should attempt to 'catch up' with the general FTA trend and take advantage of the opportunities the agreements presented[80]. The aforementioned 1998 speech by Kaoru Yosano (Konno 2009:21) hinted that other states' interest in FTAs is the reason that Japan should sign them as well. Both METI's *'The Economic Foundations of Japanese Trade Policy'* (2000b) document and MOFA's *'Japan's FTA Strategy'* (2002) clearly tied in the start of the multi-layered policy with the stalling of the WTO negotiations since the 1999

[78] Interview no. 6.
[79] Interview no. 12.
[80] *Ibidem.*

Ministerial Conference in Seattle and the proliferation of FTAs worldwide. The former document mentions the mushrooming of preferential agreements, including the formation of the EU in 1991 when the Maastricht Treaty was drafted, and the change of the US' trade policy to a multi-track approach with the establishment of NAFTA in 1994 (METI 2000b, Chapters 1 and 3). The government had become increasingly aware of the growing number of FTAs worldwide at this time and Japan's looming isolation. The financial crisis of 1997/98 demonstrated the interdependence between countries in the region.

At the same time, China started to play a more prominent role both in the region and globally, which, amongst others, caused Japan to rethink its foreign trade policy[81]. In 2000, Japan, China and Korea were amongst a small group of countries to had not signed an FTA[82]. Terada (2006:19 cites *Straits Times* 26 October 2000) cites Hisamitsu Arai, a METI Vice-Minister, who said that "if Japan were to rely only on the WTO, we will not be able to liberalise for the next few years until the next global round of trade talks; Japan will be left behind in terms of competitiveness". METI's Director-General for International Trade Policy confirms that the government realised that relying solely on multilateral solutions was insufficient and decided to sign FTAs due to the proliferation of such agreements in the region and worldwide[83]. According to Gilson (2004:88), Japan engaged in its first FTA due to a "growing trend towards establishing FTAs, rather than from a unilaterally developed decision that Japan needed such an arrangement with Singapore or any other state". The aforementioned METI (2000b) and MOFA (2002) documents clearly tie in the start of multi-layered policy with the pursuit of FTAs by the EU and the US. Research fieldwork for this thesis has indicated that, at the initial stages of Japan's FTA strategy, the industries did not lobby the government to sign free trade agreements to offset the negative effects of other states' FTAs. This is demonstrated throughout this chapter. A Consulting Fellow at the Research Institute of Economy, Trade and Industry (RIETI), Yoichi Sekizawa (2009) argues that the industries "put very little pressure on government to hit the FTA trail". On the contrary, he attributes the shift to China's interest in FTAs, as well as the growing number of such agreements worldwide, including Mexico's FTAs with the US and the EU. Therefore, it can be argued that the initial factor for Japan's interest in FTAs was competitive bilateralism and more importantly - isolation avoidance. This type of domino effect

[81] Interview no. 46.
[82] At this point Korea had already stared FTA negotiations with Chile. The first round of negotiations took place in December 1999.
[83] Interview no. 6.

(political or economic) seems evident in East Asia. The Japan-Thailand agreement was signed only a week after the Chile-Japan agreement, which in turn was concluded one day after the US-Korea treaty. One of the reasons behind the Japan-Chile FTA was the fact that Korea had already signed a similar agreement[84]. These are only a few examples from a long list of 'cause and effect' FTAs in the region.

3.3.2 Government's Preferences during the Negotiations of the First Two FTAs: with Singapore and Mexico

This section aims to outline the government's preferences at the initial stages of Japan's FTA policy. It focuses on certain issues that emerged during the negotiations of the first two agreements that have strongly impacted Japan's bilateral, minilateral, as well as region-wide FTA strategy. First, it continues the argument that the initial impulse for signing FTAs with Singapore and Mexico came from the government and not from the private sector. This is in accordance with the point made earlier that at the initial stages of Japan's FTA policy it was isolation avoidance and not economic competition which influenced the government's actions. Secondly, this section argues that it very quickly became evident that the agricultural sector's opposition to liberalisation is the main problem of Japan's FTA policy. As it was mentioned in the previous section, the government never intended to substantially reduce tariffs on sensitive products under free trade agreements. This issue remains unresolved and is just as crucial for Japan's participation in a region-wide FTA as it was in terms of bilateral agreements.

The two first FTAs, both formally announced at the September 1999 APEC Summit in Auckland, were preceded by discussions within the government[85]. According to the Executive Director at the Department of International Affairs at the Asia University, in June 1998 Noboru Hatakeyama, the then-Chairman and CEO of Japan External Trade Organisation (JETRO) and a former Vice-Minister for International Affairs met with Herminio Blanco Mendoza, at the time the Mexican Secretary of Trade and Industrial Development and a chief negotiator of NAFTA[86]. He explains that Secretary Blanco proposed a study of the Japan-Mexico FTA. Chairman Hatakeyama brought this proposal back to Kaoru Yosano, Vice-Minister for International Affairs at METI (1998-

[84] Interview no. 7.
[85] Interview no. 6.
[86] Interview no. 50.

99). This is confirmed by Konno (2009:25). In the same year Vice-Minister Yosano gave a speech at Yomiuri Conference, as discussed earlier. The feasibility study was initiated but was soon disrupted by a "disagreement over the Japanese proposal to exclude agriculture entirely from the negotiations" (Solis and Katada 2007:280). Also in 1998, Korea's newly elected president, Kim Dae Jung, approached Japan and suggested the establishment of new diplomatic relations between the two countries. The signing of an FTA was one of the ideas discussed under the *'Joint Declaration of the New Japan-ROK Partnership for the 21st Century'* (MOFA 2003:5) signed during a meeting between Prime Minister Keizo Obuchi and Korea's President, Kim Dae Jung, in October 1998 in Tokyo. Private-led studies conducted by the Institute of Developing Economies and its Korean counterpart, the Korea Institute for International Economic Policy (KIEP), started in 1998, and in 2002 a Joint Study Group was established[87]. Hence although the Mexican FTA proposal came earlier, the first feasibility study was the one with Korea. The Korea-Japan study was a private-led one, while the feasibility study for the Japan-Mexico FTA was conducted between JETRO and the Mexican Ministry of Economy (Secretary of Economy)[88]. In 1999, Singapore's government proposed to start a feasibility study for the Japan-Singapore FTA. In this case, the private-level study was omitted and the countries proceeded straight to the joint governmental study[89]. Singapore was chosen as the first FTA partner due to the lack of sensitive issues involved and complications in the Japan-Korea FTA discussions[90]. The country's market was already substantially liberalised, with around 99.9 percent of tariffs at zero rate. It is important to note that the Japan-Singapore FTA did not result from the industries' request or lobby efforts. In fact, out of 3,000 Japanese companies operating in Singapore, only six utilised preferential tariffs under JSEPA (Terada 2008:13 cites *Nihon Keizai Shimbun*, 25 June 2007).

METI's Director-General for Manufacturing Industries Policy argues that, from METI's perspective, Japan's FTAs can be divided into Manufacturing Industries Bureau-driven and Trade Policy Bureau-driven agreements[91]. METI's Manufacturing Industries Bureau is responsible for coordinating the preferences of the Japanese industries. The Bureau had a strong interest in signing agreements with other countries where Japanese companies had invested or were in a disadvantaged position due to

[87] The Japan-Korea FTA negotiations will be covered later in the chapter.
[88] Interview no. 50.
[89] *Ibidem.*
[90] Interview no. 6.
[91] Interview no. 7.

other states' FTAs. Hence, the Director-General explains that the agreement with Mexico, Korea, and later on with Chile and ASEAN's members, were all Manufacturing Industries Bureau-driven FTAs. On the other hand, the Trade Policy Bureau is responsible for Japan's overall trade policy and it wanted to build and expand the country's FTA network. In the Director's opinion, the Bureau was interested in increasing the overall number of Japan's FTA, in particular with developed economies and important markets. This has been confirmed by the Trade Policy Bureau's former Director for FTA Affairs[92]. The agreements with Singapore, Australia and Switzerland are examples of Trade Policy Bureau-driven FTAs in which the Manufacturing Industries Bureau had little interest. Therefore, Japan's FTAs can be divided into those supported by both Bureaus and those supported mainly by the Trade Policy Bureau, which does not directly represent Japanese industries and hence generally endorses all prospective FTAs[93]. The implications of this division for Japan's FTA policy formation process are further discussed throughout this chapter and in Chapter 5.

According to Konno (2009:25), at the initial stages of its FTA strategy, Japan faced two main problems. They were: an attachment to a multilateral framework and the agricultural sector's opposition to liberalisation. The latter issue is still a hindrance in Japan's current FTA negotiations, for example with Australia. In Konno's opinion, this was noticed by the Ambassador of Singapore to Tokyo, who as a result, in the middle of 1999, attempted to convince the Japanese side that Singapore was not interested in the liberalisation of the agricultural market. According to Terada (2008:12 cites Munakata, the senior METI official involved in the talks with Singapore), Singapore's officials visited the Ministry of Agriculture, Forestry, and Fisheries (MAFF) in November 1999 to confirm that agriculture would not be included in FTA negotiations. During meetings with other ministries, they assured the Japanese side that the bilateral FTA would complement WTO activities, thus reassuring Japan on both problematic issues. The Ministry of Agriculture did not object to the agreement[94]. As long as the FTA did not require further concessions on agricultural goods, MAFF did not have strong preferences on the subject. Similarly, the agriculture lobby group, represented by *JA-Zenchu* did not oppose the agreement, as Singapore was not an agricultural exporter[95]. The organisation's Deputy-General Manager recalls that from the beginning MAFF intended to exclude the whole agricultural sector from tariff liberalisation. Due to the

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[92] Interview no. 4.
[93] Interview no. 7.
[94] Interview no. 10.
[95] Interview no. 29.

low amount of initial trade in agricultural products between the two countries, the agreement was compatible with Article XXIV of the GATT. In practice, the agricultural sector was not excluded from the Japan-Singapore agreement but did not involve any additional concessions. Tariffs on products covered by the agreement were already zero percent.

The negotiations with Mexico were prompted by trade diversion concerns and Japanese companies' disadvantaged position in the Mexican market after the country had signed an FTA with the EU and joined NAFTA[96]. It was Japan's first FTA brought about by specific economic considerations, where the two sides often had conflicting interests and which demanded a substantial compromise on Japan's part. In the opinion of a former advisor of Japan's Permanent Delegation to the OECD and a former MOFA employee, negotiations with Mexico were the first 'real' test of Japan's FTA policy[97]. It was also the first Manufacturing Industries Bureau-driven agreement. Mexico applied high tariffs on many items. In 2001 the country's average tariff was 16.5 percent (Solis and Katada 2007:285). Manger (2005) argues that it was the private sector, especially *Keidanren*, who urged the Japanese government to start negotiations with Mexico. In his opinion, the automotive sector demonstrated its losses and asked the government to sign an FTA. According to Shujiro Urata (2008b:18), an FTA specialist and a former World Bank economist, Japanese companies pressured the government to sign an FTA with Mexico. However, the impression of one of the auto companies interviewed during research fieldwork was that the industry started to lobby for the agreement once the plans to start negotiations had been announced[98]. According to a senior manager in a multinational electronics corporation, during the initial stages of Japan's FTA strategy the government was unsure how to incorporate the industries' voice in the decision-making process[99]. For that reason, the companies did not actively express their preferences to the government. Hence despite the trade diversion effect and the deteriorating position of Japanese companies in the Mexican market, research fieldwork indicates that this agreement also resulted from the government's initiative and not the industries' lobby efforts which took place once it has been announced[100]. Over time business associations, such as the Japan Electronics and Information Technology Industries Association, *Keidanren,* and the Japan Chamber of Commerce and Industry,

[96] Interview no. 49.
[97] Interview no. 46.
[98] Interview no. 20.
[99] Interview no. 19.
[100] This was confirmed during interview no. 14.

started to partly fulfil this function. The Executive Director of the Department of International Affairs at Asia University also believes that at the initial stage of the FTA process with Mexico there were no lobbying activities from the private sector[101]. The agreement was initiated by the Mexican side and it took some time for any companies to become involved. According to a former advisor of Japan's Permanent Delegation to the OECD and a former MOFA employee the agreement with Mexico, similar to the one with Singapore, was a METI-led initiative[102]. At the time, the interviewee was a member of a trade policy committee at *Keidanren* and recalls that METI officials had asked the organisation to endorse the plan to start negotiations with Mexico, despite the fact that the committee members believed liberalisation under the WTO to be the right course of action. He argues that *Keidanren* started to support the agreement after JETRO initiated its feasibility study. Ravenhill (2009:14) confirms this finding. He points out that *Keidanren* published a document supporting such agreement only after the negotiations started. He lists further evidence (*ibidem*:15), which supports the idea that Japanese industries were not the driving force behind this FTA:

> *"First, the initiative for the PTA came not from Japan but from Mexico. Second, the initial response of the Japanese government was not to pursue a PTA but to offer the counter-proposal of bilateral investment treaty. Third, a JETRO survey concluded among Japanese subsidiaries in Mexico in the second half of 1999, after the initiative had been launched (Ogita 2003:244), found no company stating that it required a PTA to sustain its Mexican operations. Fourth, even though the public position adopted by Keidanren favoured a PTA, the business sector in Japan was by no means unified on the issue".*

In the opinion of the Managing Director of *Keizai Doyukai*, it is impossible to conclude that the government agreed to start negotiations with Mexico because of the companies' lobbying activities[103]. Overall, it took time for the industries to recognise the importance of lobbying the government regarding FTAs. In the early 2000s, when METI realised that Japan had been slow to get on the FTA bandwagon, it cooperated with MOFA to develop the framework for a multi-layered trade policy. During the negotiation process

[101] Interview no. 50.
[102] Interview no. 46.
[103] Interview no. 23.

of this first agreement the industries acknowledged the potential benefits of FTAs[104]. Therefore, although they did not initiate the agreement, it can be argued that it was signed with the Japanese companies' support.

The agreement with Mexico lowered tariffs on 600 Japanese forestry, fishery and agricultural products (Munakata 2006b:120). The country, with its big agricultural sector, was a difficult partner for Japan[105]. The chief negotiator of the Japan-Mexican FTA explains that for Mexico, which lacked a strong manufacturing sector, the opening up of Japan's agricultural market was the main motivation for negotiating the agreement, as the sector was a source of competitive advantage when it came to bilateral trade[106]. He estimates that agricultural products accounted for 20 percent of Mexico's exports to Japan, of which half was pork. The successful finalisation of the Japan-Mexico agreement proved to the private sector that Japan could sign FTAs even with agriculture exporting countries. This, amongst other factors, prompted the idea to start negotiations with Thailand and Malaysia. However, during the negotiations with Mexico, the Ministry of Agriculture recognised the potential significance of FTAs and started to pay attention to developments in this field. Similarly to METI and MOFA, the Ministry of Agriculture initially had a very limited understanding of FTAs and consecutive negotiations were a learning process[107]. The FTA with Singapore was concluded without additional concessions on agricultural products. The agreement with Mexico demonstrated that this was an exceptional case. Following discussions on JMEPA, MAFF strongly opposed trade liberalisation in the agricultural sector under this and all prospective FTAs[108]. Disagreement over trade in agricultural products, in particular pork but also beef, chicken, oranges, and orange juice, disrupted the FTA talks in October 2003 (Solis and Katada 2007:280). Finally, Japan's Prime Minister decided to proceed despite the agricultural sector's concerns and additional concessions were made on beef, pork, chicken, oranges, and orange juice[109]. Japan's cross-ministry conflict and bargaining during negotiations with Mexico is described in more detail in Chapter 5. The events leading to the signing of the Japan-Mexico FTA have caused other ministries and business circles to strongly criticise the agricultural lobby groups and have helped to build an image of the sector as being a stumbling block for Japan's FTA policy[110].

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[104] Interview no. 46.
[105] Interview no. 10.
[106] Interview no. 57.
[107] Interview no. 50.
[108] Interview no. 46.
[109] Interview no. 10.
[110] Interview no. 4.

3.3.3 Bilateral FTAs with ASEAN Members

Japan proceeded to sign bilateral treaties with ASEAN member economies. In this case, the fieldwork indicates that the main motivation behind the METI's interest in negotiating FTAs was private sector preference. In the opinion of the *Keizai Doyukai's* Managing Director despite the industries' support for bilateral FTAs with ASEAN members, the Japanese private sector remained far less active than its American counterpart, and its lobbying efforts were limited[111]. Nonetheless, as previously discussed, during the negotiations with Mexico, both METI and the Japanese MNCs gained experience in and an understanding of the FTA process. As a result, the companies became more active in expressing their preferences, using various communication channels, to the government. The agricultural sector continued to be the main hindrance in negotiating FTAs with ASEAN countries. Japan found a way to avoid a significant liberalisation of that sector and instead offered ASEAN members various provisions on cooperation. This was consistent with the initial assumption of the EPA approach that FTAs would not lead to a significant overhaul of Japan's domestic policy.

The Japanese government, in particular METI, had a clear idea of what it wanted to achieve in order to support Japanese multinationals' operations in East Asia: FTAs with other ASEAN countries. During the Japan-ASEAN Commemorative Summit in December 2003, discussions were held regarding bilateral FTAs between Japan and Thailand, Malaysia, and the Philippines, with which the country had particularly strong economic relations[112]. *'The Japan-ASEAN Plan of Action'* (2003:2), signed during the Summit, also spoke of accelerating the FTA process between Japan and ASEAN members. Between 2005 and 2008 Japan signed bilateral agreements with a further six members of the Association[113]. The driving force behind the FTA with Singapore was the Trade Policy Bureau[114]. Agreements with other ASEAN members states were motivated by a mixture of political and economic factors and were supported by both METI Bureaus[115]. While the Trade Policy Bureau has generally been in favour of signing as many FTAs as possible, the Manufacturing Industries Bureau, in particular, had vested interests in negotiating with ASEAN members. This is because such agreements were of great importance for Japanese MNCs, as will be demonstrated in this chapter. The Director-General of METI's Trade Policy Bureau explains that METI's

[111] Interview no. 23.
[112] Interview no. 57.
[113] This were: Malaysia, the Philippines, Thailand, Brunei, Indonesia and Viet Nam.
[114] Interview no. 7.
[115] Interview no. 46.

main intention behind FTAs with those countries was to secure supply chains in East Asia and thus ensure the functioning of MNC's production networks[116]. In his view, for the Trade Policy Bureau FTAs with ASEAN members were part of a regional integration process in addition to expanding Japan's FTA network. The interest and support of both Bureaus has facilitated the conclusion of agreements with ASEAN members, despite several difficulties and sensitive issues[117]. Nonetheless, the Director for FTA Affairs at METI's Trade Policy Bureau explains that during the negotiations of the first bilateral FTAs with ASEAN countries, the Ministry did not fully understand the implications of free trade agreements[118]. The day-to-day utilisation of FTAs by the private sector gave the Ministry a deeper understanding of the issue. It also showed the importance of non-tariff provisions, such as favourable rules of origin (RoO). As a result, over time, through communication with the private sector, the METI became aware of the growing need for including provisions for the harmonisation of procedures, regulations, and implementation modalities[119]. As will be demonstrated in Chapter 4, this is one of the most important issues when it comes to the industries' preferences regarding a region-wide FTA.

In the opinion of a Senior Research Fellow at the Institute of Developing Economies (IDE) there were three main reasons behind bilateral FTAs with ASEAN members[120]. First, this was further strengthened by competition with China, which had signed an FTA with ASEAN and was extending its influence in the region. Secondly, the government was aiming to tighten its links with what it considered its 'backyard countries', where Japanese companies have invested extensively. Finally, the government wanted to limit liberalisation in the agricultural sector and believed this would be easier to achieve under bilateral agreements compared to an FTA with ASEAN. As tariffs on industrial goods were already low, Japan offered various forms of cooperation in exchange for tariff liberalisation on FTA partners' products. MOFA's Director of EPA/FTA Policy Division argues that the country did not want to offer concessions in the agricultural sector and believed that including provisions on cooperation would allow concessions to be kept within each sector, i.e. concessions in the manufacturing sector in exchange for cooperation in the manufacturing sector[121]. Although in the Director's recollection, this was METI's and MOFA's preference, it was

[116] Interview no. 6.
[117] Interview no. 7.
[118] Interview no. 2.
[119] Interview no. 4.
[120] Interview no. 42.
[121] Interview no. 9.

not always possible. The Philippines argued that its concessions in the industrial sector were greater than the Japanese offer and requested additional concessions which would balance out the agreement. Hence they requested Japan to open parts of its labour market in which the Philippines had a competitive advantage. The country was asked to accept Philippine nurses and caregivers. MOFA's director explains that, although Japan was not ready to open up its labour market, it decided to accept the request in order to reach an agreement. The country, in particular the Manufacturing Industries Bureau, had a great interest in obtaining concessions in the automobile sector, which would allow Japanese companies to achieve a strong position in the local marketplace[122]. This is an example of cross-sector or cross-ministry bargaining, which is further described in Chapter 5.

According to MAFF's Director of the International Economic Affairs Division and a former official of the Agricultural and Development Economics Division of the UN the Ministry of Agriculture did not support but also did not oppose FTAs, as long as Japanese farmers did not lose their profits as a result of additional tariff reductions[123]. However, as in the case of Japan's first two FTAs, during the negotiations with ASEAN members, agriculture was the underlying cause of disputes between the negotiating sides. In the opinion of *Keidanren's* Deputy Director, opposition from the sector has created an impasse of policy and continues to hinder Japan's FTA network expansion[124]. MAFF's Director explains that this is because, from the Ministry's perspective, there are no possible benefits from FTAs[125]. In his view, the domestic market is sufficient for Japanese farmers and they have little interest in exporting abroad. In Japan, for instance, the price competitiveness of agricultural products is not an important factor. Production stability, food safety and high quality play a much more important role. Consumers prefer to buy more expensive products made in Japan as they fulfil safety standards. Hence Japanese agricultural products are competitive in terms of Japanese consumers' needs. Products, which Japan sells to China and Hong Kong, are characterised by high quality and high prices. As a result, export tariffs do not impede expansion into foreign markets. Some Japanese products such as eggs or poultry, are produced using inexpensive feed imported from the US and could compete in international markets. However, they are destined for a domestic market and despite competitive prices Japan

[122] *Ibidem.*
[123] Interview no. 10.
[124] Interview no. 24.
[125] Interview no. 10.

is not interested in exporting large quantities of those products[126]. As MAFF's Director of the International Economic Affairs Division argues, the Ministry believes that overall the foreign market for Japanese agricultural products abroad is not big enough to justify the abolition of tariffs in this sector[127]. At the same time, tariffs protect domestic producers from Chinese competitors.

For the Ministry of Agriculture, Forestry, and Fisheries (MAFF), the agreement with Thailand posed the biggest problem. The country is the world's largest rice exporter and Japan was reluctant to start negotiations without a mutual agreement to exclude this product from negotiations[128]. In addition, the country wanted to export other agricultural products, such as sugar and chicken. The *JA-Zenchu's* Deputy-General Manager recalls that during joint study group meetings, the organisation suggested offering provisions on development and cooperation to Thailand if it showed sufficient consideration for Japan's concerns regarding food security and sensitive products[129]. He explains that the organisation joined MAFF in lobbing the Thai Cabinet directly. As a result, Thailand agreed to exclude rice from the agreement and to provide special treatment for other sensitive products, such as sugar and starch. The agreement increased imports of agricultural products to Japan. However, this example demonstrates the strength of the Japanese agricultural groups and the special treatment they were able to secure in subsequent FTAs[130]. In comparison, Thailand did not sign the ASEAN-Korea FTA in 2006 with the other members of the Association mainly due to the lack of sufficient concessions on rice. In exchange for the exclusion of sensitive products, Japan offered Thailand provisions on agricultural cooperation and help in the industrialisation of its agricultural production. In addition, in the final stages of negotiations, Japan abandoned its request for the liberalisation of the Thai automobile market, while Thailand retracted its demands in the field of agriculture. *JA-Zenchu's* Deputy-General Manager explains that the organisation regarded Japan's FTA with Thailand as a model agreement for FTAs with other Asian countries[131]. He argues that Japan tried to replicate this model during negotiations with other Asian states, for example the Philippines and Indonesia. In each case, sensitive products were discussed. For example, the Philippines is a major exporter of pineapples. According to *JA-Zenchu's* Manager, in Japan, although the overall quantity of pineapples produced is

[126] *Ibidem.*
[127] *Ibidem.*
[128] Interview no. 41. At the time Japan's import tariff on rice was 490 percent.
[129] Interview no. 29.
[130] Interview no. 10.
[131] Interview no. 29.

small, the production is concentrated in Okinawa, causing the tariffs on this fruit to be a politically and socially sensitive issue[132]. Figure 3.1 shows the share of duty-free trade volume under Japan's FTAs. The percentage of liberalised tariffs is quite high. However, when taking into account the agricultural sector, it is evident that Japan's free trade agreements do not fully open up the country's market. Figure 3.2 demonstrates the share of duty-free tariff lines under Japan's FTA. It can be observed that the number of liberalised tariff lines oscillates around 85 percent in general and around 50 percent in the agricultural sector. These numbers indicate a firm commitment to excluding agriculture from tariff liberalisation.

[132] *Ibidem.*

Figure 3.1 Share of duty-free trade volume under Japan's FTAs

Origin of goods	Japan's offer	Agriculture	Partner's offer	Two-way trade
Singapore	94.7%	15.4%	100%	98.5%
Mexico	86.8%	45.1%	98.4%	96.5%
Malaysia	94.1%	56.4%	99.3%	99.3%
Chile	90.5%	72.9%	99.8%	92.0%
Thailand	91.6%	57.5%	97.4%	95.0%
Indonesia	93.2%	48.5%	89.7%	92.3%
Brunei	99.9%	...	99.9%	99.9%
ASEAN	93.2%	49.6%	90.7%	91.9%
Philippines	91.6%	42.6%	96.6%	94.3%
Vietnam	94.9%	83.8%	87.7%	91.5%
Switzerland	99.3%	62.0%	99.7%	99.0%

Source: MOFA, March 2010, Japan's FTA/EPA Current Status and Main Issues, p.15. Obtained during interview no. 9

Figure 3.2 Share of duty-free tariff lines under Japan's FTA

Origin of goods	Japan's offer	Agriculture	Partner's offer
Singapore	84. 4%	51. 8%	100%
Mexico	86. 0%	46. 3%	94. 3%
Malaysia	86. 80%	52. 7%	98. 6%
Chile	86. 5%	51. 7%	93. 0%
Thailand	87. 2%	54. 3%	98. 7%
Indonesia	86. 6%	52. 1%	88. 7%
Brunei	84. 6%	51. 9%	98. 9%
ASEAN	86. 5%	52. 1%	90. 3%
Philippines	88. 4%	59. 1%	98. 9%
Vietnam	86. 5%	53. 7%	71. 5%
Switzerland	85. 6%	51. 1%	79. 1%

Source: MOFA, March 2010, Japan's FTA/EPA Current Status and Main Issues, p.16. Obtained during interview no. 9

3.4 The Japanese Manufacturing Industry's Preferences for Bilateral FTAs

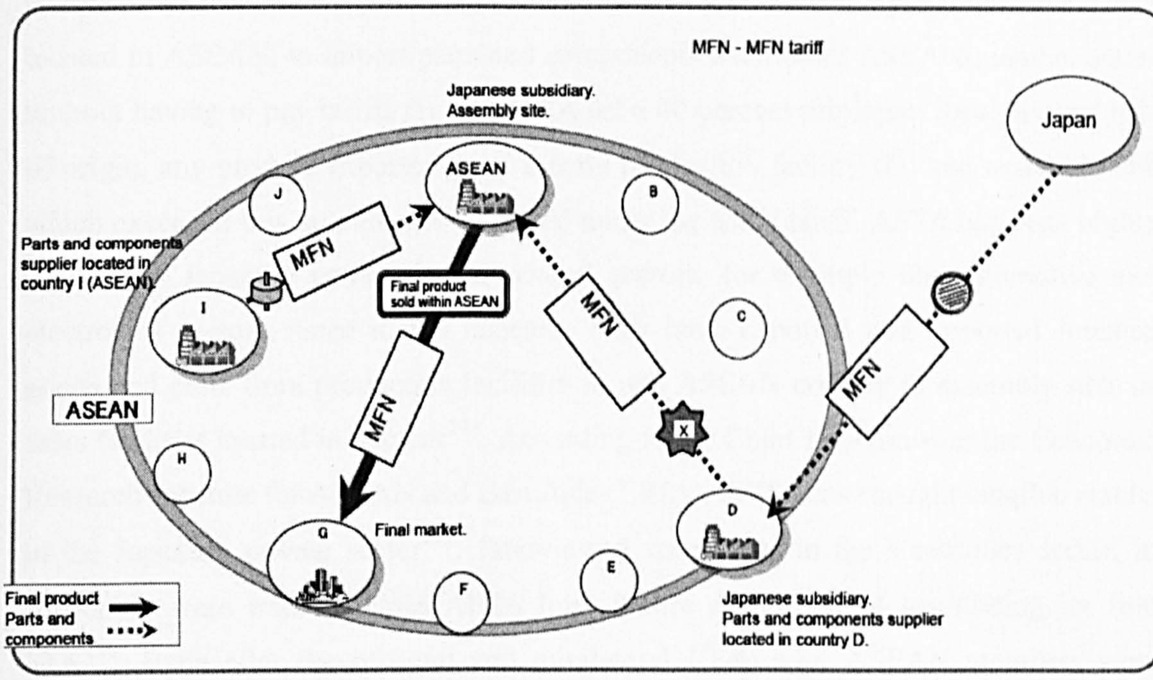
3.4.1 Situation Prior to Japan's First FTA

This section demonstrates how the manufacturing industry's preferences have shaped bilateral FTA policy. Multinational companies are the main clients of Japanese FTAs. A company decides to trade under preferential tariffs if: a) exported products meet the rules of origin of a given FTA; b) this product is not manufactured by the company locally; and c) if the MFN tariff for the product is significantly higher than the preferential tariff under the free trade treaty. In addition, companies use FTAs whenever the importer requests it. If the above conditions are not fulfilled, the company will not profit from a trade agreement. For that reason, preferences for bilateral FTAs can often vary between companies in the same sector, depending on the location of various stages of the manufacturing process, for example parts procurement and assembly. According to the Director-General for Manufacturing Industries Policy at METI's Manufacturing Industries Bureau, it is difficult to describe preferences of the private sector for bilateral agreements and both METI and MNCs have approached them on a case-by-case basis[133]. Nonetheless, certain generalisations can be made across the sectors.

Figure 3.3 presents the situation in East Asia before 1992, from the perspective of a Japanese MNC with a vertically integrated production network. A Japanese company, with a parts production facility (D) and an assembly site in ASEAN, had to pay the MFN tariff while exporting parts and components from Japan to its subsidiary in East Asia. Similarly, MFN tariffs needed to be paid while exporting parts from a Japanese parts and components supplier (D) to the assembly site located in another ASEAN member country, procuring parts and components from ASEAN suppliers located in another country (I) and while exporting the final goods to ASEAN markets (G). In the Figure, the dotted lines represent parts, components and intermediates while the solid lines represent the finished product.

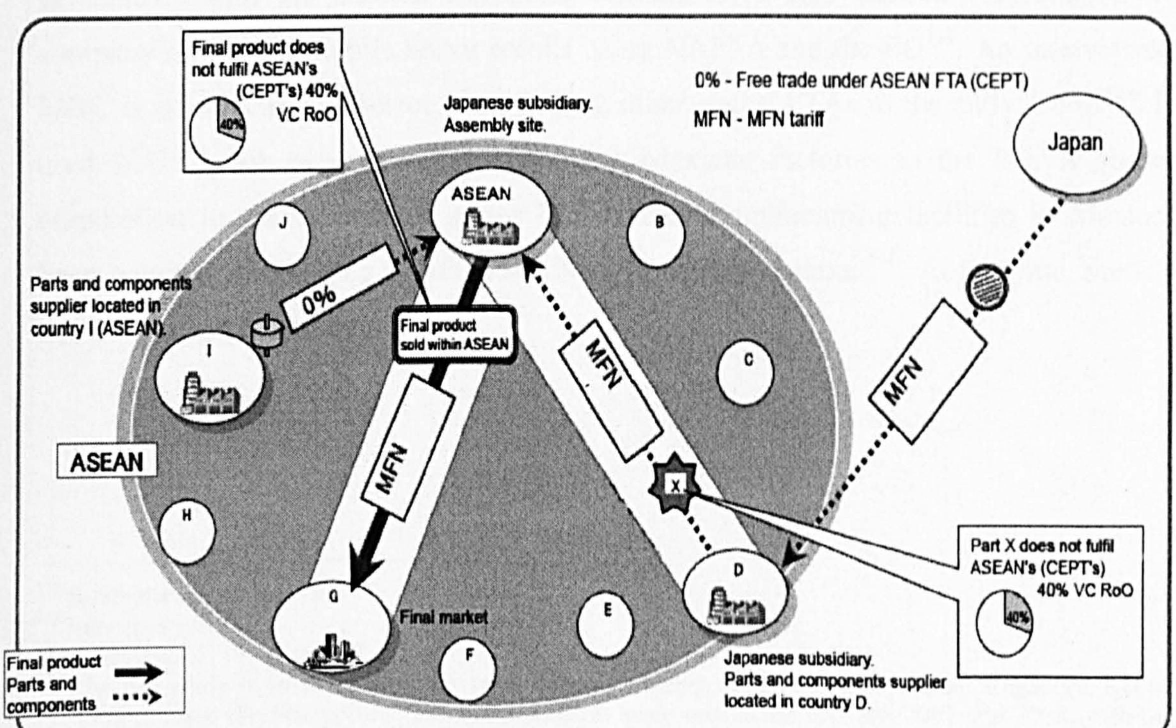
[133] Interview no. 7.

Figure 3.3 Japan's production networks in ASEAN before AFTA



Source: Translated and modified by the author, based on METI (2008)

Figure 3.4 Impact of AFTA on MNCs' production networks



Source: Translated and modified by the author, based on METI (2008)

Figure 3.4 demonstrates how the signing of the ASEAN Free Trade Agreement (AFTA) affected Japanese MNCs' production networks. AFTA allowed a Japanese assembly site, located in ASEAN, to import parts and components from other ASEAN member states without having to pay tariffs (I). As AFTA set a 40 percent minimum local content rule of origin, any product exported from a parts production facility (D) and assembly site which exceeded this amount was exported under the MFN tariff. AFTA has been highly utilised by Japanese companies in several sectors, for example the automotive and electronics sectors, since it was enacted. They have exported and imported finished goods and parts from production facilities in one ASEAN country to assembly sites or sales facilities located in another[134]. According to the Chief Economist at the Economic Research Institute for ASEAN and East Asia (ERIA), AFTA has brought tangible results in the Japanese private sector[135]. Interviewed companies in the electronics sector, in particular, were trading under AFTA long before Japan started negotiating its first FTA[136]. Even after the bilateral and minilateral FTAs with ASEAN members were concluded, Japanese companies continue to use AFTA to obtain parts and distribute final goods within ASEAN. According to two recent surveys (Kawai and Wignaraja 2009 and Hiratsuka *et al.* 2008a)[137], AFTA is the third most utilised agreement for Japanese companies. Other third-party FTAs, such as NAFTA and the EU or EU's agreements with the Eastern European nations, were also utilised before 2002. A company in the automobile sector recalls using NAFTA and the EU[138]. An interviewed MNC in the electronics sector started using other states' FTAs in the early 1990s[139]. It used NAFTA for exporting goods from its Mexican factories to the US. A global corporation in the electronics sector had several manufacturing facilities in Mexico, from which it was selling goods to the North American market[140]. At the time, the US had a 5 percent MFN duty on TVs.

[134] Interview no. 16 and 19.
[135] Interview no. 54.
[136] Interview no. 19, 15 and 17.
[137] The first study is based on a survey of 609 manufacturing companies from Japan, Singapore, Korea, Thailand and the Philippines. The questionnaires were conducted between 2007 and 2008, with the help of, amongst others, the Asian Development Bank (ADB) and Japan External Trade Organisation (JETRO). The second study comprises JETRO's 2006 large sample survey, with responses from 729 JETRO members, and a 2007 survey, with replies from 733 companies.
[138] Interview no. 20.
[139] Interview no. 16.
[140] Interview no. 19.

3.4.3 FTAs with Singapore and Mexico

As previously mentioned, Singapore's tariffs on the majority of products were already low; hence JSEPA did not bring many benefits for Japanese companies. The utilisation rate of the agreement was low[141]. According to the Japan Chamber of Commerce and Industry official, after the signing of the JSEPA, the Japanese media stressed the low number of issued certificates of origin[142]. It was suspected that restrictions had prevented Japanese companies from trading under preferential rates. In reality, only a handful of products required a certificate of origin and only a few Japanese companies exported them to Singapore. For example, the country imposed tariffs on alcohol and beverage companies were amongst the ones which benefited from the agreement[143]. Although the agreement did not include additional concessions on agricultural products, it did include textile and apparel goods as well as chemical and petroleum products (Munakata 2006b:119).

The first FTA that sparked the interest of Japanese manufacturing industry was the agreement with Mexico. Its signing was strongly supported by the Japanese private sector. Following the implementation of NAFTA and the signing of the Mexico-EU free trade agreement, Japanese manufacturers found themselves at a disadvantage in the Mexican market. Moreover, losses from increased foreign competition were concentrated in specific sectors, mainly the automobile industry. Therefore, the Japan-Mexico FTA supported the international operations of companies in particular sectors. While their American and European counterparts enjoyed preferential market access, Japanese MNCs, amongst the OECD members, were the only ones to pay MFN tariffs on automobiles in Mexico. At the time, Mexico's tariffs averaged 16 percent and tariffs on automobiles were 50 percent (Ravenhill 2005b:130)[144]. NAFTA members exported automobiles to Mexico duty-free, while the EU countries paid a tariff of 10 percent. The 'big three' Japanese automakers, Toyota, Nissan and Honda, had operations in Mexico and enjoyed a free quota of imports[145]. This was because the Mexican government allowed foreign companies to import finished vehicles for up to 10 percent of the amount of their local production (Solis and Katada 2007:287). The three companies had an advantage over other Japanese manufacturers, such as Suzuki and Mazda, which had to pay high tariffs in order to penetrate the Mexican market. Hence, the 'big three's

141 Interview no. 50.
142 Interview no. 25.
143 Interview no. 40.
144 Solis and Katada (2007:287) quote 20-30 percent tariffs on finished vehicles.
145 Interview no. 7.

motivation to support the Japan-Mexico FTA was weak. The Japanese Automobile Manufacturing Association was divided. At the time, a representative of one of the 'big three' was the Chairman of the Mexico bilateral committee within *Keidanren*[146]. As such, according to the company's Manager, it was under pressure to support the agreement. It had local manufacturing facilities in the US and Canada and exported goods from those locations to Mexico under NAFTA. Nonetheless, the company benefited from the Japan-Mexico FTA, although not to the same extent as the corporations which did not have production facilities in NAFTA countries[147]. Despite their different interests, the companies that made up the auto industry managed to find a common ground. A division responsible for the automobile industry within METI's Manufacturing Industries Bureau coordinated the conflicting preferences of companies in the sector[148]. In the words of METI's Director-General for Manufacturing Industries Policy: "some companies were strongly supporting the agreement, while others were just agreeing with the idea"[149]. A similar situation occurred during negotiations with Malaysia. The country implemented high tariffs on cars and supported its domestic auto industry with governmental subsidies. Perodua was one of the two main Malaysian producers. The Japanese automobile company, Daihatsu Motor, established a joint venture with Perodua[150]. Daihatsu provided a substantial amount of technology and sent staff members to Malaysia. The company enjoyed tariff protection and hence was rather against the Japan-Malaysia FTA. In India, Suzuki produces automobiles for the local market through Maruti Suzuki, a joint venture where Suzuki holds over 50 percent of stakes. Suzuki's cars dominate the Indian market[151]. As India imposes high tariffs on cars, the implementation of the India-Japan FTA will have a negative impact on Suzuki's position in the Indian market.

The steel industry was also involved in discussions on the Japan-Mexico FTA, as companies in this sector were exporting components for automobiles and electronic products to Mexico. However, they were using Mexico's sectoral duty exemption scheme for automobile and electronic parts[152]. Another group of companies that had a vested interest in this FTA were companies interested in producing goods for

[146] Interview no. 20.
[147] *Ibidem.*
[148] The subject of METI's decision-making process and solving conflicts of interests will be discussed in Chapter 5.
[149] Interview no. 7.
[150] *Ibidem.*
[151] *Ibidem.*
[152] Interview no. 31.

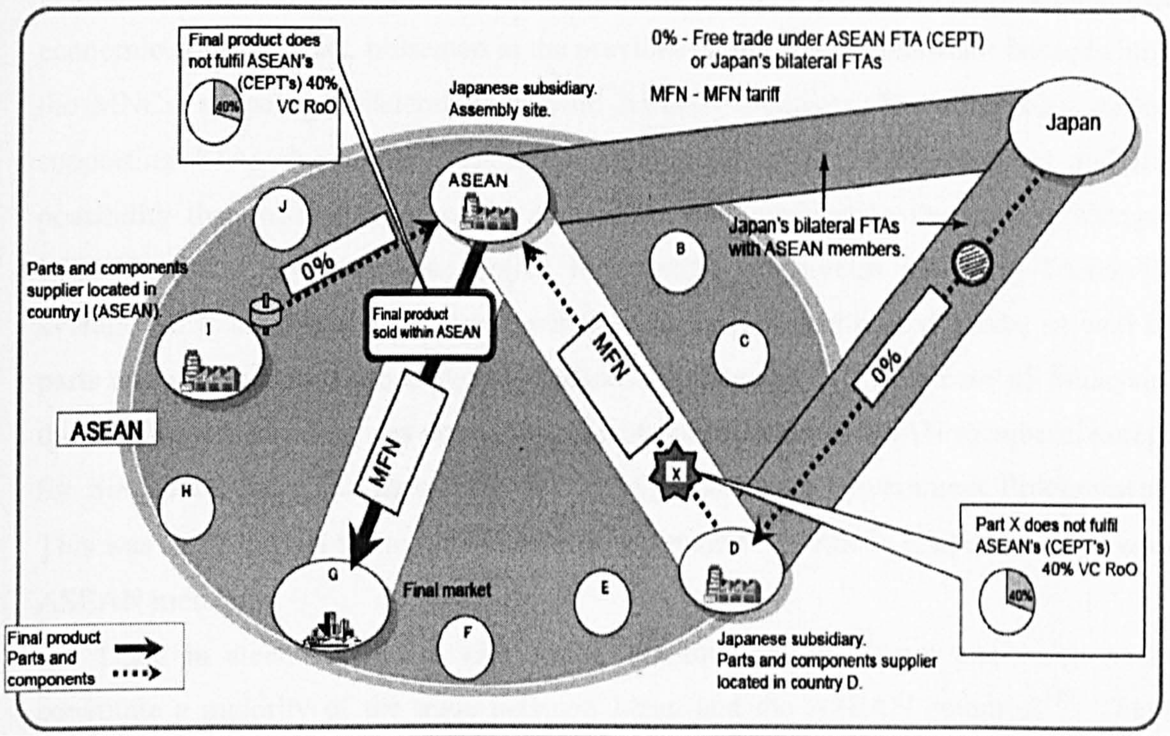
government procurement [153]. In 1996, the WTO's Agreement on Government Procurement went into effect. It regulated government procurement and introduced national treatment, transparent regulations, complaint procedures, and removed the local content requirement (JETRO 2009:130). Japan was one of the signatory parties. Mexico, on the other hand, did not enter the treaty and granted preferential status in government procurement deals to its FTA partners (Kotera 2003). These prevented Japanese companies from exporting, for example, power generation equipment and hospital medical equipment. X-ray medical equipment exported to Mexico was subjected to a 40 percent customs duty[154]. Overall, companies in various sectors supported the agreement with Mexico. Although the gains from the first two FTAs were smaller than expected, they allowed the Japanese companies to gradually recognise the benefits of such arrangements and to urge the government to formulate an FTA strategy[155].

3.4.4 Industry's Preferences for Bilateral Agreements with ASEAN Countries

Japanese companies were highly interested in signing FTAs with ASEAN member economies. Figure 3.5 illustrates the impact of tariff reductions under bilateral FTAs with ASEAN economies. Companies with vertically integrated production networks were able to import parts and intermediates from Japan to parts factories (D) and assembly sites with no tariffs (in some cases preferential tariffs). However, they still needed to pay the MFN tariffs on goods, which did not fulfil AFTA's 40 percent local content requirement.

[153] Interview no. 28.
[154] Interview no. 14.
[155] Interview no. 46.

Figure 3.5 Impact of bilateral FTAs on MNCs' production networks



Source: Translated and modified by the author, based on METI (2008)

Japanese companies utilise FTAs for the sales of finished goods, but also, more importantly, for procuring parts and components from production facilities in various countries [156]. In this respect, foreign direct investment and vertically integrated production networks determine MNCs' preferences for bilateral FTAs. Blechinger and Legewie (2000:297) write that "regional cooperation was mainly promoted by multinational firms interested in building up a horizontal division of labour with regional production and sales networks to connect their various overseas activities on a more efficient regional scale". A research fellow at the Japan Institute of International Affairs (JIIA) confirms that Japan's FTA preferences have been, to a large extent, determined by economic factors and the agreements benefit Japanese companies operating in the East Asian region[157]. Lord (2010:23) argues that in order to facilitate Japanese MNCs' operation, the country chose FTA partners "based on the production networks to which they belonged". Manger (2005:805) argues that "Japanese firms with vertically integrated operations in the host country emerge as key supporters of FTAs, in particular when their profits are under threat from FTAs signed by other countries". The

[156] Interview no. 60.
[157] Interview no. 44.

previous section mentioned isolation avoidance and tit-for-tat FTAs as important factors behind the Japanese government's preferences for bilateral FTAs. It can be argued that economic domino effect, presented in the previous chapter, is an important factor behind the MNCs' support of bilateral FTAs with ASEAN members. The companies started supporting FTAs due to the increasing competition in the Asian markets and the possibility that those treaties could strengthen their position in the region (Manger 2005:822). ASEAN countries applied high tariffs on several products. Thailand's average MFN tariff was 8.2 percent, which made importing finished goods, as well as parts and components, expensive for Japanese companies[158]. In the case of Malaysia, the tariff on automobiles was up to 300 percent. Furthermore, ASEAN members, except for Singapore, have not signed the WTO's Agreement on Government Procurement. This was an additional factor behind several companies' interest in bilateral treaties with ASEAN members.

Trade in steel, chemicals, electronics, automobiles, and parts and components constitute a majority of the trade between Japan and the ASEAN countries[159]. These industries were particularly interested in deepening the economic integration with ASEAN and negotiating FTAs[160]. As previously mentioned, Japan's FTAs with ASEAN members were Manufacturing Industries Bureau-driven. According to its Director-General the automobile, steel and electronics industries are strongly represented within the Bureau and their preferences have a strong impact on decisions made[161]. Furthermore, the CEO of *Keidanren* is usually chosen from amongst the major companies in the steel and iron, electronics and automobile industries[162].

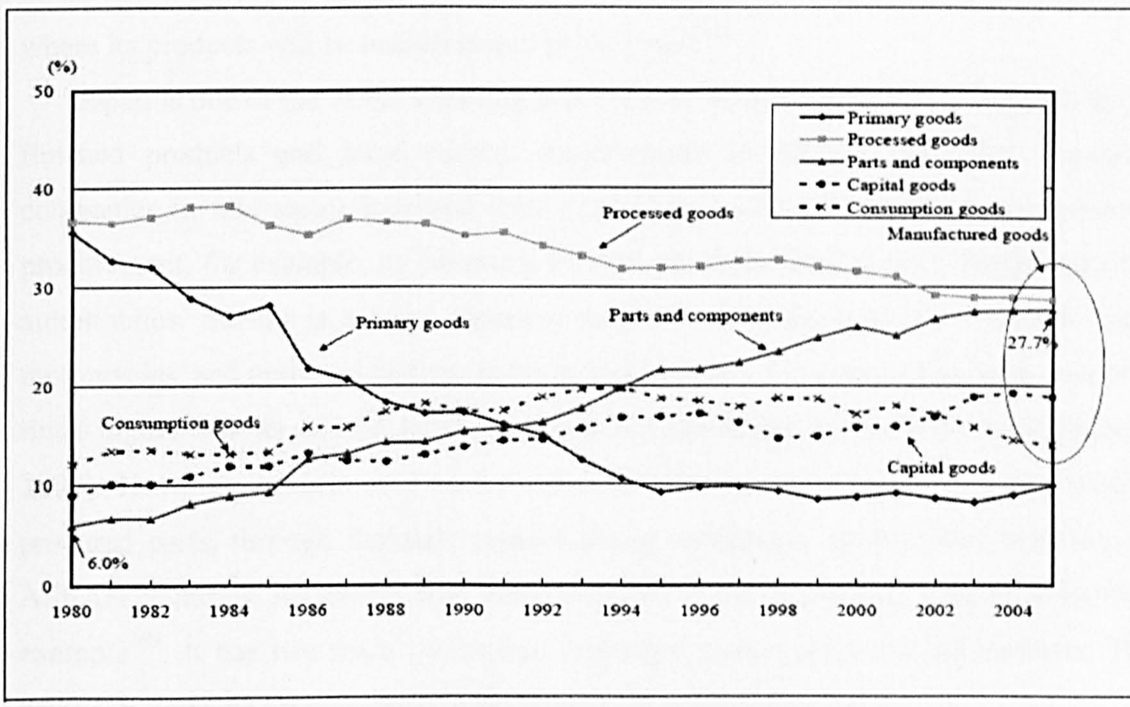
The Japanese machinery sector, which includes the automobile and electronics industries, invested heavily in ASEAN and profited greatly from economic integration in the region[163]. The electronics sector, in particular, is inclined to use FTAs for trade in parts. Urata (2008a:7) points out that in this sector "approximately 80 percent of East Asia's exports take the form of parts and the remaining 20 percent of finished products regardless of their export destinations", due to the type of goods it produces, such as white goods (major appliances), which "may be attributable to high shipping cost, as white goods, a large portion of traded electrical appliances, are bulky and heavy". Economies of scale cause Japanese companies in this sector to assemble products in one

[158] This was the rate applied in 2007 according to World Tariff Profiles (Kawai and Wignaraja 2009:5).
[159] Interview no. 7.
[160] Interview no. 8.
[161] Interview no. 7.
[162] Interview no. 46.
[163] Interview no. 28.

ASEAN state and to distribute them to others. Parts and components are often procured from various ASEAN states. As a result, the East Asian region has witnessed a significant increase of trade in parts and components over the past decades. The machinery and electronics sectors have significantly contributed to this increase. In East Asia (ASEAN+3) import shares of parts and components rose from 7.2 percent in 1980 to 32.2 percent in 2003 (Lim and Kimura 2010:1). Figure 3.6 demonstrates the trade patterns within East Asia. A sharp increase in trade in parts and components can be observed between 1980 and 2004.

Figure 3.6 Increase in parts and components trade within East Asia

Figure 3: Trade Pattern Inside East Asia (%)



Note: The values of traded goods are measured by import value in terms of US dollars.
Source: Institute of Developing Economies (IDE) 2006.

Source: Lim and Kimura 2010:3

However, the internationalisation of production networks in these sectors makes it difficult for Japanese companies to profit from the country's bilateral FTAs. The Director of the Liaison Department of an interviewed company in the electronics sector explains that it exports only two products from Japan that can be traded under FTAs in ASEAN (they must meet the RoO and not be locally produced)[164], solar cell modules

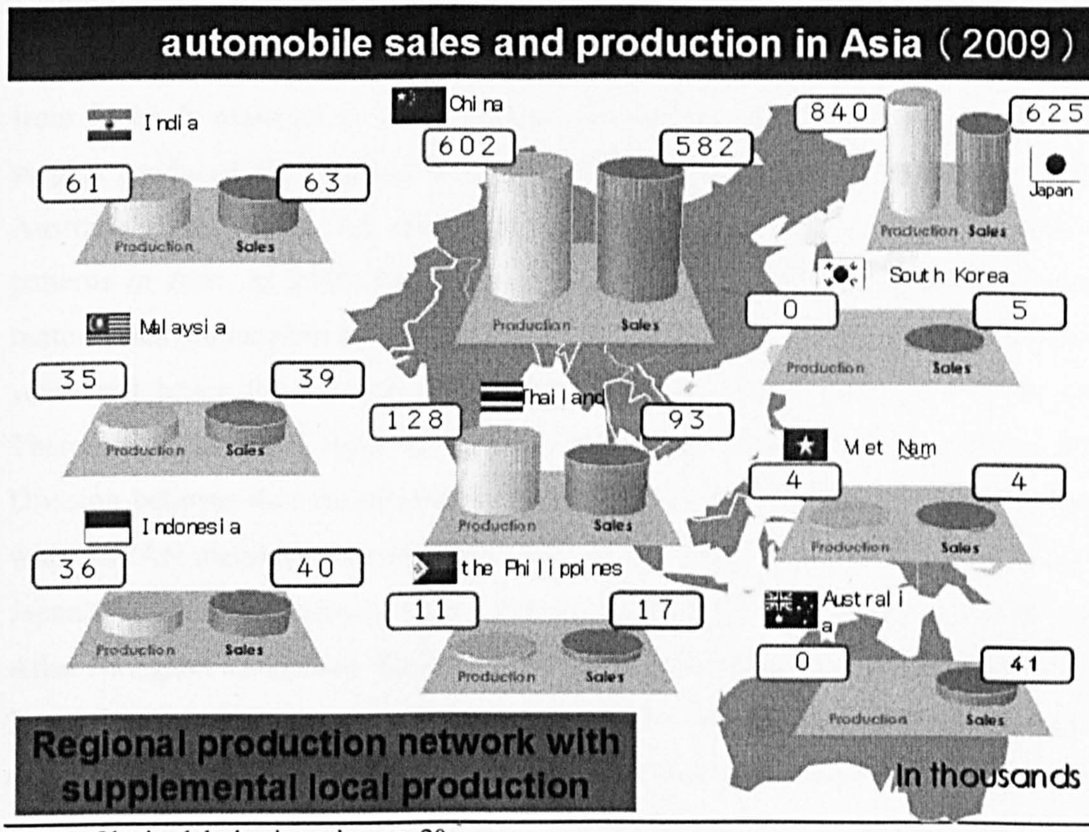
[164] Interview no. 16.

and parts for liquid crystal TVs (liquid-crystal display televisions, also known as LCD TVs)[165]. Tariffs on solar cell modules were removed under the 1996 WTO Information Technology Agreement (ITA). Hence parts for LCD TVs are the only products exported from Japan which are eligible for preferential trade. They are exported from Japan to Malaysia, where the company has an LCD TV manufacturing facility. The TV sets assembled in Malaysia are then exported to other ASEAN countries under the MFN tariff as they do not fulfil AFTA's RoO[166]. Likewise, another Japanese multinational corporation in the electronics sector locates many of its Asian manufacturing facilities in Malaysia and was interested in an FTA with this country[167]. This is in accordance with observation by Lim and Kimura (2010:15) regarding the clustering of the electronics industry in Malaysia. However, when the Japanese government asked the company about its FTA preferences, it explained that it is difficult to foresee, as it does not know where its products will be manufactured in the future[168].

Japan is one of the world's leading producers of automobiles. Due to high tariffs on finished products and local content requirements in ASEAN countries, Japanese companies in this sector localised their production, sales, and parts and components procurement, for example, by investing in steel plants producing steel components for automobiles. Suzuki is a large Japanese manufacturer whose products include cars, motorcycles, and outboard motors. In 2008, the company's overseas sales were over two times higher than its sales in Japan, and Asia was the largest destination market (Suzuki 2009). However, models sold in the Asian market are often produced using locally procured parts, through Suzuki's manufacturing companies, mostly joint ventures, in ASEAN countries. An interviewed Japanese MNC in the automobile industry is another example[169]. It has two main production segments: motorcycles and automobiles. The company procures around 80 percent of parts and components locally.

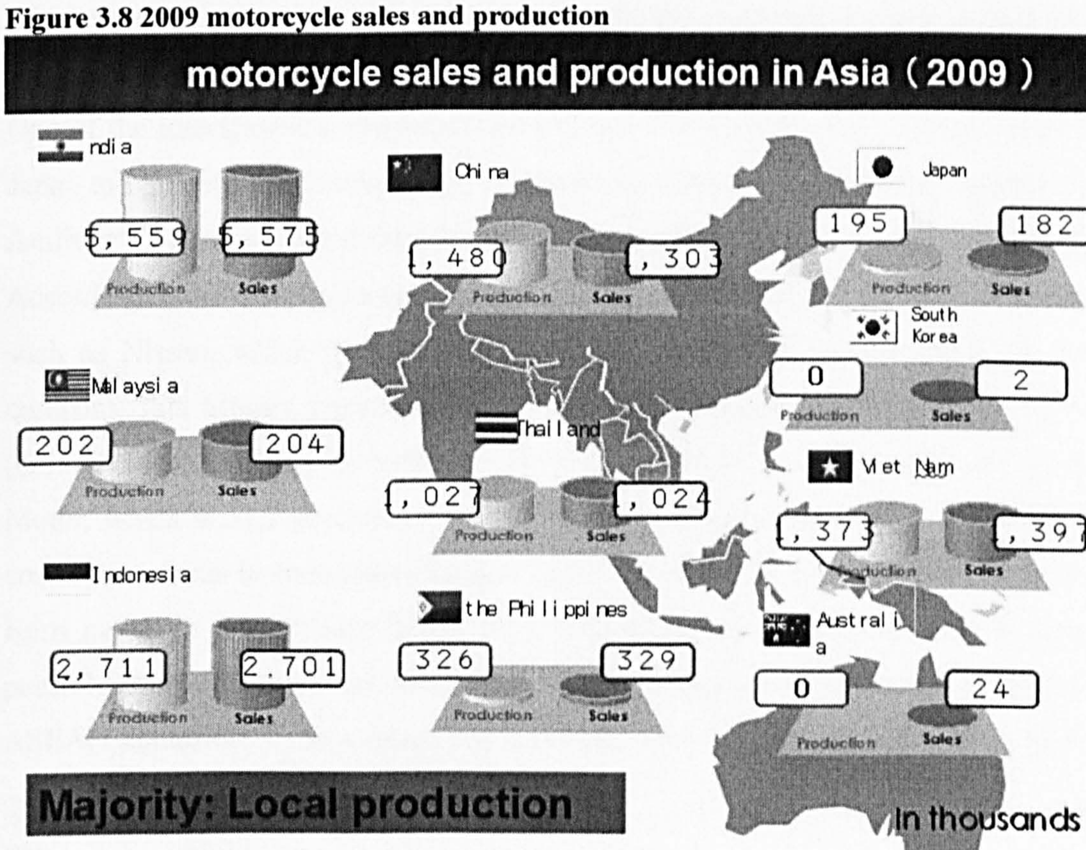
[165] *Ibidem.*
[166] This was the case prior to signing of the AJCEP. More on this issue further in this chapter.
[167] Interview no. 19.
[168] *Ibidem.*
[169] Interview no. 20.

Figure 3.7 2009 automobile sales and production



Source: Obtained during interview no. 20

Figure 3.8 2009 motorcycle sales and production



Source: Obtained during interview no. 20

Figure 3.7 demonstrates the company's automobile production and sales patterns in Asia, in 2009. The first (lighter) column represents production and the second (darker) one sales. It is clear that the majority of automobiles produced are sold locally. The surplus from Japan is exported to other markets, mainly the US, Canada, and Europe. The surplus produced in Thailand is exported mainly to Australia, under the Thailand-Australia FTA. Figure 3.8 shows the company's motorcycle production and sales patterns in Asia, in 2009. Here, the numbers are even more balanced as almost all motorcycles produced in Asian countries are sold locally. This situation has persisted for years and hence the company has little interest in using FTAs for finished goods. Therefore, although it supports and uses FTAs, the Manager of its General Affairs Division believes that the automobile sector has far less interests in trade agreements with ASEAN members than the electronics sector. Since 2007, the top destinations for Japan's vehicles and vehicle parts were the US, China, and Australia (Global Trade Atlas Navigator Database). Therefore, the major destinations are countries with which Japan does not have a free trade agreement. The companies produce vehicles locally, export them under third-party FTAs, or, in exceptional cases, under MFN tariffs.

In the first half of the 2000s, essential parts for automobiles and motorcycles, such as engines, could not be produced in Indonesia, Thailand or Malaysia[170]. Companies in this sector still needed to import crucial parts and components from Japan. In this respect, the automotive industry profited from bilateral FTAs with ASEAN members. One of the interviewed companies uses bilateral FTAs mainly for exporting parts from Japan to Indonesia, the Philippines, Thailand and Malaysia, where it has manufacturing facilities[171]. Parts exported from Japan are mass produced, which helps to lower costs. According to the company's manager it is facing competition from other manufacturers, such as Nissan, which produce cars at a very low cost[172]. For example, the Indian company Tata Motors introduced Nano, one of the cheapest automobiles in the world (around 165,000 JPY). In February 2011, Toyota Motor Corporation and Daihatsu Motor, which is 51.2 percent-owned by Toyota, announced their plan to produce low-cost automobiles in Indonesia (Reuters 2011). In 2010, Toyota launched the low-cost Etios model in India. These factors have caused the interviewed company to consider possible cost reductions, for instance mass producing the parts locally in one of the ASEAN countries[173]. As a result, the company would increase its utilisation of FTAs.

[170] Interview no. 8.
[171] Interview no. 20.
[172] *Ibidem.*
[173] *Ibidem.*

For companies in the automotive sector, the agreement with Malaysia offers the most favourable conditions for the shipment of parts and components [174]. Parts for automobiles are exported in sets. One set is composed of all of the parts necessary for car manufacture. In order to obtain the certificate of origin for a set under the Japan-Malaysia FTA, the manufacturer needs to prove the origin and cost of only one part. Although the interviewed company asked the government to include similar provisions in all prospective agreements, it remains an exceptional case[175]. Under the Japan-Thailand FTA, the producer needs to prove the origin of all parts in a set. This also increases the administration fee, which needs to be paid for issuing the certificate.

Pekkanen (2003:300) named the steel industry "the most politically powerful manufacturing sector in Japan". He writes that between 1965 and 1995 the steel sector was in first or second place in terms of the number of ex-METI officials who obtained positions on steel companies' governing boards (*amakudari*). This ensured that the steel companies' interests were represented in the ministry (Suzuki 2002:4 cites Murofushi, 1983). The sector gained a reputation for being one of the most protected in Japan. A manager at the Japan Iron and Steel Federation explains that in the 1960s, 1970s, and early 1980s, Japanese steel companies were focused on producing for the domestic market and hence were opposed to tariff liberalisation[176]. However, he argues, their position changed over time, due to the shrinking domestic market and increasing export opportunities (e.g. the Chinese market), and duties on steel and iron products were liberalised together with other industrial tariffs. The amount of investment needed to establish a steel plant abroad is much greater than in the automotive or electronics sectors. In addition, the success of steel and iron production depends heavily on experience and the technology that is employed. For that reason, companies have not localised their production and mainly export from Japan. Raw materials are imported from Brazil and Australia. These two countries are Japanese companies' preferred source of high quality materials. In addition, small amounts of low quality materials from India, Korea, Taiwan, and China are used for low-grade steel and iron products used mainly for construction purposes. Japan exports high value added steel products to Asia. Korea was the largest export destination in 2009, followed by China, Taiwan and Thailand (The Steel Industry of Japan 2010:2).

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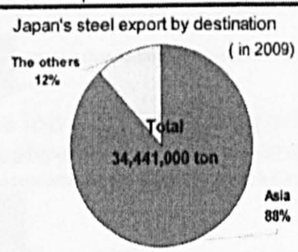
[174] *Ibidem.*
[175] *Ibidem.*
[176] Interview no. 32.

Figure 3.9 Japan's steel exports in 2009 (in tons)

1. Developments of EPA Negotiations and Japan's Export Market

Countries/ Regions *In Effect / Agreed*	Japan's Steel Export In 2009	Countries/ Regions *Under Negotiation/ Consideration*	Japan's Steel Export in 2009
Singapore	561,000 ton	Australia	330,000 ton
Mexico	659,000 ton	GCC	918,000 ton
Malaysia	955,000 ton	Peru	40,000 ton
Chile	27,000 ton	South Korea	9,830,000 ton
Thailand	2,985,000 ton	China-South Korea	-
Indonesia	921,000 ton	Mongolia	0 ton
Brunei	15,000 ton		
ASEAN (multilateral)	-		
The Philippines	738,000 ton		
Switzerland	3,000 ton		
Vietnam	1,570,000 ton		
India	711,000 ton		
% in all exports	26.6 %	% in all exports	32.3 %



Asian countries account for about 90% of Japan's total steel exports

Source: Obtained during interview no. 31

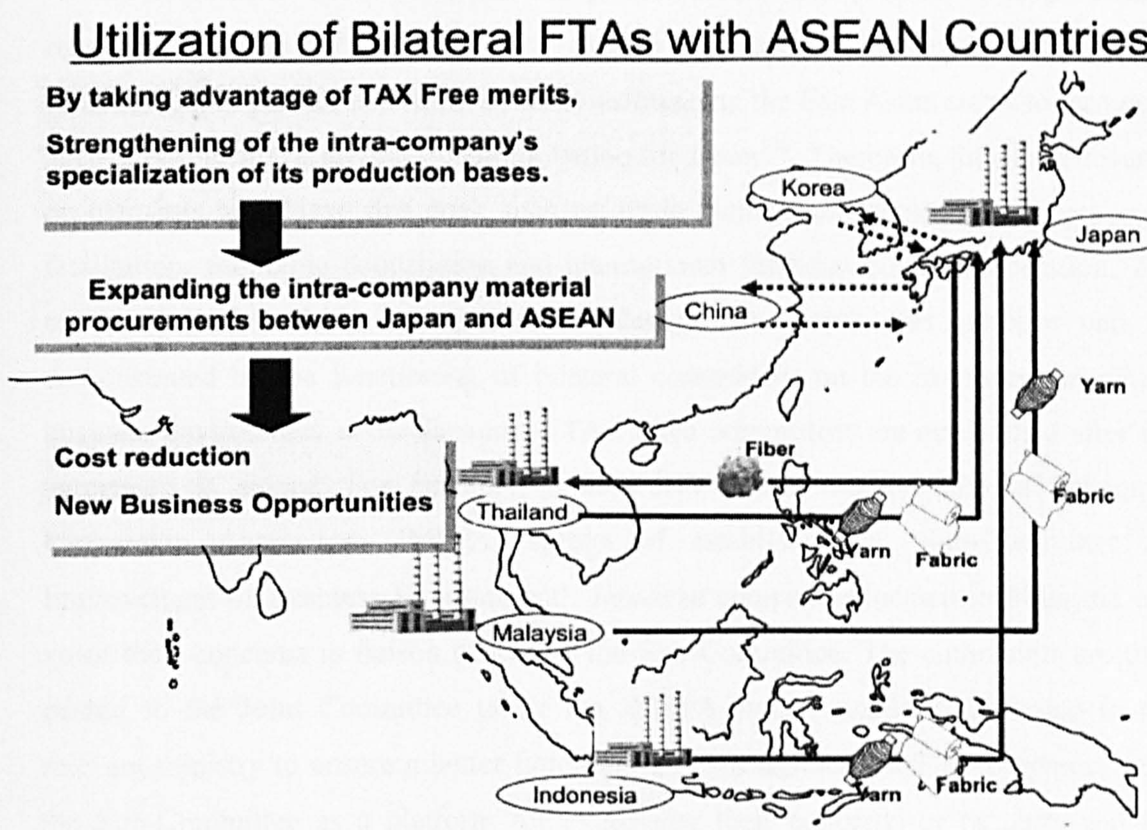
Figure 3.9 shows Japan's steel exports to selected East Asian countries in 2009. Japan's first two FTAs, with Singapore and Mexico, were moderately significant for the steel and iron industry. Thailand is the largest export market in East Asia, in terms of the number of exported tons of steel. It is followed by Vietnam and Malaysia. Malaysia implemented a 25 percent MFN tariff on steel products, while Indonesia's and Vietnam's tariffs ranged from zero to 15 percent[177]. For companies in the steel and iron sector bilateral agreements with ASEAN countries, in particular with Thailand, were of great interest.

The textile industry was also highly interested in bilateral FTAs with ASEAN countries, in particular Thailand, Malaysia and Indonesia, and strongly urged the government to conclude such agreements[178]. Companies in this sector use FTAs for all

[177] Interview no. 31.
[178] Interview no. 36.

operations between Japan and ASEAN members[179]. In order to do that, they need to comply with a two-step rule of origin, known also as double transformation. The two steps are two separate production processes needed to manufacture a final product or garment: the weaving of fabric from a yarn and the cutting and sewing of a garment from fabric. The double transformation rule requires that both processes are done in, or from materials originating in an FTA member country. For example, Thai garments need to be made from Thai fabric, or from Japanese fabric exported to Thailand, in order to be traded under the Japan-Thailand FTA.

Figure 3.10 Utilisation of bilateral FTAs by textile companies



Source: Obtained during interview no. 22

Figure 3.10 demonstrates the utilisation of bilateral FTAs and intra-company specialisation in this sector. The interviewed Japanese company in the fibre, textile, chemicals and plastics sector specialises in high-tech fibre material, which is exported to its subsidiaries in Thailand or Malaysia[180]. They use the special fibre to produce yarn

[179] Interview no. 22.
[180] *Ibidem.*

or fabric which is then exported back to Japan. This type of intra-company, cross-over material procurement between Japan and each ASEAN country allows for a substantive reduction of costs. Sewing, the final stage of making a garment, is the most labour-consuming part of production. Companies prefer to locate it in countries which have low labour costs. For that reason, the final stages of production are often located in China. The textile sector is to a great extent dependent on production in China[181]. Due to the country's increasing labour costs, textile producers try to increase imports and exports to ASEAN countries, for example Vietnam, Cambodia, and Myanmar. However, apart from Vietnam, Japan does not have bilateral agreements with those countries. For that reason, companies in this sector were also highly interested in ASEAN-Japan FTA.

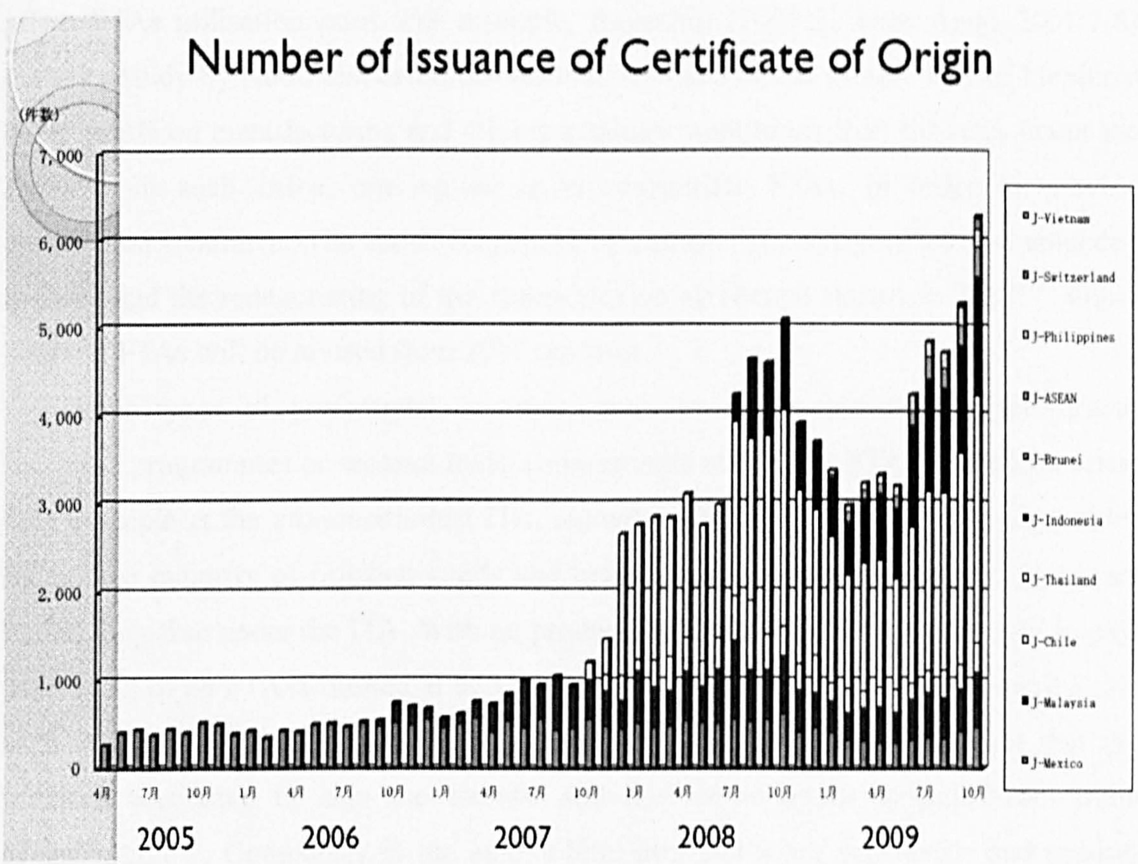
In addition to tariff reduction, the private sector also profited from provisions resulting from an EPA character of Japan's agreements. Improving the business environment in partner countries, often by influencing the East Asian states to introduce necessary reforms, is an important motivation for Japan[182]. Therefore, they have focused on elements to achieve this goal, such as: trade facilitation, investment protection or facilitation, economic cooperation and international financial policy cooperation. The extent to which these agreements are designed to serve this purpose can be demonstrated by the functioning of bilateral committees on the improvement of the business environment under Japanese FTAs. Such committees are established after the agreement is signed. For example, Article XIV of the Japan-Malaysia Economic Partnership Agreement (JMEPA) speaks of establishing a 'Sub-Committee on Improvement of Business Environment'. Japanese companies located in Malaysia can voice their concerns to liaison offices of the Sub-Committee. The complaints are then passed to the Joint Committee under the JMEPA and, if needed, forwarded to the relevant ministry to ensure a better functioning of the agreement. The companies treat the Sub-Committee as a platform for expressing their concerns or requests and for influencing national policies and procedures[183].

[181] Interview no. 36.
[182] Interview no. 58.
[183] Interview no. 34.

3.4.5 FTAs Utilisation Rates and the Importance of Third-party FTAs

Recent studies (Kawai and Wignaraja 2009, Hiratsuka *et al.* 2008a) have pointed out that the utilisation rates of Japanese FTAs are quite low. During the ADBI Annual Conference on the Political Economy of Asian Regionalism, See Seng Tan (2010) from the Nanyang Technological University in Singapore pointed out that FTA utilisation rates in Asia, in general, approximate 20 percent but differ depending on sources. Utilisation rates below 50 percent are considered low according to European standards (Terada 2008:10 cites Baldwin 2007:12). Although the number of certificates of origin issued each year is confidential, the Chamber of Commerce confirms that utilisation rates have increased[184]. The results of MOFA's research on utilisation rates are presented in Figure 3.11.

Figure 3.11 Number of issued certificates of origin



Source: MOFA, 2010, Japan's FTA/EPA Current Status and Main Issues, p.8. Obtained during interview no. 9

This chapter argues that FTAs with ASEAN members were strongly supported by the

[184] Interview no. 25.

Manufacturing Industries Bureau and the Japanese industries themselves. The fieldwork indicates that the low utilisation rates of Japan's FTAs point to the shortcomings of the agreements, such as the low preferences margins or the time-consuming procedures for obtaining the certificate of origin rather than the Japanese industries' lack of interest. There are several reasons for companies not using FTAs. If the margin of preference is negligible, companies prefer to trade under the MFN tariff. Ravenhill (2009:23 cites Estevadeordal *et al.* 2007) writes that generally under FTAs "the cost of complying with RoO is estimated to vary from four to eight percent of the overall cost of a consignment". Hiratsuka *et al.* (2008b:415) calculate that the "average preferential tariff margin at which Japanese firms will make use of FTAs is 5.3 percent". The margin of preference can change substantially over time if a country decides to lower its MFN tariffs after an FTA is implemented. For example, under the AJCEP Thailand's tariff on wire of iron or non-alloy steel (Harmonised System code 7217.10.10) is twice as high as the MFN tariff. This kind of FTA inefficiency resulting from falling MFN rates, can affect FTAs utilisation rates. For example, Ravenhill (2009:22 cites Ando 2007:7-8) quotes a study by Ando that demonstrates that in January 2007 around half of Mexico's MFN tariffs on manufacturing and mining products were lower than the rates under the JMEPA. In such cases, one option is to renegotiate FTAs, in order to provide preferential treatment. The Japan-Singapore agreement was renegotiated and amended in 2007 and the renegotiating of the Japan-Mexico agreement started in 2010[185]. Other bilateral FTAs will be revised from 2011 onwards.

Other types of preferential schemes, such as export-free zones, government incentive programmes or sectoral trade arrangements also lower FTAs' utilisation rates. One example is the aforementioned ITA, signed in December 1996. In the electronics sector, the majority of finished goods and many parts still manufactured in Japan are traded duty free under the ITA. With no products to export and no customs duty to pay, the impact of an FTA is limited at best. For that reason, the utilisation of bilateral FTAs with ASEAN members is low for the electronics industry, despite the fact that the industry was keen to sign the treaties and the sector stands to gain from trade liberalisation[186]. Companies in the automobile, iron and steel, and textile and apparel sectors still manufacture goods in Japan and therefore, can potentially benefit from the country's bilateral FTAs. Malaysia has a tariff exemption scheme for certain types of

[185] Interview no. 7.
[186] Interview no. 14.

steel, for example parts used in the automotive industry[187]. Tariffs under this scheme are almost the same as under the Japan-Malaysia FTA, where it does not require a certificate of origin. Companies in the steel and iron sector prefer to use such schemes if possible.

Another issue, which can affect the utilisation rates of Japan's FTAs, is the importance of third-party agreements for the country's MNCs. Given the location of their production networks, FTAs between third parties often play a crucial role. This is particularly true for the electronics sector, where the majority of the products are manufactured in East Asia, there are few finished goods exported from Japan and parts and components are traded between production facilities located in various countries. Companies in this sector use third-party FTAs to export parts and components as well as finished goods. The automobile industry also uses third-party FTAs, mainly to sell finished cars to markets protected by high tariffs or to trade parts and components. One of Japan's leading multinational corporations in the electronics sector produces many of its goods in Thailand, to which it imports parts from other ASEAN countries under AFTA[188]. A few parts are imported from Japan under the Japan-Thailand FTA (JTEPA) or from China and Korea under their respective FTAs with ASEAN. Finished goods are exported from Thailand to other ASEAN countries under AFTA and to third parties, for example to India under the ASEAN-India FTA. Hence Japanese companies use many FTAs, of which Japan is not necessarily a member. The importance of AFTA has already been mentioned in this chapter. According to JETRO's 2008 survey (2009:111) of Japanese companies in 13 Asia-Pacific countries[189], AFTA is the most utilised agreement. It is followed by the ASEAN-China and India-Thailand FTAs. According to an interviewed company in the automobile sector, AFTA and Japan's bilateral agreements are equally important for its operations[190]. In February 2011, India and Japan signed an Economic Partnership Agreement. However, for Japanese companies in the electronics sector it might be easier to fulfil the RoO requirements while trading under the ASEAN-India agreement than under the India-Japan FTA[191].

Third-party FTAs have a direct effect on the supply and production chains of Japanese companies. After the signing of the Australia-Thailand agreement, automobile companies shifted their exports to Australia from Japan to Thailand. The same situation

[187] Interview no. 31.
[188] Interview no. 14.
[189] This were: Thailand, Malaysia, Indonesia, the Philippines, Singapore, Vietnam, Myanmar (ASEAN7), India, Pakistan, Sri Lanka, Bangladesh, Australia and New Zealand.
[190] Interview no. 20.
[191] Interview no. 54.

occurred in the case of the India-Thailand FTA. The automobile companies concentrated their production partly in Thailand and partly in India, in order to profit from existing arrangements[192]. MOFA has used JETRO's annual survey to demonstrate the impact of the India-Thailand FTA.

Figure 3.12 Impact of the India-Thailand FTA on Japanese companies' production networks

	Questionnaire: How are you using (How has business changed since the conclusion of) the Thailand-India FTA ?
Company A	Closure of TV factory in India; switch to export from factory in Thailand; growth of TV sales in India
Company B	Start exporting from Thailand to India of high-end refrigerators and washing machines
Company C	Joint-venture air-conditioner factory switched converted to sales company; currently exporting from Thailand to India
Company D	Start exporting TV components from Thailand to India
Company E	Export of auto parts/components (transmission etc) to Thailand; Export of automobiles (finished) to India
Company F	Export of polycarbonates to India

Source: MOFA, 2010, Japan's FTA/EPA Current Status and Main Issues, p.12. Obtained during interview no. 9

The Figure shows how the implementation of the agreement affected companies in different sectors: electronics and machinery (A-D), automobile (E) and chemical (F). It is evident that, as a result of this FTA, Japanese companies changed their supply networks for both trade in parts and components and finished goods. India and Australia are important markets for Japanese car manufacturers. The increase in the volume of automobile exports from Thailand to Australia, after the implementation of the Australia-Thailand FTA, is largely related to the exports of Japanese companies, such as Honda and Toyota[193]. Similarly, the India-Thailand FTA is used by Japanese companies in the electronics and automobile sectors. The Thailand-India FTA is often used for exporting goods in the electronics sector, such as TVs and air conditioners, while the Thailand-Australia agreement is used mostly for exporting automobiles (JETRO 2009:112). The importance of third party FTAs is illustrated by the following example. Representatives of the Japanese private sector located in Thailand expressed their

[192] Interview no. 4.
[193] Interview no. 38.

preferences regarding a free trade agreement with India to the Thai government[194]: as a result, the 82 products selected for the Early Harvest Programme included TV parts, air conditioners and gear boxes – goods produced by Japanese companies in Thailand[195].

3.5 Preferences of Other Interest Groups

3.5.1 Service and Finance Sectors

According to Lim and Kimura (2010:16) despite increasing the liberalisation of trade in goods in East Asia, the liberalisation of trade in services has not progressed at the same pace and economic integration remains 'shallow'. JETRO's 2009 White Paper on International Trade and Foreign Direct Investment (2009:184) points out that "Japan's service sector has been in chronic deficit in balance of payments and is therefore said to be weak in competitiveness". Japanese companies in the service sector are expanding to Asian markets through FDI taking the form of mergers and acquisitions (mode 3 of trade in services)[196]. For example, in March 2009, a Japanese communications services company, NTT DoCoMo Inc, acquired an Indian company, Tata Teleservices Ltd, while in September 2008, Japanese companies in the energy services industry, Marubeni, Kansai Electric Power and others, acquired an electric power services company, Senoko Power from Singapore (*ibidem*:85). The service sector is interested in FTAs, although to a much lesser extent than the manufacturing sector. According to JETRO's 2009 White Paper (*ibidem*:187) based on the large sample survey 53.6 percent of companies in this sector replied that "they currently sell overseas and there are plans/percentage to expand business", compared to 81.5 percent of companies in the manufacturing sector. The percentage of companies in the service sector which consider there to be "plans/potential for future sales, although they are not currently engaged in it" was 14.9 percent, compared to 11.3 percent in the manufacturing sector. Companies which plan to sell their products abroad in the future are mainly in the information and telecommunications, professional services (legal, accounting and consultancy), construction, retail and transportation service sectors. Out of the 14.9 percent of companies planning to sell their products overseas, 64.9 percent plan to enter the

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[194] Interview no. 40.
[195] Interview no. 39.
[196] As discussed in Chapter 2, the WTO allows for the preferential trade in services between FTA member states under conditions listed in the Article V of GATS.

Chinese market, and 42.1 percent wish to penetrate the American market. China is of particular importance for the information and telecommunications sector, as it has the largest market for mobile phones and individual internet access. JETRO's White Paper (*ibidem*:187) concludes that in East Asia, the information and telecommunications sector is particularly interested in expanding its operation to Korea, Taiwan and Thailand, while companies in the construction sector wish to expand into Vietnam, Indonesia, the Philippines and Malaysia. The financial and insurance sectors, specialising in high value added services, plan to sell their products in the Thai market (*ibidem*). However, the overall percentage of companies in the service sector which have operations in East Asia is much lower than for the manufacturing sector. For that reason, their interest in FTAs is also weaker.

The service sectors' position on bilateral FTAs is illustrated by an example of an interviewed service provider in the banking sector[197]. Companies in this sector export several types of services, for instance financial consulting services, life and non-life insurance, and brokerage services. There are many channels for exporting services: establishing branches and internet banking (mode one or cross-border). Japanese banks export to China and Korea under the WTO rules. The financial services sector does not have a strong position on FTAs, although it is generally supportive of trade liberalisation and has benefited from the WTO's General Agreement on Trade in Services (GATS) negotiated during the Uruguay Round[198]. Nonetheless, companies in this sector are facing various limitations while trading in ASEAN countries, for example rules on foreign participation in the banking sector. They had hoped that the situation would improve under bilateral FTAs. Singapore, Japan's first FTA partner, had a strong service market and expectations amongst companies in the financial sector were quite high. According to a series of interviews conducted by the interviewed company's research and consulting institute amongst Japanese banks, JSEPA increased transparency of rules, but the actual benefit of the agreement remains unknown[199]. In the opinion of company's Senior Analyst, this caused the sector's enthusiasm for FTAs to wane. The financial services sector is interested in the WTO-plus and investment provisions under FTAs and would benefit from more transparent rules on trade in services and investment. However, few East Asian FTAs include such provisions on a level that could bring profits to companies in this sector[200]. According to Ishido

[197] Interview no. 45.
[198] *Ibidem.*
[199] *Ibidem.*
[200] Interview no. 45.

(2010:2), the Director of the APEC Study Centre at Chiba University, provisions on service liberalisation will be a major focus of future FTAs in the Asia-Pacific region.

3.5.2 Movement of People under Japan's FTAs and Preferences of Labour Unions

A Project Leader from the Japan Chamber of Commerce and Industry remarks that, while for the Japanese companies in the service sector the liberalisation of Mode 3 of trade in services is a primary concern, Japan's FTA partners are mostly interested in the liberalisation of Mode 4[201]. The Japanese government is reluctant to open up its labour market, despite the shortage of workers caused by the ageing population. According to the Director of the International Bureau at the National Confederation of Trade Unions (*Zenroren*), one of the two main confederations of trade unions, Japanese labour organisations for a long time had little knowledge about FTAs and their potential impact[202]. In his opinion, trade unions' awareness of preferential trade liberalisation was much lower than in countries such as Korea, the UK, and France. This changed during the 2008 G8 Hokkaido Summit, after which the national-level confederations started to pay attention to FTAs. The conducted fieldwork indicates that Japanese trade unions do not have a strong position on bilateral FTAs, although in the opinion of *Zenroren's* Director, Japan's FTAs are designed to support the operations of multinational corporations[203]. In the same year as the Hokkaido Summit, bilateral agreements with Indonesia and the Philippines were implemented. Under the bilateral agreements with Thailand, Indonesia and the Philippines, Japan committed itself to accepting skilled workers from those countries. These were Thai chefs (with over ten years of experience), and Indonesian and Philippine nurses and caregivers. For example, the JPEPA allowed 400 Filipino nurses to work in Japan for more than five years, provided that they obtain a Japanese license: this number was increased from an earlier 100. However, it was still below the Philippines' expectations. Japan also accepted 600 Filipino caregivers. Opportunities for nurses and caregivers are restricted by requirements, such as passing on-the-job training, working under the supervision of a Japanese manager and having no employee rights for up to three years (Jimenez 2007). Subsequently, they need to obtain a Japanese license, as well as pass a Japanese-language exam. Filipino nurses are also required to hold a university degree despite the fact that Japanese nationals do not need

[201] Interview no. 25.
[202] Interview no. 33.
[203] *Ibidem.*

a similar qualification for the same position (*ibidem*). Additionally, the JPEPA adds a quota system that limits the number of nurses and caregivers that are allowed to reside and work in Japan at any given time to 1,000 for the first two years (*ibidem*). *Zenroren* believes that the Philippine government wanted to open the Japanese labour market and hence, it agreed to the unequal treatment of the Filipino nurses in Japan[204]. Similarly, under the agreement with Indonesia, 1,000 nurses and caregivers are allowed to work in Japan. Indonesian skilled workers need to obtain a Japanese certificate, pass a six-months-long period of training that includes a test of both nursing and linguistic skills and undergo a two-year trial period (Fukada 2008). Indonesian nurses are also expected to have a degree or a nursing school diploma. The DPJ's *'The New Growth Strategy – Blueprint for Revitalising Japan'* (2010b:56) mentions increasing the numbers of accepted qualified nurses and caregivers under FTAs. 2010 was the third year in which Japan accepted foreign nurses and caregivers under FTAs. However, the number of Japanese institutions which hire and train Filipino and Indonesian nurses has decreased. The Director of the International Bureau at *Zenroren* explains that this is caused by the internal problems of the Japanese job market[205]. About one third of trained, licensed Japanese nurses find it difficult to continue working after marriage and childbirth and decide to stay at home. Because of the low wages that they are paid, few nurses decide to come back to work. Nurses are paid less than Japan's average national wage (Bernardino 2007). In *Zenroren's* view, such domestic problems should be dealt with before inviting foreign workers into the country[206]. Labour unions and national-level confederations are not the only organisation to carefully monitor labour under FTAs. The Japan Federation of Medical Workers' Union (*Nihon Iroren*) is a national federation and the largest medical organisation uniting over 100,000 nurses and hospital employees. Just as in the case of *Zenroren*, the Federation has only recently become aware of the potential benefits and risks of FTAs. Bilateral free trade agreements trigger nation-wide discussions on the deregulation of the labour market and immigration. *Zenroren's* position is one of caution, although the organisation recognises the potential future benefits of labour market liberalisation[207]. So far, FTAs have had a limited impact on the Japanese labour market. Trade unions and national-level confederations are much more concerned about another governmental initiative, the foreign trainee programme known as the Technical Intern Training Programme. This scheme started in 1993 and is

[204] *Ibidem.*
[205] *Ibidem.*
[206] *Ibidem.*
[207] *Ibidem.*

organised by the Japan International Training Cooperation Organisation (JITCO). In theory, trainees arrive in Japan to obtain technical skills and learn a trade. In reality, however, this controversial programme has provided Japanese businesses with cheap labour from Asian countries. Under this programme, more than 300,000 young people, mainly from Indonesia, China and Vietnam, come to Japan annually and are each given a three-year contract.

3.6 FTA Competition with China and Korea

3.6.1 Competition with China

The first part of the chapter argued that isolation avoidance was the main factor behind Japan's first FTAs. This section takes a closer look at how competition with China and Korea impacted Japan's FTA strategy. One of the main arguments of this chapter, and the entire thesis, is that while China was the main competitor in the early stages of Japan's FTA policy, this role is now played by Korea. Korea's FTA strategy has implications for Japan's bilateral, minilateral and regional FTA strategy as demonstrated in Chapters 4 and 5.

In 2010, China overtook Japan as the second largest economy in nominal GDP terms. China's role in Japan's shift towards a multi-layered trade policy was previously discussed in this chapter. The rise of China shifted the balance of power in the region and Japan needed to respond to a changing situation with a new policy. In the opinion of JETRO's Deputy Director of the International Economic Research Division, China's FTA proposal to ASEAN gave rise to Japan's interest in such agreements[208]. According to another member of the same Division, Japan has been competing with China in terms of FTA policy in East Asia[209]. Japan did not initiate the process of negotiating FTAs with Singapore, Korea and Mexico, nor actively propose an FTA until 2002, one day after China signed the Framework Agreement on ASEAN-China Comprehensive Economic Co-operation, when it proposed a treaty to ASEAN (Urata 2003:103). Urata (2010c) has concluded that Japan and China have both been striving to gain the position of regional leader by attempting to strengthen relations with Korea and ASEAN. In 2005, Takashi Inoguchi (2005), a professor at the University of Tokyo, wrote that

[208] Interview no. 39.
[209] Interview no. 40.

China's growing interest in ASEAN and in establishing an FTA with the Association, had caused Japan, historically ambivalent about its regional identity, to become aware of the prospect of Chinese dominance in the region and to strike back by entering into negotiations for a similar FTA. Several scholars shared this opinion on the country's competitive diplomacy. In 2004, Ippei Yamazawa (2004), a former President of the International University of Japan and the Institute of Developing Economies, as well as a former coordinator of the Japan-Korea FTA study group, wrote that "the mass media often reports that China is taking the initiative while Japan is lagging behind in pursuing FTAs and further integration in East Asia". China's FTA policy has been described as 'aggressive' by Shujiro Urata (2003:102). The country has not only signed several bilateral agreements but also practised unilateral liberalisation and opened up the extremely sensitive agricultural sector. The Early Harvest programmes are an example of China's liberalisation efforts. They allowed prospective FTA partners, for example ASEAN and Pakistan, to benefit from increased market access before a free trade agreement was fully implemented. In 2006, *The Financial Times* (Beattie 2006) voiced the opinion that China has done more to open up markets in the region than other countries under bilateral or minilateral treaties. In this respect, it has been more successful than Japan. In 2005, Aggarwal and Koo (2005:205) commented that Japan's declared interest in a prospective broader East Asian agreement may be explained by a desire to counterbalance China's growing influence. Masaki (2007:19) shares this opinion and argues that "beneath the recently accelerated FTA strategy lies an intensifying rivalry with China over energy resources, as well as for political and economic influence in Asia".

The concluded fieldwork indicates that China no longer plays a pivotal role in determining Japan's FTA policy. *Keizai Doyukai's* Managing Director confirmed the strong impact of China's foreign economic policy towards Southeast Asian countries for the formation of Japan's early FTA strategy[210]. According to a professor of Economics at Tokyo Denki University and a former Economic Planning Agency member, the 'China factor' is important for Japan in terms of economic competition, but also as a long-term geopolitical factor[211]. However, the respondents do not consider China's FTA strategy to be a major factor behind Japan's current policy. Furthermore, it can be argued that at the initial stages of Japan's FTA policy, countries in East Asia mutually influenced each other, causing the proliferation of FTAs. Manger (2005:822) points out

[210] Interview no. 23.
[211] Interview no. 60.

that the shift of Japan's trade policy towards bilateral solutions took place long before China's 2002 proposal, when Japan entered into negotiations with Singapore. FTA specialist, Takashi Terada (2009:16) wrote that, from a broader perspective, "Japan has at various turns become a follower or a reactive player to China's strategic moves that caused the structural changes in East Asia". Nonetheless, Terada (2006:25) argues that it was signing of the Japan-Singapore FTA and the possibility of an agreement between Japan and Korea that motivated China to propose an FTA to ASEAN. China did not want to be left behind in the FTA race, which in turn caused Japan to seek a similar agreement. In Munakata's opinion (2006b:115) China's proposal to ASEAN was a result of its competition with Japan and Korea. China was trying to "break up the encirclement of Japan's FTA strategy" (Yang 2008:11 cites Liu, Changli 2005). The Director-General of METI's International Trade Policy Bureau confirms this, explaining that Japan's shift towards a multi-layered policy caused China to accelerate its FTA policy[212]. He concludes that China, Korea and Japan have been competing with each other in terms of FTA strategy. Korea's initial interest in FTAs was further strengthened by the increasing proliferation of such treaties, in particular the Japan-Singapore agreement and the ASEAN-China FTA proposal (Koo 2008:8). This had further implications for a broader East Asian region. Urata (2008b:18) writes that competition for market access and political leadership amongst East Asian countries, in particular between China and Japan, is the main reason behind the proliferation of FTAs in the region and accelerated the FTA strategies of other states.

The importance of competition with Korea in Japan's FTA policy is further proof that the domino effect, or isolation avoidance, has caused East Asian states to sign FTAs in response to other countries' agreements. In Japan's case this also reflects the notion that the county has traditionally only implemented major changes as a result of outside pressure, referred to as *'gaiatsu'*[213], and the 'reactive state' view of Japan's foreign policy introduced by Kent Calder (1988). As Hirata (1998:1) explains, according to this view, "Japan is portrayed as passive, risk-avoiding, and ineffective in conducting foreign policy" and is able to change its diplomatic course only when faced with foreign pressure. Competition with other countries can be viewed as outside pressure causing Japan to sign subsequent FTAs.

[212] Interview no. 6.
[213] The term *'gaiatsu'* was discussed in Chapter 2.

3.6.2 Competition with Korea

According to the conducted fieldwork, in recent years competition with Korea has become the single most important external factor behind Japan's FTA policy. This section argues that over the last few years, Japan's rivalry with China has been replaced by concerns over Korea's growing influence. The 'China factor' remains one of the long-term geopolitical factors which will continue to influence the region in the future. At the moment, however, it is Korea's FTA policy that incites Japan to seek new solutions and re-evaluate foreign trade strategy. Korea has been more successful than Japan not only in signing high-level treaties with important partners but also in dealing with domestic opposition. A Senior Research Fellow from the Institute of Developing Economies explains that up until 2007/2008, Japan was mainly reacting to China's FTA policy in the region[214]. Since then, however, Japan has been closely observing the emergence of a new regional competitor: Korea. Korea announced the start of FTA negotiations with Chile and feasibility studies with countries such as the US, Japan, New Zealand and Thailand in November 1998 (Koo 2008:9). It signed an FTA with Chile in 2003. In 2004, it signed an agreement with Singapore and a year later with the European Free Trade Association (EFTA)[215]. The Korea-ASEAN FTA on trade in goods was signed in August 2006, between Korea and nine members of ASEAN (without Thailand). The negotiations of FTAs with other countries, for example Canada, Mexico and Australia, were still ongoing at the end of 2011. Agreements with, amongst others, China and Russia are under consideration. Korea started FTA negotiations with the US in 2006 and with the EU in 2007. They were signed in June 2007 and October 2010 respectively. By the end of 2011 the Korea-US FTA was approved by the US Congress and the Korean National Assembly. The EU-Korea FTA has been provisionally applied since July 2011.

The strong global performance of brands such as Samsung, Korea's increasing economic and political significance and accelerating FTA policy have raised the concerns of Japan's government officials, as well as the private sector. All of the 60 interviewees mentioned Korea as a major factor behind Japan's FTA strategy, as well as growing pressure to compete with the country. In the words of the Deputy Executive Director of the APEC Business Advisory Council (ABAC), Japan sees Korea as

214 Interview no. 42.

215 These are: Iceland, Liechtenstein, Norway and Switzerland.

"running just behind us and ready to overtake us"[216]. In particular, Korea's agreement with the European Union is problematic for Japanese industries. As Japan's and Korea's trade structure is similar, the country's agreement with the EU could potentially be very harmful for Japanese industries, in particular the automobile and electronics sectors (JETRO 2009:109). The EU imposes a 10 percent tariff on cars and commercial vehicles. It also applies high tariffs, with a maximum tariff of 14 percent, on electrical appliances (JETRO 2008:3). Tariffs on liquid-crystal panels (liquid-crystal display panels, also known as LCD) are around 15 percent, which will make Korean LCD TVs more competitive in the European market[217]. A Japanese global corporation in the electronics sector admits that it did not welcome the EU-Korea FTA[218]. The company has only a small manufacturing facility in Korea; hence it cannot use Korea's agreement to export products to the EU. From the company's perspective, Korea's FTAs are a serious concern. The steel and iron industry is also concerned about losing clients[219]. At the moment, Japanese exports of steel products to the EU are stable due to their high quality. However, increasing imports from Korea might eventually pose a problem. The competitiveness of Korean automotive companies might increase as a result of the agreement. Their manufacturing facilities located in the EU might choose to import materials from Korea, which would directly impact the Japanese steel industry. The competitive advantage the Korean companies will enjoy on the European market once the agreement is enacted has caused Japanese MNCs to lobby the government to sign a similar treaty with the EU. When expressing its preferences on prospective FTAs to METI, the company requested provisions similar to the ones found in the country's treaties. Sugawara (2010:18) points out that faced with Korean competition, Japanese companies might need to move even more production bases overseas, which, in turn, will cause a loss of jobs in the country. Japan's agreement with Chile is an example of how competition with Korea influences the preferences of Japanese industries. Chile had signed a trade treaty with Korea. A small number of Japanese automobile companies invested in Chile. They did not establish local assembly facilities and exported finished products from Japan. After the signing of the Chile-Korea FTA, Korean companies, such as Hyundai, could export their cars under a preferential rate, which made it important for Japanese companies to make similar arrangements[220].

[216] Interview no. 26.
[217] Interview no. 12.
[218] Interview no. 19.
[219] Interview no. 32.
[220] Interview no. 7.

Despite low levels of exports, the Japanese companies were at a disadvantage compared to their Korean counterparts and requested a similar agreement[221]. Korea has also negotiated an agreement with the US. However, a company in the automotive sector explains that this FTA does not cause so much concern[222]. This is because the company focuses mostly on compact cars and its main competitors are companies like Volkswagen and Fiat. A proposed agreement between Korea and China has been subject to an official feasibility study since 2006 and would not be in the interest of Japanese companies. For this reason, the Japanese industry supports negotiations with the EU, the US, and possibly China[223]. The differences between Japan and Korea in terms of FTA policy formation process and dealing with the opposition will be analysed in detail in Chapter 5.

3.7 'Failed' FTA Negotiations

3.7.1 Korea

In some instances, negotiating a bilateral agreement proves to be problematic or even impossible. The negotiations might be delayed, stalled or stopped due to the parties' inability to reach a compromise. This occurred during Japan's negotiations with Korea and Australia. Looking at these two 'failed' cases helps to understand what factors are necessary for the success of an FTA project on the Japanese side and how domestic groups' preferences influence the country's FTA policy. In both examples, internal domestic factors such as the distribution of benefits and costs determined Japan's position in the negotiations. First, the expected benefits for the industries were not sufficient to cause them to strongly lobby the government to sign the agreement. The second factor was the negotiating partner's firm position and unwillingness to retract its requests, in particular in the agricultural sector. It can be argued that, in these two cases, without a sufficient outside pressure, either from an international community or from the industries, the Japanese government, and the Trade Policy Bureau in particular, was unable to overcome the resistance of the agricultural sector. In this respect, the two examples illustrate Japan's impasse in FTA policy, which prevents it from taking a more active role in regional economic integration and from signing bilateral FTAs with big

[221] *Ibidem.*
[222] Interview no. 20.
[223] Interview no. 27.

markets such as the EU or the US. In his speech from 15 November 2009, Prime Minister Yukio Hatoyama (2009) announced that Japan will accelerate FTA negotiations with both Korea and Australia. During the APEC Summit in Yokohama, Japan (7-14 November 2010), Prime Minister Naoto Kan announced his intention to increase efforts for trade and investment liberalisation, for concluding FTA negotiations with Australia and for resuming FTA talks with Korea (Foster and Hosaka 2010).

The FTA negotiations between Japan and Korea were adjourned in November 2004. From the Korean perspective, the official reason was Japan's unwillingness to open its agricultural market, for example to lower duties on seaweed. According to a former advisor of Japan's Permanent Delegation to the OECD and a former MOFA employee, this was only a partial reason[224]. Another issue was the trade imbalance between the two countries. Korea had a trade deficit with Japan and the signing of an FTA could potentially widen this gap. Hence the Korean SMEs and labour unions strongly opposed the agreement with Japan. In Korea, the labour unions' position is equal to or stronger than that of the agricultural lobby groups[225]. Korean electronics and machinery companies were worried about Japanese competitors entering their market. The Japanese side was not willing to lower tariffs on Korean fishery and agricultural products like seaweed, which were much cheaper than their Japanese equivalents. *JA-Zenchu's* Deputy-General explains that the organisation was surprised to hear that the Japanese agricultural sector and the level of its liberalisation ambitions were blamed for the stalling of negotiations with Korea[226]. The Deputy-General explains that at the joint study level both sides agreed that the negotiations would be conducted based on the recognition of the special place the agricultural sector has in both countries' economies. It was understood that Japan and Korea have a very similar agricultural model. *JA-Zenchu's* Deputy-General recalls that the strategy from the beginning was to exclude sensitive products from negotiations. This view was confirmed by the *'Japan-Korea Free Trade Agreement Joint Study Group Report'* (2003). The chapter on tariff liberalisation and facilitation (2003:24) states that the Japan-Korea agreement "should address the sensitive sectors of each country and come up with appropriate measures to resolve the issue, while exercising flexibility". It explains that during the joint study research "both sides found that the two countries share similarities in many aspects, including the small scale of production and low rate of self-sufficiency" (*ibidem*:24).

[224] Interview no. 46.
[225] *Ibidem.*
[226] Interview no. 29.

However, at a later point, the Korean government changed its approach and *JA-Zenchu's* Deputy-General believes that this was caused by the Korean manufacturing industries' concerns[227].

Recently, the Japanese government has been actively working towards the resumption of negotiations with Korea; throughout 2008, meetings were held to this effect[228]. During the trilateral summit meeting between China, Japan and Korea that was held on 29 and 30 May 2010 in Korean Jeju Island, Prime Minister Yukio Hatoyama met with the Korean president, Lee Myung-bak. Hatoyama confirmed that Japan was ready to make further concessions[229]. Both Hatoyama's and Kan's administrations have increasingly attempted to reassume negotiations with Korea, including a consultation on the Director-General level in October 2010[230]. At a press conference in August 2010, Katsuya Okada (2010), Japan's Minister for Foreign Affairs, said that MOFA was making efforts to resume negotiations with Korea, as both countries share an understanding of market economics, democracy, and the political situation in the region. In addition, he considered it necessary for the two countries to increase their cooperation owing to China's FTA with Hong Kong and Taiwan. Korea is Japan's close political ally in Northeast Asia[231]. An FTA could strengthen relations between the two states. According to the Director for FTA Affairs at METI's Trade Policy Bureau the Korean government is aiming to obtain. concessions in several fields besides the agricultural sector[232]. He explains that one of the issues is non-tariff measures which prevent Korean companies from successfully competing in the Japanese market, rules on government procurement, and insufficient provisions on industrial cooperation. METI's Director confirms that the Japanese side has made a continuous effort to satisfy these demands. Gradually, however, the effort has lessened, due to the number of requests from the Korean side. For example, Korea would like Japanese companies to organise a 'reversed exhibition' in Korea, whereby instead of a seller demonstrating offered goods or services, Japanese buyers would need to organise an exhibition and invite Korean sellers[233]. Member of the Korean industries, in particular automotive companies such as Hyundai, are still concerned about Japanese competitors entering

[227] *Ibidem.*
[228] See MOFA (2008).
[229] Interview no. 3.
[230] Interview no. 9.
[231] Interview no. 40.
[232] Interview no. 3.
[233] Interview no. 6.

their market without the protection offered by tariffs[234]. Being a small country, the Korean economy is strongly dependent on exports[235].

When Japan and Korea first entered into a joint FTA study, neither of them had signed FTAs. It was considered appropriate to sign the first agreement with a neighbouring country[236]. Since then, many things have changed. Korea has signed several agreements with countries such as the US and the EU. Although both agreements were ratified only in the second half of 2011, they achieved almost 100 percent liberalisation and the level of expectations for Korean FTAs has risen[237]. Japan might not be able to fulfil such expectations. Katz (2010), the Editor-in-Chief of *'The Oriental Economist'*, points out that Japan's FTAs typically remove tariffs on about 50-60 percent of agricultural products aside from rice, while under the KORUS and the EU-Korea FTA about 99 percent of non-rice trade was liberalised within five to ten years. At the same time, although Japanese companies initially supported the agreement with Korea, an important trade partner, it is a relatively small market and industry interest has lessened over time. Several companies would still like to see an agreement with Korea realised, for example an interviewed company in the automobile sector as it does not have production facilities in the country[238]. Korean tariffs on automobiles and some electrical goods are high. For that reason, companies in the electronics sector often export to Korea using the ASEAN-Korea agreement[239]. The liquor industry is a good example of how Japanese companies' preferences for the agreement differ. Companies in this sector generally do not oppose the treaty, but they do not strongly support it either[240]. *Sake* producers would like to see an agreement with Korea realised. Japanese *sake* is highly competitive and well known in international markets. However, *shochu* producers are concerned about the negative impacts of such agreement. Their products would compete with the more popular and cheaper Korean version, *soju*. The Korean *soju* company, Jinro, is already exporting its products to Japan.

According to METI's Director-General for International Trade Policy, negotiations with Korea have not been successful due to a lack of strong interest in the agreement on both sides of the table[241]. Japanese industries are not particularly interested in an FTA

[234] *Ibidem.*
[235] Interview no. 10.
[236] Interview no. 5.
[237] *Ibidem.*
[238] Interview no. 20.
[239] Interview no. 16.
[240] Interview no. 12.
[241] Interview no. 6.

with Korea[242]. In addition, the trilateral FTA project between China, Japan and Korea (CJK) appears to be a plausible alternative. The official trilateral study was launched in early 2010. Scheduled to conclude by mid-2012, the inter-governmental study group completed three meetings in 2010. So far, due to a wide range of issues covered, the discussion has been limited to a unilateral airing of opinions and there has been no convergence of views. The final joint study group meeting on the feasibility of the CJK FTA took place in December 2011. In a way, the trilateral FTA project has increased the pressure on the Japanese government to sign an agreement with Korea, in particular as Korea and China are conducting an FTA feasibility study and in January 2012 announced their intention to negotiate a bilateral FTA. At the same time, it has further weakened corporate interest in a bilateral agreement. In the opinion of the Director-General for Manufacturing Industries Policy at METI's Manufacturing Industries Bureau, parts of the manufacturing industry have a strong interest in the CJK FTA[243]. From the industries' perspective, a trilateral FTA might be a better solution than a bilateral one as it provides more options. Concerns over Japan's agricultural sector, non-tariff barriers (NTBs) and government procurement regulations have also been raised by the EU, with which Japan is currently discussing the possibility of a free trade agreement, as described later in this chapter. The Union also does not demonstrate a strong interest in an FTA with Japan. European companies have little to gain as Japan's MFN tariffs on manufacturing products are already quite low. The difference between Korea and the EU is that Japanese companies strongly support the agreement with the EU[244]. It is a much bigger trading partner and Japan is more likely to be persuaded to make concessions. Korea's 48 million population market might not prove to be a sufficient incentive for Japan.

3.7.2 Australia

The first round of negotiations between Australia and Japan took place in April 2007. In January 2011, the 12th round of negotiations took place in Tokyo. Agriculture is the key issue prolonging the talks. The country requested a high level of liberalisation in this sector and an immediate abolition of tariffs, which Japan is not prepared to accept[245].

[242] Interview no. 3.
[243] Interview no. 7.
[244] Interview no. 19.
[245] Interview no. 6.

Australia is a major agricultural exporter. The opening up of the agricultural market is the key reason behind FTA negotiations with Japan[246]. The Australian side would like to lower Japan's tariffs on rice, wheat, barley, sugar, butter, skimmed milk, cheese and beef: all of which are sensitive products[247]. Without a substantial structural reform of the sector, it will be difficult for Japan to conclude the agreement. Additionally, the US is also interested in eliminating tariffs on Japanese rice, wheat, barley, and beef and if Japan opens up its agricultural markets for Australian products there is a possibility that it will demand similar concessions[248]. FTA negotiations with Australia started despite strong opposition from the Ministry of Agriculture and agricultural organisations. *JA-Zenchu* argues that they should never have begun[249]. The organisation is aware that, in order to comply with the WTO regulations, each FTA should reach a 90 percent liberalisation level. According to its Deputy-General Manager, it is impossible to reach this level with Australia while excluding all sensitive products. Prior to the first round of negotiations, *JA-Zenchu's* representatives spoke to Australian delegations visiting Japan[250]. They explained that, from the agricultural sector's perspective, it is not possible to conclude the agreement. Rural areas are dependent on the agricultural sector and MAFF cannot ignore their position. Without a clear political decision on FTA strategy it is difficult to overcome this opposition. This is one of the main reasons behind Japan's impasse in FTA policy.

The Director for Economic Partnership (EPA/FTA) at METI's Trade Policy Bureau, who is responsible for FTA negotiations with India and Australia, explains that Japanese companies have a very limited interest in an agreement with Australia[251]. He believes that the Japanese industries would benefit less from such an FTA than from a similar agreement with, for example, China. The Director-General at METI's Manufacturing Industries Bureau, which assessed the preferences of companies in various sectors, confirms that profits from such an agreement would be limited[252]. The automobile industry is just such an example. According to a policy analyst from the Foreign Investment and Trade Policy Division of the Australian Treasury Department the domestic automobile sector is dominated by foreign investors[253]. The two main companies are GM Holden and Toyota, both of whom have been producing automobiles

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[246] Interview no. 3.
[247] Interview no. 11.
[248] *Ibidem.*
[249] Interview no. 29.
[250] *Ibidem.*
[251] Interview no. 5.
[252] Interview no. 7.
[253] Interview no. 35.

in Australia for a long time. Toyota has a large manufacturing base in the country and enjoys tariff protection. The local government offers support for Toyota's production of hybrid cars. Two of the interviewed companies in the automobile sector stated that they have little interest in investing and producing in Australia due to Toyota's competition and strong position in the market[254].This preference is strengthened by the fact that although the investment environment in Australia is stable and regulations are transparent, manufacturing costs are high. Wages are much higher than in China or in ASEAN countries. METI's Director-General for Manufacturing Industries Policy explains that even with no tariff protection, it would be difficult for Japanese automobile companies to penetrate the market, given the large distances and related transport costs[255]. In addition, in order to sell their products in Australia, companies would need to establish a large sales network. This would engender further costs. For example, Mitsubishi used to manufacture in Australia but left the country in 2008 due to low levels of sales and small profit. Australia's MFN tariff on automobiles is 5 percent[256]. Therefore, foreign companies prefer to export automobiles to Australia than to manufacture locally[257]. Korean companies Hyundai Motor Company and GM Daewoo export finished vehicles to Australia, and China exports low-priced cars. Japanese automobile companies export mainly through Thailand and the Australia-Thailand FTA, which was mentioned earlier in this chapter[258]. An interviewed company explains that it switched parts of its production from Japan to Thailand in order to export to Australia[259]. Therefore, although the company does not have a manufacturing facility in Australia, it does not require an FTA with this country. Of course, an FTA with Australia could increase Japanese automakers' flexibility and allow them to export products directly from Japan.

Japan imports steel, natural gas, and other resources from Australia. However, the steel and iron industry does not have a strong preference regarding an agreement with Australia. It has been investing in the natural resources sector in Australia for many years, for example in the mining industry. Trade relations between Australian and Japanese companies in this sector are well established. In order to develop an

[254] Interview no. 20 and 21.
[255] Interview no. 7.
[256] This is according to the Global Trade Atlas Navigator Database. Accessed October 2010, JETRO Business Library, Tokyo.
[257] Interview no. 35.
[258] Interview no. 7.
[259] Interview no. 20.

internationally competitive mining industry, large investments are required [260]. According to the Japan Iron and Steel Federation, companies are concerned about securing their supplies of high quality steel[261]. To that end, they make arrangements to provide a safety net for Japanese importers. Large companies, such as Nippon Steel, secure imports by private business agreements with their suppliers. Therefore, the Federation explains, there is no need to repeat this under an FTA.

The agreement with Australia is another example of a Trade Policy Bureau-driven FTA. The Manufacturing Industries Bureau has little interest in concluding the agreement[262]. The Trade Policy Bureau, on the other hand, strongly supports the agreement from a broad, strategic point of view. Australia is a member of ASEAN+6 and APEC and is an important political ally in East Asia. In the opinion of METI's Trade Policy Bureau, Japan should aim to sign an agreement with Australia as, although negotiations can be challenging, agreements with developed economies or allies are considered from a political perspective to be easier[263]. The Bureau considers Australia to be a very important potential FTA partner. According to its Director for FTA Affairs, Australia is one of the key countries as it not only has an FTA with ASEAN but also with the US[264]. In his opinion, an agreement with Australia would be a milestone for Japanese trade policy. The two countries have traditionally been allies and have worked together towards the establishment of APEC, as will be discussed in Chapter 4. Nonetheless, the Bureau does not want to enter into an open confrontation on the subject with the agricultural sector and the Australian side is determined to persuade Japan to lower its tariffs on agricultural goods. The domestic opposition to the agreement with Australia is very strong. The interest of the domestic sectors is weak, as has been demonstrated in this section.

3.8 Recent Bilateral FTA Policy

Just as for the ministries, for the private sector Japan's consecutive FTAs were a learning process. At the early stages of Japan's FTA policy, companies were mainly interested in tariff reductions and not, for example, in the liberalisation of investment or

[260] Interview no. 35.
[261] Interview no. 32.
[262] Interview no. 7.
[263] *Ibidem.*
[264] Interview no. 3.

trade in services[265]. This might be explained by the fact that tariffs in the ASEAN region were initially quite high. In time, after Japanese companies started using AFTA and other FTAs, tariffs were no longer the main problem. Due to the increasing economic integration in East Asia and tariff liberalisation achieved under unilateral or reciprocal schemes, provisions on non-tariff barriers started playing a much bigger role in determining the benefits of an FTA. Tariff reduction is still important, despite the falling MFN rates, but a strong focus is also placed on how FTAs can further improve MNCs' operations and business environment or secure Japanese investments in East Asian. Japanese businesses, although often divided by different preferences, are also increasingly interested in the standardisation of rules and regulations under bilateral FTAs[266]. There is a strong parallel between this tendency and the industries' preferences regarding a region-wide FTA, which will be discussed in Chapter 4. Securing access to natural resources is an example of a non-tariff issue that has become increasingly important in Japan's bilateral FTA policy[267]. In May 2006, METI published the '*New National Energy Strategy*' (2006). The document spoke of securing access to oil, gas, and other resources by deepening the economic relations with resource-rich countries, for example by concluding FTAs. The Indonesia-Japan FTA, signed in 2007, was the first free trade agreement used for this purpose. A similar clause was included in the Brunei-Japan agreement, also signed in 2007 (Masaki 2007:19). Both of those countries are oil and natural gas producers and Indonesia is Japan's biggest supplier of liquefied natural gas, providing over 40 percent of imports. Apart from Australia, the country is also negotiating bilateral FTAs with another important natural resources provider, the Gulf Cooperation Council. In addition, Japan is conducting a joint FTA study with Mongolia, which would be this country's first free trade agreement. Mongolia has extensive natural resources, including new coal fields. So far, there has been no mention of an energy clause in this FTA, but according to the Director for FTA Affairs at METI's Trade Policy Bureau the Japanese government believes that even without it an agreement with Mongolia will help to secure stable imports of resources[268].

The increasing competition with Korea, amongst other factors, has caused Japan to consider signing high-level FTAs with important trade partners or big markets such as the EU, China and the US. This has been confirmed by the Director of MOFA's

[265] Interview no. 39.
[266] Interview no. 23.
[267] Interview no. 3.
[268] *Ibidem.*

EPA/FTA Policy Division[269]. There is a strong interest from the Japanese industries in such treaties, although, as in the case of agreements with ASEAN countries, preferences vary between companies. Of the three mentioned groups, Japan is currently discussing prospects for a free trade agreement with the EU. Such an FTA would replace the 2001 Japan-EU Ten Year Action Plan, which expires in 2011 (Midford 2010). There is a common conviction in Japan that the EU has little interest in negotiating an agreement with them as the country's tariffs are already low[270]. Because of this, the benefits for the EU would be limited (Sugawara 2010:7). For example, the EU imposes a 10 percent tariff on automobiles, while Japan's rate is zero (Sekizawa 2009). Ravenhill (2009:30) confirms that the EU does not have much incentive to sign an FTA with Japan. In November 2010 a meeting took place between Prime Minister Naoto Kan and the EU leaders. While the former expressed interest in starting an official joint FTA study in the spring of 2011, the European side opted for prolonging the initial talks and holding meetings on the ministerial level (*The Japan Times* online 13 November 2010). According to Andra Koke (2010), Head of Trade and Development Unit at the European Commission's Directorate-General for Trade, the EU is concerned about Japan's NTBs. This was also confirmed during the November meeting, when European Commission President Jose Manuel Barroso asked the Japanese side to make a strong commitment to liberalising non-tariff barriers and accelerating deregulation in government procurement and other trade areas (*The Japan Times* online 2010). During the panel discussion on the future of Asia-Europe relations at the Asian Development Bank Institute, British Ambassador to Japan David Warren (2010) also stressed the importance of non-tariffs barriers for the European side.

The Japanese industries are highly interested in signing such an FTA, which would not only provide them with an access to the European market but also eliminate their disadvantage compared with Korean companies. Although an agreement with the EU is a long-term project, in 2009 Japan signed its first FTA with a European country: Switzerland. This was an important development, as Japan's FTA with Switzerland bears a resemblance to the country's first FTA with Singapore. The trade volume between the two countries is low, which caused the interviewed companies to question the usefulness of this agreement. However, it has a strategic and diplomatic significance. Just like the agreement with Singapore, this was clearly a Trade Industry Bureau-driven

[269] Interview no. 9.
[270] Interview no. 8.

FTA[271]. From the government's perspective, Switzerland was an important partner for several reasons. This is Japan's first FTA with a European country and its first European-style FTA[272]. Although not a member of the European Union, it can be argued that Switzerland is for Europe what Singapore has been for East Asia – a gateway and a 'test FTA'. The agreement could benefit the private sector, as Switzerland has signed an FTA with the EU. Despite the low trade volume between Japan and Switzerland, the agreement included several sensitive issues. For example, Switzerland is a strong exporter of cheese and was determined to open Japan's markets for this product[273]. Cheese production in Japan is concentrated in Hokkaido and the large dairy farms were a source of strong support for the local LDP politicians[274]. The agricultural sector and MAFF oppose the proposed agreement with the EU, although the protests are not as strong as in the case of the Australia-Japan FTA. MAFF's Director for APEC and European Affairs explains that the Ministry understands that it is important for the manufacturing companies in the automotive and electronics sectors to maintain their competitiveness[275]. However, he argues the Korean company Samsung dominated the European flat-TV market, even before the EU-Korea FTA has been signed, and both countries paid a 14 percent tariff on flat TVs. MAFF's Director points out that even under those circumstances Japanese brands failed to capture a significant market share and tariffs are not the only factor determining market share. This illustrates the domestic debate between the two Ministries. As there are valid arguments on both sides, it is difficult to reach a compromise.

In 2011, Japan has signed two other FTAs: with India in February and with Peru in May. The agreement with India was of great importance for the manufacturing industry. As discussed in this chapter, the automobile industry was particularly interested in this agreement due India's high tariffs on automobiles. Therefore, the FTA with India is one of the Manufacturing Industries Bureau-driven ones.

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[271] Interview no. 7.
[272] Interview no. 46.
[273] Interview no. 10.
[274] Interview no. 7.
[275] Interview no. 10.

3.9 Preferences for the AJCEP

3.9.1 The AJCEP

The ASEAN-Japan Comprehensive Economic Partnership Agreement (AJCEP) was signed in April 2008 and came into effect in December 2008. The origins of this FTA date back to 2002. In his Singapore speech, delivered in January 2002, Prime Minister Junichiro Koizumi (2002) proposed an "Initiative for ASEAN-Japan Comprehensive Economic Partnership". A Joint Declaration (ASEAN-Japan Summit 2002), drafted during the November 2002 ASEAN-Japan Summit held in Phnom Penh, Cambodia, spoke of implementing "measures for the realisation of a Comprehensive Economic Partnership (CEP), including elements of a possible Free Trade Area, which should be completed as soon as possible within ten years, and to establish a Committee to consider and draft a framework for the realisation of the CEP between Japan and ASEAN". As a result, the '*Framework for Comprehensive Economic Partnership between Japan and the Association of South East Asian Nations*' was signed in October 2003 and negotiations started in April 2005. The AJCEP was negotiated and signed parallel to FTA negotiations with respective ASEAN economies. The Japan-Vietnam FTA was signed after the AJCEP was implemented, and the agreement with the Philippines, although signed in 2006, went into effect ten days after the treaty with ASEAN. In a way, Japan's bilateral FTAs with ASEAN and the AJCEP are two parts of Japan's overall trade policy towards the Association. This part of the chapter analyses the government and industries' preferences regarding the AJCEP. It questions the value added by the agreement in comparison to bilateral treaties? In particular, Japan's solution to the coexistence of the two types of FTAs helps to demonstrate Japan's pragmatic approach to regional trade liberalisation and to draw inferences regarding preferences for a prospective region-wide FTA and its harmonisation with existing agreements. The analysis of this issue in Chapter 4 draws heavily on the AJCEP's case. Furthermore, Japanese companies have formed their preferences on the usefulness and scope of the prospective region-wide treaty based partially on the AJCEP's example.

3.9.2 The Preferences of the Japanese Ministries

The objectives of the two types of FTAs were somewhat different. Bilateral agreements, above all, serve the interests of Japanese industries and improve the business environment in East Asian countries. The AJCEP has an additional political dimension. ASEAN countries have strong economic ties with Japan through vast investment, financial aid, and official development assistance (ODA). Before the start of negotiations in 2005, ASEAN countries were concerned that Japan's bilateral approach might cause a division within the Association and the less developed members would be left behind (Terada 2008:11). Therefore, it was politically important to have an agreement covering all ASEAN countries[276]. The AJCEP includes Laos, Cambodia, and Myanmar. This was one of the reasons behind MOFA's and METI's Trade Policy Bureau's support for the agreement[277].

Instead of signing a minilateral agreement with ASEAN first as China and Korea had done[278], Japan decided to start with bilateral treaties. There are several explanations for this two-track strategy towards ASEAN. The Director for FTA Affairs at METI's Trade Policy Bureau explains that the idea for AJCEP was not fully formed when Japan started negotiating bilateral agreements[279]. Terada (2009:10) mentions that Japan did not consider signing an agreement with ASEAN as a whole until China's proposal and instead, preferred to negotiate bilateral agreements with member countries with which it had strong, long-standing economic ties, for example based on ODA. According to a Deputy Director at JETRO's International Economic Research Division, developed economies, like the US and Japan, prefer to negotiate bilaterally, as in this way, they can obtain higher concessions[280]. On the other hand, a former METI Director-General for International Trade Policy and a negotiator of the Japan-Philippines and Japan-Malaysia FTAs, recalls that, in 2004, the interest of ASEAN countries in an FTA with Japan varied significantly[281]. Therefore, Japan started signing bilateral agreements with the countries which were most interested. Furthermore, there were differences in opinion within the Japanese government. A Deputy Director at JETRO's International Economic Research Division points out that in MOFA's understanding the minilateral agreement

[276] Interview no. 2, 8, and 50.
[277] Interview no. 3 and 9.
[278] Korea signed and FTA with Singapore two years prior to ASEAN-Korea FTA and China signed an FTA with Singapore in 2008, four years after the ASEAN-China FTA was signed. The countries do not have any other FTAs with ASEAN member economies.
[279] Interview no. 2.
[280] Interview no. 40.
[281] Interview no. 8.

was premature[282]. In turn, MOFA's Director of EPA/FTA Policy Division explains that METI wanted to sign the AJCEP first, due to the internationalisation of production networks and the *de facto* presence of Japanese companies in ASEAN[283]. He considers MOFA's approach at the time to be more pragmatic. The ministry preferred to commence with bilateral treaties. In addition, he explains, MOFA was cautious about engaging in minilateral, semi-regional FTA negotiations, as it was concerned about the effect this might have on Japan's relationship with the US[284]. The decision was made to negotiate bilateral agreements first, due to the anticipated complexity of a minilateral FTA. In the end, since 2005 the negotiations have progressed simultaneously.

Terada (2008:11) recalls that before the start of negotiations with the Association, there was a possibility that the ASEAN-Japan FTA might be established by consolidating existing agreements. In the end, a separate agreement was negotiated and added on top of the existing ones. In order to solve the issue of the coexistence of the two types of agreements, a flexible clause was included, allowing users to choose the FTA that provided the most advantageous conditions. The bilateral agreements and the AJCEP coexist side by side, raising questions on the possible aggravation of the noodle bowl effect. In practice this means that countries such as Japan and Singapore are connected by two separate FTAs. As of January 2009, there were 44 FTAs concluded in East Asia, of which 37 were signed and in effect and the remaining seven were signed (Kawai and Wignaraja 2009:2). Most of the bilateral, minilateral and planned regional FTAs in East Asia coexist with other treaties. Therefore, one product is often subjected to several tariff rates and phase-in schedules under different agreements. The signing of the AJCEP raised questions on the complications that might entail in terms of additional regulations and administrative requirements. The former Director for FTA Affairs at METI's Trade Policy Bureau argues that the government has no intention of harmonising or consolidating these agreements, as companies use both the bilateral and the AJCEP, especially as the former often offer higher concessions[285]. Furthermore, interviewed Japanese MNCs in various sectors do not regard the coexistence of the AJCEP with bilateral agreements to be a major problem. According to a representative of the Japan Chamber of Commerce and Industry, the idea that overlapping agreements cause the noodle bowl syndrome is an exaggeration in the opinion of Japan's private

[282] Interview no. 39.
[283] Interview no. 9.
[284] *Ibidem.*
[285] Interview no. 2.

sector[286]. He explains that most companies trade few products and the majority of East Asian FTAs use similar RoO. Even if the company is exporting to several countries, the one thing it needs to control, in order to be able to comply with the RoO in different FTAs, is the percentage of local content[287]. *Nippon Keidanren's* Deputy Director believes that the problem does not lie in the overlapping rules of origin, but in the quality and access to information on them[288]. In the Director's opinion, even if JETRO's branch in Thailand has good information on the implementation schedules, RoO and local procedures, it is not necessarily accessible to smaller Japanese companies located in Tokyo.

There are two levels on which the AJCEP coexists with other provisions. First, as was already mentioned, the AJCEP includes a flexibility clause. Japanese companies are free to export under the treaty that offers better conditions and tariffs for their products: they can choose the FTA they want to use. An exporter wishing to sell a product to Thailand compares tariff rates for it between the MFN, Japan-Thailand and ASEAN-Japan preferential tariffs and simply chooses the lowest one. The flexibility clause is the solution to the overlapping agreements between Japan and ASEAN members. Before the provision was implemented, it was discussed at a meeting between the government officials, industry representatives and scholars[289]. During this meeting, companies explained the narrowness of their area of operations. The MNCs are used to trading under particular provisions of bilateral treaties with ASEAN members and would not like to see them replaced with a new treaty. They argued that the coexistence of overlapping agreements does not pose a problem for the private sector. A Senior Researcher at JETRO's Overseas Research Department argues that companies only need to compare three sets of rules of origin[290]. He bases this opinion on several research interviews with representatives of small and big businesses conducted by JETRO all over Japan. In addition, the former chief negotiator of the Japan-Mexico FTA explains that several members of the government share an opinion that the possibility of choice between the overlapping FTAs reduces the negative impacts of coexisting agreements[291]. In order to facilitate the comparison of tariffs between the MFN, bilateral agreements and the AJCEP, JETRO has compiled a free database, developed by FedEx. It provides information on duties, liberalisation schedules and rules of origin. It also allows for the

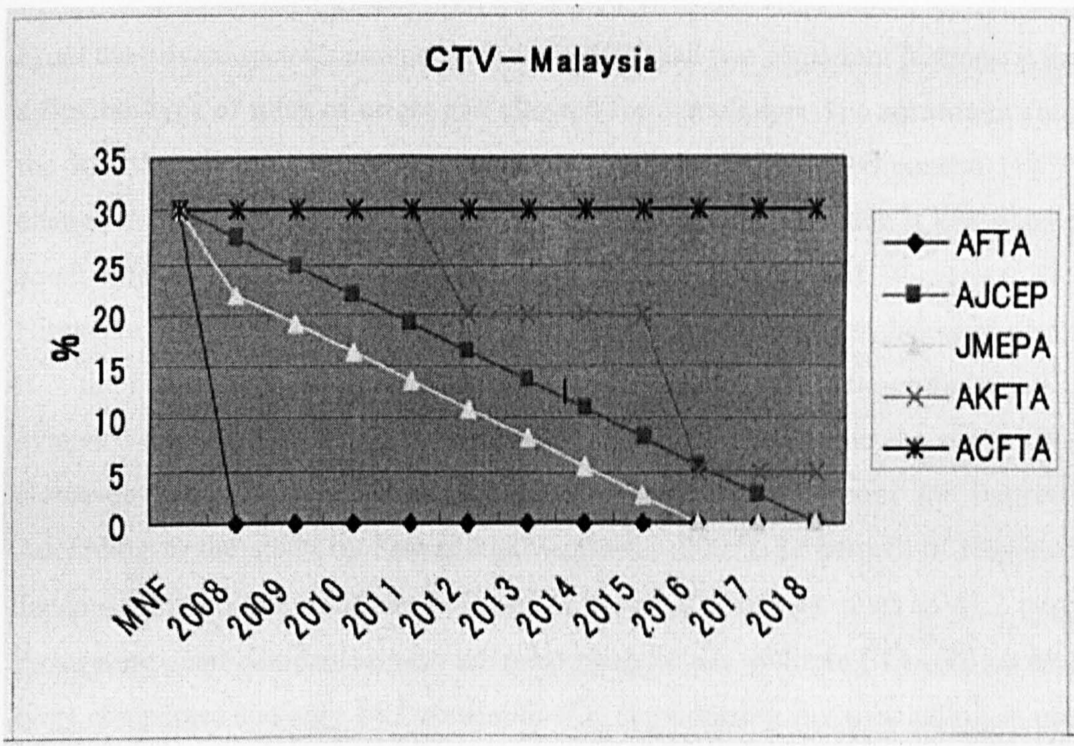
[286] Interview no. 25.
[287] Interview no. 14.
[288] Interview no. 24.
[289] Interview no. 48.
[290] Interview no. 38.
[291] Interview no. 57.

comparison of tariff rates over several years, based on products' Harmonised System (HS) 8-digit code. New information is added with each signed agreement. The Deputy Director of JETRO's Overseas Research Department explains that the utilisation rates of Japan's FTAs have risen since the database was introduced[292]. The FedEx database might be especially useful for smaller companies, which find it difficult to utilise a complex tariff reduction system under several separate FTAs. However, a representative of the Japan Chamber of Commerce and Industry points out that the database is not ideal for quick and easy comparisons of tariffs[293]. The user can compare rates of only up to three countries. For example, Singapore's Ministry of Trade and Industry database calculates the best preferential tariff rate[294]. For importing products to Japan, the Ministry of Finance has a one-stop website, where an importer can check tariffs[295]. There is no equivalent for exporting from Japan.

The second level, on which the AJCEP requires the coexistence of various provisions, is within the actual agreement. Before the start of negotiations with ASEAN, the Japan Chamber of Commerce and Industry presented its preferences to the government. The Chamber explained that it would like the AJCEP to have same rules of origin as in bilateral agreements and one implementation schedule within the minilateral treaty[296]. The AJCEP incorporated rules and implementation schedules from bilateral agreements with particular ASEAN members. In other words, the majority of concessions under bilateral agreements were extended to the AJCEP. This means that the agreement does not have a common implementation schedule. In fact, the ASEAN-Japan Comprehensive Economic Partnership Agreement has ten separate liberalisation schedules, plus the one under AFTA (Lim and Kimura 2010:16). If under JTEPA, Thailand committed to liberalising a tariff over ten years, under the minilateral agreement phase-in schedules were, in most cases, set for the same amount of time. However, in the case of Malaysia and Singapore bilateral agreements went into effect in 2006, two years before the AJCEP. For Thailand this gap is one year.

[292] Interview no. 39.
[293] Interview no. 25.
[294] Available from http://www.fta.gov.sg/index.asp.
[295] Interview no. 25.
[296] *Ibidem.*

Figure 3.13 Import tariffs on LCD TV in Malaysia (by year, by FTA)



Source: Obtained during interview no. 14

Figure 3.13 illustrates the difference in tariffs for an LCD TV for Malaysia, under AFTA, the AJCEP, bilateral agreements with Japan (JMEPA), the ASEAN-Korea FTA (AKFTA), and the ASEAN-China FTA (ACFTA). It can be seen that tariffs under the bilateral treaties and the AJCEP correspond to each other with a delay of two years. In addition, each agreement introduces different, overlapping product-specific and sector-wide rules of origin and lists of sensitive items (Lim and Kimura 2010:16). According to the former Director for FTA Affairs at METI's Trade Policy Bureau, varying implementation schedules are a result of a compromise of interests within each industry[297]. The former Director expects that a gradual shift will take place and the companies will start using the AJCEP more often, especially when tariffs under both types of agreements converge. In reality, however, the private sector has very little interest in trading under the AJCEP, as will be demonstrated in the next section.

[297] Interview no. 4.

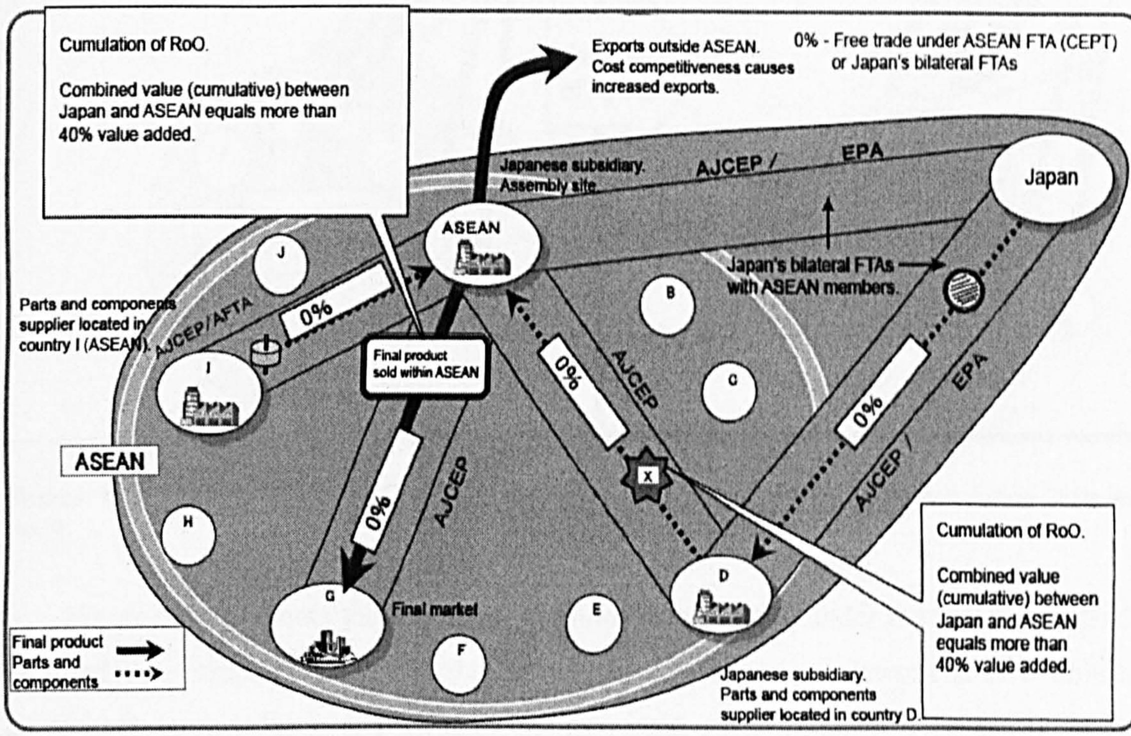
3.9.3 Preferences of Japanese Industries

From the private sector's perspective, the AJCEP had two important features: it included a flexible type of rules of origin and allowed for cumulation. The agreement simplified the RoO by allowing companies to choose between value-added content (VC) and a change in the tariff classification (CTC) rule. This type of provision is known as the co-equal rule of origin. According to recent studies (Kawai, and Wignaraja 2009 and Hiratsuka *et al.* 2008a) on the impact of multiple rules of origin on Japanese companies, it is the preferred solution for most industries. Kawai (2009) argues that there is little evidence that rules of origin have harmed the private sector over the past eight years. However, with the increasing number of FTAs, there is room for improvement. According to the study by Kawai and Wignaraja (2009), 31 percent of respondents in Japan confirmed that multiple RoO add to business costs. As much as 41.2 percent of those were giant companies, who are most likely to use multiple FTAs, 20 percent were large companies and only 14.3 percent SMEs. Harmonising RoO, including an option of using the VC or CTC rule was the preferred solution for 51 percent of respondents in all selected countries. According to the second study (Hiratsuka *et al.* 2008a) 27.8 percent of companies stated that multiple RoO add to business costs. For 33 percent of respondents this was not a problem at present but might be in the future. The study argues that the co-equal rule of origin is the preferred solution. This has also been confirmed in a more recent article (Kawai and Wignaraja 2011a). The co-equal rule of origin is popular within the East Asian region. First, Japan introduced it for several product lines in the ASEAN-Japan agreement and bilateral FTAs, for example, the one with Malaysia and the one with Thailand[298]. Then, the ASEAN-Korea[299] and the ASEAN-Australia-New Zealand (AANZFTA) FTAs and AFTA introduced that system[300]. AANZFTA uses the co-equal RoO on approximately 83 percent of all tariff sub-headings (Primer on Rules of Origin 2009:5). Extending the co-equal rule across the region could off-set the negative aspects of overlapping agreements and allow for the harmonisation of RoO in the future. There are additional reasons for implementing the rule. For industries using a specific production process and technology, such as the chemical industry, the CTC rule of origin is often impossible to apply. On the other hand, rules of origin based solely on the VC can be restrictive and difficult to comply with. An automobile is comprised of around 30,000 parts and components, purchased

[298] This was done for the CTC on the sub-heading level, HS 6 digits.
[299] This was done for the CTC on the heading level.
[300] Interview no. 2.

from several to several hundred vendors and local suppliers, which makes applying the local content rule of origin difficult[301]. When all FTA members use the same types of rules of origin, diagonal cumulation is possible, as explained in Chapter 2. This provision was particularly important for the textile sector.

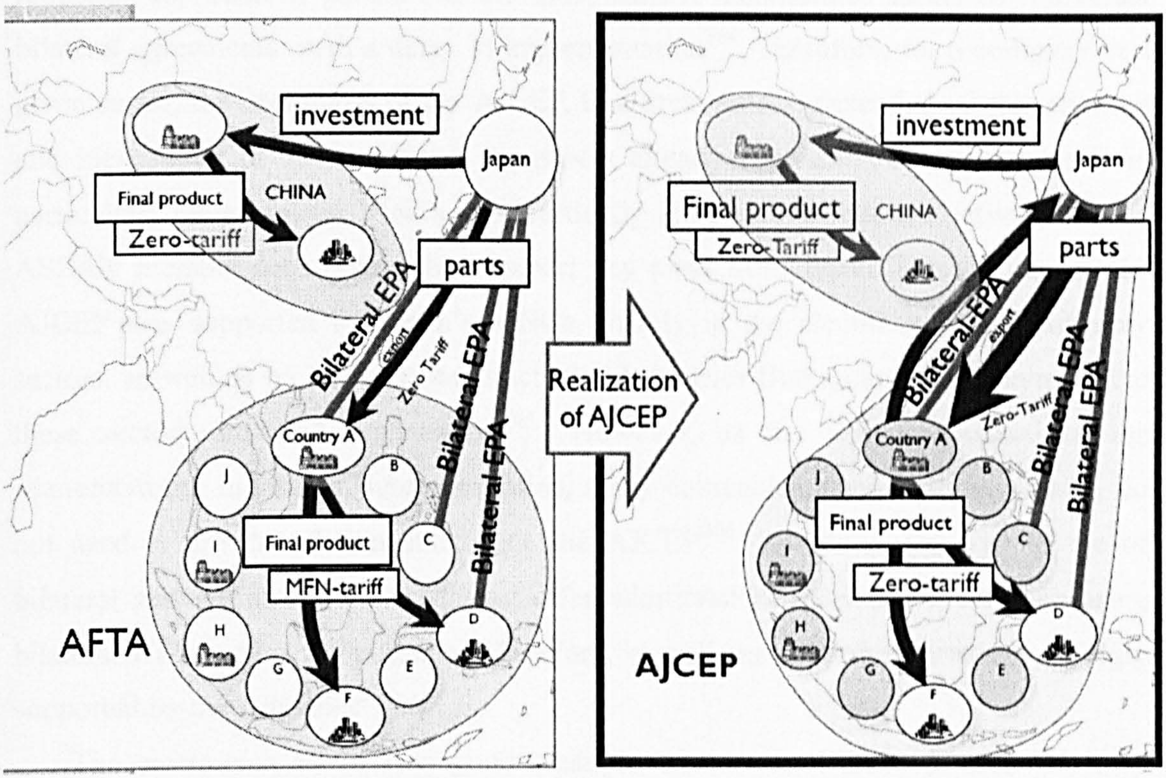
Figure 3.14 Impact of the AJCEP



Source: Translated and modified by the author, based on METI (2008)

301 Interview no. 14.

Figure 3.15 Impact of the AJCEP (II)



Source: MOFA, 2010, Japan's FTA/EPA Current Status and Main Issues, p.7. Obtained during interview no. 9

Figure 3.14 presents the impact of cumulation and RoO under the AJCEP on trade in goods. A company with a vertically integrated production network is now able to trade both intermediates and finished goods within ASEAN under zero tariffs. It can now produce in Thailand, using Korean parts under the ASEAN-Thailand FTA, and export the finished product to another ASEAN country duty-free under the AJCEP, even if Korean parts constitute more than 40 percent of the finished good[302]. This is further illustrated by Figure 3.15, which presents the same scenario. For Japanese industries the co-equal rule of origin and cumulation were the main advantage of the AJCEP. The agreement has been referred to as the 'lowest common denominator' type of FTA[303]. MOFA's *'FTA Strategy'* (2002) spoke of the planned agreement with ASEAN. Point four of the document, *'The type of free trade agreement Japan is aiming for (what to negotiate)'* (*ibidem*), states that "in order to ensure that such partnership be comparable to economic integration in other regions, it should offer the greatest possible liberalisation in a broad range of areas". Nonetheless, the agreement covers trade in goods only. It achieved a limited scope of liberalisation and had little value added in

[302] Interview no. 15.
[303] Interview no. 60.

terms of tariff concessions. The Japan-ASEAN FTA had little meaning in terms of tariff reduction for trade in goods. For the most part, it incorporated tariffs of individual bilateral agreements, with a delay in implementation[304]. Therefore, for a company in a given sector, the usefulness of the AJCEP, to a great extent, depended on the structure and localisation of its operations. As it was already explained, the co-equal rule is particularly beneficial for MNCs with vertically integrated production networks in the ASEAN member economies which export key parts from Japan. For that reason the AJCEP was supported by Japan's MNCs, mainly in the electronics and machinery sectors, as well as by METI's Manufacturing Industries Bureau and *Keidanren*, where these sectors are well represented[305]. However, as the Director-General of the Manufacturing Industries Bureau explains, many companies, even in those sectors, do not need to use cumulation and hence the AJCEP[306]. For them, the coexistence of bilateral and minilateral FTAs do not offer additional benefits. They continue using bilateral FTAs whenever possible. Therefore, overall the agreement was not strongly supported by the industries[307].

The electronics sector is a good example of how an FTA with ASEAN is of significance for Japanese companies. As explained earlier, the production base of corporations in this sector is located mostly outside Japan and they often manufacture only a handful of products in Japan. For example, one of the interviewed corporations manufactures only camcorders in Japan[308]. The introduction of the co-equal rule was particularly important to Japanese manufacturers of the LCD panels and televisions. Those high value added parts for liquid crystal TVs are only manufactured in certain countries in the region, for instance, Japan and Korea (JETRO 2009:111). A company producing LCD TVs in ASEAN imports the panel, which by itself constitutes 60 or 70 percent of the final product's price. As the part exceeds AFTA's 40 percent VC rule it is not eligible for preferential tariffs. Having only bilateral agreements with ASEAN members, Japanese companies could import the panel to ASEAN duty free under ITA and sell the finished product locally under bilateral FTAs. However, the MFN tariff needs to be paid when exporting to other ASEAN countries. When Korea signed an FTA with ASEAN, Korean LCD panels could be exported from one ASEAN country to another. Therefore, LCD panels produced in Japan lost their competitive advantage.

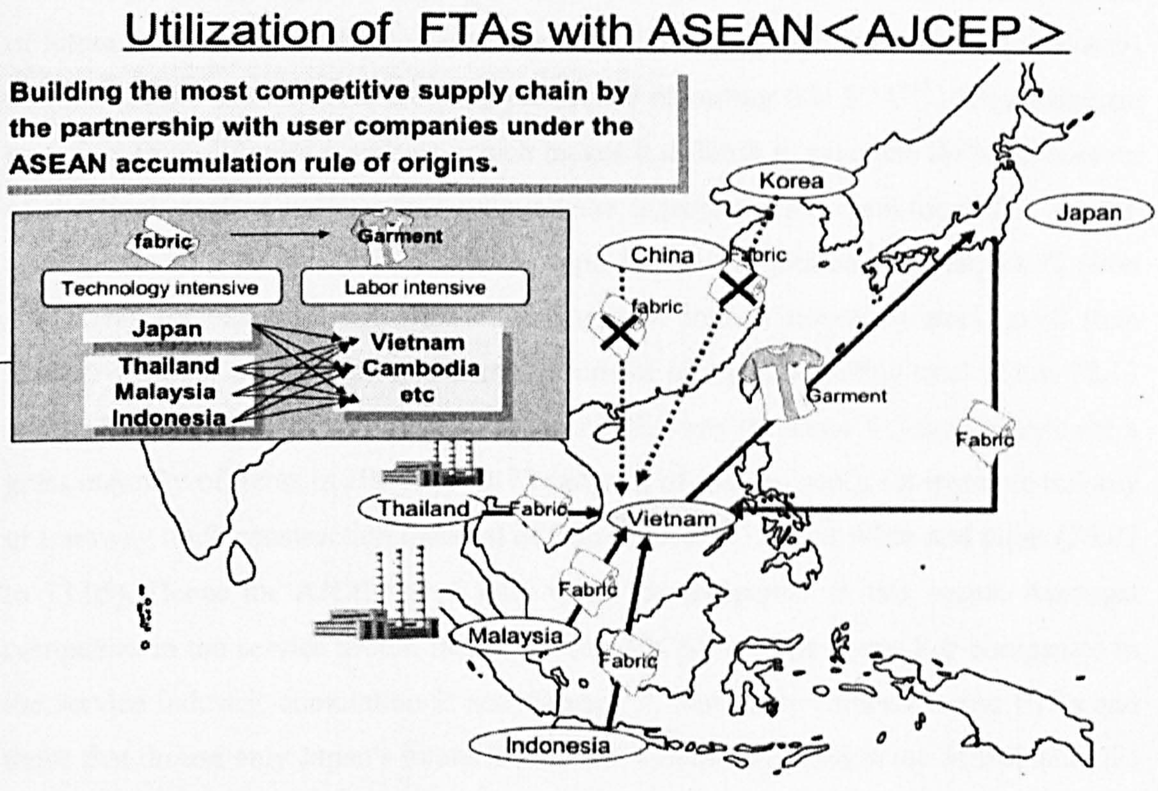
[304] Interview no. 7.
[305] *Ibidem.*
[306] *Ibidem.*
[307] *Ibidem.*
[308] Interview no. 14.

Japanese companies in the electronics sector strongly advised the government to sign a similar agreement to retain their competitive advantage in panels and other high value added parts and components. The AJCEP offers much lower tariffs on LCD TVs and LCD panels than the ASEAN-Korea FTA[309]. This further confirms the argument that competition, and in particularly competition with Korea, shapes the Japanese companies' preferences for FTAs.

For the textile and apparel sector, the AJCEP was of interest as it included the least developed members of the Association, with which Japan did not have bilateral agreements[310]. Several companies in the textile and apparel sector have established production facilities in Cambodia, Vietnam, and Laos[311]. They find cumulation under the AJCEP useful while complying with the double transformation rule of origin. The textile and apparel industry needs to comply with the two-step rule of origin (double transformation). Under bilateral FTAs with ASEAN members companies in this sector were not able to import a garment from Thailand if it was not made from fabric originating in Thailand, but, for example, in Cambodia: cumulation under the AJCEP allows them to do that.

309 Interview no. 15.
310 Interview no. 8.
311 Interview no. 46.

Figure 3.16 Utilisation of the AJCEP by textile companies



Source: Obtained during interview no. 22

Figure 3.16 demonstrates how the AJCEP improves the operations of Japanese companies in the textile industry. They can now use fabric from Thailand, Indonesia and Malaysia to produce garments in Vietnam. As discussed earlier in the chapter, sewing, the final stage of making a garment, is the most labour-intensive part of the production. Therefore, companies prefer to locate it in countries which have low labour costs, for example Vietnam. An interviewed company in the textile and chemical fibres sector explains that a lot of its final production takes place in Vietnam, which has a garment sector but not a fabric sector[312]. Under a bilateral FTA with Vietnam it would be impossible to produce in the country and fulfil the double transformation rule of origin. JETRO (2010b:19) confirms that the AJCEP is used mostly by the textile and clothing, as well as the ceramics and earth and stones, sectors.

The automotive sector was one of the sectors which had little interest in an agreement with the Association. As explained earlier, many companies produce and sell most of their products locally[313]. According to a manager of the interviewed automotive company it exports and imports between ASEAN countries using AFTA and hence does

[312] Interview no. 22.
[313] Interview no. 20.

not benefit from the ASEAN-Japan treaty[314]. Therefore, during the initial consultations with the private sector, the company informed the government that the AJCEP was not of interest unless it provided lower tariffs than bilateral agreements. Similarly, the steel and iron sector did not have a strong preference regarding this FTA[315]. They purchase materials from different countries, which makes it difficult to calculate the local content of the final steel or iron product once all the ingredients are combined. The AJCEP agreement sets a 40 percent VC rule of origin for several products in Chapter 72 (iron and steel), for example semi-finished products of iron or non-alloy steel (tariff item number 72.07 of the HS code), or bars and rods of iron and non-alloy steel (items 72.13 to 72.15 of the HS code). Furthermore, the AJCEP sets the same VC type of rule for a great majority of items in HS Chapter 73 (articles of iron or steel), for example railway or tramway track construction material of iron or steel (73.02) or tubes and pipes (73.03 to 73.05). Hence the AJCEP is of little value for companies in this sector. Amongst companies in the service sector, interest in the AJCEP is even lower. For companies in the service industry, cumulation is not relevant[316]. Not many companies use FTAs and those that do use only Japan's bilateral treaties. A Senior Analyst at the Mitsubishi UFJ Research and Consulting who is also a former official of the MOFA responsible for services explains that the few WTO plus provisions in Japan's bilateral FTAs with ASEAN members are not aimed at the service or financial sectors[317].

In 2010, the ASEAN Trade in Goods Agreement (ATIGA) consolidated the Common Effective Preferential Tariff (CEPT) and the ASEAN Free Trade Agreement (AFTA) provisions, in force since 1992. Amongst other revisions, it introduced the co-equal rule of origin. This rendered the AJCEP unnecessary for many companies. The usefulness of the agreement was already questionable. After the ATIGA went into force, the beneficial effects of the AJCEP were significantly reduced. Japanese companies tend to use bilateral FTAs, offering deeper concessions and WTO provisions, for exporting parts and components from Japan to assembling facilities in ASEAN countries or for exporting final goods[318]. For example, a Japanese company may export parts to an assembly facility in Thailand using the Japan-Thailand FTA. Then, the final product in distributed to Malaysia, where it is sold. This can be done either under the AJCEP or under the ATIGA. The automotive and electronics industries have long-standing

[314] *Ibidem.*
[315] Interview no. 32.
[316] Interview no. 45.
[317] *Ibidem.*
[318] Interview no. 28.

experience with the AFTA. The utilisation rates of the AFTA have already been mentioned. They are familiar with the agreement as many of them have been using this treaty since its inception[319]. The number of companies using the AJCEP is very low[320]. This was confirmed during the fieldwork. One of the interviewed companies in the electronics sector states that it utilises the ATIGA and not the AJCEP, as there is no added value in this treaty[321]. Similarly another company in the electronics sector has profited greatly from the cumulation of the RoO under the AJCEP[322]. However, since the ATIGA was introduced it utilises this treaty instead of the AJCEPT. For companies in the textile industry, for which the main advantage of the AJCEP lay in cumulation, the agreement continues to offer benefits[323].

3.10 Conclusions

The aspects of Japan's FTA policy discussed in this chapter are relevant for further analysis of this policy on a minilateral or regional level. This chapter has discussed the Japanese government's and industries' preferences for bilateral FTAs over a time span of over a decade and for the AJCEP. First, it presented the preferences of the Ministries, companies, and the agricultural sector for Japan's first bilateral FTAs as well as treaties with ASEAN members. Second, it discussed the role of isolation avoidance and competitive bilateralism for the initial shift to a multi-track approach and competition with China and more recently Korea. The chapter analysed two 'failed' FTA cases and aimed to identify the reasons behind the lack of substantial progress in negotiations. Last, it discussed the preferences regarding the agreement with ASEAN.

As demonstrated in this chapter, a decision to attempt to exclude the agricultural sector from trade liberalisation was made early on – an expected low level of liberalisation was part of the government's motivation for naming its FTAs Economic Partnership Agreements. This indicates that even during the initial discussions in the early 2000s, METI and MOFA did not expect FTAs to cause a dramatic overhaul of domestic policies. This could be explained by the government's experience in trade liberalisation negotiations under the WTO, where Japan was on the defence regarding

319 Interview no. 46.
320 Interview no. 25.
321 Interview no. 15.
322 Interview no. 16.
323 Interview no. 22.

the liberalisation of agriculture. MAFF was determined to exclude the agricultural sector from trade liberalisation and made continuous efforts to avoid tariff reductions in all subsequent FTAs. The Ministry was able to secure special treatment for Japan's agricultural products in all bilateral FTAs. For that reason, MOFA's Director of the EPA/FTA Policy Division argues that Japan's free trade agreements are quasi-FTAs or 'part economic cooperation' agreements and that the Ministry would like to sign high-level treaties[324]. Lincoln (2004) goes as far as saying that Japan's EPAs are 'so-called free trade areas' and calls the country's position on agriculture 'unyielding'. The agricultural sector's opposition to trade liberalisation has further implications. The increasing competition with Korea has caused Japan to rethink and attempt to re-invent its bilateral FTA strategy. Sugawara (2010) writes that putting into force the AJCEP marked an end of what he calls the first phase of Japan's FTA strategy, centred on ASEAN and its members.

Japan has already signed all the 'easy' trade agreements where it could proceed without conducting substantial domestic reforms or liberalising sensitive products. Prospective FTAs with important trade partners and big markets such as the EU, the US, or even Australia are bound to require substantial concessions in this field. Unable to resolve its domestic problems with the sensitive sectors, Japan is unable to conclude high-level FTAs or agreements with important trade partners and hence formulate a clear vision for its FTA strategy. Japan needs to resolve the issue of the agricultural sector's opposition to lowering tariffs and low levels of trade liberalisation in its FTAs. In short, in order to proceed and successfully compete with Korea, Japan will need to sign FTAs, causing a significant overhaul of its domestic policy. This contradicts initial plans for the country's strategy. Japan faces the same problems when it comes to prospective region-wide agreement. What constrains its FTA policy is a political impasse, which is analysed in detail in Chapter 5. According to the Deputy Director of JETRO's International Economic Research Division, as a result the country's policy is reactive to external factors[325]. This supports the proposition that international factors, such as competition and isolation avoidance, are driving Japan's bilateral FTA strategy. For example, JETRO's 2009 White Paper (2009:109) stresses the importance of accelerating FTA negotiations in light of other countries' FTA strategies. The country's FTA policy seems to have stalled and to be in need of a breakthrough. It was hoped that such a breakthrough might have been achieved after the change of administration in

[324] Interview no. 9.
[325] Interview no. 39, the view of Japan as a 'reactive state' has already been mentioned in this Chapter.

2009. Although no immediate breakthrough was achieved, the DPJ (2010a) changed the domestic decision-making process, published a new FTA strategy document and announced Japan's intention to join the TPP negotiations[326]. Nonetheless, the change of administration to the DPJ provided an opportunity to rethink the approach to FTAs. According to the Director for FTA Affairs at METI's Trade Policy Bureau, the stalling of the Doha Round, coupled with Korea's FTA policy and other international developments, such as the progress of the Trans-Pacific Partnership negotiations, created a momentum for Japan's involvement in FTA negotiations[327]. He points out that over the past two or three years there have been discussions within the Japanese government on ways to conduct the necessary reforms.

The chapter has stressed the importance of METI's Trade Policy Bureau in Japan's shift towards a multi-track approach and expansion of the FTA network[328]. Furthermore, it has described the Manufacturing Industries Bureau's role in representing the interests of the private sector, particularly at the initial stages of Japan's FTA strategy, when the companies themselves have not yet undertaken lobbying efforts. Companies' preferences have strongly influenced the Bureau's position and involvement in subsequent agreements. It was demonstrated that FTAs, which gained the support of both METI's Bureaus, were easier to negotiate despite the opposition from the agricultural sector. Agreements, which were not supported by the Manufacturing Industries Bureau, were at times difficult to conclude, especially if the other party made requests for concessions in the agricultural or another sensitive sector. The two 'failed' FTA cases demonstrate that without the support of Japanese industries and the Manufacturing Industries Bureau, the Trade Policy Bureau was unable to overcome the opposition from the agricultural sector. With a low level of interest and mounting difficulties the 'costs' outweighed the 'benefits' and the negotiations were stopped or stalled. The FTAs with Singapore and Switzerland are examples of Trade Policy Bureau-driven treaties in which the private sector and the second Bureau had little interest. They were successfully concluded due to a comparative lack of disagreement between the parties.

It could be argued that while the agricultural sector's opposition to trade liberalisation is constant, what has changed on the domestic front are the preferences of the Japanese industries represented by the Manufacturing Industries Bureau. The AJCEP

[326] Chapter 5 discusses these two points in detail.
[327] Interview no. 3.
[328] This is confirmed in the subject literature, for example Lord 2010:22.

is an example of an FTA initially supported by both METI's Bureaus. The Manufacturing Industries Bureau supported the agreement as it offered benefits to specific sectors. However, overall Japanese industries did not strongly endorse the agreement. The lack of interest in the AJCEP is mainly due to the fact that the agreement brings little additional benefits. It does not offer substantial additional liberalisation of tariffs, or deep liberalisation provisions. Being an agreement on trade in goods only, it offers no provisions on trade in services or investment. It is a 'lowest common denominator' agreement, connecting Japan and all ASEAN countries. The change in circumstances, resulting from the revision of AFTA and the introduction of ATIGA, rendered the agreement unnecessary for many industries, with the exception of companies in the textile and apparel sector.

Finally, the chapter stressed the pivotal role of isolation avoidance, the domino effect and competition with China and Korea for the development of Japan's bilateral FTA strategy. The fieldwork indicates that these are the main factors behind Japan's interest in bilateral FTAs. As demonstrated, a notion of 'not being left behind' and 'catching up' with global trends has been present in the domestic discussions on FTA policy since Kaoru Yosano's speech in 1998. DPJ's *'Basic Policy on Comprehensive Economic Partnerships'* (2010a) mentions the fact that Japan aims to sign agreements with major trading partners, which "will withstand comparison with the trend of other such relationships". This can be seen as a response to recent developments in East Asia, in particular Korea's FTAs with the EU and the US. All of the 60 interviewees point to Korea as the driving force behind Japan's recent bilateral strategy. The government and corporations consider this to be a major threat. Furthermore, the importance of isolation avoidance and economic competition is illustrated by another part of the document. It concludes that "if Japan's trade and investment environment becomes less attractive than the environment in other countries, there is a possibility that future employment opportunities will be lost" (DPJ 2010a:1). For Japanese industries, which are heavily dependent on foreign exports, FTAs are inherently competitive. The financial benefits from preferential tariffs are felt by importers and consumers, as they purchase the goods at lower prices. The exporter benefits from FTAs vis-à-vis a foreign company[329]. For example, if Korean products are cheaper than Japanese products in the EU, due to the implementation of the EU-Korea FTA, consumers might prefer to buy Korean goods. Hence an FTA with the EU gives Korean companies an advantage over Japanese companies. From the industries' point of view, the main reason for signing FTAs is to

[329] Interview no. 15.

level the playing field and offset trade diversion or other negative results of foreign states' agreements. For that reason, Korea's expanding FTA strategy is worrying Japanese companies.

The discussions surrounding Japan's minilateral FTA highlights the question which will need to be addressed in the context of a regional treaty: how to harmonise wider FTAs with the existing bilateral ones? The solution offered by the AJCEP is far from perfect and its application to a region-wide FTA is questionable. The following chapter demonstrates that both the government and the private sector draw heavily on the experience of the AJCEP, while forming their preferences regarding a region-wide treaty. *Keizai Doyukai's* Managing Director explains that from the government's perspective the AJCEP is finalised and working[330]. However, the industries would like to see the liberalisation under the AJCEP deepened. Nonetheless, the AJCEP provided the Japanese government with an opportunity to introduce a flexible clause and cumulation. Since then, both the government and the business circles have been considering the application of those provisions in a wider context. The coexistence of bilateral treaties with the AJCEP raises questions and speculations regarding a region-wide FTA. Such an agreement would need to be either harmonised with existing treaties or added as an overlapping layer. This issue is further explored in the next chapter.

[330] Interview no. 23.

Chapter 4

A Region-wide FTA: Japan's Options and Preferences

4.1 Introduction

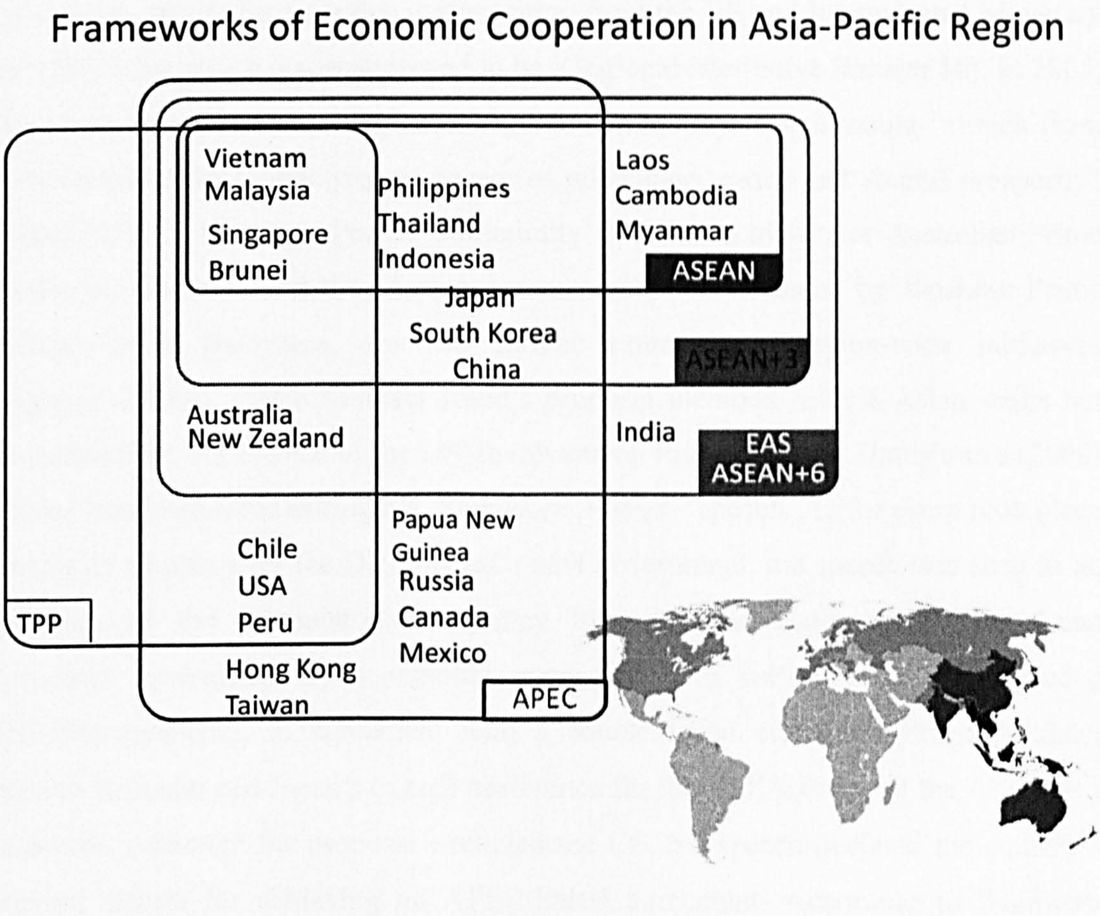
Building on the analysis of the previous chapter, Chapter 4 discusses the preferences of the Japanese government and the country's industry for a region-wide FTA. Furthermore, it analyses the lead-up to the country's statement on joining the Trans-Pacific Partnership (TPP) during the November 2010 Asia-Pacific Economic Cooperation (APEC) Summit. It argues that the same problems which constrain Japan's bilateral and minilateral FTA policy are relevant for a discussion on the prospective broader agreement in the East Asian or Asia-Pacific region. In short, Japan's behaviour during the APEC Summit might be explained by the same factors which prevent the country from signing high-level bilateral FTAs with major trading partners: they have been referred to in this thesis as an FTA policy impasse. With developments in the region such as the creation of the Association of Southeast Asian Nations +1 (ASEAN+1) FTA network, competition with Korea and an acceleration of the TPP process, a prospective region-wide FTA has become an important topic. The election of the Democratic Party of Japan (DPJ) in 2009 provided an opportunity to commence a domestic debate on the subject.

The conducted fieldwork asked a series of questions in regard to the prospective broader agreement. First, it asked which forum would be a suitable base for such an agreement from the perspective of various domestic groups. Secondly, it asked what kind of agreement this should be; specifically, what type of solutions and provisions it should include. Finally, it asked how to harmonise the existing agreements with the future region-wide FTA. This chapter does not attempt to provide a detailed account of the development of integration in Asia or regional frameworks. Instead, it focuses on the preferences of domestic actors and Japan's involvement in regional economic integration frameworks as a part of the country's overall FTA strategy. As final decisions regarding Japan's participation in a region-wide FTA have not been made and the coexisting frameworks continue to be under study, the preferences of the Japanese government and the country's industry will be discussed in terms of general issues and themes.

4.2 A Short Overview of Japan's Involvement in Region-wide FTA Frameworks to Date

Japan is currently participating in three coexisting frameworks with a regional, economic integration agenda that includes the fostering of a regional FTA: ASEAN+3 (China, Japan, and Korea, also known as APT), ASEAN+6 (China, Japan, Korea, India, Australia, and New Zealand), and APEC. It is also considering joining the TPP. Figure 4.1 shows the membership of ASEAN, ASEAN+3, ASEAN+6, APEC, and the TPP groupings.

Figure 4.1 Frameworks for economic cooperation in the Asia-Pacific region



Source: Watanabe, Y., 2010, Japan's Economic Partnership Agreement and Regional Integration in East Asia - Japan's Economic Diplomacy in Asia-Pacific, presentation during Asian Development Bank FTA seminar in Phnom Penh, Cambodia 27-30 April 2010. Obtained from the author – modified

The '*Basic Policy towards further promotion of Economic Partnership Agreements (EPAs)*' (MOFA 2004) states that "EPAs contribute to the creation of international environment further beneficial to our country from the politically and diplomatically strategic points through, among others, fostering the establishment of an East Asian community". The idea of a region-wide economic community including an FTA has been present in East Asia for decades under different names. The Malaysian Prime Minister Mahathir Mohamad's proposal for the East Asian Economic Group (later renamed the East Asian Economic Caucus) in 1990, was the first conceptual framework for East Asian regionalism (Terada 2007:15). It was based on what is today's the ASEAN+3 membership. Japan did not endorse the proposal. This was partially caused by APEC's strategic role in the country's foreign trade policy and partially by the US' concerns that such a framework would divide APEC members by excluding the US and undermine the organisation's trade and investment liberalisation initiatives (Kawai 2005:38). Japan's Vice-Minister of Finance for International Affairs, Eisuke Sakakibara, proposed the establishment of an Asian Monetary Fund in September 1997, however the proposal was rejected mainly due to opposition from the US and International Monetary Fund (IMF), for which it was supposed to be a regional alternative (*ibidem*:16). In 2005, India made a proposal for an Asian economic community, which would "stretch from Christchurch to the Himalayas, as an arc of advantage, peace and shared prosperity" (Kumar 2010:8). The 'Asia Pacific Community' introduced by former Australian Prime Minister Kevin Rudd and the 'East Asian community' introduced by Japanese Prime Minister Yukio Hatoyama, are two further examples of region-wide initiatives (Penghing 2010:4). Prime Minister Rudd's proposal included several Asian states but also stressed the importance of the US' involvement. Prime Minister Hatoyama's (2009) proposal was introduced during his *'Singapore Address'* speech. As the event took place a couple of months after the DPJ formed a new government, the speech was seen as an expression of the administration's policy toward Asia. Hatoyama's East Asian community envisioned 'open regional cooperation' in various fields. It included ASEAN+6 countries, in agreement with a course taken earlier by Prime Minister Junichiro Koizumi and Japan's overall preference for the ASEAN+6 over the ASEAN+3 framework. Although the proposal excluded the US, the speech declared the country's increased efforts for achieving an APEC-based agreement. According to Sugawara (2010:2) such an East Asian community does not extend beyond these visions from 1990s and what was advocated by the Liberal Democratic Party (LDP) government and Prime Minister Koizumi. Sugawara (2010:13) comments that this was a 'community' (with a small 'c') and not a 'Community' with a large 'C' such as the European Community. Prime Minister Koizumi's speech (2002) in January 2002 mentioned a community with ASEAN, Japan, China, Korea, Australia, and New Zealand as members, based on open regionalism principle. In addition, he stressed the importance of cooperation with South Asia, including India, as well as the vaguely defined 'indispensable' role of the United States. At the Hua Hin Summit, Japan made additional comments on the prospective East Asian community, proposing to base it on the "principle of openness, transparency and inclusiveness and functional cooperation" (APT 2009)[331]. At a press conference in January 2010 the Minister of Economy, Trade and Industry, Masayuki Naoshima, stressed that the East Asian community proposal was a long-term project, so far only vaguely defined, that would not be realised in the foreseeable future and should be preceded by a deeper economic integration[332].

The idea for a region-wide FTA in East Asia has been gaining momentum since the establishment of the ASEAN+1 network. By the end of 2010, all five ASEAN+1 FTAs were in effect. However, the region-wide FTA project remains conceptual and little progress has been made towards its realisation. Study groups have been organised to produce reports on the feasibility of proposed FTAs. The study group for APT continues to produce a report every two years[333]. An ASEAN+3 FTA, known as the East Asian Free Trade Area (EAFTA), was first advocated by China and supported by Malaysia. In 1998, the East Asian Vision Group (EAVG) was created. Its aim was to research the prospects of an East Asian Community and to consider an ASEAN+3 FTA. The EAVG's (2001) recommendations included the establishment of the EAFTA and the transformation of the ASEAN+3 framework into the East Asian Summit. EAVG's report led to the creation of the East Asian Study Group (EASG), made up of government officials, in 2001. Its aim was to research the feasibility of the proposal. EASG published its final report during the ASEAN+3 Summit in Phnom Penh in 2002. It concluded that the APT forum is best suited for the furthering of regional cooperation and recommended the establishment of the EAFTA (Corning 2009:43). It also spoke of transforming the ASEAN+3 into the East Asian Summit (EAS).

Ultimately, the EAS was based on the ASEAN+6 framework. In 2004, the ASEAN+3 Economic Ministers' Meeting set up an Expert Group, which was accepted by the 8th ASEAN+3 Summit in Vientiane, Laos. The group presented its findings to the ministers in 2006 and recommended starting an East Asian FTA process (Urata 2008a:18). This was not implemented and the Expert Group conducted a second study, submitted in 2009. The Phase II Study Report (Lee 2009) conducted by the Joint Expert Group, recommended that the EAFTA should be a high-level, comprehensive agreement

[331] At the same time, the Philippines and Australia made additional proposals. For details see Kumar (2001:8).
[332] Press Conferences at the Foreign Correspondents' Club of Japan (FCCJ), 15 January 2010, Tokyo.
[333] The study group on the feasibility of CEPEA produces a report once a year.

on trade in goods, services and investment. It should include WTO-plus provisions, trade and investment facilitation measures and economic cooperation, as well as full cumulation of rules of origin (RoO) (*ibidem*:4). The group suggested a gradual consolidation of the AFTA and the ASEAN+1 FTAs through the harmonisation of RoO and tariff concessions. The final EAFTA should also have one implementation schedule. The report recommended starting negotiations by 2012 at the latest (*ibidem*:23). The 2009 ASEAN+3 Summit in Hua Hin (APT 2009) concluded that APT is the "main vehicle towards the long-term goal of building an East Asian community with ASEAN as the driving force". In the meantime, ASEAN+3 has been working well as a forum for economic regional integration and has been making progress in terms of financial cooperation. For example, it accomplished a multilateral currency swap arrangement, known as the Chiang Mai Initiative, and the APT Regional Foreign Exchange Reserve Pool.

In April 2006, Japan proposed an ASEAN+6 FTA, as part of the Comprehensive Economic Partnership for East Asia (CEPEA) (Shigematsu 2006:21, Terada 2009:11)[334]. This was preceded by the aforementioned speech by Prime Minister Koizumi (2002), in which he proposed an East Asian community with Australia and New Zealand as core members. Similarly to EAFTA, the feasibility of CEPEA is still under review. The first CEPEA study report was submitted in 2008. During the ASEAN Summit at Hua Hin, in October 2009, a second CEPEA study was submitted. The Phase II Report (Nezu 2009) conducted by the Track Two Study Group Report chaired by Risaburo Nezu, recommended that CEPEA should be a high-level, comprehensive agreement including WTO-plus provisions and based on three pillars of economic cooperation, trade and investment facilitation, and trade and investment liberalisation. The report mentioned institutional development under the CEPEA, for example through using existing ASEAN working groups and including representatives from an additional six countries to discuss regional issues (*ibidem*:59). It concluded that the ASEAN+6 leaders should confirm the objectives and structure of the future CEPEA in order to establish a common understanding and start concrete discussions on the steps needed to achieve the agreement (*ibidem*:61). As the Summit did not reach a conclusion on which FTA it should advance, further study groups were appointed to conduct research on EAFTA and CEPEA (Chia 2010:20). During the EAS in Hanoi in 2010, these groups were asked

[334] A similar proposal was made by India during an ABAC Meeting in Kuala Lumpur in 2005. The Pan-Asia Free Trade Area would resemble NAFTA and include ASEAN+ 6 countries. For details see *SiliconIndia News* 2005.

to provide a timeline for regional integration (Kumar 2010). A Joint Expert Group EAFTA report mentions the lack of FTA between China, Japan and Korea as one of the obstacles for establishing a region-wide agreement, in particular as the biggest trade flows in the region take place between these three countries (Lee 2009:4). This is also true in the context of CEPEA. There is still much work that needs to be done between the six spokes of ASEAN+6. In addition, Terada (2008:20 cites former Singapore Trade Minister George Yeo) argues that ASEAN members have little interest in a region-wide FTA, as they are concerned about being sidelined in an agreement including China, Japan and Korea: countries which account for nearly 90 percent of the East Asian economy. Asked in August 2008 if ASEAN would initiate the consolidation of the ASEAN+1 agreements into a region-wide one, the ASEAN Secretariat replied that the organisation would not be undertaking such a difficult job[335]. Ravenhill[336] points out that since Malaysian Prime Minister Mahathir Mohamad's proposal for the East Asian Economic Caucus the great majority of initiatives in the ASEAN+3 and ASEAN+6 frameworks originated in the +3 and +6 countries respectively. In the meantime, ASEAN+6 is also a forum for discussions on other, not necessarily economic topics and furthers the so-called 'new cooperation issues' such as: the environment, natural disasters, and disease prevention. During the 2005 ASEAN Summits in Kuala Lumpur (ASEAN, ASEAN+3, ASEAN+6), ASEAN+6 A was transformed into an East Asian Summit, with Australia, New Zealand and India as members.

At the same time, since its creation in 1989 APEC has been actively promoting economic integration and cooperation in the Asia-Pacific region. Japan has played a pivotal role in the creation of APEC. In 1988, the country proposed that the economic ministers have regional meetings and the Australian government showed interest in the proposal. This cooperation between two countries resulted in the formation of APEC (Terada 2007:7). The Free Trade Area of the Asia Pacific (FTAAP) idea emerged during the 2004 APEC Summit in Santiago, Chile, and was proposed by APEC's Business Advisory Council (ABAC) (Penghing 2010:6). The Council recommended a feasibility study of FTAAP, which was finally accepted during the 2006 APEC Summit in Vietnam. At that time, the proposal found little support from some of APEC's key members, namely Japan, China, Malaysia, and Indonesia (Dent 2006:245).

The origins of the FTAAP to some extent date back to the 1960s and the Pacific

[335] Interview no. 58.

[336] Views expressed during the 'Asia-Pacific, Regionalism and Global Governance' conference, University of Leeds, 12-13 May 2011.

Free Trade Area (PAFTA) idea. A Japanese economist from the Japan Economic Research Centre (JERC), Kiyoshi Kojima, proposed an FTA between Japan, the US, Canada, Australia and New Zealand with the region's developing countries as associate members (Dent 2007:449). The proposal was based on a concept of 'regionalism without discrimination' (Terada 2005:8). In 1968, the Pacific Trade and Development Forum (PAFTAD) discussed the feasibility of PAFTA: however, the agreement failed to gain sufficient support. Nonetheless, with MOFA's support Kojima's idea helped to develop a "new dialogue networks on trade-related issues", which provided a foundation for the development of the Asia-Pacific framework and the creation of APEC in 1989 (Dent 2007:449).

Ippei Yamazawa (2010b:Chapter 6), the former coordinator of the Japan-Korea FTA Study Group, points out that APEC, with its traditional voluntarism and consensus-based decision-making procedures, has not yet made a transition to binding trade liberalisation, which makes a binding FTAAP difficult to imagine. He comments that "the current studies of FTAAP have not gone into (the) concrete procedures of achieving it" (*ibidem*). Since 2006, APEC has conducted further feasibility studies of FTAAP, including "streamlining the ROOs among existing FTAs to minimise the noodle bowl effect, reducing compliance costs and increasing FTA utilisation rates, and docking-merging-enlarging some of the existing FTAs so that they form a larger regional FTA over time" (Chia 2010:23)[337]. JETRO (2009:112) points out that "FTAAP was put on the agenda for research as a long-term project at the 2006 APEC Leaders Summit". The DPJ's *'The New Growth Strategy – Blueprint for Revitalising Japan'* (2010b), set a target of creating the FTAAP by 2020. It is worth noting that the document refers to FTAAP as part of the efforts for establishing an East Asian Community. The November 2010, APEC Summit in Yokohama reaffirmed the target date for the conclusion of the FTAAP as 2020 (*The Straits Times* 15 November 2010). For Japan, from a purely economic perspective, an APEC-based community is desirable: it accommodates the US and Russia, although not India[338]. Still, an APEC-wide FTA is hard to imagine, despite the enthusiasm of the project's supporters[339]. APEC includes the US, Russia, China, Hong Kong and Taiwan, as well as countries with diverse economic models, making an APEC-wide FTA politically, ideologically and culturally almost impossible at present due to large diversity.

[337] Since 2009 another study has commissioned.
[338] Interview no. 48.
[339] See, for example, C. Fred Bergsten 2007.

Recently, a new development has changed the dynamic of the regional integration process. The establishment of the Trans-Pacific Strategic Economic Partnership Agreement (TPSEPA, also known as the P4) had a snowball effect amongst APEC members. The TPSEPA between Singapore, New Zealand, and Chile was announced during the 2005 APEC Summit in Busan, Korea. Brunei joined later that year and the FTA came into force in 2006. Brunei's accession to the agreement was said to "demonstrate the potential of the Trans-Pacific SEPA to grow into a larger strategic agreement for trade liberalisation" (Singapore FTA Network 2010). In March 2008, the US joined P4 talks on financial services and investment agreements (JETRO 2009:113). The US' decision was immediately seen as a stepping stone towards an APEC-wide FTA (Palmer 2008). Those predictions were not without reason, as the Bush administration had announced its interest in the agreement in February 2008 and in September 2008 had declared its intention to join the treaty (*Agence France Presse* 2008). In a speech in Tokyo on November 2009, President Barak Obama (2009) confirmed the US' interest in engaging in the agreement. In 2009, Malaysia, Taiwan, and Japan also expressed an interest in the scheme.

The extended agreement became known as the Trans-Pacific Partnership. The first round of negotiations with the US, planned for March 2009, was delayed in February 2009 due to, amongst other factors, the change of administration in the US (JETRO 2009:113). The first round of negotiations finally took place in March 2010 in Australia and the second in June 2010 in the US (*The Trans-Pacific Partnership Digest* 2010). Australia, Peru, and Vietnam (the latter with an observer status) joined discussions during the APEC leaders meeting in November 2009. Malaysia joined in October 2010. A further four countries, the Philippines, Canada, Taiwan, and Thailand, expressed their interest in the agreement during the November 2010 APEC Summit in Yokohama[340]. During the Yokohama APEC Summit, Prime Minister Naoto Kan announced that Japan would start consultations with nine negotiating TPP countries and reach a decision on whether Japan should join the agreement, by June 2011 (Foster and Hosaka 2010). Japan also joined the first summit of the nine negotiating TPP countries, held on 13 November in Yokohama, with an observer status[341]. Although the participants did not agree on the final scope and depth of the agreement during the conducted rounds of talks, including the sixth round between 28 March and 1 April 2011, the TPP was

[340] The US, Australia, Malaysia, Vietnam and Peru were already negotiating at this point. Vietnam became a full member during the 2010 Summit.

[341] The March 11 2011 earthquake in Japan is likely to delay the country's decision on the framework (Bloomberg 2011 and Nanto *et al.* 2011).

initially expected to be a high-level, comprehensive FTA, similar to the original P4 and to include the liberalisation of trade in goods, services and investment, as well as intellectual property rights (IPR) protection and other non-tariff provisions[342]. Under the P4 agreement, members were required to remove tariffs on all products within ten years (Urata 2011). However, some observers are sceptical when it comes to the prospective TPP agreement. Ravenhill[343] has expressed the opinion that the US aims to establish separate bilateral schedules under the TPP as the country has little to gain from the agreement having bilateral FTAs with the majority of negotiating countries. Capling and Ravenhill (2011:572) argue that while the TPP "might achieve advances on some dimensions, e.g. services and non-tariff measures, it will fall short of aspirations for multilateralisation on others, particularly if it comprises multiple layers of bilateral treaties rather than being a single regional agreement".

4.3 Japanese Governmental Preferences for a Region-wide FTA

4.3.1 ASEAN+3 *Versus* ASEAN+6

The Japanese government was initially supportive of the ASEAN+3 grouping. In 1999, the Ministry of Foreign Affairs (MOFA) embraced the concept of the forum and spoke of ASEAN+3 meetings as "an East Asian summit in a practical sense" (Terada 2007:16). The Ministry of Economy, Trade and Industry (METI) has also been supportive of the framework. In 2002, it proposed the *'East Asia Free Business Zone Initiative'* based on ASEAN+3. However, it then formulated the ASEAN+6 idea and has been a strong supporter of the project ever since. MOFA, on the other hand, has only recently been converted to the idea, having supported the APT framework for many years[344]. Under LDP's administration, METI bureaucrats supported the ASEAN+6 framework while MOFA was leaning toward ASEAN+3[345]. Terada (2009) points out that METI's and MOFA's policies have often been mistaken or misrepresented as Japan's national policy, despite the fact that they have not been discussed with the second ministry or other political actors. He gives an example of METI's support for the creation of APEC in 1989, when "MOFA, having previously opposed the new organisation, only involved

[342] Interview no. 38.
[343] Views expressed during the 'Asia-Pacific, Regionalism and Global Governance' conference, University of Leeds, 12-13 May 2011.
[344] Interview no. 53.
[345] Interview no. 46.

itself at the stage of the Senior Officials' Meeting (SOM) held directly before the meeting of APEC members" (Terada 2009:8). Similarly, Terada (2009:8 cites *Asahi Shimbun*, 28 July 2006) notes that METI did not consult MOFA before it announced the ASEAN+6 proposal, despite the fact that foreign policy is within MOFA's jurisdiction. The Ministry's approach was to create CEPEA by combining existing ASEAN+1 agreements (Terada 2009:13). In time, however, the views of the ministries converged and ASEAN+6 became the main strategy for a regional FTA. Terada (*ibidem*) argues that further differences between METI and MOFA lie in how the ministries perceive the purpose of regional frameworks. While METI perceives ASEAN+6 as a basis for a region-wide FTA aiming to establish a single market, whereas it is arguable that MOFA views it as a strategic and political framework and intends to support preferential trade liberalisation through bilateral agreements.

There are strong geopolitical and economic reasons for Japan to favour CEPEA[346]. The inclusion of India, Australia, and New Zealand in the regional FTA project is in compliance with Japan's political and strategic preferences in two ways. First, as ASEAN+3 is a smaller grouping, Japan could find itself in confrontation with China over several issues. An Associate Professor of International Economics at Chiba University argues that China favours the ASEAN+3 framework as it will allow them to exert more political influence[347]. According to JETRO's Senior Researcher at the International Economic Research Division, the country prefers the EAFTA over the CEPEA as the latter includes democratic countries and Western values[348]. Dent (2010b:27) explains that China initially expressed concerns over EAS membership due to the fact that a larger number of involved countries may negatively influence the coherence of the prospective East Asian community. Whilst China and Malaysia opted for East Asian Summit membership based on the APT, Japan, Indonesia, and Singapore supported a broader framework based on the ASEAN+6 (Penghing 2010:13). In particular, China was against regional integration based on the ASEAN+6 and supported ASEAN+3 as the main framework (Terada 2009:13). Despite the success of Japan's diplomacy and conversion of the ASEAN+6 forum into the EAS, there was no formal decision to base a region-wide free trade agreement on the EAS framework (Rozman 2007:266). From Japan's perspective, the presence of big economies, such as Australia and India, prevents China's dominance in the East Asian Summit. Hence one

[346] *Ibidem.*
[347] Interview no. 48.
[348] Interview no. 38.

explanation is that by expanding the number to plus six, Japan dilutes regional implications and avoids potential conflicts with China[349]. Dent (2010b:27) points out that Japan's preference for a broader East Asian forum dates back to the middle of the 1990s and the country's efforts to include Australia and New Zealand in the Asia-Europe Meeting (ASEM) framework. Nonetheless, China's position had an impact on Japan's preferences. In the words of a Senior Research Fellow at the Institute of Developing Economies in Tokyo: "if China wants ASEAN+3, we need to say ASEAN+6"[350]. In his opinion, competing for regional influence with China is a crucial factor behind Japan's preference for CEPEA over EAFTA[351]. According to Terada (2009:9-10), it was China's proposal to conclude a feasibility study of an ASEAN-China FTA[352], and the desire to counterbalance China's rise, that caused Japan to consider including Australia in the regional framework. He argues that Hitoshi Tanaka, MOFA's Vice-Minister, who drafted Prime Minister Junichiro Koizumi's 2002 Singapore speech, supported the strengthening of relations with Australia. This corresponds to an argument made in Chapter 3 of this thesis that in the early stages of Japan's bilateral FTA policy, competition with China had an impact on Japan's preferences, while over the last couple of years competition with Korea has become more significant. This is also true when it comes to region-wide FTA preferences.

Secondly, including Australia, US' second most important ally in East Asia, would help to balance Japan's regional interests with the strategic goal of maintaining the special partnership with the US (Beeson and Yoshimatsu 2007:244). Japan and Australia have a long-standing tradition of regional cooperation and community-building, as discussed in Chapter 3 and earlier in this chapter[353]. According to Terada (2007:18), Prime Minister Koizumi wanted to include Australia in order to strengthen the strategic partnership in the face of China's emergence. Australia, New Zealand and India are also democratic countries. In 2006, Prime Minister Shinzo Abe advocated the need to strengthen relations with Australia and India as those countries share Japan's democratic values, such as freedom, democracy, and human rights (Terada 2007:18). The Ministry of Foreign Affairs expressed concern that the interests of developed economies would

[349] Interview no. 53.
[350] Interview no. 42.
[351] While, as discussed in Chapter 3, Japan competes with Korea in terms of FTA network and access to major markets, competition with China in terms of regional influence was relevant for the formation of ASEAN+6 framework. Furthermore, prior to 2006, when Japan proposed the ASEAN+6 framework, Korea's FTA network was in the early stages of development: the country has signed FTAs only with Chile, Singapore and EFTA.
[352] This was proposed during the Fourth ASEAN- China Summit, 2000, Singapore.
[353] For more see, for example, Terada 2005.

be sidelined in an ASEAN+3 framework where the majority of members are developing countries (Terada 2009:9 cites MOFA representative, personal interview). In CEPEA, Australia and New Zealand represent developed economies. Hence a Senior Research Fellow at the Institute of Developing Economies argues that of the three aforementioned schemes, ASEAN+6 would best serve Japan's political interests[354]. Recently, a new variation of the ASEAN+6 framework has emerged: ASEAN+8 with Russia and the US, which in November 2011 became the expanded East Asian Summit. The US and Russia are members of APEC but not of ASEAN+6, while India is a member of ASEAN+6 but not of APEC.

There is also a strong business reality behind the CEPEA project that causes METI to favour this framework[355]. As explained in Chapter 3, both India and Australia are important markets for Japanese products and trading partners. Economic interdependence in East Asia is a daily reality and, from this perspective, it is only natural that India should be included in a region-wide FTA project. CEPEA seems to be the best solution for Japanese companies, which is why METI came to believe that ASEAN+6 and EAS is a suitable base for a region-wide FTA. A former Director for FTA Affairs at METI's Trade Policy Bureau confirms that the framework is a better option for Japanese companies with vertically integrated production networks[356]. As Terada (2009:18) concludes:

> *"While MOFA considered and supported the involvement of Australia as well as India by taking into account the US concern about the rise of China and the nature of ASEAN+3, a process where undemocratic or developing economies dominate and the views of developed or democratic nations would not be easily reflected, METI's interest in the framework was based on India's and Australia's economic role as the fastest growing largest economy and stable energy resource supplier, respectively".*

[354] Interview no. 42.
[355] Interview no. 7.
[356] Interview no. 4.

4.3.2 Japan's Relations with the US and the TPP

Prime Minister Yukio Hatoyama's *'Singapore Address'* (2009) confirmed that the new administration continues to regard the Japan-US alliance as the linchpin of Japan's foreign policy. In contrast to the market-led, functional integration in East Asia, the special partnership with the US plays a strategic, central role in Japan's foreign policy. Rozman *et al.* (2007:1) write that "for the past 150 years one of its greatest foreign policy dilemmas has been how to balance the West, coming from afar and representing modernity, and Asian neighbours, long behind in the pursuit of modernisation and power but temptingly close at hand". Japan's approach to regionalism is still strongly influenced by the US foreign policy. Rozman *et al.* (2007:4) argue that Japan's strategy toward the US has been much more consistent, focused on long-term objectives and planned to a much greater extent than the strategy toward East Asia. In these scholars' opinion, the country's lack of a clear regional strategy is partly caused by the difficulty of balancing its policy towards the two regions (*ibidem*:245). According to Beeson and Yoshimatsu (2007:238) Japan hoped that APEC would strengthen the US' economic ties with the East Asian region and at the same time promote economic growth that would be less dependent on the US. Japan's interest in APEC has been somewhat lessened by the formation of the ASEAN+3 and ASEAN+6 forums.

Whilst Japan's regional cooperation efforts were initially centred on the Asia-Pacific option, which it has supported since the 1960s and which led to the creation of APEC, it has been leaning towards the East Asian alternative[357]: nonetheless, some analysts stress that Japan's shift towards Asia was focused on economic interests and had a functional dimension[358]. This is reminiscent of the academic debate from the early 2000s regarding Japan's 'shift towards Asia' and whether or not it represents a genuine turn in foreign or economic policy. Hund (2003:394) writes that Japan is neither intent on nor willing to transform ASEAN+3, or any other East Asian grouping, into an FTA or a unified economic bloc. He quotes Blechinger (*ibidem*:400 cites 2001:88) who has predicted that Japan's foreign policy will not drastically change direction and that, given the geopolitical situation, Japan is more likely to opt for the Asia-Pacific framework than the purely East Asian one. Japan's involvement in East Asia can be seen as superficial and focused on securing economic gains rather than as a genuine shift towards regional integration from its traditional pro-US policy (Hund 2003:394, Krauss

[357] For more on Japan's support for the Asia-Pacific framework see Beeson and Yoshimatsu 2007:237.
[358] Interview no. 58.

2003:325).

Japan has maintained the special partnership whilst participating in economic integration in East Asia. Narine (2004:423) argues that Japan has found "non-institutional ways to promote their regional interests". Green (2003) calls this shift the 'Asianisation' of Japan's foreign policy, believing that it should not be overstated as Japan continues to rely on the US for military defence and US-led financial institutions. Since then, however, the economic and strategic factors discussed in Chapter 3 have tied Japan's interests to the region. The 1997/98 East Asian financial crisis has created an opportunity to discuss regional economic integration without the US[359]. At the time of Malaysian Prime Minister Mahathir Mohamad's proposal for the East Asian Economic Caucus, the US strongly opposed the concept of an East Asian FTA without its participation. After the financial crisis the ASEAN+3 Summit met every year to discuss economic stability, without any objection from the US[360]. On the other hand, the US' engagement in the TPP framework has caused this project to be of great interest to Japan. It is now the most plausible Asia-Pacific alternative to the East Asian FTA (ASEAN+3 or ASEAN+6). Yamazawa (2010a) expresses a concern that the TPP, in its current form, excludes several East Asian economies and that "the TPP is Trans-Pacific, but it should not divide Asia from the Pacific". In his view the creation of a seamless business environment in the East Asian and Asia-Pacific region should be the goal of the TPP.

The problems that Japan is facing during discussions on its participation in the TPP negotiations are the same as those which constrain the country's bilateral FTA policy. The proposed agreement has had a snowball effect in the Asia-Pacific region, whereby many states have started to show interest in the process. In particular, the involvement of the US has caused Japan to worry about being 'left out'. This is yet another example of how isolation avoidance has affected the country's FTA policy. At the same time, just as in the case of the bilateral treaties, the agricultural sector's opposition poses a serious obstacle to Japan's participation in the framework. Since 2008, the country's politicians and scholars have observed the progress of the US's involvement in the project with a growing concern. This was reinforced by expectations that the US might urge Malaysia and Thailand to join the TPP, as it has been negotiating bilateral agreements with those countries[361]. In December 2010, Malaysia has started negotiations with the TPP

[359] Interview no. 40.
[360] The US-ASEAN Summit took place for the first time in the summer of 2010 (JETRO 2009).
[361] Interview no. 39.

members, while Thailand expressed its interest during the 2010 APEC Summit. The more important trading partners in East Asia and the Asia-Pacific region join the TPP, the greater the pressure on Japan, which also increases the likelihood that it will wish to join in order to avoid isolation. Japan's chairmanship of the APEC 2010 Summit has intensified discussions on the country's participation in the project. It was expected that Japan would use this opportunity to make a declaration regarding the initiative or try to further economic integration within the APEC forum. Japan's government was urged to join the TPP by observers and scholars within the country (e.g. Terada), as well as voices from abroad. Yamazawa (2010a) repeats Prime Minister Naoto Kan's statement that Japan's accession to the TPP would be a necessary "second country opening" (after the Meiji era) and considers it to be a good reason for joining the TPP negotiations[362]. During his keynote speech at the *'APEC Japan 2010 Symposium'*, Dr. C. Fred Bergsten (2009), Director of the Paterson Institute for International Economics, expressed his opinion that Japan should join the agreement, as "this would provide a critical mass to the whole exercise, make it very important in trade and economic terms, establish Japan's leadership in the entire APEC process, and put a whole additional cast on the TPP initiative and what it will mean". He (*ibidem*) also stated that Japan and the US should "work closely together to move the process forward in 2010, and perhaps bring it to a successful conclusion (...) at the Honolulu summit in the fall of 2011". In addition, he said that he considers Japan's participation in the TPP to be a stepping stone towards realising the FTAAP proposal. The desire to avoid isolation that is behind Japan's interest in the TPP is reinforced by other considerations. As the negotiations begun in 2010, even if the country had decided to join in June 2011, it would have been well behind in them. Ito (2010) quotes Shujiro Urata, who comments that "there are seven or eight months until June and most of the negotiations will be over by then (...) the TPP negotiations are trying to create new rules and a new system not only for trade but for the economy in the Asia-Pacific region (...) and without participating, Japan's views will not be reflected at all". In case the agreement is negotiated, Japan does not want to be excluded from discussions and decisions on its future shape. It can be seen that in order not to be 'left behind' Japan not only needs to participate in the framework but should also participate early enough to be able to influence the decision-making process.

The preferences of certain domestic groups to join the TPP are constrained by the

[362] During the World Economic Forum in Davos in 2011 Naoto Kan mentioned that Japan is undergoing its third economic opening up, after the Meiji Restoration and economic reforms after the World War II (BBC News 2011).

agricultural sector's opposition. The high degree of liberalisation involved in the discussed TPP agreement makes it impossible for Japan to join while retaining its usual levels of protection. For that reason, as late as in February 2010, the future of Japan's participation in the scheme was uncertain and many observers claimed that the country was not ready to join the negotiations and the necessary domestic reforms would take a long time[363]. The DPJ's *'The New Growth Strategy – Blueprint for Revitalising Japan'* (2010b) in June 2010 did not mention the TPP initiative. However, in a speech on 1 October 2010, Prime Minister Naoto Kan (2010a) announced that Japan would consider participating in the TPP agreement. This statement met with protests from the opposition, as well as from members of the DPJ party. According to *Kyodo News* (21 October 2010), 110 of the ruling party's policymakers (from both chambers of the Diet), including the former Prime Minister Yukio Hatoyama, asked Prime Minister Naoto Kan to take the agricultural sector's interests into consideration and to be 'cautious' in expressing an interest in the TPP. The news agency wrote that "the lawmakers are concerned that Japanese farmers could suffer 'a critical blow' if the country joins the TPP as the agreement in principle requires members to eliminate all tariffs to zero" (*ibidem*). Prime Minister Naoto Kan's announcement regarding Japan's participation in the TPP at the 2010 APEC Summit has caused strong protests from the agricultural sector and agricultural cooperatives, which organised a demonstration in the vicinity of MOFA's and METI's offices in Tokyo. It can be argued that such a reaction is one of the main reasons behind a lack of a decisive commitment to the framework. The decision to avoid a more serious declaration might be seen as a compromise towards the agricultural lobby. However, a poll by *Yomiuri Shinbun* (Katz 2010), a Japanese newspaper, from autumn 2010, showed that 61 percent of respondents supported then Prime Minister Naoto Kan's announcement and would like to see Japan join the agreement despite the high level of liberalisation involved. Until the June 2011 deadline, Japan was supposed to consider implementing necessary reforms (e.g. agricultural subsidies) and dealing with domestic opposition groups. Chapter 6 provides an update on Japan's TPP policy in 2011. Finally, on 11 November 2011, Prime Minister Yoshihiko Noda announced that Japan will join the TPP negotiations.

To participate in any region-wide agreement, not only the TPP, Japan will need to decide how to approach the agricultural sector's opposition. Farming households constitute between 1 and 2 percent of the Japanese society[364]. MAFF's position towards

[363] Interview no. 26 and Terada (2009:18).
[364] Interview no. 42.

a region-wide FTA does not differ significantly from its position on previous agreements: if Japan can participate without harm to the agricultural sector, the Ministry will not oppose it; however, if it requires further liberalisation Japan should not participate. In practice, MAFF is against any FTA which would include the US, Canada, Australia, New Zealand, and China[365]. These countries are not only big agricultural exporters, but also export products that are regarded as sensitive for Japan. The TPP initiative involves Australia, with which Japan has had difficulties negotiating a bilateral agreement, as described in Chapter 3. Hence the Ministry does not support the TPP[366]. *JA-Zenchu* (Japan's Central Union of Agricultural Cooperatives) takes a stronger stand: they believe that an APEC-based region-wide agreement including the agricultural sector is almost impossible[367]. One of the reasons for this is the existence of several different agriculture models within APEC, for example the Japanese small-scale family farmers' model[368]. *JA-Zenchu's* Deputy-General Manager argues that while the manufacturing sector has strong ties with the US and considers it natural to strengthen the relationship with them, the agricultural sector does not have similar ties. In March 2010, Sugawara (2010), former advisor of Japan's permanent delegation to the OECD, wrote that Japan is not ready to be a part of the TPP. According to METI's Director-General for International Trade Policy, who was in charge of preparing the Ministry for the 2010 APEC Meeting, to consider participating in the TPP Japan needs to overcome the same type of issues that prevent it from successfully negotiating an agreement with Australia, namely the liberalisation of agriculture[369]. *Bloomberg* (2011) quotes Gerald Curtis, a professor of Japanese politics at Columbia University, as saying: "you can't have a TPP or a US-Japan FTA unless you bite the bullet on agricultural reform, and they're not even close to doing that". Nagata (2010a) estimates that participation in the TPP would require Japan to immediately abolish 80 percent of all its tariffs and make further liberalisation of ten percent of tariffs within the next ten years.

Prior to the APEC Summit, at the end of October 2010, the Ministry of Agriculture, Forestry and Fisheries published its calculations of the impact of the immediate removal of tariffs on 19 major agricultural products. According to MAFF, such liberalisation would limit domestic agricultural production by 4.1 trillion JPY (currently eight trillion

[365] Interview no. 10.
[366] *Ibidem.*
[367] Interview no. 29.
[368] For more information on Asian farmers' models see the Joint Statement of the Asian Farmer's Group for Cooperation (AFGC 2010).
[369] Interview no. 6.

JPY)[370]. The food self-sufficiency rate on caloric basis would fall from 40 to 14 percent. In addition, the immediate removal of agricultural tariffs would cut national real gross domestic product by 7.9 trillion JPY and 3.4 million people would be unemployed. One of the main issues that Japan would need to address is the elimination of tariffs on rice, which is currently subsidised by the government and subject to a 778 percent import tariff. *The Japan Times'* article (Nagata 2010a) quotes a Japan Research Institute (JRI) representative who estimates that without the government's support domestic rice production would fall from 8.8 million tons to two million annually within ten years, while if the government was to implement a compensation scheme of "23,000 JPY in compensation per 10 acres to rice farmers whose paddies measure more than 2 hectares, Japan would manage to produce about 5 million to 6 million tons of rice in 2020"[371]. Another article in the same newspaper (Ito 2010) mentions MAFF's predictions that 90 percent of domestic rice production would be replaced by imports in case of tariff reductions. The discussion on the government's efforts to reform the agricultural sector is continued in Chapter 5.

4.3.3 Japan's Pragmatic Approach to the Coexistence of the Three Regional Frameworks

Japan has not experienced any great difficulty during its participation in the three regional economic integration schemes. Ippei Yamazawa comments that there was no conflict of interest between them[372]. At the same time, Japan would like to be part of a high level, ambitious FTA network and the Asia-Pacific forum and hence is attempting to join the TPP[373]. The Minister of Economy, Trade and Industry, Masayuki Naoshima, confirmed that the government does not want to choose between coexisting region-wide integration schemes[374]. Instead, it prefers to use all three initiatives to promote economic growth. The country continues to follow all three frameworks as each of them has a business reality. For example, the APT and the ASEAN+6 fora have a slightly different agenda. While the former focuses more on economic issues, the latter includes 'new cooperation issues'. ASEAN+1, ASEAN+3 and ASEAN+6 meetings often take

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370 These figures obtained during interview no. 29.
371 The agricultural cooperatives oppose joining the TPP, fearing that cheap rice imports and direct compensation schemes for farmers will weaken their position. More on this issue in Chapter 5.
372 Interview no. 58.
373 Interview no. 2.
374 Press conferences at the Foreign Correspondents' Club of Japan (FCCJ), January 15 2010, Tokyo.

place at the same time and in the same venue and therefore, it is easy to simultaneously participate in them. At the same time, participation in the APEC process ensures the existence of a regional forum that does not exclude the US. Japan will probably continue to support all of the frameworks. It can be argued that the country's approach to FTAs is pragmatic, as it uses bilateral agreements and region-wide FTA framework initiatives in order to secure certain economic interests. When negotiating bilateral trade treaties, Japan places a high importance on the elements that further the country's strategic objectives and profit its interest groups, such as the multinational corporations, as shown in Chapter 3. This type of approach is not unique to Japan. Based on an Asian Development Bank (ADB) study, Capannelli (2010) argues that practical, gradual regional economic integration is typical for East Asia. Capannelli and Seng (2010) argue that regionalism in Asia is informal, flexible, and based on a consensus decision-making style.

Another ADB (2010) study mentions a bottom-up and pragmatic style of regional cooperation. Capannelli and Filippini (2009:3) write that "Asia's pragmatic and flexible approach to regionalism is partly dictated by history". They describe it as: market-driven, focused on economic issues, and dealing with differences in culture and development. Yoshimatsu (2008) has coined the term 'pragmatic functionalism' to describe the style of cooperation in East Asia. He stresses the fact that East Asian states "have little interest in formal organisations that would exert binding power on them but rather enhance mutual benefits through cooperation that does not affect state sovereignty" (*ibidem*:15). References to pragmatism and flexibility can also be found in descriptions of ASEAN's integration and the 'ASEAN way', which is based, amongst others, on consensus-building decision-making. The former Secretary-General of ASEAN, Rodolfo Severino (2001) described the Association as a "group of sovereign nations operating on the basis of ad hoc understandings and informal procedures rather than within the framework of binding agreements arrived at through formal processes". Cockerham (2009:25), writing about ASEAN's integration process, argued that "in (a) region that has a great deal of variety among ethnicities, political systems, and economic development, functional cooperation with significant constraints on supranationalism would be in the best interests of its members". In 2001 a Chinese scholar (Penghong 2001:13), explaining the country's interest in agreements which help to secure markets for its products and investments wrote that "functional and pragmatic cooperation is in the first priority of China's external cooperation". Due to the pragmatic approach to regional integration, Capannelli (2010) recommends maintaining several regional frameworks and using them for different purposes[375]. For example, the EAS forum might be useful for regional environmental cooperation or disaster prevention, the APT for financial cooperation, and the APEC for trade facilitation (Urata 2010b, 2010c). Such a division of labour would facilitate gradual, multi-track regional economic integration.

4.3.4 The Sequencing of Regional Frameworks and Technical Aspects of 'Docking and Merging' FTAs

The fieldwork indicates that both Japan's scholars and its government officials consider a region-wide FTA to be the final goal. A former Ministry of Finance (MOF) Customs and Tariff Bureau representative argues that the region-wide FTA would be the best solution, but will be difficult to achieve due to a high number of players[376]. There are additional, non-economic matters which further complicate the process. For example, relations with China are aggravated by unresolved historical issues. Although most observers, analysts and government officials agree that, in theory, the bigger the FTA, the more economic gains it will bring, all of the proposed schemes have their pros and cons. As a result, the fieldwork research demonstrated that despite Japan's official support for the ASEAN+6 framework as a basis for a future region-wide FTA, the issue of which multilateral agreement Japan should attempt to join first remains a question of personal judgement and preference. Within the same ministry there are those who support the pro-US option and the idea of joining the TPP and those of an Asia-centric orientation who believe in deepening economic integration with ASEAN through the ASEAN+3 or ASEAN+6 frameworks.

According to a Chief Economist at the Economic Research Institute for ASEAN and East Asia (ERIA), a region-wide agreement should be based on the ASEAN+6 grouping, preferably opened for accession, and have consolidated rules of origin (RoO)[377]. Urata, a member of the CEPEA and EAFTA feasibility study groups, argues that a region-wide FTA should be established in East Asia (2010b). He classifies both of the agreements as medium-level, while the TPP is a high-level FTA. Therefore, he argues that Japan should lead the CEPEA process and join the TPP. According to a

[375] A similar opinion was expressed during interview no. 58.
[376] Interview no. 12.
[377] Interview no. 54.

former Director for FTA Affairs at METI's Trade Policy Bureau, the final region-wide FTA should cover all aspects of trade and include cumulative RoO[378]. In his opinion, wider membership would bring more benefits and limit the spaghetti bowl effect, while the cumulation of rules of origin and the convergence of procedures and standards would increase the impact of such an agreement. A former member of Prime Minister Koizumi's Economic Planning Agency also agrees that a region-wide FTA or a customs union with harmonised rules of origin and procedures is the final goal[379]. In his opinion, Japan should aim to achieve that in an ASEAN-centric structure. ASEAN and Japan share similar strategic objectives, for example counterbalancing China's influence. In the same way, opinions vary when it comes to sequencing the realisation of region-wide frameworks. For the Director for Economic Partnership (EPA/FTA) at METI's Trade Policy Bureau, a region-wide FTA should be build on the basis of smaller regional FTAs, such as ASEAN+1 agreements[380]. However, another METI official, a former Director for FTA Affairs at the same Bureau argues that CEPEA and EAFTA negotiations should start at the same time[381]. An Associate Professor of International Economics at Chiba University and a member of FTA Study Meeting at the Institute for International Trade and Investment believes that political considerations should determine the sequencing of regional frameworks[382]. For example, Japan should join the TPP after the creation of CEPEA as the former Prime Minister, Hatoyama, has already committed to this initiative.

In general terms, there are two options: one approach is to start bilateral negotiations first, another is to jump straight into multilateral negotiations. In practice, there is usually a reason why particular countries have not yet established an FTA. For example, as previously discussed, in 2010 all five ASEAN+1 agreements were in force. However, there is no FTA between the Northeast Asian countries. This agreement would be a stepping stone towards a successful implementation of any region-wide arrangement. The conclusion of the China-Japan-Korea FTA (CJK) would facilitate the negotiations of CEPEA and EAFTA[383]. A Research Fellow at the Japan Institute of International Affairs (JIIA) agrees that the trilateral FTA between China, Japan and Korea should come before a region-wide agreement[384]. A member of the CEPEA and

378 Interview no. 4.
379 Interview no. 60.
380 Interview no. 5.
381 Interview no. 4.
382 Interview no. 48.
383 Interview no. 54.
384 Interview no. 44.

EAFTA study groups and a former World Bank economist, Shujiro Urata, has published widely on numerous topics related to the multilateralising of free trade agreements in East Asia. In one of his papers (2010a:17), he lists two alternatives for creating a region-wide FTA in the region. One of them is to consolidate existing FTAs into a broader agreement. This option is easier when agreements contain similar content. Urata (*ibidem*:17) gives an example of an attempt to consolidate Japan's agreements with ASEAN members. In this case, the consolidation turned out to be impossible, due to the differences in the contents of the bilateral agreements. As a result, Japan and ASEAN created a new agreement and added it 'on top' of pre-existing bilateral ones. Hence the attempt to multilateralise FTAs has failed. The second option is to enlarge existing agreements. This approach, referred to by Urata as 'merging or docking' can be illustrated by the European Union and its subsequent enlargements. This concept has already been mentioned in the context of FTAAP. The Deputy Director of MOFA's EPA Division explains that the 'docking and merging' of existing FTAs is a term used by MOFA, for example, in reference to future APEC-wide trade negotiations, where Cambodia, Laos, and Myanmar are not members of APEC but are part of ASEAN and India is also not a member of APEC but is an important regional economy[385]. In Urata's (2010a:17) opinion, the initial FTA, which other countries join, is usually a high-level type of trade agreement. He considers the TPP initiative to be a good example of an FTA which has a potential to grow into a region-wide agreement. In another 2010 paper, Urata (2010c) distinguishes five ways to 'dock and merge' FTAs in order to create a region-wide agreement in East Asia: 1) by consolidating five ASEAN+1 agreements into CEPEA; 2) by establishing ASEAN+3 FTA and expanding it gradually to CEPEA and then to FTAAP[386]; 3) by establishing a CJK FTA and expanding it in the same order as in point two; 4) by starting with CEPEA and transforming it into FTAAP; or 5) by expanding TPP membership and transforming it into FTAAP. According to the Director for FTA Affairs at METI's Trade Policy Bureau, the direction currently advocated by METI is similar to the third point: to negotiate a trilateral FTA and then proceed with a regional agreement[387].

Another question is how to approach the final goal of forming a region-wide FTA from a practical point of view. The merger of existing agreements would require a substantial political effort, due to the vast differences between them. One option is to

[385] Email correspondence with the author, September 2010.

[386] This is also advocated by Kawai and Wignaraja (2011a:1): ASEAN+3 FTA should be followed by CEPEA which in turn should be "followed by connections with North America and Europe".

[387] Interview no. 4.

develop a 'best practice' model. According to the former Director for FTA Affairs at METI's Trade Policy Bureau, with each signed FTA the users (Japanese corporations) are drawing conclusions about what they consider to be best practice provisions and request the inclusion of such provisions in prospective agreements or revised versions of existing ones[388]. Hence in his opinion, a gradual convergence of Japan's FTA is taking place. As explained in Chapter 3, one example is the spread of the co-equal rule of origin. METI's Director sees the potential for further convergence, especially in the field of procedures and regulations. According to Asia University's Department of International Affairs' Executive Director, by the year 2015 most of FTAs in the region should be completed and many of them will be using the co-equal rule[389]. If this is the case, it would be possible to then transform existing treaties into a region-wide agreement by 'docking and merging'. Another option is to sign FTAs one by one. According to the Chief Economist at ERIA, the best solution would be to start with bilateral or minilateral FTAs and harmonise them as much as possible[390]. Even if the implementation of full cumulation is not possible, any improvement which simplifies procedures or rules of origin is desirable. Furthermore, he stresses this would help to sustain the political momentum for a region-wide FTA. Once functioning bilateral solutions are in place, harmonisation could be accomplished by introducing a flexible solution, as was the case with the AJCEP. As explained in the previous chapter, initially METI wanted to start negotiations of the AJCEP while MOFA preferred to establish bilateral agreements first. In retrospect, a Director for FTA Affairs at METI's Trade Policy Bureau recognises that it was beneficial to start with bilateral agreements, as they included a higher level of liberalisation and WTO-plus provisions[391]. Bilateral negotiations made it easier to establish the AJCEP, which is a less ambitious FTA. He explains that the Ministry's approach to a region-wide FTA is similar. Despite the EAFTA and CEPEA study groups' recommendations there is an expectation that the region-wide FTA would be a 'lowest common denominator' type of agreement. Similarly, a former Ministry of Finance representative expects that CEPEA and EAFTA would be low-quality FTAs[392]. Therefore, METI would first like to realise a minimal standard and achieve deeper liberalisation in the region through bilateral agreements or

[388] *Ibidem.*
[389] Interview no. 50.
[390] Interview no. 54.
[391] Interview no. 4.
[392] Interview no. 12.

the trilateral FTA[393]. Urata (2010a:9), comments that the proposed FTAs in East Asia, including EAFTA and CEPEA, have two distinctive features: the inclusion of economic cooperation, and a low level of trade liberalisation. This has important implications for the industries' preferences for a region-wide agreement, as explained in section 4.4.

As discussed in the previous chapter, Japan has a flexible approach to rules of origin when it comes to overlapping FTAs with ASEAN members. This flexible approach indicates a preference to avoid committing to one particular set of regulations and leaving the option of choice that permits applying solutions which, in the given moment, better suit industry interests. This way of thinking is portrayed by METI officials and certain economists as an answer to the 'multilateralising bilateralism' debate and a way to lessen the effects of the noodle bowl syndrome, or eliminate them entirely[394]. According to this approach, the coexistence of different types of FTAs is a solution in itself and part of a multi-layered foreign trade policy. In the opinion of a Deputy Director at JETRO's International Economic Research Division, the Japanese government perceives the flexible and gradual option, of which the sequencing of FTAs with ASEAN countries is an example, as a way to reach a region-wide FTA[395]. First, Japan signed bilateral agreements with the most likely partners. Then the AJCEP was signed and tariffs were gradually reduced. The next step would be to harmonise rules of origin, for example by implementing the co-equal rule. This would gradually lead towards a region-wide FTA. Similar views were expressed by the interviewed METI officials. According to a former Director for FTA Affairs at METI's Trade Policy Bureau, a flexible clause, similar to the one used in the AJCEP, might be initially implemented in a region-wide agreement[396]. This would facilitate a transition to a full-fledged regional FTA. This opinion is shared by METI's Director-General for International Trade Policy[397]. In his view, such an approach could help to foster a prospective region-wide agreement by increasing the flexibility and allowing for a gradual harmonisation of existing agreements. Once an initial region-wide FTA has been signed and implemented it can gradually be improved and simplified. Similarly, according to METI's Director for Economic Partnership (EPA/FTA), who is responsible for FTA negotiations with India and Australia, as well as a joint trilateral FTA Study Group, the ideal solution would be to coordinate all of the rules of origin and to harmonise the

[393] Interview no. 4.
[394] Interview no. 46.
[395] Interview no. 40.
[396] Interview no. 4.
[397] Interview no. 6.

existing agreements[398]. As this would be extremely difficult to achieve an alternative, and a second-best, option is to let the users choose.

Despite these opinions, METI is not officially promoting the use of a flexible approach in the prospective region-wide FTA[399]. In the view of the aforementioned Director for Economic Partnership (EPA/FTA) this is a *de facto* way of thinking[400]. When negotiating a new agreement, METI tries to take into account the existing FTAs and their rules of origin and coordinate agreements as much as possible. Amongst Japanese scholars and FTA specialists, opinions are divided on the application of the flexible approach to a region-wide FTA. According to a Chief Economist at ERIA, it would be possible to have another layer of overlapping agreements, as it is easier to conduct separate negotiations than to consolidate existing FTAs[401]. A member of an FTA Study Meeting Group at the Institute for International Trade, from Asia University, believes that the flexible option might not be a solution and some sort of coordination process will be necessary to conciliate three levels of FTAs[402]. Another member of the Study Meeting confirms that the flexible option might not be possible in the case of a region-wide FTA as a triplication of structures might prove to be too complex[403]. Even if, from the private sector's perspective, the coexistence of different levels of FTAs is admissible, from a diplomatic point of view it is a complex situation. Hence the aforementioned Study Meeting Group member predicts that 'dock and merge' efforts will be initiated by the government and not the private sector. In his view, countries which are members of APEC as well as the ASEAN+3 or ASEAN+6 frameworks might be particularly supportive of the 'docking and merging' of existing and planned FTAs. The concept of flexible provision is not only cited in the context of East Asian FTAs. The TPP agreement also faces the issue of overlapping with bilateral FTAs, i.e. between the US and Australia, Singapore or Chile. According to a former advisor of Japan's Permanent Delegation to the OECD there is a discussion within the framework on how to coordinate coexisting agreements[404]. So far, the TPP has not recognised the coexistence of overlapping agreements as a plausible solution.

398 Interview no. 5.
399 Interview no. 3.
400 Interview no. 5.
401 Interview no. 54.
402 Interview no. 50.
403 Interview no. 48.
404 Interview no. 46.

4.4 Industry Preferences for Further Trade Liberalisation

4.4.1 The Importance of Non-tariff Issues

This part of the chapter discusses how the FTAs' main clients, the Japanese multinational corporations, perceive the prospect of a region-wide agreement. Is there a need for a broader trade treaty? The fieldwork research asked two questions. First, what type of provisions would Japanese companies like to see included in future FTAs and why? Secondly, are they interested in a region-wide agreement and if so, what form should it take? Based on the fieldwork research, this section demonstrates that Japanese MNCs have low expectations and as a result, show little interest in the CEPEA and EAFTA projects. On the other hand, they are highly interested in the TPP due to the economic domino effect; increasing competition with Korea; and interest in export expansion to markets which have so far been protected by high tariffs, such as the US.

Japanese business federations have their own preferences for a region-wide agreement. In the opinion of the Deputy Director of the Japan Business Federation (*Keidanren*), Japan's FTA policy is based on the premise that liberalisation under the WTO is the optimal solution and the final goal[405]. Hence a region-wide FTA should not be a politically formed community like the EU, but an open agreement preferably based on the APEC block. According to *Keidanren's* representative, excluding Pacific countries from regional economic integration is not a good idea as the East Asian economy is still heavily dependent on the US market[406]. In his opinion, Japan should opt for an APEC-wide FTA which would be open for accession by countries like India. A Managing Director of the Japan Association of Corporate Executives (*Keizai Doyukai*) explains that as the Japanese domestic market is not expanding, Japanese companies should take advantage of the Southeast Asian and Chinese markets[407]. In his view, Japan's economy has reached a level where regional or bilateral FTAs are a necessity for economic growth.

Despite the fact that Japanese companies in several sectors can agree on what type of provisions they would like to see included in FTAs, it is difficult to determine which forum would be best suited for a region-wide agreement from the industries' point of view. As in the case of bilateral agreements, the answer depends on the mix of products a given company sells and the locations it uses for production. If a company is involved

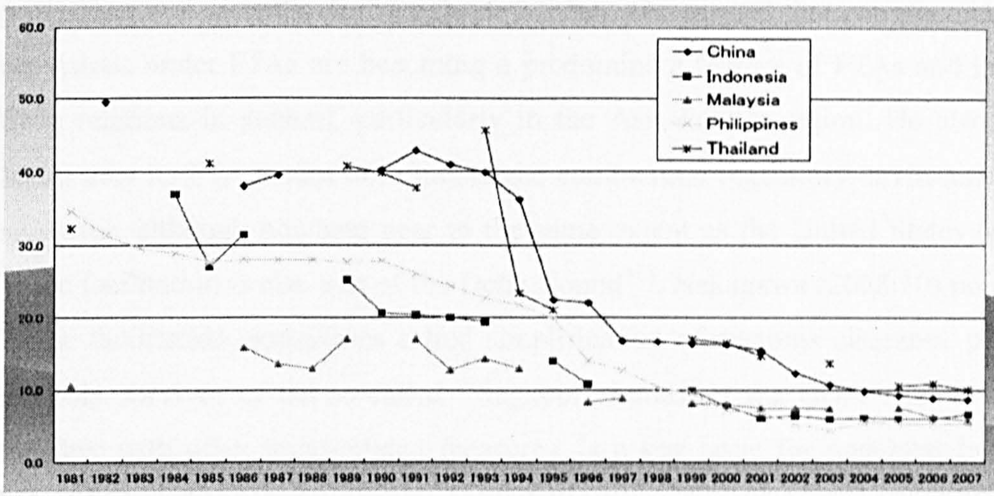
[405] Interview no. 24.
[406] *Ibidem.*
[407] Interview no. 23.

in business activities in the US, it is much more likely to opt for the APEC-wide treaty or the TPP. If, on the other hand, the company is investing in ASEAN, it is likely to prefer an ASEAN-based agreement. Although industry interests were an important factor behind METI's preference for the CEPEA project, in the view of METI's Director-General for Manufacturing Industries Policy, from the manufacturing companies' point of view there is little difference between a regional agreement realised under the ASEAN+3 framework and one realised under the ASEAN+6 framework[408]. This is because most companies pay attention to tariff reductions and implementation schedules between individual countries, depending on where they locate their production. In addition, as explained in Chapter 3, tariffs in East Asia were significantly lowered by various forms of liberalisation. Although they remain high on some products, average tariffs in East Asia have fallen. This can be observed in Figure 4.2, which demonstrates tariff liberalisation in selected East Asian economies. Furthermore, after the signing of the ASEAN-Japan FTA, companies were able to profit from the cumulation of rules of origin between their sales or manufacturing facilities in member countries and their headquarters in Japan. The country's extensive FTA network has helped to limit the impact of tariffs, while third-party agreements offered companies indirect access to other foreign markets. As a result, the problem of tariffs in East Asia has been significantly reduced[409]. Elimination of tariffs on goods is still desirable from the manufacturing sector's perspective as with no tariffs there will be nothing to calculate at the border. However, companies export final products mostly from ASEAN or China, rather than Japan and hence not under Japanese FTAs. Tariffs are still an important barrier when it comes to the North American or European markets. Companies trading or investing in those markets would like to see import duties lowered.

[408] Interview no. 7.

[409] There are other matters that are currently of importance for Japanese industries in East Asia, for example: access to the Chinese market and the inclusion of Taiwan in the FTA network.

Figure 4.2 Average tariff rates in selected East Asian states (in percentages)



Source: Urata 2010b:19

Chapter 3 suggested that with tariffs no longer the primary concern in East Asia, other types of barriers are now posing a much bigger problem when it comes to bilateral FTAs. The same issues are discussed in the context of a region-wide FTA. For Japanese companies investment liberalisation and trade facilitation is becoming an increasingly important aspect of regional economic integration[410]. They are equally interested in improving the business environment and the harmonisation of regulations and standards. In terms of FTAs this means including deep liberalisation or WTO-plus provisions and especially provisions on trade facilitation. *Keidanren's* Deputy Director confirms that Japanese industries would like to see further integration with ASEAN exceed tariff reduction and include such provisions[411]. Under current FTAs, the East Asian countries have not achieved a seamless market (Kumar 2010). Several barriers to trade and problems with infrastructure remain. Furthermore, trade facilitation and the harmonisation of provisions would allow small and medium enterprises (SMEs) to play a greater part in the internationalisation of production networks. Lim and Kimura (2010:20) write that "the proliferation of bilateral and sub-regional FTAs has created duplication and overlapping of RoO and other trade and investment rules and regulations that would increase the transaction cost of doing business in the region, affecting SMEs adversely". In the Asia-Pacific region, where high tariffs still pose a considerable difficulty, the liberalisation of non-tariff barriers to trade is also becoming increasingly important for Japan's MNCs. This is evidenced by their efforts to lobby the government through the APEC Business Advisory Council Japan (ABAC-Japan) to

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[410] Interview no. 12, 16 and 32.
[411] Interview no. 24.

include such issues in APEC's agenda[412]. The increasing importance of non-tariff provisions was recently cited by Dent (2010a), who argued that commercial regulatory provisions under FTAs are becoming a predominant feature of FTAs and international trade relations in general, particularly in the Asia-Pacific region. He also noted that Japan uses its FTA model to influence the commercial regulatory environment of other countries, although nowhere near to the same extent as the United States (*ibidem*:76). Trade facilitation is also part of the Doha Round[413]. Nakagawa (2008:10) points out that "trade facilitation, sometimes called simplification of customs clearance procedure, is the only survivor of the so-called 'Singapore issues' of the DDA". Trade facilitation, together with other trade-related measures, is a key issue for understanding Japanese industries' preferences for a region-wide FTA.

4.4.2 Reducing Lead Time

WTO-plus provisions and trade facilitation are an important part of Japan's comprehensive EPA approach. Urata (2008a:20) points out that "Japan emphasises the importance of (the) liberalisation and facilitation of investment and service trade, as such measures would provide (a) free, transparent and stable business environment for Japanese firms, which have invested heavily in East Asia". For example, as mentioned in Chapter 3, within existing FTAs Japan usually sets up bilateral committees on the improvement of the business environment. The goal of such committees is to harmonise trade and investment regulations. The DPJ's (2010b:26) *'The New Growth Strategy – Blueprint for Revitalising Japan'* spoke of forming a seamless Asian market which would include trade and investment liberalisation and facilitation, as well as IPR[414]. One of significant aspects of trade facilitation is the reduction of lead time. Lead time refers to the time from when the decision to start the production is made to when the manufacture of the final product is completed and it has arrived at its destination. It includes elements such as ordering the product, parts procurement, assembly, transportation, customs clearance, and safety checks. Lead time can equate to a number of days, depending on the type of product. As described in Chapter 3, under vertical *keiretsu* Japanese companies had a well-established pyramid structure of suppliers. As

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412 Interview no. 27.

413 Interview no. 12.

414 In terms of domestic reforms for creating a seamless Asian market the DPJ's (2010a:26) text mentioned strengthening the exchange of finance, transportation and other services between the country and the region.

this type of arrangement continued for many years, companies knew what to expect and lead time was kept short. However, this changed when parts of the production networks were moved abroad. As a result, MNCs started to pay more attention to issues of supply chains logistics and efficiency. Toyota's 'just-in-time' manufacturing system, a part of the 'lean production' system, is one example[415]. A company using such a system needs to be able to quickly transport goods from one place to another, as it does not stock items in each factory. The reduction of lead time is an important issue for many Japanese companies in the East Asian region[416]. In fact, all of the interviewed corporations have admitted that currently it is their key concern. Reducing lead time makes the production process more flexible and adaptable. It is important for companies in the electronics and machinery sectors; it is also key for those in the automobile sector, although to a lesser extent due to the high amount of locally procured parts. For Japanese companies in the steel industry, as well as the textile sector, reducing lead time is also of interest.

Figure 4.3 An example of lead time in a global company in the electronics sector

Total Lead Time	Planning and ordering	Parts procurement	Checks	Transport to the assembly site	Manufacturing
Existing: 88	20	30-60	2	1	5
Desired: 46.5	10	30	0.5	1	5

Source: Obtained during interview no. 15

Figure 4.3 shows that a Japanese global manufacturing company in the electronics sector has a lead time of about 88 days for producing a certain model for a given market[417]. That means that if it wants to sell the final product in December, it needs to make a decision and start ordering in October. If during this time the company or the customer wants to change or cancel the order, it would be difficult to make the necessary adjustments. If goods are no longer required they need to be stored, which

415 For details see, for example, Toyota 2011.
416 Interview no. 28.
417 Interview no. 15.

implies additional costs. In this example, production takes only five of the 88 days. Lead time depends on many factors; however, parts procurement is the most time-consuming stage. The company has little control over this process, as it includes transportation and border clearance. If it uses suppliers located in several countries, their delivery times usually differ. The final lead time depends on the last delivery date. As those external factors are not directly related to the quality of the finished product, this is the stage that MNCs would like to see shortened. Other stages, such as safety checks and testing, cannot be shortened. For that reason, according to the conducted fieldwork, the industries would like a region-wide FTA to include provisions facilitating parts procurement. The ability of FTAs to reduce lead times has become the key interest for many companies. Figure 4.4 presents the components of trade facilitation and their evaluation for ASEAN states. It can be observed that for ASEAN economies cross-border trading, which is directly related to parts procurement, is both expensive and time-consuming[418].

Figure 4.4 Components of the ease of doing business and their evaluation for ASEAN economies in 2010

Table 2.2 Components of ease of doing business and their evaluation for ASEAN economies, 2010

		2010								
		Brunei	Cambodia	Indonesia	Lao PDR	Malaysia	Philippines	Singapore	Thailand	Vietnam
Starting a Business	Procedures (number)	18	9	9	7	9	15	3	7	11
	Time (days)	116	85	60	100	11	52	3	32	50
	Cost (% of income per capita)	10	138	26	12	12	28	1	6	13
	Min. capital (% of income per capita)	0	37	60	0	0	6	0	0	0
Dealing with Licenses	Procedures (number)	32	23	14	24	25	24	11	11	13
	Time (days)	163	709	160	172	261	203	25	156	194
	Cost (% of income per capita)	5	54	195	144	7	82	20	12	248
Employing Workers	Difficulty of Hiring Index (0-100)	0	44	61	11	0	56	0	33	11
	Rigidity of Hours Index (0-100)	0	33	0	0	0	0	0	0	13
	Difficulty of Firing Index (0-100)	0	30	60	50	30	30	0	0	40
	Rigidity of Employment Index (0-100)	0	36	40	20	10	29	0	11	21
	Firing costs (weeks of wages)	4	39	108	162	75	91	4	54	87
Trading Across Borders	Documents for export (number)	6	11	5	9	7	8	4	4	6
	Time for export (days)	28	22	21	50	18	16	5	14	22
	Cost to export (US$ per container)	630	732	704	1860	450	816	456	625	756
	Documents for import (number)	6	11	6	10	7	8	4	3	8
	Time for import (days)	19	30	27	50	14	16	3	13	21
	Cost to import (US$ per container)	708	872	660	2040	450	819	439	795	940
Closing a Business	Time (years)	3	..	6	..	2	6	1	3	5
	Cost (% of estate)	4	..	18	..	15	38	1	36	15
	Recovery rate (cents on the dollar)	47	0	14	0	39	4	91	42	18

Source: Urata 2010d

418 The table also indicates that the time and cost of direct investment in ASEAN countries varies significantly.

Parts procurement can be further divided into preparation of documents, customs clearance and control, port and terminal handling, and inland transport, both in the exporting as well as the importing country. Japanese companies experience many difficulties with customs procedures and would welcome harmonisation in this field. According to Waller (2010), Director of the Australian APEC Study Centre and Melbourne APEC Finance Centre at RMIT University, 60 percent of APEC's trade transaction costs come from ports and terminal handling (customs clearance) and inland transport. In addition, the customs clearance and inland transport stages cannot be accurately calculated beforehand as they often depend on customs officers and other external conditions. Traffic in a port might hold up a vessel for a number of days. If a customs officer is not sure whether exported parts require duties, or the description of the shipped product is unclear, the border clearance procedure can easily be extended to several days[419]. The producer might need to provide additional, detailed information. One of Japan's MNCs from the heavy industry and machinery sector explains that while exporting medium technology products and parts, even the way the product is named on the invoice and the packing list may influence the duration of customs procedures[420]. Japanese companies would welcome provisions which would shorten the time required for customs procedures. An interviewed global company in the electronics sector explains that it would like to see the harmonisation and simplification of customs procedures[421]. Two companies in the electronics and automotive sectors mentioned the simplification of procedures related to obtaining the certificate of origin[422]. A basic fee for a certificate is 2,000 JPY with an additional 500 JPY per each part[423]. While this is an important source of revenue for the Chamber of Commerce and Industry, if the company exports low cost parts the administrative fee can exceed the benefits of trading under preferential tariffs. Transparent and easy administrative procedures for obtaining the certificate of origin or customs clearance and the harmonisation of the rules of origin were also mentioned as important by companies in the steel and iron sector[424]. This would prevent unnecessary delays in lead time, for example caused by the product being held at the border. One of the country's leading global companies in the electronics sector recalls having problems with customs procedures under the Japan-Malaysia

[419] Interview no. 17.
[420] *Ibidem.*
[421] Interview no. 19.
[422] Interview no. 16 and 20.
[423] Interview no. 20.
[424] Interview no. 31.

agreement (JMEPA)[425]. Since it was signed in 2005, the FTA was written in an older (2002) version of the Harmonised System (HS) tariff codes. The company uses the newer (2007) tariff codes, under which descriptions of several lines' and products' tariff codes have changed[426]. At customs, the company was required to explain the difference between the FTA rules and the new codes it was using. In addition, some of the products listed under the agreement were no longer being traded, while new products were not included in the JMEPA. According to the interviewed corporation's senior manager, each time it introduces a new product there is the possibility of a delay at customs if it is not listed or does not fit the HS descriptions of goods eligible for preferential treatment[427]. JETRO's document (2008:4) *'How to enjoy preferential tariff rates through EPAs/FTAs (when importing from Japan)'* acknowledges this problem. FTAs with Singapore, Mexico, Malaysia, Chile, Thailand, and Indonesia were all signed before the 2007 HS codes were introduced. This may lead to a difference between an HS code in an import declaration (ID) and the one in a certificate of origin[428]. Such administrative problems need to be eliminated. For example, there were initial difficulties with using the North American Free Trade Agreement (NAFTA)[429]. Over time, both the Japanese companies and customs officers have learned how to deal with these issues.

Apart from customs clearance, the transportation of parts is another stage in the process where a region-wide FTA could help Japanese companies to reduce lead time. An interviewed company in the electronics sector explains that under the existing FTAs in East Asia, spare parts can be imported duty free if they are shipped on the same vessel as the finished product[430]. If shipped separately, every part requires a certificate of origin. This is caused by the fact that the spare parts business is profitable and importers wish to control it. Therefore, they lobby the government to introduce appropriate provisions. If spare parts are sold by an authorised service parts distributor or service point, the profit is kept within the company. Unaffiliated parts vendors reduce companies' profit. On the other hand, such procedures lengthen lead time. Therefore, some big companies oppose this rule. A senior staff member of an interviewed electronics company explains that even if parts are sold by authorised service centres,

425 Interview no. 19.
426 The newest amended version of the HS went into force on 1 January 2007. The amendments were accepted in June 2004 by the World Customs Organisation.
427 Interview no. 19.
428 For Singapore and Mexico this problem has been solved through renegotiations of bilateral FTAs. See Chapter 3 for details.
429 Interview no. 19.
430 Interview no. 15.

the company uses mainly small local service points and does not make a substantial profit from selling spare parts[431]. The company would like to be able to make a list of pre-registered parts which it would be able to freely export. At the moment, the change in the tariff classification (CTC) rule of origin is applied to spare parts. The interviewed company would prefer a 40 percent value content (VC) or the eliminations of duties for parts in this sector[432]. Although specific preferences might differ between companies in different sectors, the need for simpler rules of origin for parts procurement has been acknowledged by APEC. The latter's *'Model Measures for RTAs/FTAs'* (2007a:7) adopted during the 19th APEC Ministerial Meeting in Sydney addresses the issue of accessories, spare parts, and tools. It states that "good's standard accessories, spare parts, or tools delivered with the good are treated as originating if the good is an originating good" (*ibidem*:7).

Standards and certifications are part of the technical barriers to trade (TBT) which can be liberalised under high-level FTAs, for example by including provisions on the harmonisation of domestic and international standards and the mutual recognition of conformity assessments. Export documents, as well as safety standards, for example for electrical appliances, can differ greatly even between ASEAN members (Terada 2008:16). These kind of trade-related measures are an important issue for Japanese industries, as they can significantly lengthen lead time. Due to the global financial crisis, several, in particular the developing, countries, have started to apply restrictive regulations on the standards and certifications of steel and iron products. In 2008, such compulsory compliance was introduced by India for six, and by Malaysia for 57, iron and steel products (JETRO 2009:99). India additionally implemented an import government licensing requirement for several steel and iron products (e.g. automobile parts, such as gearboxes) (*ibidem*:100). Indonesia followed its lead in 2009. According to JETRO's survey (*ibidem*), this has resulted in increased costs for Japanese steel and iron companies. A manager of the Japan Iron and Steel Federation explains that further trade facilitation is needed in this area[433]. Similar restrictions have been implemented in other sectors in the wake of the financial crisis. In 2009, Indonesia introduced an importer registration requirement and pre-shipment testing on 505 products in various sectors, including electrical and electronic products [434] (JETRO 2009:100).

[431] *Ibidem.*
[432] *Ibidem.*
[433] Interview no. 31.
[434] Requiring registering of importers and manufactures, inspection of products prior to shipment and regular reports.

Environmental standards can also constitute non-tariff barriers to trade. One of Japan's leading companies in the automobile sector estimates it would benefit greatly from the harmonisation of environmental standards across the East Asian countries[435]. Japanese companies would welcome improvements in regard to several other issues in the region which. JETRO's survey (2009) ranked business risks and issues in selected Asian countries for Japanese companies in all industries. Inadequate infrastructure was considered an important issue. IPR, forex risk, labour costs, and legal problems were all major obstacles to trade for Japanese companies in 2009. Lim and Kimura (2010:20) conclude that "it is necessary to create a conducive business environment through the provision of standardisation of products and services, rules and regulations and a seamless market infrastructure in the region".

Several of the above issues have been addressed by APEC or other regional organisations and frameworks, which shows that they are of growing importance to MNCs. APEC has been intensifying its efforts to promote paperless trade, e-customs procedures and a general simplification and standardisation of customs regulations. APEC's Trade Facilitation Action Plan I (TFAP), was adopted in 2002, and TFAPII in 2007; both aimed to reduce trade transaction costs in the region by 5 percent within five years. TFAPII focuses on four trade-related measures: standard and conformance, customs procedures, business mobility, and electronic commerce. By July 2010 the results of TFAPII were still inconclusive and the final assessment had not been conducted. The development of infrastructure is another important aspect of trade facilitation that can help to reduce trade costs. The Asian Development Bank (Bhattacharyay 2010) has been advocating a 'Seamless Asia' concept, defined as "an integrated region, connected by world-class efficient environment-friendly energy, transport, telecommunications infrastructure pan-Asia network". Improving infrastructure would help to deepen the liberalisations and expand production networks (Lim and Kimura 2010:16). In Japan, MOF's International Bureau is also making efforts to harmonise the regulations for finance and investment in the region[436].

[435] Interview no. 20.
[436] Interview no. 12.

4.4.3 Investment Liberalisation and Protection

Another issue that many Japanese companies would like to see improved under bilateral or regional FTAs is investment liberalisation and protection[437]. Investment liberalisation achieved under an FTA brings many benefits. Nonetheless, for many, especially the developing countries, it is a sensitive area. Therefore, only a few countries include high level investment liberalisation provisions in FTAs or BITs. The Japan-Korea bilateral investment treaty is an example of such an agreement. The Japan-Singapore FTA includes TRIMs and TRIMs-plus provisions, for example a number of provisions prohibiting various performance requirements for investments by FTA members (Kumar, United Nations 2007:14). The conducted fieldwork indicates that trade and investment facilitation in East Asian or APEC regions is of great importance for Japanese companies. A deeper integration of ASEAN countries, in terms of investment facilitation, would help to improve the operations of Japanese production networks. In particular, elements such as deregulation or the removal of limitations on foreign investment, for example allowing FTA members' investors to engage in joint ventures, would help to improve the business environment[438]. This could be achieved under a re-negotiation and improvement of existing FTAs or by negotiating a high-level comprehensive agreement. Based on an annual survey by the Japan Machinery Centre for Trade and Investment (JMC), Urata (2010a) identifies the barriers to foreign direct investment (FDI), which Japanese companies experienced in 2009 while trading in ASEAN countries. As shown in Figure 4.6, FDI facilitation, an element of high-level FTA investment provisions, approximates 80 percent of incidents, showing the importance of further improvement and harmonisation in this field.

[437] Interview no. 7.
[438] Interview no. 27.

Figure 4.5 Investment climate in ASEAN 10 economies in 2009: the number of incidents by category and country

Table 4.2 Investment climate in ASEAN10 economies in 2009: the number of incidents by category and country

	Brunei	Cambodia	Indonesia	Laos	Malaysia	Myanmar	Philippines	Singapore	Thailand	Viet Nam	Total	Share by category (%)
(a) The number of Japanese affiliates in each country	1	10	659	6	769	10	419	991	1,577	332	4,764	
(b) Issues to be solved for FDI liberalization and facilitation												
<u>FDI liberalization</u>	0	0	17	0	11	8	10	1	19	8	74	20%
i) Restrictions on foreign entry	0	0	10	0	5	2	7	0	8	3	35	10%
ii) Performance requirements	0	0	3	0	3	0	0	0	3	2	11	3%
iii) Restrictions on overseas remittances and controls on foreign currency transactions	0	0	2	0	1	6	2	0	5	2	18	5%
iv) Restrictions on the movement of people and employment requirements	0	0	2	0	2	0	1	1	3	1	10	3%
<u>FDI facilitation</u>	0	14	51	4	44	20	42	6	50	58	289	80%
v) Lack of transparency in policies and regulations concerning investment (institutional problems)	0	5	13	0	13	8	7	0	12	18	76	21%
vi) Complicated and/or delayed procedures with respect to investment-related regulations (implementation problems)	0	3	23	1	14	7	16	0	24	19	107	29%
vii) Insufficient protection of intellectual property rights	0	0	1	0	2	0	3	0	1	1	8	2%
viii) Labor regulations and related practices excessively favorable to workers	0	0	2	0	5	0	10	3	3	4	27	7%
ix) Underdeveloped infrastructure, shortages of human resources, and insufficient investment incentives	0	6	9	3	8	5	6	3	9	13	62	17%
x) Restricted competition and price controls	0	0	3	0	2	0	0	0	1	3	9	2%
Total	0	14	68	4	65	28	52	7	69	66	363	100%

Source: Urata 2010d

For example, one Japanese corporation in the electronics sector recalls having a problem with investment regulations in Thailand, who had a complicated procedure for setting up service centres[439]. The Japanese company needed to apply for permission to a local office and the procedure took several months. When it wanted to set up another office, it needed to repeat the entire process. One of the company's senior managers recalls that it took over a year to set up an after-service office in Thailand[440]. The MNC used the bilateral committee under the Japan-Thailand FTA to resolve this problem. Companies in the automotive sector would also welcome additional investment liberalisation, for example, the limitation of remittance[441]. As was previously explained, due to local content requirements, the Japanese auto industry localised its means of production several decades ago. Nonetheless, a significant part of R&D is still

[439] Interview no. 19.
[440] *Ibidem.*
[441] Interview no. 20.

conducted in Japan (JETRO 2010b:4). Limitations on remittance make it difficult for Japanese automobile companies producing locally to recover the costs of R&D undertaken in Japan. This cannot be done through sales and as remittance is not considered to be a direct cost a company often has to pay a double tax on it[442]. This problem is not limited to ASEAN countries. The interviewed automotive company's manager explains that he would like to see the improvement of the business environment in China, where regulations on the remittance of money and IP rights are not sufficiently transparent[443]. Such issues could be solved by including provisions on the free flow of money in bilateral FTAs, the WTO negotiations, or any other type of agreement.

Recently, Japanese companies became increasingly aware of another type of investment provision – investment protection. The Deputy Director of the Overseas Research Department at JETRO points out that until recently Japanese companies were not familiar with provisions on investment protection, such as expropriation or investor-to-state disputes and did not ask the government to include them in FTAs or BITs[444]. This changed as a result of several incidents[445]. One of the most well-known is the Saluka *versus* the Czech Republic case. In the late 1990s, a Japanese company, Nomura Security, set up a shell company in the Netherlands, Saluka Investments (Permanent Court of Arbitration 2006:5). It then purchased Investiční a Poštovní Banka a.s. (IPB), a commercial bank in the Czech Republic, in March 1998. The Czech government put IPB under forced administration and sold it to another Czech bank, CSOB. This caused Nomura to file a complaint to the Permanent Court of Arbitration in 2001, based on the 1991 *'Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic'*. Nomura won the case in 2006 and received a large compensation from the Czech government. According to the Deputy Director of JETRO's Overseas Research Department, Japanese companies have been paying an increasing amount of attention to the investment protection offered by FTAs and BITs and would like to see such provisions in prospective treaties[446]. Furthermore, Japan is expanding its BIT network, in particular with countries with which it has not signed an FTA, such as Egypt, Pakistan, China, and Korea. Japan signed a BIT with China in 1998 and with Korea in 2002. The trilateral

[442] *Ibidem.*
[443] *Ibidem.*
[444] Interview no. 40.
[445] Interview no. 3.
[446] Interview no. 39.

investment treaty between China, Japan, and Korea was initially expected to be signed in May 2011. This deadline was then moved to the end of December 2011. However, by January 2012, the agreement was still not concluded.

4.4.4 Industry Interest in a Region-wide FTA

According to a former Director for FTA Affairs at METI's Trade Policy Bureau, a region-wide agreement would have three main benefits for Japanese industry: 1) cumulative rules of origin; 2) convergence in procedures and rules; and 3) encouraging negotiations of the bilateral FTAs which are not currently in effect, in particular between China, Japan, and Korea[447]. As explained earlier in the chapter, the last point results from METI's understanding that a region-wide FTA will achieve a lower level of liberalisation than bilateral agreements. METI's Director-General for Manufacturing Industries Policy points out that a wider FTA would have its advantages, such as the promotion of harmonised standards and rules (e.g. non-discrimination) even if the level of liberalisation is low and respective schedules are negotiated separately[448]. Similarly, all of the interviewed companies expect that a region-wide agreement, whether APEC-based or ASEAN-based, will be a low-level, 'lowest common denominator' type of FTA which deals mainly with market access and does not include WTO-plus provisions on investment and IPR, nor the harmonisation of regulations and standards or other provisions focusing on trade facilitation. They assume it will play a role similar to the AJCEP by linking a large number of countries. Despite EAFTA and CEPEA study group reports, based on their communication with METI and other parts of the government the interviewed companies consider it unlikely that an East Asian FTA would include deep liberalisation provisions and hence prove useful[449].

In the opinion of a global company in the electronics sector, any effort made towards the harmonisation of regulations and standards in the region would be welcomed. However, the private sector does not expect an East Asian FTA to be more useful than the AJCEP[450]. The industries anticipate that, similarly to the AJCEP, a multilateral, regional FTA, if implemented, would include individual tariff schedules and lists of sensitive products. Therefore, it will not provide a seamless East Asian

[447] Interview no. 4.
[448] Interview no. 7.
[449] Interview no. 14, 15, 16, 17, 19, 20.
[450] Interview no. 19.

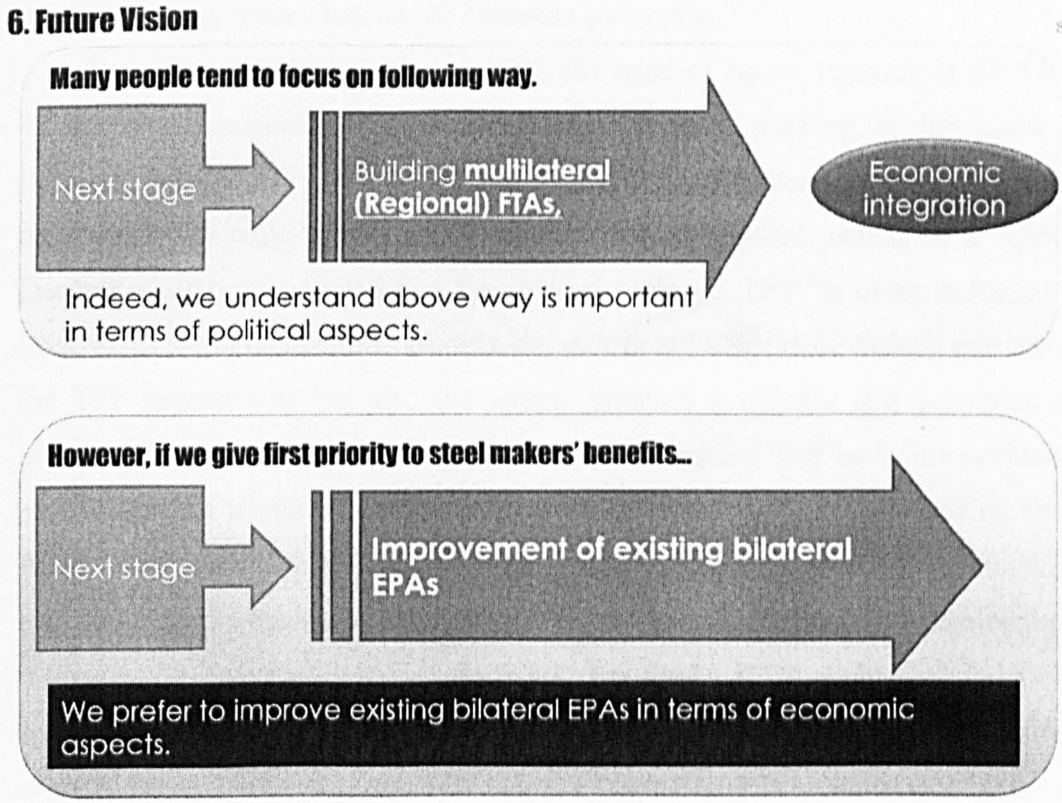
market. For all of the above reasons, Japanese industries have a low level of interest in a prospective region-wide FTA. Dee (2010:4) argues that empirical studies show that domestic regulatory reforms conducted by Asian countries would bring stronger results than a wide regional FTA based on the ASEAN+6 forum[451] [452]. Expectations for an Asia-Pacific FTA are even lower due to the larger number of involved economies and their diversity. This is similar to the aforementioned view of *Keidanren* on the APEC-based FTA as being open and focusing primarily on harmonisation.

The conducted fieldwork clearly indicates that Japanese companies not only have not lobbied the government to sign a region-wide FTA but also have little interest in such an agreement. A company in the electronics manufacturing sector points out that the usefulness of a region-wide FTA is highly dependent on the combination of products traded in a given market and the main type of barriers it uses[453]. For example, in some East Asian countries, technical barriers and standards are the main obstacle and focusing on lowering tariffs in those countries would be futile. Companies in the automotive industry have also expressed a weak interest in a region-wide FTA. A manager from an interviewed company in this sector explains that "in the electronics sector many parts are produced in various countries making FTAs more beneficial" while for automobile companies with a high degree of local production and parts procurement a region-wide agreement is not particularly attractive[454]. Similarly, a manager from the Japan Iron and Steel Federation argues that a region-wide FTA in East Asia would only be desirable if it brings a single market[455]. He explains that "if the region-wide agreement includes countries who are currently not interested in promoting FTAs, or takes leadership in promoting trade facilitation, it might be beneficial"[456]. As explained in Chapter 3, companies in this sector export around 90 percent of products to East Asia. They consider a region-wide FTA to be an important step, but improving existing bilateral agreements is more of a priority. Figure 4.7 demonstrates the steel and iron sector's official stand on a region-wide FTA. According to the industry's Federation, bilateral FTAs are much faster to conclude than a multilateral agreement, as the negotiations for the latter take time. Hence improving existing bilateral agreements would provide quicker results. In fact, the interviewed companies in all of the sectors confirmed that

[451] Her study combined econometric evidence with computable general equilibrium modelling.
[452] Simulations based on a computer general equilibrium (CGE) model confirm that a region-wide agreement including trade liberalisation, facilitation and economic cooperation would have a bigger impact on the GDP of involved countries. For more see Urata (2008b:20) and Ando and Urata (2007).
[453] Interview no. 19.
[454] Interview no. 20.
[455] Interview no. 31.
[456] Interview no. 32.

they would like to see an improvement and a deepening of Japan's existing FTAs and that this would bring more benefits than an AJCEP-type region-wide agreement.

Figure 4.6 Steel and iron sector's preferences for prospective region-wide FTA



Source: Obtained during interview no. 31

As explained in Chapter 3, FTAs are inherently competitive for Japanese companies. For that reason, the emergence of the TPP had a significant impact on industry preferences and made it crucial for Japan to join the agreement. *Keidanren* encouraged the government to use the November APEC Summit meeting in Yokohama to announce Japan's intention to participate in the TPP[457]. The organisation's Deputy Director argues that if Japan fails to get involved in the agreement, it will be left behind and hence should conduct the necessary structural reforms in the agricultural sector[458]. According to *Kyodo News* (2010), the chairman of the Japan Chamber of Commerce and Industry has also expressed his support for Japan's participation in TPP. If concluded, the agreement will not only eliminate the majority of tariffs but also include deep liberalisation provisions, as well as, for example regulations on government procurement. Participation in the agreement would provide market access for Japanese

[457] Interview no. 24.
[458] *Ibidem.*

corporations and prevent a situation where they are excluded from decision-making about regulations and standards in the Asia-Pacific region. Companies trading on or investing in APEC's member markets, in particular the North American market, are naturally more interested in joining the TPP. The US' tariffs are still very high in several sectors, making them a barrier for Japanese companies.

Bloomberg (2011) cites Jesper Koll, the head of equity research at J.P Morgan in Tokyo, who commented that "corporate Japan is really pushing, as they know Japan's failure to enter the TPP would be a further step towards second- or third rate nationhood on the global stage". The article also quotes *Keidanren*, which in a report from December 2010 commented that Japan should join the TPP "in order to restore Japan" (*ibidem*). This demonstrates not only the industries' support of Japan's participation in the TPP negotiations but also the strong isolation avoidance and economic domino effect motivation behind this support. It can be argued that isolation avoidance is a motivation that is mutually reinforced by the government and the industries. During an APEC chief executive officer (CEO) Summit in Yokohama, then Prime Minister Naoto Kan spoke to the business leaders about Japan 'being left behind' while other countries in the region successfully conclude FTAs (Sakamaki 2010). Being left behind can be argued to refer to two different aspects. On one hand, as was mentioned earlier in the chapter, Japan's interest in the TPP has to a large extent been motivated by the actions of the US. This is related to isolation avoidance but also to taking part in the decision-making process on the shape and regulatory aspects of the future agreement. On the other hand, similarly to bilateral FTA policy, competition with Korea plays a crucial role here. The previous chapter spoke of Korea's FTA policy as the main 'threat' for Japan.

According to the Director for Economic Partnership (EPA/FTA) at METI's Trade Policy Bureau responsible for FTA negotiations with India and Australia as well as the joint trilateral FTA Study Group, it was competing with Korea in the European and North American markets that led the Japanese Prime Minister Naoto Kan to look towards the TPP[459]. In the Director's experience, the DPJ has been paying an increasing amount of attention to Korea's FTA strategy, in particular how the country has dealt with domestic opposition to liberalisation. Competition between Japan and Korea has become severe in some parts of the electronics and automobile industries[460]. This has reinforced the MNCs' interest in the TPP, especially as Korea has signed an agreement with the US. The possibility of Japan joining the TPP negotiations in turn is a cause for

[459] Interview no. 5.
[460] Interview no. 15 and 16.

concern for Korean companies. The President of the Centre for International Public Policy Studies, recalling his discussions with Korean scholars, explains that if Japan joins the TPP, there will be a major change in the business environment in the region for Korean industries, as Japanese companies, including those in the finance and services sectors, will penetrate the North American market[461].

4.5 Preferences of Other Interest Groups and Sectors

4.5.1 The Labour Unions

As mentioned in Chapter 3, since the 2008 G8 Hokkaido Summit the labour unions have been increasingly aware of the ongoing discussions on globalisation, both under the WTO and preferential liberalisation initiatives. According to a Director of the International Bureau at the National Confederation of Trade Unions (*Zenroren*) the trade unions are not against globalisation as the "capitalist economy is global in nature"[462]. Hence the organisation admits that Japan might need to respond to outside events by joining some kind of bilateral or regional preferential agreement. In his opinion, Japan's trade unions are not against FTAs *per se*, but they are concerned about trade agreements serving mainly the interest of employers and MNCs[463]. For that reason, *Zenroren* is promoting the idea of an FTA social clause, a special clause within the agreement designed to protect workers' rights. For example, prospective FTAs should include an obligation from both sides to observe labour standards and International Labour Organisation (ILO) conventions. This would prevent nation states from competing for FDI at the expense of domestic workforces. The social clause should also involve some sort of standard concerning immigrant workers. There is an ongoing discussion on adopting a points system for the acceptance of highly skilled workers (Sugawara 2010:15). Japan's labour markets are officially open only to skilled workers. However, there are several exceptions, such as second or third generation Latino workers, many of whom work in the manufacturing industry or several million descendants of Koreans who came to Japan during the country's colonisation of Korea. The latter issue has been causing a heated political debate. There are ongoing discussions on granting voting rights, at least for local government elections, to ethnic Koreans living in Japan. Second

[461] Interview no. 47.
[462] Interview no. 33.
[463] *Ibidem.*

generation Koreans, although born in Japan, are not regarded as citizens and do not have full resident status. In the opinion of *Zenroren's* Director these kinds of domestic social issues should be dealt with before the country decides to open up its markets under bilateral or region-wide agreements[464].

4.5.2 The Service Sector

According to a Senior Analyst at Mitsubishi UFJ Research and Consulting and a former MOFA official responsible for services and the WTO service negotiations in Geneva, the Japanese service sector is not interested in a region-wide FTA[465]. Japanese companies in this sector set up service branches or subsidiaries abroad on an individual basis, and due to the nature of the sector they are not interested in third-party trade agreements. The financial service sector's knowledge and understanding of FTAs is still limited although the insurance sector has been more active in lobbying for bilateral FTAs or the inclusion of certain provisions than the rest of the sector, for example the elimination of limitations on foreign participation whereby a country imposes limitations on the nationality of board members or workers[466]. The same Senior Analyst admits that in the future the sector could profit from certain aspects of a high-level region-wide agreement, for example, the recognition of professional qualifications in industries such as banking services, investments and telecommunications[467]. Additionally, the financial sector would like to see more WTO-plus provisions in future FTAs, for example provisions on licensing, establishing branches, and minimum capital levels for setting up branches[468]. There is usually a queue for obtaining the license needed to set up branches. Bilateral FTAs might offer provisions to eliminate or shorten the period of waiting. Such problems can be resolved under the WTO negotiations and not necessarily under FTAs. According to a former Director for FTA Affairs at METI's Trade Policy Bureau, negotiating this type of provision with East Asian partners is difficult, as the Asian countries are reluctant to include them[469]. The service sector would in particular like to see deep liberalisation provisions included in Japan's FTAs

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[464] *Ibidem.*
[465] Interview no. 45.
[466] *Ibidem.*
[467] This could be, for example, similar to ASEAN's Mutual Recognition Arrangement (MRA) on Engineering Services signed in Kuala Lumpur in 2005.
[468] Interview no. 45.
[469] Interview no. 4.

with Vietnam, Thailand, and India[470]. Thailand is the hub for ASEAN countries and the manufacturing industry has invested heavily in that country. Hence there is a market for Japanese services. Similarly, Vietnam is seeing an intensification of Japanese investment from the manufacturing sector, which creates a demand for Japanese services.

4.6 Conclusions

The chapter has presented the preferences of the Japanese government, its industry (four sectors) and other domestic groups regarding a region-wide free trade agreement. It has answered three key questions. First, it discussed suitable frameworks for such an agreement according to selected groups of actors. It then demonstrated their preferences regarding the type of agreement Japan should be aiming to sign. The private sector, in particular, has a clear vision of the provisions which it would like to see included in all prospective FTAs. Finally, the chapter discussed possible approaches to the harmonisation of existing agreements. There is no clearly outlined strategy or concise vision within the Japanese government as to how the country should proceed with region-wide negotiations, how to sequence multilateral regional FTAs, or how to harmonise them with existing treaties. In a way, coexistence and participation in several regional frameworks is the *de facto* strategy. As discussed, MOFA acknowledges that at some point in the future overlapping FTAs in East Asia and Asia-Pacific regions will need to be 'docked and merged'. So far, however, no efforts have been made to streamline coexisting treaties and frameworks. The fieldwork research presented in Chapters 3 and 4 demonstrated that, in the opinion of government officials, Japanese scholars and private sector representatives, the coexistence of FTAs is not a major issue and does not cause inconvenience to FTA users. It could be further argued that according to the Japanese government, the situation will naturally resolve itself in the future. At the present moment, there is no indication that Japan is intending to lead the process of the harmonisation of regional FTA frameworks. On the contrary, the country will most likely react to outside developments. For example, external circumstances such as the planned enlargement of the TPP agreement and the US' engagement in the initiative have caused the DPJ administration to announce that it is considering joining the negotiations. The conducted fieldwork has identified Japan's competition with

[470] Interview no. 45.

Korea as the main external factor driving Japanese bilateral and multilateral FTA policy. As mentioned in Chapter 3, both the government and the private sector are increasingly aware of Korea's FTA policy. In particular, the signing of the EU-Korea agreement, as well as the Korea-US FTA and the intensification of efforts to finalise the agreement in the second half of 2010, has led the bureaucracy and the DPJ administration and to pay greater attention to Japan's foreign trade policy, in an attempt not to 'be left behind' (Prime Minister Naoto Kan, cited by Sakamaki 2010). Therefore, it can be argued that just as the competition with China has led Japan to opt for the ASEAN+6 instead of the ASEAN+3 framework, Korea's FTA policy is steering Japan towards the TPP and FTAs with a higher level of complexity, e.g. the DPJ's commitment to increase its efforts to finalise the Australia-Japan agreement and the recent progress of the trilateral FTA initiative. Both for the government and the industries external factors to a great extent determine preferences regarding a region-wide FTA. In addition, there is no clear, concise strategy on how to proceed with negotiating such an agreement. Since the early stages of Japan's FTA policy, the country has intended to sign free trade agreements with ASEAN members due to the location of Japanese production networks. This has now been realised and the remaining, planned bilateral or broader FTAs are politically or economically difficult (e.g. with Korea, Australia, and China). Japan's FTA policy seems to be at an impasse and the country is uncertain which direction to take. For all of the above reasons, Japan is passive and reactive when it comes to a region-wide FTA and remains highly influenced by international developments.

The private sector does not strongly support the idea of a region-wide agreement. Despite the fact that both trade theory and econometric studies of FTAs[471] state that there is a correlation between the size of the FTA and the economic gains that result from it, Japanese industries are far more interested in improving the quality of existing bilateral treaties than in signing a region-wide one. There are several reasons behind this lack of interest. First, Japanese companies expect that a region-wide FTA, either ASEAN-centred or APEC-wide, will most likely be a low-level, 'lowest common denominator' type of agreement. This opinion is shared by some ministry representatives, as demonstrated in the earlier parts of the chapter. Secondly, the conducted fieldwork indicates that Japanese corporations are mostly interested in deep liberalisation and WTO-plus provisions, in particular trade and investment facilitation provisions. All of the interviewed companies admitted that reducing lead time is

[471] For example, Kawai and Wignaraja (2007:18 cites Gilbert et al. 2004), Zhang et al. (2006), Urata and Kiyota (2003).

currently one of their main concerns. As a low-level FTA would not provide such provisions and would take a considerable amount of time to negotiate, Japanese industries prefer to improve and deepen existing FTAs, for example through renegotiations. The low utilisation rates of Japanese FTAs, as mentioned in Chapter 3, can also result from the fact that the type of agreements being negotiated are a political compromise and do not reflect the real needs of the companies. JETRO's White Paper (2009:138) comments that "the meaning of FTAs is not in their conclusion, but in their use by companies". Furthermore, from an industry perspective, further liberalisation could be achieved by other means, such as the WTO negotiations. Japanese companies show little interest in a region-wide agreement, as like the AJCEP it will probably offer no additional advantages. The industries do not lobby the government to sign such an agreement. However, the interviewed companies admit that any convergence of rules or standards would be welcomed. Japanese industries are conscious of international developments, for example, Korea's FTA policy, and are seriously concerned by the increased competition in the European and American markets. This competition causes them to support Japan's participation in the TPP or to opt to sign bilateral FTAs with a higher level of liberalisation, despite protests from the agricultural sector.

The pervious chapters have demonstrated a number of issues which currently constrain Japan's FTA strategy: for example, the reform and liberalisation of the agricultural sector, which is directly related to the question of what type of agreement the country is aiming to participate in. The same problems impede the formation of a clear strategy for a region-wide FTA. As in the case of bilateral FTA strategy, these questions need to be addressed before Japan can take the initiative in a regional framework and overcome the current FTA policy impasse. The following chapter looks for the sources of this impasse in Japan's policy formation process and assesses how a political shift impacted FTA strategy. The change of the government and the DPJ's rise to power in 2009 allowed for a reconsideration of the country's FTA strategy.

Chapter 5
The Aggregation of Domestic Preferences into Japan's Trade Policy

5.1. Introduction

Following on from the argument contained in the previous chapters, this chapter analyses the reasons for Japan's impasse in FTA policy and the fact that the agricultural sector remains one of the main hindrances in overcoming this from a structural perspective. It also focuses on the domestic decision-making and how these decisions are presented to foreign partners during international FTA negotiations. Therefore, it demonstrates how the domestic win-set is formed. The theoretical framework in Chapter 1 referred to Putnam's two-level game model and the government as playing the role of a transmission belt between the interests of domestic actors and international partners. The government aggregates domestic preferences and forms them into a national strategy in the process of forming a domestic win-set. When speaking of Japan's FTA policy, this chapter refers to the decisions and the decision-making process that has taken place during negotiations with the country's FTA partners rather than official government papers. During each FTA negotiation four ministries have played a pivotal role: the Ministry of Foreign Affairs (MOFA), the Ministry of Economy, Trade and Industry (METI), the Ministry of Agriculture, Forestry and Fisheries (MAFF), and the Ministry of Finance (MOF). The formation of Japan's FTA strategy, as well as the aggregation of domestic preferences into a domestic win-set has taken place as a result of the communication and coordination between these four ministries and their constituencies. This chapter describes this process: the functions, roles and constituencies of the four ministries and the roles of actors such as the Prime Minister and the Cabinet Office and the interaction between them during the different stages of the FTA negotiations. In order to analyse how domestic preferences are aggregated into state policy (how the level 2 game occurs), particular attention is paid to the official and unofficial communication channels between domestic interest groups and the ministries to ascertain whether, and how if so, the interests of the former become incorporated into the policies of the latter. This part of the thesis focuses on the role each of the actors play in the domestic policy (win-set) formation process, their communication, and the coordination of their preferences. The chapter also analyses the FTA negotiation from the Japanese perspective. This includes the technical aspects of the negotiation process such as who negotiates the treaties as well as general observations on Japan's negotiating style in relation to Putnam's two-level game model.

At the end of August 2009, the Democratic Party of Japan (DPJ) won the general election for the House of Representatives[472], after over half of a century of almost uninterrupted leadership by the Liberal Democratic Party (LDP), as mentioned in Chapter 3. The change in administration was followed by further changes to the country's policy, the function of the government, and the decision-making process. Additional comments are made on the influence of DPJ's administration on the domestic level of the policy formation process.

5.2. The Four Ministries, their Constituencies and Other Actors

The four ministries involved in the FTA policy formation have different jurisdictions. MOFA's task is to coordinate the work of the other three ministries and to represent Japan during the international stage of the FTA negotiations. METI is responsible for the liberalisation of trade in goods and services. The Ministry of Finance is in charge of rules of origin and procedures; it plays a secondary role. MAFF represents the agricultural sector. This section analyses the inter-ministerial policy formation stage. This includes the role of each of the four ministries in the FTA policy-making process and the communication channels between them and the interest groups they are in direct contact with and which impact their preferences.

5.2.1 The Ministry of Foreign Affairs (MOFA)

According to Japanese legislation, the Ministry of Foreign Affairs is the only organ allowed to represent Japan during international FTA negotiations. MOFA's official role is to coordinate FTA policy between the ministries. It leads discussions and represents the government as a main negotiator. Within MOFA, the Economic Partnership Division, which is part of the Economic Affairs Bureau, is responsible for trade agreements policy. From the beginning, MOFA has been responsible for drafting working-level propositions and final position papers, such as the 2002 '*Japan's FTA Strategy*'

[472] This is the lower house of the Japanese Diet.

document, the 2004 *'Basic Policy'* and the November 2010 *'Basic Policy on Comprehensive Economic Partnerships'*. Around 2005 equilibrium developed and the four ministries established a division of responsibilities, described at the beginning of this section. According to the EPA/FTA Policy Division (MOFA) Director's recollection, around 2003 a kind of 'ministerial turf wars' took place and it was not certain who would lead FTA policy in terms of internal coordination[473]. The conflict did not concern the direction of FTA policy, although, as described in Chapters 3 and 4, at times MOFA's and METI's positions on FTAs varied significantly. For example, during the Japan-Mexico FTA negotiations Mexican officials complained that the MOFA and METI did not speak in one voice (Manger 2005). At this time, both MOFA and METI were jockeying for power and the position of domestic coordinator of FTA strategy. In the opinion of MOFA's representative, METI was ambitiously attempting to increase its influence over international negotiations. This can be partially explained by the fact that foreign economic policy has traditionally been a domain of METI, in particular the bureaucrats within the ministry (Sato 2001:15). Sato (*ibidem*:14) gives an example of Prime Minister's Yasuhiro Nakasone's attempts to increase the position of MOFA *vis-à-vis* that of METI. After several rounds of FTA negotiations with Singapore and Mexico, the situation reached the point where it was futile to continue the domestic struggle. The Ministry of Foreign Affairs, partially by default, was charged with a coordinating function. This was because MAFF would oppose to the idea of METI drafting the policy proposal, as it expected that such a proposal would be biased towards the interests of the business sector. Similarly, METI would not agree with MAFF taking a leading role in FTA policy formation. The Ministry of Finance's position was neutral[474].

MOFA supports FTAs from a strategic point of view: as such agreements help to tighten the diplomatic and economic ties between states. On the other hand, it needs to take into account the preferences of groups and ministries who oppose trade liberalisation. As it is responsible for all aspects of foreign policy, MOFA assesses trade liberalisation strategy from a broad range of perspectives, including national security and political issues[475]. Therefore, MOFA's position on FTAs is constrained by other ministries' interests and considerations exceeding trade policy. According to a Senior Researcher Fellow at the Institute of Developing Economies the Ministry's position can be described as "mixed, slightly positive but very weak"[476]. Although the Ministry is

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[473] Interview no. 9.
[474] Interview no. 12.
[475] Interview no. 46.
[476] Interview no. 42.

often approached by a number of lobby groups, it is not subjected to strong lobby efforts, as it is the case for METI and MAFF. Being responsible for foreign policy it does not represent any particular interest group. However, according to the Director of MOFA's EPA/FTA Policy Division, who is responsible for negotiations with India and Australia, during FTA negotiations MOFA occasionally tries to use external pressure (negotiating partner's position) to influence other ministries, for example to persuade the agricultural sector to show more flexibility[477]. To that end, it demonstrates that Japan needs to make sacrifices in order to convince the FTA partner to make concessions. Using an example of ongoing FTA negotiations with Peru, the Director of the EPA/FTA Policy Division describes this as MOFA speaking on behalf of Peru and Peruvian interest groups to METI or MAFF and the domestic interest groups they represent.

5.2.2 The Ministry of Economy, Trade and Industry and its Constituencies

5.2.2.1 The Ministry of Economy, Trade and Industry

The Ministry of Economy, Trade and Industry is the single most important pro-FTA force in Japan. Its role in the country's shift towards FTAs and in developing foreign trade policy has been stressed in previous chapters. METI has been advocating and supporting the signing of FTAs from the beginning. In terms of constituency and lobby groups, METI represents, first and foremost, the preferences of the manufacturing sector, but also the service sector and other business sectors. METI is strongly influenced by industry preferences and interests, and in turn, it influences other ministries, the Cabinet, and the Prime Minister's (PM's) Office[478]. The Ministry's officials are sometimes asked to explain FTAs and their merits to the DPJ's politicians[479]. Within inter-ministerial meetings METI attempts to demonstrate that the benefits of FTAs exceed their costs, which can be counterbalanced by appropriate measures[480]. It is important to point out that, contrary to common belief, METI does not have a unified position on the subject of FTAs. Amongst METI's several bureaus, agencies and groups there are two sub-organisations particularly involved in trade agreements' policy, as mentioned in Chapters 3 and 4. The first one is the Trade Policy Bureau. The Bureau's task within the

[477] Interview no. 9.
[478] Interview no. 50.
[479] Interview no. 3.
[480] Interview no. 6.

Ministry is to formulate foreign economic policy. In terms of FTAs this function is held by the Economic Partnership Division, a division focusing solely on free trade agreements. The Trade Policy Bureau does not directly represent any industry sectors or interest groups. Its position is independent. It is responsible for aggregating METI's final policy from the information it receives from the Manufacturing Industries Bureau and other bureaus. It communicates this policy or the preferences of the private sector to other ministries and coordinates them with the preferences of the other actors. In the words of the Trade Policy Bureau's Director for Economic Partnership (EPA/FTA) "the Trade Policy Bureau is like the Manufacturing Industries Bureau when speaking to MAFF and like MAFF when talking to the Manufacturing Bureau"[481]. In other words, it acts in the manner of Putnam's transmission belt in going between the business sector and other ministries, although the communication between METI and MAFF occurs mainly through MOFA. On occasion, METI discusses policy directly with MAFF. This happens mainly when there is a deadlock in the FTA negotiations, when it attempts to convince MAFF to make a compromise. In the FTA negotiation process, the Trade Policy Bureau takes part in inter-ministerial preparatory coordination meetings and in the official negotiation rounds with foreign partners. As the Trade Policy Bureau does not work directly with the industries it is rarely lobbied by the private sector. For the private sector the usual channel for communicating with the government is through the Manufacturing Industries Bureau. However, the Trade Policy Bureau does sometimes discuss issues directly with the industry representatives. This is usually the case when cross-cutting, common issues, such as rules of origin, are involved. The coordination committee is organised within the Chamber of Commerce and Industry, where the Trade Policy Bureau speaks directly to member companies. When it comes to rules of origin (RoO), each industry has strong preferences, hence it is difficult to coordinate policy without joint consultation[482].

The second bureau involved in FTA policy is the Manufacturing Industries Bureau. The Manufacturing Industries Bureau focuses on private sector preferences. The Bureau is in charge of coordinating the manufacturing industry's interests. It has a division for each major industry sector, for example: the Automobile Division or the Industrial Machinery Division. Those divisions have direct contact with companies in each sector as well as their counterpart business industry associations, e.g. the Japan Chemical Industry Association. Because of this, the Bureau's policy is well coordinated with the

[481] Interview no. 5.
[482] Interview no. 7.

private sector. The Bureau also communicates regularly with *Keidanren* (Japan Business Federation)[483] and its working committees for prospective FTAs. The Bureau organises joint meetings with industry associations and the Federation. Each association formulates their position on the planned FTA and communicates it to the Manufacturing Industries Bureau. The sectoral coordination is at the individual industry association level. Then, inter-industry discussion and coordination take place at a joint meeting between *Keidanren*, the associations, and the Bureau. *Keidanren's* role is to facilitate the final discussion, which is usually quite formal, while the coordination and final decision-making takes place at METI's Manufacturing Industries Bureau[484]. Previously, before the internationalisation of Japan's production networks, exports from Japan were the Bureau's only concern and it was easy to express a unified voice for private sector interests. However, this is no longer the case and, as demonstrated in the previous two chapters, even the preferences of companies in the same sector can vary. It is difficult to present the overall opinion of the manufacturing sector. For that purpose, the Manufacturing Industries Bureau evaluates each FTA on a case by case basis and establishes a special task group[485].

In order to make the final decision on a proposed FTA, the Manufacturing Industries Bureau attempts to assess the benefits and losses of each prospective agreement. It makes a judgement based on economic considerations: for example, trade volume can be one objective criterion. According to the Bureau's Director-General, even if some sectors are negatively affected by an FTA, the Bureau can still support the agreement provided that the benefits for other sectors are greater than those losses[486]. In the Bureau's opinion, from an economic perspective it is often fairly easy to judge whether an FTA will engender positive results: what causes difficulties are the political aspects of such decisions. For example, automotive companies normally benefit from FTAs as they have a large trade volume from Japan. On the other hand, small textile companies may be forced to go bankrupt as a result of the same agreement. From an economic viewpoint, making a judgement is quite easy, but the Bureau must also consider political implications in addition to economic ones. In that case, one solution is to offer assistance to sectors which lose profits because of an FTA. For example, they may offer technical cooperation or assistance to help workers to change their

[483] This communication exceeds FTA issues. Trade issues are only one of the subjects discussed between *Keidanren* and the Manufacturing Bureau. Green taxes are another example of other matters that are being covered.
[484] Interview no. 7.
[485] Interview no. 28, Bilateral Committees under Keidanren will be discusses later on in this chapter.
[486] Interview no. 7.

occupations or to make production more efficient. Such supplementary measures are often inevitable in order to reach a consensus even within the Manufacturing Industries Bureau. They are discussed and agreed on a case-by-case basis. As demonstrated in Chapter 3, during negotiations with Mexico, the Japanese Automobile Manufacturing Association was divided in its preferences regarding the agreement. The Manufacturing Industries Bureau was in charge of coordinating the final position of the industrial sectors. On a national level, the interests of the whole country needed to be considered, including those of the agricultural sector, as the farmers were cautious about increasing imports from Mexico. They needed to be persuaded by the Prime Minister. On the other hand, even if the liberalisation of certain products causes farmers to lose profit, consumers may benefit from the low cost of fresh fruits. To make a final decision, the interests of consumers, producers and manufacturing agencies need to be balanced. In this particular case, the final decision was made by the PM and the Cabinet Office[487].

The Manufacturing Industries Bureau's FTA preferences often differ from those of the Trade Policy Bureau, as the former directly represents Japanese corporations. Chapter 3 divided Japan's FTAs into those supported by the Trade Policy Bureau and those supported by both Bureaus. Hence while the Trade Policy Bureau is the driving force behind Japan's FTAs and is always in favour of them, the Manufacturing Industries Bureau is sometimes indifferent. The Trade Policy Bureau occupies the stronger position within the Ministry and during the inter-ministry meetings the Manufacturing Industries Bureau often needs to make compromises[488]. Despite occasional differences of opinion, the two Bureaus cooperate closely in FTA policy formulation. Japanese traditional management practices, namely job rotation, facilitate this process. There is a constant movement of personnel between the two Bureaus, which allows officials from both sections to understand each-other's position and to resolve conflicts on a case-by-case basis[489].

The Manufacturing Industries Bureau, and other METI bureaus, exchange views not only with industry associations and *Keidanren*, but with foreign business associations and domestic labour unions. The Bureaus have met more frequently with the trade unions (e.g. *Rengo*) since the DPJ won the election in 2009[490]. When international negotiations are in progress, METI continues to coordinate policy with its constituency through the Manufacturing Industries Bureau. This communication does

[487] *Ibidem.*
[488] Interview no. 42.
[489] Interview no. 7.
[490] Interview no. 3.

not usually take place through *Keidanren* but directly with individual companies.

5.2.2.2 Between METI and Companies: Communication Channels and Gathering Information on Domestic Preferences

5.2.2.2.1 The Private Sector

Several types of organisations assist METI in the process of gathering information on industry preferences and thus participate in the FTA policy formation process. They are intermediaries between the companies and the government. Often, those organisations are business associations, where individual companies are members. Below is an analysis of how different organisations and interest groups communicate their preferences to METI and influence policy-making within the Ministry.

As demonstrated in the previous two chapters, there are several Japanese companies which strongly support FTAs. These are usually companies which have affiliates in foreign countries and export parts from Japan. However, their support is often less visible and weaker than the opposition from the agricultural sector[491]. In terms of outbound interests, there is usually no conflict between various industries[492]. Problems arise during discussions on inbound demands from the FTA partner states, as industries want to protect existing regulations. Each industry is represented by an organisation that works to protect its interests, for example industry associations, such as the Japan Chemical Industry Association, the Japan Textile Federation, and the Japan Automobile Manufacturers Association. Companies in various sectors are also directly represented in the government. The role of the Manufacturing Industries Bureau within METI has already been discussed. Other ministries have similar connections with the non-manufacturing sectors. For example, the Ministry of Land, Infrastructure, Transport and Tourism has divisions for different sectors within its Policy Bureau (e.g. construction), and the Ministry of Internal Affairs and Communications oversees the IT and telecommunication industries. If healthcare goods or the labour movement is discussed during FTA negotiations, the Ministry of Health, Labour and Welfare joins the discussions, working alongside MOFA.

Communication between METI and the private sector takes place directly through

[491] Interview no. 42.
[492] Interview no. 4.

the Manufacturing Industries Bureau and indirectly through *Keidanren.* During each round of FTA negotiations, MOFA receives requests to lower manufacturing tariffs from the international partner. Depending on the level of the talks, the request can be passed to METI's International Trade Bureau, which represents the Ministry in negotiations. The Bureau conveys this request to the Manufacturing Industries Bureau, who then speaks, through the relevant division, to the companies or industry associations representing the particular sector[493]. The private sector's response is passed from the Manufacturing Industries Bureau to the International Trade Bureau, which in turn communicates it to MOFA, the ministry responsible for negotiating with the foreign counterpart. MOFA then passes the domestic response to the FTA partner. Hence this channel works both ways. It is also used before the start of the official negotiations, in order to establish the bottom line of what concessions can be made on the part of the domestic industries and what the industries would like to see liberalised by the FTA partner state. For example, if Japanese companies are interested in decreasing the tariffs on three products, METI will try to list them in order of priority, according to their desirability[494] [495]. The least desirable items on that list will be dropped first during the international negotiations round. The same kind of list, in an inverted order, is complied for the inward tariff reductions' request (the issues on which Japan will compromise first). A representative of one of the leading Japanese MNCs in the electronics sector confirms that there is a common interest and understanding between the company and METI, but the latter is often constrained by the interests of the other ministries[496]. For that reason, whenever the company has a chance, for example during *Keidanren's* joint meetings, it attempts to present their position to the members of the other ministries and offer the necessary evidence.

5.2.2.2.2 Industrial Associations

The industrial associations unite companies in the same sector and are in close contact with METI's Manufacturing Industries Bureau. For example, the Japan Textile Federation (JTF) has monthly meetings with the government. It speaks mainly to

[493] Interview no. 8.
[494] The Trade Policy Bureau composes the list and communicates with international partners, while the Manufacturing Industries Bureau discusses the order with the companies.
[495] Interview no. 4.
[496] Interview no. 19.

METI's Manufacturing Industries Bureau, but sometimes to the Trade Policy Bureau. During such meetings, FTAs are a major issue. The EU, Korea, China, Thailand, Taiwan, and Japan have an inter-governmental steel industry meeting group designed to increase cooperation and limit trade frictions. This is attended by the Japan Iron and Steel Federation, which was also asked to make a presentation during the China, Japan, and Korea trilateral FTA study meeting. Although Japanese business associations support FTAs they do not strongly lobby the government, as they do not wish to openly confront the agricultural lobby groups[497]. Hence their official position is that Japan should protect its agriculture but also needs to conclude FTAs. Unlike companies and business associations in the EU and the US, Japanese business associations do not have a history of strong lobbying. Hence FTA negotiations are usually initiated, or led, by the government or scholars rather than by business associations[498]. However, many business associations consider trade and investment liberalisation to be an important part of their agenda to increase the competitiveness of Japanese products. A good example is the Japan Automobile Manufacturers Association (JAMA), which supports FTAs and further efforts to create an integrated, single ASEAN market (JAMA 2010a:12). To that end, it proposes undertaking steps such as the harmonisation of technical regulations and the promotion of Mutual Recognition of Approval. In addition to trade liberalisation, JAMA strongly advocates the trade and investment facilitation provisions described in Chapter 4. It promotes (JAMA 2010a:16) the international harmonisation of standards and cooperation on automatic parts supply. This is not necessarily done through FTAs, but can be achieved through other forums[499].

5.2.2.2.3 Keidanren

Keidanren mainly represents large companies. It was originally formed in 1946. The organisation, as it is known today, was established in 2002 when the *Keidanren* in its earlier form and *Nikkeiren* (Japan Federation of Employers' Associations) amalgamated. It has an FTA committee and member companies cooperate with the government in

[497] Interview no. 4.
[498] *Ibidem.*
[499] JAMA has also been, for example, participating in the AEM-METI Economic and Industrial Cooperation Committee Working Group on Automobile Industry (AMEICC-WGAI) meeting since 1998.

order to promote them[500]. However, it usually finds itself in opposition to the agricultural sector, although it does not like to enter into direct confrontation with this group[501]. Within *Keidanren*, there are Bilateral Economic Cooperation Committees for particular countries, for example a committee on Thailand or Indonesia. They encompass companies with operations in the particular country and often discuss issues connected to FTAs. The Federation shares the responsibility of organising Bilateral Economic Cooperation Committees with the Japan Chamber of Commerce and Industry, which organises a number of the bilateral committees. *Keidanren* also cooperates with the Chamber's offices in other countries.

Keidanren works closely with METI[502]. This communication takes several forms. Like METI, *Keidanren* has a general international department and an industries department[503]. The general international department often speaks directly to the Trade Policy Bureau, while the industries' department consults with the appropriate division within the Manufacturing Industries Bureau[504]. *Keidanren's* member companies also contact the Manufacturing Industries Bureau directly and METI might additionally contact *Keidanren* during FTA negotiation rounds, if further information is needed[505]. This occurred, for example, during the re-negotiations of the Japan-Mexico FTA. The government asked *Keidanren* for a detailed evaluation of the agreement's current form, as it was suspected that it was not sophisticated enough in terms of such aspects as rules of origin. The Federation also receives complaints on certain FTA provisions (e.g. trade facilitation issues) directly from the manufacturing companies and it can then request that the government implements changes, for example allowing for self-issued certifications of origin. Therefore, the Federation participates indirectly in the decision-making process by providing the government with information on the private sector's preferences. In addition, agricultural cooperatives have a member within the *Keidanren*. Hence the interests of the agricultural sector and the manufacturing industries can be discussed directly within this forum.

The Federation issues policy proposals related to various issues. It also cooperates with another body working on trade liberalisation – the APEC Business Advisory Council (ABAC), as well as the Support Council for ABAC-Japan (SCABAC-J). ABAC

[500] Currently, the Federation is focusing on promoting an agreement with the EU.
[501] Interview no. 24.
[502] *Keidanren* had a strong position under the LDP's administration. This position somewhat weakened under Yukio Hatoyama's administration, however, it gradually started resuming discussions with the government when Naoto Kan became Prime Minister.
[503] Interview no. 5.
[504] *Ibidem.*
[505] Interview no. 24.

comprises industry representatives from each country. It advises the 21 APEC member economies on behalf of the business sector. The Council issues an annual report to APEC's leaders before the Ministerial Meeting in October and the APEC Economic Leaders' Meeting in November. The report is based on a consensus between ABAC members[506]. The Council discusses the trade liberalisation or trade facilitation issues raised by the MNCs in APEC. *Keidanren* cooperates with ABAC through the SCABAC-J. As discussed in Chapter 4, ABAC was the initial supporter of the Free Trade Area of the Asia-Pacific (FTAAP) leading to a formal proposal during the APEC Summit in 2004 (Penghing 2010:6). In order to work out an optimal policy proposal, ABAC meets four times a year and consults with *Keidanren* and other business organisations before sending a unified message from the private sector to APEC's leaders. Additionally, ABAC's representatives sometimes meet directly with the companies to hear their preferences.

5.2.2.2.4 The Japan Chamber of Commerce and Industry

The Japan Chamber of Commerce and Industry (JCCI) is heavily involved in the FTA policy formation process. While the first agreements were being negotiated, the JCCI explained its position on FTAs to the government[507]. Although supportive of FTAs, it considered them to be complementary to the WTO activities. According to the Chamber's Project Leader, there was a difference in opinions between the Chamber and *Keidanren*, as for the latter FTAs were an alternative to liberalisation under the WTO[508]. Currently, as confirmed in fieldwork interviews, the Chamber's views are similar to those of *Keidanren*, as confirmed by representatives of both organisations[509]. JCCI represents mainly medium-size companies. It is involved in the FTA process in several ways. First, the Chamber is responsible for issuing certificates of origin. In order to receive a certificate the company submits an application including a copy of its registration number with a signature and the cost analysis of the product along with other documents which demonstrate how it complies with the value added or a change in tariff classification rule of origin. The company is then given an ID number. When it wishes to export the product, it uses a computer system to input its ID number and the

[506] Interview no. 26.
[507] Interview no. 25.
[508] *Ibidem.*
[509] Interviews no. 24 and 25.

order data: the product, the invoice number, and the shipment method. The certificate is issued within two days for a small fee (2,000 JPY). Previously the JCCI required additional detailed information on the suppliers the company was using and the percentage of their input to the final value of the product. Two years ago, the government asked the Chamber to soften the procedure[510]. The JCCI receives complaints from companies who would prefer self-certification, which would be an important step towards trade facilitation. However, this is a decision that needs to be made by the government. Some of Japan's current or prospective FTA partners, for example the Mexican government, refuse to accept self-certification for RoO. One of the major issues during the FTA negotiations with India was the fact that the country requested stricter RoO procedures. Furthermore, ASEAN is reluctant to allow self-certification as the member countries are afraid of the trans-shipment of products from China[511]. On the other hand, one of Japan's current FTA partners, Switzerland, does accept self-certification. Despite only having a small volume of trade with this partner, some companies obtained the position of an Authorised Economic Operator and are able to self-certificate.

Apart from issuing certificates five to seven times a year, the JCCI gives seminars for private companies on applying the rules of origin in each of Japan's FTAs. In the opinion of JCCI's Project Leader, this is not sufficient to solve the problem of Japanese companies' lack of knowledge of FTAs, particularly the smaller companies[512]. The seminars are held in Tokyo and other major cities in Japan, and companies who cannot travel to them because they are located in rural areas and smaller cities still struggle to comprehend the RoO system. In addition to such events, the JCCI provides a daily information service on rules of origin. Despite the fact that Japan's first FTA was signed in 2002, many companies still request information on the most basic issues (for example: what are RoO? or what is the Harmonised System code?).

Similarly to *Keidanren*, the JCCI passes the information on the private sector's interests in prospective FTAs to the government on. These recommendations do not differ substantially from the opinions collected by *Keidanren*. The two organisations represent similar interest groups, which is why their preferences are also very similar. Along with *Keidanren*, the JCCI runs Bilateral Economic Cooperation Committees. *Keidanren* runs the Committee for Thailand and Indonesia, while the Chamber deals

[510] Interview no. 25.
[511] Interview no. 41.
[512] Interview no. 25.

with Malaysia, the Philippines, and India. Through the work of those Committees the JCCI consults with its counterparts in other countries and reports back to METI. It also requests that companies submit their comments on the planned FTA to the Committee. Additionally, study groups are organised in order to request the opinions of the industry representatives and academics, for example in the case of the Japan-EU, the Japan-Peru, and the Japan-Switzerland FTAs[513]. Within the government, the JCCI communicates mainly with METI. However, in the case of service trade negotiations it invites the representatives of all the relevant ministries to join the discussion, for example the Ministry of Finance, the Ministry of, Infrastructure, Transport and Tourism, and the Ministry of Internal Affairs and Communications.

5.2.2.2.5 Keizai Doyukai

Keizai Doyukai (Japan Association of Corporate Executives) was established in 1946. Its members are approximately 1,300 top corporative executives, from 900 large corporations. Because of that, the Association prides itself on taking a wider economic perspective rather than seeking to represent particular companies. Although the organisation has supported the WTO over the promotion of the liberal economic order, in the past decade it has also promoted FTAs. In the opinion of the organisation's Managing Director, further liberalisation of investment as well as trade would profit Japan's economy, its citizens, its companies, and other countries[514]. The WTO is considered to be the most effective path to achieving this goal. *Keizai Doyukai* also promotes regional and bilateral arrangements, as such schemes are within the concept of the GATT/WTO framework. In the opinion of *Keizai Doyukai's* Managing Director the government is overly passive when it comes to FTAs and should make more effort to create a favourable environment for Japanese business in the region, instead of adjusting itself to the already established system[515]. In his words "this is not system creation, but system adaptation"[516]. This has caused a discrepancy in the regional *de facto* and *de jure* integration discussed in Chapter 1.

Over the past 20 years, *Keizai Doyukai* has issued economic policy proposals to the government. Each year it issues between 30 and 40 policy proposals mainly on macro-

[513] Interview no. 39.
[514] Interview no. 23.
[515] *Ibidem.*
[516] *Ibidem.*

level issues. Those that are considered to be of use to foreign leaders are translated into English. The recommendations are distributed to the government, bureaucrats, politicians, and *Keizai Doyukai* members. Depending on the case, some of the proposals are taken directly to the PM's Office or to the relevant ministers. The Association also organises an international conference and policy forum to discuss the details of the published document, for example the fiscal reform, and invites politicians, bureaucrats, and journalists to discuss the matter. This kind of informal consultation takes place two or three times a year. The organisation contacts relevant politicians, ministers or the PM directly, depending on the issue under discussion.

In terms of cooperation with other organisations, on the domestic front *Keizai Doyukai* has worked with the Japan External Trade Organisation (JETRO) on a committee that seeks to promote inward FDIs in Japan[517]. Promoting inward FDIs was a new challenge for JETRO, as the organisation's main function is to promote Japan's investments abroad. The Organisation was charged with finding potential investors and, in a certain amount of time, to realise ten percent of those proposed investments (for example, establishing an office)[518]. The Association also participates in several international meetings, although recently, the number of these has lessened. One of the international fora in which the organisation has been discussing its policy recommendations for the past 35 years is the ASEAN-Japan Business Forum. The Forum meets once a year, in an ASEAN country, and every third year in Japan. The subjects under discussion have included regional liberalisation issues and the ASEAN-Japan FTA. *Keizai Doyukai* is also indirectly involved in the EU-Japan Business Roundtable. This forum has a sector- oriented approach and has recently been discussing the proposed EU-Japan FTA. Several of *Keizai Doyukai's* members participate in the Roundtable and submit a report to the Association after each meeting. Additionally, the Association's Committee for Economic Development organises an international meeting with its counterpart organisations in other countries. In late October 2010, the meeting was held in New York and the participants focused on the issue of corporate governance.

[517] The committee no longer meets.

[518] In Japan there is no ministry that is in charge of promoting inward FDIs and with the authority to negotiate conditions. Interview no. 23.

5.2.2.2.6 The Japan Machinery Centre for Trade and Investment

The Japan Machinery Centre for Trade and Investment (JMC), established in 1952, is one of the broader industry associations and an example of an alternative way for companies in various sectors to discuss their position on FTAs with the government. JMC's members include approximately 270 major- and medium-size companies manufacturing and creating a range of diverse products from heavy machinery, industrial plants, aircrafts and related parts to home appliances, semiconductor parts, cameras, and microscopes. The JMC has committees for discussing issues of trade and investment, as well as FTAs. It also, on occasion, invites government officials to speak about FTA policy or rules of origin. As *Keidanren* and the JCCI organise Bilateral Economic Cooperation Committees to prepare for prospective FTAs, the JMC members communicate their preferences directly to those Committees. However, the JMC also, on occasion, establishes a committee and invites governmental officials onto it. During these meetings, which have an informal character, the government representatives can offer policy briefs and the member companies can express their preferences[519].

The JMC collects and analyses information regarding the position of the domestic sectors and trends in the overseas markets. It also promotes intra-industry cooperation. The Centre's most important input in FTA policy formation is its database, entitled *'Issues and Requests relating to Foreign Trade and Investment'*, on the difficulties with trade and investment that Japanese companies are facing abroad. The JMC sends out an annual questionnaire to companies on the subject[520]. Government officials can access the database and ask for further details if required: in this case, the JMC contacts the company directly. An example is a complaint received from a company in the electronics sector. This company complained about India's additional duty, which was not compatible with the WTO rules[521]. The issue has been partly solved. The JMC has been involved in the discussions on RoO since the Uruguay Round of the WTO negotiations, when the Rules of Origin Agreement (on non-preferential trade) was concluded. In the words of the Centre's Senior Manager of the International Trade &

[519] This is not an official communication channel, but it was mentioned as a useful way of expressing private sector opinions by one of the interviewed companies in the electronics sector. Interview no. 28.

[520] Called *'Questionnaire on Problems relating to Trade, Investment and Local Manufacturing in the Asian and Pacific Countries and Area'* and done by the Japan Business Council for Trade and Investment Facilitation. It is similar to the EU's Market Access Database, European Commission's report on the private sector's complaints regarding trade barriers in each country. One important difference between the two is that the EU accepts complaints all the time, while the JMC conducts a survey once a year.

[521] Details of this complaint are confidential, according to interview no. 28.

Investment Group:

> *"The government has increasingly been taking care of (the) private sector's interests, for example by negotiating FTAs. In terms of WTO negotiations, they can do it by themselves and they know everything about it, but in (the) case of bilateral negotiations they need the help and experience of (the) industries"*[522].

Additionally, the JMC takes part in discussions on: standards and procedures, US security issues, the harmonisation of rules, trade facilitation and the environment.

5.2.2.2.7 The Japan External Trade Organisation

JETRO plays a secondary role in Japan's FTA policy formation process. It is organised and functions as a secretariat office for pre-FTA study groups for free trade agreements with the EU, Switzerland, and Peru[523]. In terms of the agreement with the European Union, JETRO hosted a work group studying the potential for an Economic Integration Agreement (EIA) between the EU and Japan, between January 2007 and July 2008. In 2009, JETRO became a secretariat for the EU-Japan EIA Research Committee. JETRO has an indirect input in Japan's FTA policy as the organisation is the source of important research data, analysis and intelligence. JETRO's White Papers and annual large-sample surveys were discussed in Chapters 3 and 4.

5.2.3 The Ministry of Finance and the Financial Sector

5.2.3.1 The Ministry of Finance (MOF)

The Ministry of Finance supervises issues related to tariffs and custom procedures. It is one of the three ministries to have been engaged in the FTA policy from the outset[524]. MOF is mainly responsible for tariff systems (Custom Tariff Law), tariff collections, and the Japan Customs. It is especially interested in procedures such as rules of origin[525].

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[522] Interview no. 28.
[523] Interview no. 40.
[524] MAFF was not involved in the JSEPA negotiations.
[525] Interview no. 12.

The liquor, tobacco and salt industry come under MOF's jurisdiction. The liquor sector falls under the National Tax Agency Japan, the tobacco and salt monopolies under MOF. These three industries are exceptional cases and their position differs from that of the other sectors. At the beginning of the 20th century, Japan experienced a salt shortage. Hence the government has used a monopoly to control the price since the end of the Meiji Era (1905). Similarly, Japan's tobacco monopoly, Japan Tobacco, is a governmental corporation. The Ministry of Finance occasionally receives requests from the liquor industry but the other two sectors do not oppose FTA negotiations[526]. The tariff rates for tobacco are already low in Japan.

The Ministry of Finance is in an interesting position when it comes to free trade agreements. Like MOFA, it does not have an industry group behind it[527]. Furthermore, the Ministry does not benefit directly from such agreements and they are not a part of its broader agenda. Therefore, MOF has a neutral policy and a very narrow interest in FTAs[528]. Its main concerns are procedures, tariffs, and customs authorities. It also receives inbound certificates of origin. As tariffs are already only a small part of total revenue the Ministry does not oppose further liberalisation but advocates the simplification of tariffs and is interested in the effects proliferating FTAs have on that system. MOF's Customs and Tariff Bureau, responsible for tariffs (also preferential), is in close contact with the Budget Bureau within the Ministry. The Budget Bureau is concerned about the prospect of having to compensate for lowering import tariffs and other negative domestic effects of FTAs. For example, if the tariffs on agricultural products are reduced, the Ministry of Agriculture will request more money. On the other hand, FTAs may strengthen the Japanese economy, which, in MOF's understanding, includes increased revenue either in corporate tax or other forms of income.

According to a former Customs and Tariff Bureau bureaucrat official, most of the discussions on FTA within the Ministry focus on domestic issues, mainly rules of origin[529]. In terms of inward RoO (imports to Japan) METI would like to have as many product-specific rules (PSR) as possible. This type of rules of origin can be viewed as restricting access to domestic markets and to be a form of protection. Despite lower tariffs, METI and companies in less competitive industries would still like to have some type of protection from foreign exports. Hence in the experience of the MOF official, METI and MAFF would like to see complicated and difficult-to-satisfy inbound RoO,

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[526] *Ibidem.*
[527] See point 6.2.3.2 for details.
[528] Interview no. 12.
[529] *Ibidem.*

while having simple outbound RoO[530]. On the other hand, MOF prefers simpler systems, and opts for sector general rules. The fieldwork indicated that Japanese companies would like to see simple rules for both outbound and inbound trade. However, during FTA negotiations, the ministries are under strong pressure from interest groups, which often results in a complicated PSR system.

The DPJ's accession to power has changed the decision-making process within the Ministry of Finance. The structure of the Ministry is as follows: the politicians are represented by the Minister, two Senior Vice-Ministers and two Junior Vice-Ministers. The bureaucrats are represented by another Vice-Minister and four Director-Generals responsible for different bureaus. During LDP's administration, the bureaucrats reported to the Vice-Minister on the bureaucrat's side and only sometimes to the LDP's Vice-Ministers or the Minister. This can be demonstrated by the fact that a MOF's former Customs and Tariff Bureau official recalls not even knowing the name of the LDP's Vice-Ministers whilst working for the Customs Bureau[531]. The change of administration to the DPJ affected this reporting order. Currently the MOF's political staff meet about once a week to make decisions on policy issues. The bureaucrats report to this internal ministers' council, namely the DPJ's Senior Vice-Ministers, and carry out its decisions. The Customs Bureau officials report to the DPJ's Junior Vice-Minister in charge of the Bureau who then passes it the internal ministers' meeting and no longer reports to the bureaucratic Vice-Minister.

5.2.3.2 The Financial Sector

The financial sector falls under the jurisdiction of the Financial Services Agency: it is a governmental body that has been separate from MOF since 2000. It deals with the regulation of the financial industry, while MOF oversees financial policy. The Japanese Bankers Association is a business association including major banks, with a rotating chairmanship and smaller banks as members. The Association communicates with the Financial Services Agency regarding its policy preferences. The financial industry is not directly involved in FTA negotiations. The officials from MOF join the negotiation and represent the sector but the Financial Services Agency is excluded. Despite that, there are several ways for the companies in the financial industry to inform the government of

[530] *Ibidem.*
[531] *Ibidem.*

their preferences. One of the ways to do so is through *Keidanren*, but the Japanese Bankers Association and the General Insurance Association of Japan (GIAJ: the business association for the insurance industry) also have a direct communication channel with the government. As mentioned in Chapters 3 and 4, the banking sector does not have a strong preference when it comes to FTAs, as it does not utilise them to the same extent as the manufacturing sector[532]. As explained in Chapter 3, Japanese companies in this sector do not use FTAs despite the fact that they export many types of services to East Asia. This is due to the type of agreements being signed and the lack of provision of interest to the banking sector.

5.2.4 The Ministry of Agriculture, Forestry and Fisheries and the Agricultural Sector

5.2.4.1 The Ministry of Agriculture, Forestry and Fisheries (MAFF)

The structure of MAFF is similar to that of METI. The International Affairs Department, under the Minister's Secretariat, functions like the Trade Policy Bureau. It is responsible for overall foreign policy. The Agricultural Production Bureau is similar to the Manufacturing Industries Bureau and has divisions for products or sectors, for example, the Milk and Dairy Products Division. The Ministry of Agriculture, Forestry and Fisheries represents farmers and agricultural cooperatives and is subjected to a great deal of pressure from farming interest groups. The agricultural lobby groups and the politicians who support them are the strongest interest group influencing Japan's FTA policy[533]. They check the contents of every planned FTA and strongly oppose any plans for liberalising products in their sector. In particular, the farmers and the agricultural cooperatives oppose the importations of rice, wheat, barley, beef, and fruit. As explained in Chapter 3, the agricultural cooperatives have played an important role for many years. They have branches in every village and using this framework they are able to garner the farmers' opinions and also their votes[534]. MAFF is the only ministry which has a

[532] Interview no. 45.

[533] Another interest group, although with a very limited influence, are the consumers. In recent years, those groups have become more conscious about food security, contamination and overall food quality. They do not want to buy Chinese food products, despite the fact that they are significantly cheaper. Not only farmers, but also, to a lesser degree the consumer, oppose importing food, and rice from abroad. Interviews no. 42 and 44.

[534] Interview no. 42.

formal contact channel with the agricultural associations and cooperatives[535].

5.2.4.2 The Changing Role of Agricultural Cooperatives and the New Decision-making Process Under the DPJ

The FTA policy formation process within MAFF and the role of the agricultural cooperatives has changed significantly as a result of the change in administration. Out of the four main ministries, MAFF's internal communications and decision-making process has been probably the most affected by the transition[536]. The LDP had a strong connection with the agricultural cooperatives and *JA-Zenchu* (Japan's Association of Agricultural Cooperatives). Before the start of the negotiations for each FTA, the LDP held informal consultations to understand the position of the agricultural cooperatives, which are strongly connected to local politics. The Ministry consulted the LDP on all details of agricultural policy, who in turn consulted with local-level LDP politicians. During the initial stages of an FTA process, MAFF bureaucrats would visit the LDP headquarters each day and report on the current situation[537]. The LDP politicians would travel back to their constituencies (local areas) and collected preferences on the matter. If the LDP politicians encountered strong opposition at the local level, MAFF would not start negotiations. The connection between *JA-Zenchu*, LDP politicians and MAFF were often referred to as the iron triangle power[538]. The metaphor captures the way in which the three sides are "are interlocked in a mutual exchange of favours dependent on the continuing flow of benefits" (George Mulgan 2001:4). The politicians, as the voice of the agricultural sector[539], could, in return, count on rural areas' support during elections. According to the Director of MAFF's International Economic Affairs Division, participation in an initiative which the *JA-Zenchu* opposed, without prior consultation, would put the Ministry in a very difficult position due to the organisation's influence in the LDP[540].

This situation changed when the DPJ took office in 2009. The current administration does not consult with *JA-Zenchu*, due to their strong connection with the

[535] Interview no. 3.
[536] Interview no. 10.
[537] *Ibidem.*
[538] More often this name was given to the connection between the LDP, bureaucrats and big businesses, as discussed in Chapter 3.
[539] These are members of the so-called *Nōrin-zoku* – Agriculture and Forestry Tribe, one of the 'tribes' within the LDP party, an agricultural lobby group within the party.
[540] Interview no. 10.

opposition LDP party. This is not to say that the agricultural cooperatives or the agricultural sector have lost their influence. The DPJ's (2009b:28) 2009 general election manifesto included a statement on promoting the "liberalisation of trade and investment through the conclusion of a free trade agreement (FTA) with the United States". The agricultural cooperatives and the LDP strongly opposed this proposed policy and the plan was suspended. In later documents and speeches, the DPJ changed their focus from the conclusion of the Japan-US FTA to the facilitation of the negotiations on the Japan-US agreement without jeopardising the interests of the farmers or rural areas. The DPJ's administrations do not have strong ties with agricultural cooperatives and the party's politicians are less influenced by the sector's interest groups. However, it is important to point out that there is also a DPJ agricultural lobby[541]. The DPJ is influenced by and has ties with local politics and local farmers rather than with an institutionalised lobby organisation as was the case with the LDP. In reality, the DPJ is also dependent on the support of rural areas. The party attempted to obtain the support of the rural constituencies in the 2009 general election as well as in the 2010 House of Councillors' (Upper House) election[542]. If it had been able to secure a majority in the Upper House in the 2010 election in addition to the one in the Lower House, the DPJ would have had a couple of years of uninterrupted governance, and it could have implemented bolder policy reforms. The party did not garner enough seats to achieve a majority in the Upper House without the support of their coalition partners. As a result, the DPJ's agricultural trade policy lacks a strong political direction and has been denigrated as ambivalent and internally contradictory[543].

Agriculture remains a serious issue, especially for local politics in certain regions. For example, in Hokkaido, agricultural production is highly concentrated and remains an integral part of both the economic and the social aspects of the local community. In Hokkaido, agriculture is the main industry and the level of dependency on production in this sector is high. According to the Director for FTA Affairs at METI's Trade Policy Bureau, even the local manufacturing industries support Hokkaido farmers in their opposition to trade liberalisation[544]. For that reason, the flexible approach of Japan's FTA partners, allowing for exclusions and replacing tariff reductions with cooperation provisions, was necessary in order for the country to be able to sign trade agreements. Without accommodating the interests of the agricultural sector Japan would not be able

[541] Interview no. 5.
[542] *Ibidem.*
[543] Interview no. 5.
[544] Interview no. 3.

to do so. Another reason behind the agricultural sector's continued influence is the concerns about food security and self-sufficiency. At the moment domestic production covers only about 39 percent of the national requirement, while 61 percent of food is imported. The national aim is to raise this to 50 percent[545].

The new administration, directly influenced by local agricultural politics, has tried to decrease the influence of *JA-Zenchu* and the cooperatives. Throughout 2010, MAFF's bureaucrats did not have official contacts or consultations with agricultural cooperatives. This was the result of a direct request from the Minister of Agriculture, Forestry and Fisheries[546]. Since 2009, the Ministry's officials take direction directly from the Minister and *JA-Zenchu* is losing its contact channels with the government. MAFF's product divisions have experts on each commodity and the Ministry's bureaucrats can collect the information that is necessary for policy-making without speaking directly to farmers or cooperatives. The consultation process under the LDP administration was never aimed at gathering information but was designed to discover *JA-Zenchu's* political opinion and gain support. During the previous administration, it was the LDP which was the highest authority for MAFF rather than the Minister of Agriculture, Forestry and Fisheries[547]. The politicians whom the MAFF bureaucrats currently speak to are the Minister and other DPJ representatives at the Ministry. The bureaucrats pass information and data directly to the Minister of Agriculture, Forestry and Fisheries, who makes the final judgement. The Ministry is then in charge of implementing the decision. Hence for MAFF officials the change of administration meant a disruption of their old decision-making processes and communication channels. This was not the case for the other ministries: for example, METI. In the opinion of MAFF's Director for APEC and European Affairs, International Economic Affairs Division, METI's bureaucrats are able to operate much more independently from the politicians, the ministers, and even the ruling party, which is why they can continue their FTA policy in a more or less unchanged fashion[548]. As industrial policy causes less political divisions, METI's bureaucrats have a mandate to act independently. In the agricultural sector, there are sharp differences in opinions, which cause MAFF to be greatly affected when the political landscape changes.

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[545] *Ibidem.*
[546] Interview no. 10.
[547] *Ibidem.*
[548] *Ibidem.*

5.2.4.3 The Agricultural Trade Policy, its Impact on FTA Policy and the New Income Support System 2010

One way of dealing with the opposition to agricultural trade liberalisation would be to compensate those who could lose in such a scenario. This decision would need to be supported by strong political leadership, as it would require spending a substantial amount of money from the National Treasury. According to some calculations, in order to compensate one farmers' household, the government would need to spend about US$ 50,000-60,000 per year (four to five million JPY)[549]. According to the Director for APEC and European Affairs at MAFF's International Economic Affairs Division, if the government wished to abolish all tariffs it would need to inject up to three trillion JPY into the sector[550]. One of the DPJ's problems during their first year in office was the loss of support attributed to budgetary funding issues[551]. For example, the government established a child allowance of 13,000 JPY in 2010, per month, per child. This scheme raised questions about the government's public spending[552]. In 2011, the child allowance was supposed to be increased to 26,000 JPY. This was later changed to 20,000 JPY. However, in 2011, the government cancelled this increase.

In 2010 the DPJ administration introduced a new form of income compensation for farmers (the individual farm household income support system for rice began in FY 2010). The idea behind the programme was not new. The expectation amongst the policy observers was that the DPJ would provide subsidies for farmers in exchange for lowering the agricultural products' tariffs and opening up the Japanese market. However, there was no agreement within the party on whether this should be done[553]. It was also supposed to change the form of protection from high tariffs to direct compensation. The system had the potential to "transform Japan's agricultural policy from a system relying upon price support and consumer burdens to one resting upon direct payments and taxpayer burdens and create a domestic agricultural sector with no need for protection by high tariffs" (Sugawara 2010:15). Subsidies and various forms of protection have caused Japanese consumers to pay 1.7 times the market price for food (Katz 2010). However, the system did not achieve this aim and the farmers are receiving compensation while the high tariffs remain intact. The way the subsidies' scheme was

549 Interview 42.
550 Interview 10.
551 Interview no. 42.
552 For more on DPJ's 2010 and 2011 fiscal problems and spending cuts see Nagata 2010b.
553 Interview no. 6.

implemented has defeated its goal.

Under the WTO, in the Agreement on Agriculture (negotiated during the Uruguay Round), there are three types of agricultural subsidies: amber box, green box, and blue box[554]. The tariffication of import restrictions, including quantity, was a part of the WTO Uruguay Round negotiations. Yamashita (2009:619) writes that:

> *"Japan has agreed to raise the minimum access tariff quota of 5 per cent of domestic consumption in the case of tariffication to 8 per cent. However, in 1999, Japan ceased the application of the special treatment and introduced tariffication, because the increase in minimum access would lead to even more reductions in production. As a result of Japan's delay in introducing tariffication, however, the minimum access rate was raised to 7.2 per cent and remained the same ever since".*

The minimum access quota is the volume of trade allowed under the lower tariffs. Both the US and in 2003 the EU lowered their agricultural tariffs by implementing 'green box' direct payments for farmers (Yamashita 2009:620). A type of trade policy measure being used is decoupled payments, which do not depend on the type or volume of production. The current tariff on rice in Japan is 778 percent (Yamashita 2010a). Japan defends rice tariffs under the WTO negotiations. In 1995 the Food Control Law was abolished and a set-aside programme implemented in its place. The set-aside programme was designed to maintain the price of rice by limiting rice production. To avoid the overproduction of rice, around 29 percent of paddy fields were set aside. In order for farmers to join the production-limiting programme the Japanese government gave annual subsidies to farmers, establishing a cartel (Yamashita 2009:626).

Since the late 1990s the price of sensitive agricultural goods, such as rice, wheat, soybean, and milk, were maintained through direct payments. This was explained by the Ministry of Agriculture by the fact that direct payments are less trade-distorting than maintaining artificially fixed market prices, which were abolished for rice in 1998. The wholesale price of rice dropped by 30 percent between 1993 and 2000 (Sakuyama 2003). Between 2004 and 2005, at the time of Doha Round negotiations, the LDP Cabinet discussed this issue with the rice, wheat, and soya bean sectors[555]. It considered shifting

[554] Amber box policies distort production and trade or support prices. Subsidies directly related to production quantities fall into this category. Blue box policies are defined as potentially trade distorting, but as having conditions that limit distortion. Green box policies are not trade distorting. They do not burden the consumer and do not involve price support (WTO 2002).

[555] Interview no. 29.

the protection measures for these foods from 'amber box' to 'green box', non-trade distorting direct payments. Since 2005, the current 70 percent 'amber box' price support payments (filling the gap between the price of production and the farmers' income) for wheat, sugar, and soya bean, were changed to decoupled payments, which fit in the 'green box' category (Yamashita 2009:627). According to *Bloomberg* (25 March 2011 cites the Organisation for Economic Cooperation and Development), Japanese farmers derive 47 percent of their revenue on average from subsidies, price supports, and restrictions on imports. That compares with ten percent for the US and 24 percent for the European Union.

In 2010, the income compensation programme for all rice-farming households was implemented. It included 'amber box' subsidies and the maintenance of the production-limiting programme[556]. The current compensations' scheme differs greatly from the DPJ's original plan for agricultural policy reform. Due to the shrinking national budget, the LDP government decided to limit subsidies to a group of farmers above a certain threshold of production. This policy was not supported by the part-time farmers, who constitute the majority of Japan's farmers[557]. Part-time and small-scale farmers opposed reforms aimed at supporting only full-time farmers. In *JA-Zenchu* both the full-time and part-time farmers' votes were counted equally, hence the part-time farmers' interests prevailed. The previous version of the scheme was based on the elimination of the rice production limitation programme (programme to set-aside paddy fields). The proposed policy reform was designed to decrease prices, in order to make it unprofitable for part-time farmers to continue producing rice. After part-time farmers released their land, direct payments could be made to full time farmers who would then be able to consolidate and accumulate land and farm more efficiently. Reducing the price of rice and increasing production efficiency would also facilitate Japan's participation in high-level FTAs and the WTO negotiations. Japan's population decrease correlates to the total domestic demand for rice. Rice's price has decreased 25 percent in the last ten years as a result. Rice consumption per capita has also dropped: it halved in the last 40 years (Yamashita 2010a). In order to cope with the changing demand, without the policy being reformed the production-limiting programme will need to increase by setting aside more and more land. The set-aside programme can maintain artificial high rice prices. However, currently, about 40 percent of paddy fields have been set aside and it

[556] Interview no. 11.
[557] Interview no. 29.

would be difficult to increase this number[558]. Therefore, the price of rice has been dropping. If the price continues to fall and the production cost to go up, the gap between the two will increase. At the moment, the gap is small but is likely to widen, requiring higher direct payments. On the other hand, having an efficient rice production system would allow Japan to export surplus rice to China and other Asian countries. Full utilisation of the existing paddy fields would also help to increase Japan's food self-sufficiency. This was the DPJ's way of thinking until 2003[559]. According to the Director for APEC and European Affairs, International Economic Affairs Division at MAFF and a former Agricultural and Development Economics Division of the UN, the former president and secretary-general of the DPJ, Ichirō Ozawa, was one of the people behind the initial DPJ policy proposal[560]. His plan was to eliminate tariffs, reduce prices, and then substitute duties by direct payments. Ozawa was against subsidies given to farmers without any conditions and those who participated in the set-aside programme as this made it impossible for Japan to cope with the rules of the WTO or high-level FTA negotiations[561]. However, before the election to the Upper House in July 2004, the proposal was changed. In the new version, direct payments would be given to every farmer regardless of the size of their land. The change was supposed to ensure the farmers' support. Giving subsidies to every farmer would impede the structural reform of agriculture. Before the August 2009 general election to the Lower House, another change to the proposal was implemented: the DPJ dropped the idea of dismantling the set-aside programme. In effect, the high rice price continues to be maintained and backed by the set-aside programme in addition to direct subsidies to all farmers. This strengthens the protection of small scale farmers, who are likely to keep their land and not release it to the full-time farmers, thus preventing consolidation (Yamashita 2010b). This would increase the numbers of small- scale farms, which is contrary to the initial intentions of the reform. In 2005, a Japanese policy specialist, Aurelia George Mulgan (2005:298), argued that the pace of structural change and the market opening of the agricultural sector will indicate how the Japanese economy is adapting to increasing globalisation. She explained that, while "selective income support policies may also hasten the departure of small-scale farmers from the industry" it is unlikely that "Japanese agriculture will reach internationally competitive levels in the short to medium term" and "maintaining the momentum on trade agreements will mandate

[558] Interview no. 11.
[559] *Ibidem.*
[560] Interview no. 10.
[561] Interview no. 11.

policies that protect and preserve an uncompetitive farm sector while at the same time offer partial concessions on market access" (*Ibidem*). This prediction was correct, with the exception of the introduction of selective income support.

Some of the members of the DPJ are still interested in the agricultural reform that would tie subsidies with opening up of the market. Additionally, a small party, *Minna no Tō* (Everyone's Party), headed by Yoshimi Watanabe adopted this idea in their manifesto during the 2009 election. The Research Director of the Canon Institute for Global Studies and former Deputy Director-General of MAFF's International Affairs Department, who has been a strong supporter of the policy proposal since the beginning, advocates limiting the eligibility for direct payments to full-time farmers and decreasing the overall amount of payments[562]. Part-time farmers' income from farming is quite small. From a paddy field of a one-tenth hectare a farmer can receive a negligible annual profit of 26.000Y ($US 320). Several analysts agree that the compensation programme should be selective. For example, offered for a limited time to farmers who lost profits as a result of trade liberalisation, or for farmers who are taking steps to reform and modernise their production systems[563].

JA-Zenchu also criticises the new subsidies' scheme. According to *JA-Zenchu*'s Deputy General Manager the organisation would prefer to shift from trade-distorting to non-distorting trade policy measures, which would be in line with WTO recommendations[564]. However, he believes that maintaining the set-aside programme is necessary in order to keep the current high price of rice, as the programme, together with government payments, help to retain the balance between supply and demand. According to a former MOF official, the Ministry also does not favour the direct payments scheme. As the ministry responsible for the national budget it considers the subsidies to be 'spoiling' farmers[565]. In addition, the official argues that Korea, which introduced direct payments in the agricultural sector, in exchange for lowering tariffs, is a good example for Japan to follow[566]. In Korea, as in Japan, agriculture accounts for less than three percent of GDP (World Bank, World Development Indicators, December 2010). However, the country was able to sign an agreement with the US and the EU, despite the farmers' strongly voiced protests.

The direct payments scheme has had an impact on the agricultural cooperatives'

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[562] *ibidem*
[563] Interview no. 50
[564] Interview no. 29
[565] Interview no. 12
[566] *ibidem*

position, as the new compensations scheme has caused them to lose profit. Since its victory in the 2009 Lower House election, the DPJ has attempted to weaken the cooperatives' influence. The party started to examine *JA-Zenchu's* financial performance and operations[567]. The Japanese Committee of Deregulations currently has a working group who focus on agricultural cooperatives. It is one of the three biggest issues, according to a Committee member[568]. The Committee is also looking at *Zenno's* (the National Federation of Agricultural Cooperative Associations) exemption from anti-trust laws, which gives the organisation a strong economic and political power. The agricultural cooperatives have already expressed their opposition to deregulation. An exemption from anti-trust laws is, in their opinion, quite necessary, as without it farmers couldn't jointly purchase fertilisers or jointly sell their products. As discussed in Chapter 3, under the LDP the cooperatives bought rice from farmers, offering them a good profit margin. This was possible as *JA-Zenchu* was able to offer farmers predictable and stable prices. Currently, however, this is no longer the case. The organisation cannot predict and set a forward price, as they are unsure of the future financial performance[569]. The price offered by cooperatives is too low in the farmers' opinion, and causes them to sell directly to the private market. Additionally, the cooperatives organised the farmers' votes in the LDP era. The DPJ wishes to obtain farmers' support directly, skipping the middle man. Coupled with the new decision-making process within MAFF, the DPJ administration is continuing its efforts to weaken the agricultural cooperatives position.

5.2.5 Labour Unions: *Rengo*, *Zenroren*, and the Ministry of Health, Labour and Welfare

MAFF is well known for its opposition to FTAs and to trade liberalisation in the agricultural sector. The Ministry of Health, Labour and Welfare is another source of opposition, as well as strong 'welfare tribes' within the LDP party. The fieldwork, and hence the analysis in this chapter, was limited to the main four ministries which play a central role in the negotiation process. However, it did include the labour unions as a second, after the agricultural cooperatives, interest group. As the movement of people

[567] Interview no. 54.
[568] Interview no. 11.
[569] Interview no. 54.

has been included in some of Japan's FTAs, the labour unions have been increasingly involved in domestic FTA policy discussions. Japan has two main labour unions: *Rengo* (Japanese Trade Union Confederation) and *Zenroren* (National Confederation of Trade Unions). *Rengo* represents 6.8 million workers and organises multinational companies and the public sector organisations. *Zenroren* is the smaller of two unions and represents around 1.2 million members. It mainly represents companies in the public sector and small- and medium- size enterprises (SMEs). According to some observers, under DPJ's administration the labour unions are said to have more influence on Japan's FTA policy than under the previous administration[570]. However, this is not easily measurable.

Writing about the Japan-Mexico FTA, Manger (2005:817) argued that the labour unions, although officially critical of the agreement, did not strongly oppose it, while in the case of other FTAs their opposition was expressed by the Ministry of Health, Labour and Welfare. The fieldwork conducted for this thesis indicates that Japan's labour unions do not oppose FTAs. In particular, *Zenroren* does not have strong preferences when it comes to such treaties and does not lobby the government, as there are no plans for a notable increase in the number of foreign workers coming to Japan[571]. As mentioned throughout the thesis, the unions were not much aware of the possibilities or dangers of FTAs. The issue that awakened their interest in free trade treaties was the inclusion of provisions on 'the movement of natural persons' in the agreement with Indonesia and the Philippines. In the case of nurses and caregivers it is difficult to speak of opposition and lobbying from the labour unions. There is very little fear of inflow of an increased foreign workforce, according to one of *Zenroren's* managers[572]. The number of Indonesian and Filipino nurses admitted under the FTAs is restricted by various provisions, as explained in Chapter 3. As a result, those numbers are not significant enough to affect Japanese nurses' and caregivers' wages[573]. The labour unions are aware of the increasing global competition and their views on FTAs are often similar to those of the management. They support FTAs as they strengthen the Japanese companies' ability to compete[574].

The Japanese labour unions have ways to express their opinions of FTAs. The government enacted the International Labour Organisation's *'C144 Tripartite Consultation (International Labour Standards) Convention'* from 1976, which

570 Interview no. 46.
571 Interview no. 4.
572 Interview no. 33.
573 Interview no. 48.
574 Interview no. 33.

establishes a tripartite consultation body between the government, employers, and workers. This body functions both as a central-level commission, and on the prefecture-level. In the central-level commission, both labour unions and employers are represented by 15 members. On the labour unions' side the members are mostly scholars and academics. Since *Rengo* and *Zenroren* divided into two separate bodies in 1989 all 15 appointed representatives were from *Rengo*. *Zenroren* became involved in the activities of the organisation in 2009, when one of the 15 positions was given to one of its members for a period of three years. The organisation focuses on several issues, including FTAs. The tripodal organisation functions as a tribunal where trade unions and employers can file complaints. The disproportionate number of members between *Rengo* and *Zenroren* indicates that in terms of policy formation, the influence is in the hands of corporations, as *Rengo* does not represent SMEs. This is the case not only when it comes to discussing FTAs, but other domestic problems as well. An example of how domestic policy formation is skewed towards the interests of the MNCs is *Hakenho* (the Labour Dispatching Law). The law was revised in 2004, allowing the agency's workers (temporary workers) to be used in production sites, which was discussed in the trilateral tribunal. *Zenroren* demanded a fundamental review of this law, as around 200,000 temporary workers, mainly in the manufacturing sector, were fired during the last economic crisis[575]. During the Koizumi administration the law was changed. Since then Toyota, Nissan, Canon, and other big corporations, have been using many part-time workers in their factories. In times of economic downturn, part-time workers are easy to fire. *Zenroren* requested the prohibition of part-time workers; however, *Rengo* opposed the proposal as part-time workers are of great use for MNCs.

5.2.6 The Prime Minister and the Cabinet of Japan

The National Diet has the power to refuse or approve the enforcement of a signed FTA (the ratification process). The Cabinet Office is an organisation within the Cabinet of Japan, which is the executive branch. The politicians have the final vote in the FTA decision-making process. In theory, the Prime Minister sets the overall direction for the FTA policy. Prime Minister Junichiro Koizumi's and Prime Minister Yukio Hatoyama's visions for regional economic integration have been discussed in Chapter 4. When there is a disagreement between the ministries, the final decision-making power lies in the

575 *Ibidem.*

hands of the PM. For example, before starting negotiations with Australia, Koizumi decided to enter into negotiations with this country, despite the opposition of the LDP politicians with links to agriculture. Therefore, the preferences of the PM and the ruling party should be an important factor behind the formation of FTA policy. During the fieldwork research, none of the interviewees mentioned the PM as being a leading force in Japan's FTA policy formation process. On the contrary, the fieldwork indicates that a lack of strong political leadership from the Prime Minister is one of the causes of the current FTA policy impasse. Lord (2010:28) confirms this finding, arguing that "although the PM makes decisions and signs treaties it is a bureaucratic-centred system", which results in "what is often described as a bureaucratic-centric decision making system in which Kasumigaseki, home of Japan's ministries, plays a critical role in creating Japan's policies and laws". The issue of the PM's role in the FTA policy formation process is discussed in detail later on in this chapter.

Similarly, the Cabinet, which includes ministers from the four previously discussed ministries, has a limited decision-making power, as its primary role is to coordinate the efforts of the ministries[576]. While MOFA coordinates FTA policy in international negotiations, the Cabinet Office is supposed to play this role during domestic-level consultations, before the official FTA negotiations[577]. This is difficult as the Cabinet Office does not have a section for FTA policy. During Koizumi's administration, the PM's Office established the Economic Planning Agency to be responsible for economic policy coordination, with a focus on macroeconomic issues and economic reform measures including FTA policy. According to a former member of the Agency, its activities included promoting FTAs and reforms supporting further trade liberalisation[578]. The Agency included scholars, politicians and leaders from the private sector. It was a small body, in charge of formulating basic policy, which the ministries were supposed to implement. During the Shinzo Abe and Yasuo Fukuda administrations the office remained but its position was very weak[579]. It was later merged with the Cabinet Office and ceased to exist after the DPJ took office.

[576] Interviews no. 42, 60 and 5.
[577] Interview no. 12.
[578] Interview no. 60.
[579] Interview no. 42.

5.3. Formulating of the FTA Policy and International FTA Negotiations

The Japanese government usually discusses FTA policy on a case by case basis[580]. There are individual strategies for individual FTAs. However, what is lacking is a clear, coherent overall FTA strategy. After the 2004 ministerial meeting document (MOFA 2004), the national FTA policy was not updated until 2010 as a result of the ministerial meetings which took place throughout this year. Under the previous administration, Japan did not have a strong FTA policy coordination mechanism, for example one operated by the Cabinet Office or the Diet. Hence it developed a balanced 'best-practice' based on the cooperation of the four leading ministries with different jurisdictions: METI is responsible for the liberalisation of trade in manufactured goods and services; the Ministry of Finance is in charge of rules of origin; MAFF represents the agricultural sector; and MOFA's task is to coordinate the work of the remaining three ministries and represent Japan during FTA negotiations. This system developed in the middle of the 2000s, after several disagreements amongst the ministries. Over time, the FTA policy preferences of three of the ministries (MOFA, METI, and MOF) converged and an equilibrium developed: MAFF opposes FTAs while the other three ministries support further liberalisation, although to a different degree. Any conflicts are usually between MAFF, which doesn't want to lower its tariffs, and METI, whose tariffs are already very low. The roles of the four main ministries have not changed as a result of the election of the DPJ. What has changed, to a certain extent, is domestic coordination and policy-making. It is too early to assess the DPJ's FTA policy. However, there have been some visible changes in the way that FTA policy is discussed and who it is discussed by.

5.3.1 Pre-FTA Coordination

5.3.1.1 Inter-Ministerial Meeting

The coordination of domestic FTA policy takes place between the four ministries. Before starting international negotiations, domestic preferences are coordinated using this system. Finally, MOFA requests permission from the Prime Minister to start negotiations. The structure of the pre-FTA negotiations' consultations has changed

[580] Interview no. 4.

significantly with the change in administration. During the LDP administration, there was no official forum for this process. Only one inter-ministerial meeting was held on the ministerial level, which resulted in the 2004 document (MOFA 2004). The four ministers coordinated their preferences without a formal system in place. Important decisions were discussed with the PM. Before the start of FTA negotiations, when the final position papers were being prepared, MOFA's representatives discussed the policy with the remaining three ministries. There was no official, regular contact between MAFF and METI, apart from in exceptional circumstances[581]. MOFA was entrusted to speak on behalf of the other ministries and to draft the final position paper.

After the change of administration, ministerial-level meetings were held much more frequently. Under the DPJ, the ministerial meetings are the most important decision-making body for FTA policy[582]. Still, throughout 2010, the ministerial meetings served as a forum for discussion and, so far, have not engendered a new decision-making mechanism. The ministries' consultation group meets to discuss FTA policy on different levels. Before each ministerial meeting, the Deputy Director-Generals (DDG) from the four ministries meet frequently. In 2010 the PM, the Cabinet Secretary's officials, the Minister, the Vice-Minister and the DDGs from each of the four main ministries (MOFA, METI, MOF, and MAFF) met every other month or at times even once a month. The Ministers and Vice-Ministers are members, while the DDGs are observers. A compromise between the preferences of each ministry is reached during those meetings. The level of the meeting depends on the importance of the matter under discussion. The participation of the Cabinet Secretary's Office or the Prime Minister ensures a stronger political coordination power[583]. MOFA's Minister, Katsuya Okada, initiated this type of meeting. The Cabinet Office intervened, as it wanted to strengthen the PM Office's position[584]. The meetings are now run by the Cabinet Office. Minister Okada (or his successor) chairs the meetings and supervises the progress of each of the ongoing FTA negotiations. The Director for FTA Affairs at METI's Trade Policy Bureau, estimates that around 15 such meetings took place between November 2009 and August 2010[585]. Depending on the topic, the other ministries can participate. One of the first meetings in 2010 was focused on conducting future trade negotiations in a unified fashion[586]. The content of the subjects under discussion remains confidential, however the majority of

581 Interview no. 5.
582 Interview no. 12.
583 Interview no. 3.
584 Interview no. 4.
585 Interview no. 3.
586 Interview no. 48.

meetings focused on the formulation of the new FTA strategy document[587]. On 6 November 2010, the Ministerial Committee on Comprehensive Economic Partnerships published the *'Basic Policy on Comprehensive Economic Partnerships'* (DPJ 2010a). In terms of actual policy direction the new document was scarcely different to the 2004 document. This was the DPJ's intention, as according to Minister Okada "it is not good to make a drastic policy change every time there is a change in government"[588]. The 2010 strategy document is more detailed than its predecessor. The content of the 2004 document is still valid and sets a general direction for Japan's policy, while the new strategy deals with more serious issues, for example whether Japan wants to sign bilateral FTAs with big markets such as the EU or the US or whether Japan will join the Trans-Pacific Partnership (TPP) negotiations. What is different about the new document is that there was no coordination with the business associations, for example *Keidanren* or other interest groups, during its drafting. This was a purely political decision made by politicians from the four ministries and the Prime Minister's Office. The top political leaders had submitted documentation on their preferences to MOFA's Minister.

As explained in the previous section, DPJ's administration initially attempted to limit the role of bureaucracy in FTA policy formation. Within MOFA the new administration dispensed with a large number of working-level meetings and a bottom-up style of working[589]. However, the Ministry's political staff members were not able to handle the complexity of the FTA strategy, as they often lacked experience in the matter. Hence, from April 2010, working-level preparatory meetings took place in addition to ministerial level meetings. Although this might appear to be a reversal of policy, it is actually different than the situation under the LDP's rule in several ways. The Director of the EPA/FTA Policy Division at MOFA explains the difference between the two processes[590]. Within the Ministry, political representatives are now setting an agenda and instructing working groups to prepare certain documents for the meetings, (e.g. statistics). Previously, under LDP's administration, the bureaucrats used to prepare recommendations for the political leaders, who adopted or rejected policies. The working groups prepared detailed information on the recommended optimal solution. Under DPJ's administration, the working groups are required to provide several options, including a list of pros and cons, for the political staff to choose from.

[587] In the summer of 2010, the DPJ (2010b:56) announced the release of the new strategy document (DPJ 2010a) by autumn.
[588] Press Conferences at the Foreign Correspondents' Club of Japan (FCCJ), August 2010, Tokyo.
[589] Interview no. 9.
[590] *Ibidem.*

5.3.2 International FTA Negotiations Stage

International FTA negotiations take place in rounds. During the negotiations rounds a similar, although slightly more formal system is used than at the preceding domestic coordination stage. The meetings take place on three levels[591]:

- The third level is also known as the expert's level. The members are various experts from the negotiating countries. The negotiator from MOFA is the chair, usually in a Director or Senior Deputy Director rank.
- The second level is the DDG level. The DDGs from the four main ministries preside over the meetings as co-chairs. The bulk of the negotiations are done on this level. Additionally, many officials from the general level and Assistant Directors are present.
- The first level is the Vice-Minister's level. The partner country is also usually represented by a Vice-Minister. MOFA's Deputy Minister chairs the meetings. No representatives of other ministries attend those meetings. This is due to the Japanese legislation and the provision on the division of responsibilities and power. Only MOFA has the authority to conduct diplomatic negotiations.

The majority of negotiations are done on the second level, which consists of four DDGs representing different interest groups. Each of the involved ministries has their own targets and goals. Hence often the most difficult part of FTA negotiations takes place between the ministries and not with their foreign counterparts[592]. Part of this coordination process takes place before the rounds of negotiations commence, during the four ministries' meetings. The goal of the pre-negotiations consultations is to formulate a common domestic position. However, under changing circumstances, adjustments are implemented parallel to the negotiations. During the international FTA negotiations consensus-building can continue to take place between the ministries and their constituencies (e.g. METI and the private sector). There is a constant exchange of information and opinion between the two. In urgent cases this is often done over the telephone. The ministry informs its constituency about the progress of negotiations, asks about any existing complaints, and in problematic cases discusses a compromise. The concessions are usually made sector by sector. Therefore, the government contacts trade

[591] Interview no. 5.
[592] Interview no. 44.

associations which deal with that specific industry's interests[593]. The four DDGs always coordinate domestic policy. Representatives of the main four ministries are present during negotiations to make sure that last-minute adjustments are possible and that there are no misconceptions. Japan's FTA negotiations process can be prolonged once a difficult issue, such as sensitive agriculture products, arises. In the partner state, the negotiating authority is usually concentrated in one ministry, most commonly the ministry of trade. In Japan this is not the case, therefore the presence of all four representatives is desirable[594].

Each round of negotiations takes a couple of days (usually four). On the first day there is a meeting at the DDG level, during which overall matters are discussed. After that, the negotiators separate to discuss prospective parts or chapters of an FTA, e.g. trade in goods and services. Over the next two or three days, the experts meet. A representative from MOFA (at Director level) chairs the meetings; however, officials from relevant ministries are also often present. On the last day of the round, or whenever it is deemed necessary, there is a wrap-up meeting at the DDG level. Additionally, once every two or three rounds, a meeting on the first level is organised. This is done for ceremonial reasons and in order to involve more senior officials in the negotiation process. Meetings on the first level serve as a last resort, if there is an important issue that cannot be solved at the DDG level. The Vice-Ministers have the authority to negotiate and make compromises on behalf of their states. Depending on the issue, representatives of ministries other than the main four are also present at the rounds. During negotiations on trade in services or the labour movement other ministries join the discussions. The same thing occurs when the liberalisation of the construction sector or the communications industry is discussed. During the negotiations on the liberalisation of the service sector the number of representatives on each side can increase to ten or 20 people.

5.3.3 Cross-Ministry Bargaining

Given the specific domestic decision-making system, the Japanese government prefers to conduct FTA negotiations in a sector by sector manner. This means that during the international stage of the FTA negotiations, the bargaining and the trade-offs are usually

593 Interview no. 28.
594 Interview no. 10.

done within the jurisdiction of each ministry. METI negotiates the liberalisation of trade in industrial goods with its foreign counterpart, while MAFF discusses concessions in the agriculture sector with its counterpart. If METI wants the FTA partner to commit to bigger tariff reductions, it can offer investment promotion, ODA, etc in exchange. As was demonstrated in Chapter 3, when Japan wishes to open up its partner's auto industry, and has little to offer in return, as its manufacturing tariffs are already very low, it offers various types of cooperation. A similar situation occurs in the agricultural sector. In order to keep existing tariffs, the Japanese side can offer the FTA partner some form of agricultural cooperation (making production more efficient or high-tech, or offering assistance to farmers). Therefore, in a way, the agricultural sector and the non-agricultural sectors are discussed independently[595]. For the Japan-Thailand FTA, MAFF completed negotiations first, due to the agreement on excluding rice reached previously, as discussed in Chapter 3[596]. The majority of negotiations with other ASEAN member countries were also conducted in this sector-by-sector manner[597]. Usually, Japan requests concessions in industrial tariffs, while Japan's FTA partners ask for barriers to be lowered in the agricultural sector. In the cases of issues that can be solved within each ministry, a consensus can often be reached before the international negotiations' stage[598]. However, sometimes, during the negotiation rounds, the FTA partner requests concessions or offers a reduction on one product in conjunction with another product. With the representatives of four ministries present, coordination can be done on site.

At the final stages of the negotiations, the sector by sector discussions can be replaced by cross-ministry bargaining. This is usually prompted by the FTA partner although, according to the Director for FTA Affairs at METI's Trade Policy Bureau, it is not always clearly stated[599]. If the partner country tries inter-ministerial bargaining (the liberalisation of agricultural products in return for lower tariffs in the automotive industry, for example), the Japanese ministries need to discuss the issue. This is a difficult stage, as if there is a disagreement there is the possibility that one of the ministers will walk out and break the negotiations. This can make the counterpart country feel like they are negotiating with several ministries at the same time, as in the case of the Japan-Mexico FTA, which was the first example of inter-ministerial bargaining. Mexico wanted to open up Japan's agricultural sector, while Japan

[595] Interview no. 8.
[596] Interview no. 54.
[597] Interview no. 3.
[598] Interview no. 39.
[599] Interview no. 3.

demanded concessions in the automotive, or the mineral resource, sector[600]. The two countries were able to close the gap within each sector up to a point, but then the negotiations became stuck. *JA-Zenchu's* Deputy-General Manager recalls that in the last stages of the negotiations there were four items on which the two sides could not agree: pork, oranges, automobiles and automobile components, and steel[601]. In his opinion, it was part of Mexico's negotiating strategy. The country had two products 'in offence' and two 'in defence', meaning that for the two products for which Japan wanted to receive concessions, the Mexican side demanded a compromise on two products in the agricultural sector. METI criticised MAFF's stand on imports of pork and other agricultural products, which caused MAFF to retaliate and threaten to leave the negotiations[602]. MOFA was the body overseeing and managing the entire process, but after a certain point it formed a 'troika' with the two other ministries[603]. The lead negotiator, the Foreign Minister and the Ministers from METI and MAFF tried to coordinate their positions. Reaching a compromise under such circumstances is a very time-consuming and difficult task. Therefore, in the opinion of the Director of MOFA's EPA/FTA Policy Division, Japan needs to have a strong, consolidated position before the start of the international negotiations[604]. This kind of coordination should ideally be done by MOFA. However, the Ministry does not have enough political power to coordinate the preferences of two strong ministries: METI and MAFF[605]. Therefore, in the case of the Mexican negotiations the final decision was made by the PM's, Cabinet Office[606]. One of the ways to solve the issue of cross-sectoral bargaining is for Japan to make concessions in its requests for the liberalisation of their counterpart's market (i.e. abandon its request). This took place, for example, during negotiations with Thailand, when Japan abandoned its request regarding the automotive industry protecting its rice market, as explained in Chapter 3. A similar phenomenon occurred in the recently concluded negotiations with Peru. Up to a certain point, bargaining took place within the sectors, but there was also a disparity between the interests of the two states, i.e. agriculture versus certain industrial areas, for example automobiles and motorcycles. Peru realised that if it lowers tariffs in those industrial sectors, Japan would not open up its agricultural market, hence it delayed making a commitment in this field. In the words

600 Interview no. 9.
601 Interview no. 29.
602 Interview no. 54.
603 Interview no. 9.
604 *Ibidem.*
605 Interview no. 46.
606 Interview no. 7.

of the Director of MOFA's EPA/FTA Policy Division, the automotive industry was 'taken hostage'[607]. Australia is a similar case. If Japan does not make concessions in the agricultural field, the Australian side is unlikely to reduce tariffs in the manufacturing sector[608]. Cross-ministry bargaining is an additional constraint that weakens Japan's position during FTA negotiations[609].

5.4 The Characteristics of Japan's Domestic FTA Policy Formulation and Decision-making Process

5.4.1 Changing of the Government Administration

During the LDP era, the ministries and their bureaucrats held a much stronger political position than the politicians or the government. They were considered to be "the largest and smartest think-tanks in Japan"[610]. Therefore, they were in charge of making policies and drafting laws. In Japan, few laws originate from the Diet[611]. In a 1998 article Mikuni (1998) wrote that a politician's role "is to formalise what is decided by the bureaucracy". This thesis is also confirmed by Johnson in *'Japan: Who Governs? The Rise of the Developmental State'* (1995). Japanese bureaucrats retire in their early fifties. As their salaries are quite low, they generally seek further positions after retirement[612]. Usui and Colignon (2004) speak about the links between politicians and bureaucrats in Japan. They analyse two of the most common ways of entering national political office: being an ex-bureaucrat and being a hereditary politician. According to the authors, over 60 percent of the seats in the 2003 election were taken by a person representing one of those categories. Usui and Colignon write (2004:20):

> *"By definition, seikai tenshin (ex-bureaucrats) politicians link the central bureaucracy with national and local political office, creating a base for regional policies and inducing alliance among local government, central bureaucracy, and local business. (...) The stability of seikai tenshin in the Lower House of the Diet represents the fusion of the bureaucracy with high political office. In contrast, the dominance of hereditary politicians*

[607] Interview no. 9.
[608] Interview no. 3.
[609] Interview no. 9.
[610] Interview no. 54.
[611] Interview no. 23.
[612] The practice called *'amakudari'* (descent from heaven), mentioned in Chapter 3.

at all levels of political office represents the fusion of local interests into national politics".

In the media, the writer of an article in the *Asia Pacific Times*, *'Bucking the Japanese system, Hatoyama's real revolution will take place behind the scenes'*, Neidhart (2009), quotes Karel Van Wolferen, who has called Japan a "paralyzed superpower" with a "strong position of bureaucrats and the lack of influence over the country's policies of politicians". A similar thesis has been argued by Johnson (1975) as early as 1975. The DPJ ran for office with a programme that spoke of limiting the role of bureaucracy and increasing the influence of politicians. The 2009 DPJ Manifesto (2009b:3) spoke of "restoring true democracy by establishing an administration controlled by politicians". The change of administration was supposed to bring about a change in the governing structure. Additionally, the new administration wanted to reduce the size of the government and hence, costs. The 2010 DPJ's Manifesto (2010c:17) states:

> *"The Administrative Vice-Minister Meeting, which symbolised the bureaucracy's control of government administration, has been abolished. The process of drafting, coordinating and deciding policy is now led by the politicians in the top three positions in each ministry (minister, senior vice-minister, and parliamentary secretary."*

The DPJ's vision to limit the role of bureaucracy also impacted the domestic FTA policy formation process, where the politicians started playing a bigger role. This change has been already described in regards to the Ministry of Agriculture, Forestry and Fisheries. In each ministry there are currently five politicians, mostly from the Democratic Party: the Minister, two Vice-Ministers and two supporting officials (Deputy Vice-Ministers). In addition, the National Policy Unit was established to coordinate ministries' activities and report to the Prime Minister. Bureaucrats are not allowed to represent the ministries during press conferences. This function has been limited to five politicians within each ministry[613]. Initially, after the DPJ's victory, the bureaucrats were sidelined and their influence was minimised, in the attempt to establish a centralised authority in terms of trade negotiations[614]. As explained by the Director of MOFA's EPA/FTA Policy Division, initially, there was a mutual distrust between the DPJ's politicians and the bureaucrats[615].

[613] Interview no. 54.
[614] Interview no. 48.
[615] Interview no. 9.

Part of the problem was the DPJ's conviction that the policies were made by the bureaucrats and the role of politicians was limited to rubber-stamping the final projects. The DPJ was not familiar with the internal policy formation process, as the party had been in opposition for several years and excluded from governmental decision-making. The policy of limiting the role of the bureaucrats caused them to attempt to control all aspects of policy-making, including FTA strategy. This proved to be time-consuming and resulted in several difficulties. In order to successfully formulate and implement policies the DPJ needs to utilise the bureaucrats' vast experience and knowledge, which is the result of years of engagement in trade issues. The party has slowly learned how the process functions and, after the initial transition stage, has started to apportion responsibility to the bureaucrats.

The DPJ's manifesto (2009b) mentioned the promotion of FTAs and the conclusion of the Japan-US agreement. In his *'Singapore Address'* speech Prime Minister Yukio Hatoyama (2009) mentioned the finalisation of negotiations with Korea, India and Australia and the promotion of the Comprehensive Economic Partnership for East Asia (CEPEA) and FTAAP. As discussed in Chapter 4, the DPJ's *'On the New Growth Strategy (Basic Policies)'* (2009a:21) spoke of achieving FTAAP by 2020 and "doubling the flow of people, commodities and money into Japan". Despite this initial interest, since coming into power the party has been preoccupied with other issues (such as the US military base, and the global economic crisis). Hence it had little resources to actively engage in the promotion of free trade agreements. Additionally, the topic of the Okinawa military bases attracted a lot of attention and media coverage at the end of 2009 and throughout 2010. On the other hand, within Hatoyama's government the Social Democratic Party (SDP) strongly supported the protection of the agricultural sector and opposes increasing imports in this sector (Sugawara 2010:11). However, in the opinion of METI's Director-General for International Trade Policy, the DPJ administration is much more involved in the discussions on FTA policy than its predecessor[616].

The DPJ's attempts to centralise FTA policy making culminated in the *'Basic Policy on Comprehensive Economic Partnerships'* (DPJ 2010a) published as a result of inter-ministerial coordination meetings. Amongst others, the document declares Japan's intention to sign high-level FTAs with major trade partners. As it has been discussed in the previous chapters, such agreements would require conducting domestic reforms, for example in the agricultural sector. So far, this has been difficult to achieve due to a

[616] Interview no. 6.

strong opposition from farming pressure groups and the vested interest of the government (the LDP and to a lesser extent the DPJ) in this sector. The new FTA strategy introduces structural changes in the government, which are designed to enable "appropriate domestic reforms with respect to areas of the agricultural industry, movement of natural persons workers from abroad to Japan, and regulatory reforms" (DPJ 2010a:3). Firstly, the government will organise *'Ministerial Meeting for Realisation of a Free Trade Area in the Asia Pacific'* (this is a provisional title), in which representatives of relevant ministries, as well as the Prime Minister's Office, will participate. With respect to agricultural-sector reform, the document announces the creation of *'The Headquarters for the Promotion of Agricultural Structural Reform'* (also a provisional title). The headquarters will consist of the Prime Minister (the Chair), the Minister of State for National Policy (the Vice-Chair), and the Minister of Agriculture, Forestry and Fisheries (another Vice-Chair). The new governmental body was expected to develop basic policy until June 2011. With respect to overall regulatory reforms for 'opening up the country' and increasing the inflow of foreign workers to Japan, a detailed plan was supposed to be put forward in 2011 by the Government Revitalisation Unit at the Prime Minister's Office. However, due to the triple disaster that hit Japan on 11 March 2011 this has been postponed. The Government Revitalisation Unit is one of the governmental bodies created by the DPJ as a part of the centralisation of decision-making under the politicians' lead. It was established in October 2009, under Prime Minister Hatoyama's administration. One of its purposes was to "review the division of roles among the national government, local public authorities, and private companies" (Cabinet Secretariat, 2009). The new FTA policy document (DPJ 2010a) confirms the increasing role of intra-governmental bodies and politicians in FTA policy formation, which is in accordance with the general direction the DPJ has been undertaking in this respect since it came into power.

5.4.2 The Decision-making Process

Sugawara (2010:2), a former advisor of Japan's Permanent Delegation to the OECD and a MOFA official, wrote in March 2010, that "Japan's international trade policy faces an impasse in bilateral, regional and global levels". This impasse, referred to throughout the thesis, includes the opposition to further liberalisation that makes it difficult for Japan to sign FTAs with major trade partners. It partially results from the dearth of organs within the government able to take responsibility for political decisions. The main characteristic of Japan's free trade agreement policy is the fact that the role of Putnam's transmission belt is not played by one governmental organisation or ministry, but jointly by four ministries and, to a much lesser extent, by the Prime Minister's Office. The coordination takes place not only between preferences of domestic interest groups but also between the ministries which represent them. Lord (2010:27) explains that Japanese trade policy is "crafted amid tension between different ministries, a direct consequence of the diffusion of power and authority throughout the bureaucracy that permeates the Japanese political system". Such a consultation process, to a certain extent, takes place in every country. The Office of the United States Trade Representative (USTR) is a unified gateway for the US' FTA policy and represents the country as a centralised organ responsible for trade negotiations. Lawyers representing each industry can submit their proposals directly to the USTR. The organisation also needs to coordinate its policy with each ministry, as well as the Department of Agriculture and the agricultural sector, where such products are concerned. Hence in this respect, it does not have independent power. In the case of Australia, the ministry responsible for trade negotiations is the Department of Foreign Affairs and Trade. It combines the functions of Japan's METI and MOFA. However, there is still a great deal of internal coordination needed due to the Ministry's dual function. However, in Japan, this process is particularly time-consuming. Japan's preference for consensus-based decision-making is well known. According to Konno (2009:25), a former METI's Minister, the fact that Japan's policy is, arguably, reactive to other countries' initiatives is related to a specific decision-making process within the government. He writes (*ibidem*:26):

> *"First, government decisions must be made by consensus. Second, every ministry, however remotely is the matter in question concerned with their business, must be involved in the decision. Third, each ministry is staffed with life-long employees, has permanent jurisdictions over a certain segment of Japanese society, and stands on its own power base in the political parties".*

Prior to each round of FTA negotiations, lengthy consultations between the government and various interest groups take place. Before the start of the negotiations the four ministries discuss their position. The consultation process continues parallel to the rounds and between them, until the final agreement is reached. The government attempts to facilitate the consensus by making sure that all four ministries are included in the FTA discussions at all levels. The coordination of domestic preferences is a lengthy and arduous process in Japan but it is viewed as necessary for obtaining a domestic consensus[617]. Another issue slowing down the decision-making process is the lack of communication between various divisions and departments dedicated to FTA policy within the Japanese ministries[618]. Decision-making is extremely time-consuming and requires repeated consultations on several levels. The situation is even more difficult when the policy proposal goes against the interests of a domestic pressure group or part of the governing party's constituency (Konno 2009:26). For all of the above reasons, reaching a domestic compromise and a final position overlaps with international-level negotiations: negotiators discuss the agreement with the foreign partner on all three levels, but at the same time, the four ministries and their constituencies continue to coordinate the policy amongst themselves. Each decision needs to be accepted both by the foreign partner and the international-level negotiators, as well as by the relevant ministries on the domestic front. The negotiators have little discretion to make policy decisions independently from their ministries and the numerous consultations, before the start of negotiations as well as during them, prolong the decision-making process. FTA policy is not the only area where Japan's coordination process takes a long time. During APEC meetings, Japan is represented by two Senior Officials. It is common practice that a country has one representative. Japan is an exception to this rule, being represented by representatives from both MOFA and METI[619]. Some observers feel that, in the case of FTA policy, this should be a domestic-level discussion, and only after reaching a unified front should the ministries present their position in the international forum. Part of the reforms proposed by the DPJ was intended to improve the decision-making process. For example, according to the Director of MOFA's EPA/FTA Policy Division, the DPJ's Minister of Foreign Affairs, Katsuya Okada, has been 'strongly' intervening in the FTA Division's activity within MOFA and giving top-down directions[620]. Nonetheless, these efforts have brought little results. In the opinion of *Keizai Doyukai's* Managing Director, Japan is a bureaucratic society and not a private sector-orientated one[621]. Different groups' interests are deeply intertwined, creating a resistance to change.

[617] Interview no. 50.
[618] Interview no. 49.
[619] Interview no. 48.
[620] Interview no. 9.
[621] Interview no. 23.

5.4.3 The Changing Role of Politicians and Bureaucrats and the Need for Stronger Political Leadership

It is widely agreed that a strong PM or robust political leadership is needed to overcome the recent impasse in Japan's FTA policy[622]. The FTAs with ASEAN countries and the Association were negotiated relatively easily[623]. There was a general consensus on the need to sign those agreements; hence during the last years of LDP's administration strong political leadership was not necessary to conduct further FTAs. As explained in detail in Chapters 3 and 4, currently, all the 'easy' agreements have been signed. The Asian Development Bank Institute (Asian Policy Forum 2010:12) calls this a principle of "moving from the easy to the difficult FTA". The trade agreements that were negotiated without much political effort have already been concluded. In order to proceed with FTAs, Japan will need to find solutions to its domestic problems. This requires strong political leadership from the Prime Minister's Office or another part of the government. This sentiment is strengthened by Korea's expanding FTA network and Japan's unwillingness to be left behind other countries in the region and the world. Without a stronger political leadership it will be difficult for Japan to overcome the current impasse in FTA policy, open up its agricultural market, or participate in any high-level FTA, whether bilateral or minilateral. This notion was strongly reflected in the fieldwork[624]. A former MOFA official expressed the opinion that MOFA or the Cabinet Office should play a bigger role, similar to the American model, in order to successfully promote further FTAs[625]. In Japan, however, this kind of leadership is lacking. If the Prime Minister were to strongly and firmly support trade liberalisation, then the opposition from the agricultural sector could be overcome. Such strong support could result from a belief that gains from further liberalisation for the industries and the Japanese society as a whole clearly outweigh the losses in the agricultural sector or a believe that the country would be at a disadvantaged position as a result of not taking any action. A strong political leadership would also be easier to achieve if the elected officials relied less on the political support of the representatives of the agricultural sector and hence were not dependent on their approval. However, the Japanese PM is constrained by the necessity of consultations with all of the involved parties and

622 Interview no. 42.
623 Interview no. 12.
624 Interview no. 10, 5 and 54.
625 Interview no. 46.

ministries, has little responsibility, and in reality does not make many decisions[626].

Urata (2011) argues that declining popularity ratings were one of the reasons behind Prime Minister Naoto Kan's inability to secure Japan's participation in the TPP negotiations during the APEC Summit in 2010. He explains that "without strong support from the general public, the Cabinet cannot implement policies of their preference, especially controversial policies such as the TPP" (*ibidem*). Similarly to METI and MOFA, the PM and the Cabinet Office are reluctant to enter into a direct confrontation with the agricultural sector. Hence the Prime Minister's role is, in many ways, very limited. A former advisor of Japan's Permanent Delegation to the OECD, a former MOFA official, recalls that even under Junichiro Koizumi's administration, the influence of the Cabinet Office on FTA policy was limited[627]. He considers the lack of strong leadership and political coordination as a major problem for Japan's FTA policy and one of the main reasons behind the current impasse. In 2004, George Mulgan (2004:5) argued that due to the strong ties between the ruling party and bureaucracy and a related lack of institutional power, Japan lacks the 'transformational leadership' that could be embodied in the Prime Minister, which could lead to, for example, economic reform. She explained that "Japanese prime ministers and their cabinets have generally appeared weak and self-effacing, responding to political events rather than attempting to shape them" (*ibidem*:8). After the DPJ took over it was expected that the new PM's Office would provide strong political leadership. This has not been the case. In the opinion of *Keizai Doyukai's* Managing Director, during the former Prime Minister Yukio Hatoyama administration each minister acted like the Prime Minister: hence, there was no one leader[628]. Similarly, Lord (2010:31) argues that "without powerful Prime Ministerial leadership, it is unlikely that the bureaucratic rivalry which has characterised much of Japan's trade policy to date will play a less significant role in future FTA policy" and "as long as the Prime Minister's biggest contribution to FTA policy is delegation of authority, FTAs will continue to lack overarching strategic coherence".

The situation in Japan, and the country's lack of political leadership, is often contrasted to Korea's successful FTA policy. There are several reasons behind the differences in the two countries' FTA strategies. For example, Katz (2010), editor-in-chief of the *Oriental Economist*, points to the disparity in representation and writes that

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626 Interview no. 42.
627 Interview no. 46.
628 Interview no. 23.

in Japan "roughly one-half of the people live in the six most urban prefectures, but they get only 38 percent of the district seats in the Upper House", while in Korea "by contrast, the highly urban region around Seoul houses 48 percent of the voters and elects 45 percent of the seats in the unicameral parliament". Still, it is the political system that seems to have the greatest impact on the differences in the countries' FTA policy. Korea has a presidential system and a top-down style of decision making that is very different from Japan's method of governance. The Korean President has much more political authority than the Japanese Prime Minister. He has the deciding vote when it comes to promoting FTAs, and the negotiating team has a mandate to act independently during FTA negotiations. According to the Director for Economic Partnership (EPA/FTA) at METI's Trade Policy Bureau, the presidential system in Korea plays an important role in the promotion of FTAs[629]. Pre-FTA consultations with interest groups and the sectors' representatives are kept to minimum. This makes the Korean decision-making process much quicker than Japan's process. In the opinion of *Keidanren's* Deputy Director, unlike his Japanese counterpart the President is willing to ignore what the interest groups want in order to sign a politically important FTA[630]. Korea's FTA policy "has been shaped by a top-down political initiative rather than a bottom-up demand from various interest groups and the general public" (Koo 2008:2).

Korea has two strong protectionist interest groups: the agricultural sector and the labour unions. Koo (2008:2) points out that when President Kim Dae-jung decided to sign the first FTA with Chile, these opposition forces were disorganised and pre-occupied due to the IMF's austerity programme and the economic reforms undertaken in the aftermath of the 1997/98 East Asian financial crisis, which allowed the government to commence negotiations. After the implementation of the Korea-Chile FTA in 2004 the government passed a series of side-payments to the industries and the groups who were harmed in the effect of trade liberalisation. The Office of the Minister for Trade (OMT) plays an important role in Korea's FTA policy. The Office was formed after 1998 under the Ministry of Foreign Affairs and Trade. Its purpose was to design and implement foreign trade policy and to lead trade negotiations. In time, it became the strongest force in Korea's foreign trade policy. The Office is, to a large extent, immune from interest group pressure but consults closely with various private business councils and the National Economic Advisory Council under the President's Office (Koo 2008:18). It does not consult SMEs or farmers, and the majority of the feedback it

[629] Interview no. 5.
[630] Interview no. 24.

receives comes from large businesses or their associations. Koo (2008:3) describes Korea's FTA policy-making style as 'embedded autonomy' (a term used originally by Peter Evans in 1995): President Kim's strong initiative to sign the first FTAs was promoted by the OMT, while the government provided side-payments to the groups which lost profits as an effect of economic liberalisation. The strong presidential support for signing FTAs continued in President Moo-hyun Roh's administration. For President Roh FTAs were the core element of economic policy and regional strategy (Koo 2008:15). During his time in office, the OMT gained the central position in FTA policy formation. As previously discussed, in Japan, FTA negotiations tend to take place separately, within each ministry's jurisdiction. There is a possibility that one of the ministries will break the discussions by refusing to compromise and walking away from the talks. In Korea, the Ministry of Foreign Affairs and Trade is responsible for the entire process and hence can control all aspects of the negotiations and make appropriate decisions when difficulties arise (Katz 2010).

The US-Korea FTA proposal was initially strongly opposed by the majority of Korean society. It was expected that Korea would need to agree to the imports of sensitive agricultural products such as beef and pork. Nonetheless, the Korean President decided to promote the agreement in order to tighten diplomatic ties with the US[631]. For Korea, it is imperative to have a relationship with the US, mainly due to security concerns over North Korea. In order to decrease the tension, the Korean President decided to sign the Korea-US agreement, at the cost of accepting additional agricultural imports. In 2010, most Korean citizens supported the agreement. This is an example of Korea's top-to-bottom style of governance, whereby the government implements the President's decisions[632]. This type of decision-making style is not without limits. For example, gaining support for the ratification of a signed FTA can pose a problem: this was the case in the US-Korea agreement. The Japanese style of decision making, including long domestic negotiations, is time-consuming. However, once a consensus is reached the ratification of an FTA is automatic.

[631] Interview no. 42.

[632] For more on the comparison of domestic decision-making processes between Japan and Korea and an analysis of how the Korean government overcomes agricultural sector's opposition to trade liberalisation see Choi and Sejin (2011).

5.5. Conclusions

This chapter has demonstrated how the government collects information on preferences through its ministries as well as the mechanisms behind the formation of a domestic win-set. The characteristics of Japan's domestic FTA policy formulation process include a decentralised decision-making system, which makes it difficult to overcome interest-group pressure. The preferences of each domestic group are opposed, limited, and constrained by the interests of others. FTAs with ASEAN member countries have been negotiated on a sector-by-sector basis, with the ministries seeking to avoid infringing on each other's jurisdictions. There was little joint coordination between the ministries and hence little incentive towards cohesive Japanese position on FTAs. In addition, as confirmed by the former Director for FTA Affairs at METI's Trade Policy Bureau, the Japanese government preferred to make decisions regarding its FTAs policy on a case-by-case basis[633]. As several observers have pointed out, there was no clear, grand FTA strategy within the government[634]. Hence the trade agreements that were being signed were relatively easy agreements: they did not demand a drastic overhaul of the domestic policy, which was in accordance with the initial government's assumptions, as discussed in Chapter 3. Those problems were passed on to the DPJ's administration. With no centralised body responsible for FTA policy and weak political leadership it is difficult to overcome the domestic impasse and to implement bolder policy solutions. Based on a compromise between domestic voices, the outcome does not always favour the majority of citizens but can be determined by small groups with a strong measure of political influence or those who are decisively opposed to reforms and trade liberalisation (e.g. agricultural sector lobby groups). Pro-FTA groups are reluctant to enter into an open conflict with agricultural lobby groups. For that reason, international political and economic factors can play a crucial role in overcoming the domestic impasse. In particular, as discussed in Chapters 3 and 4, the recent rise of Korea as an active FTA player had a profound impact on Japan's foreign trade strategy and caused the newly elected DPJ government to implement certain changes to the policy formation process. Konno (2009:24), a former METI minister, writes that Japan's shift towards multi-layered trade policy in the late 90s resulted from the "domestic reflection and revaluation of policy objectives as well as external factors, for example proliferation of FTAs signed by the EU and the US".

633 Interview no. 4.

634 Interview no. 50, 41 and 38.

Similarly, external circumstances and the pressure resulting from other states' activities, has caused Japan to attempt to reinvent, or at least to redefine, its approach to FTA strategy. The major changes introduced by DPJ include the establishment of frequent inter-ministerial meetings on FTAs; the formulation of a new FTA strategy document based entirely on discussions between ministers and not on consultations with interest groups; and shifting the balance of power towards the politicians within the ministries, although to a varying extent in the four discussed institutions. The domestic debate on the need for stronger political leadership by the Prime Minister instead of by the ruling party, as well as on the need for policies to be formulated by politicians and not by bureaucrats, which was mentioned earlier in the chapter as one of the main initial concerns of the DPJ's agenda, are not new topics. In the aforementioned article, George Mulgan (2005:297) mentions both issues and argues that the question of stronger leadership by the Prime Minister was also discussed during the Koizumi administration. Nonetheless, the conducted fieldwork clearly points to the need for stronger political leadership in order to conclude further bilateral FTAs with important trading partners or to participate in multilateral agreements with a significant level of market opening. Although there is always a necessity for adjustments between the domestic standpoint and the international partner's requests, the lack of strong political leadership and a centralised decision-making body, when it comes to FTA policy, weakens Japan's position and prevents the efficient formation of such a domestic compromise. The ministries, supported by domestic actors, enter negotiations as separate bodies and do not present a unified front. The distinctive character of Japan's FTA policy formation is the fact that a domestic compromise is not accomplished before the beginning of negotiations and the ministries often act as independent bodies, representing only their sectors and not the domestic position as a whole. With a lack of centralised policy coordination, when it comes to FTAs the final domestic position (compromise) is not achieved on a national level but on a sectoral level or rather at a ministerial level, and the four discussed ministries share the role of Putnam's transmission belt. For that reason, reaching a domestic consensus is often as time-consuming as international negotiations and can occur at the same time.

Chapter 6
Conclusions

6.1 Summary of Conclusions and Structure of the Thesis

This thesis has assessed the preferences of selected groups of actors to analyse Japan's FTA policy. It has argued that the interplay of these preferences within the state, together with a specific decision-making and policy formation process, have constrained Japan's FTA strategy to date and continue to have an immense impact on the current policy towards the proposed East Asian FTA and the Trans-Pacific Partnership (TPP). The thesis views Japan's FTA policy as embedded in a broader economic and political environment, both on a national and an international level. Changes in this environment can affect actors' preferences and lead to changes in countries' free trade agreements policies. One example of this is the FTAs signed by other states. By providing market opportunities or incentives to sign defensive agreements, third-party FTAs can impact the balance of pros and cons for further preferential trade liberalisation. In Chapter 1 of the thesis, this environment was defined as the four groups of factors: domestic political, international political, domestic economic and international economic. The main stakeholders of Japan's FTA policy were identified as the government, mainly the four ministries, and the two most powerful domestic interest groups, the business sector and agricultural lobby groups. The choice of actors was dictated by the characteristics of the policy formation process and the communication flows between these groups, as described in detail in Chapter 5. Using Putnam's (1988) model, the thesis has demonstrated how the preferences of the main actors have become the state's policy in the process of establishing a domestic win-set. Having identified the main actors in Japan's FTA strategy and the level of analysis determined by the choice of preferences as the main concept of the thesis, the fieldwork research targeted representatives of the groups of actors who are, or were, directly involved in the FTA policy formation process. Sixty interviews were conducted with, amongst others, members of the FTA divisions within ministries and senior managers with an overview of their company's FTAs utilisation policy. Apart from identifying preferences, the fieldwork addressed two other issues: communication channels and the issue of representation. It discussed how the preferences of domestic interest groups are communicated and represented within the government and how this affects the domestic policy formation process.

Chapter 1 of the thesis presented the research questions and placed the study in the broad theoretical context of the political economy field. It discussed the research framework and relevant theoretical models, as well as other studies on the impact of domestic preferences on foreign policy in East Asia. The chapter concluded with a description of the fieldwork data collection process. Chapter 2 introduced FTAs: their characteristics and classifications. The analysis of Japan's FTA policy in the following text was based on the definition and information provided here. The chapter introduced the concept of the spaghetti bowl and gave an overview of the multilateralising bilateralism debate in relation to FTAs. Chapter 3 opened with a brief explanation of Japan's economic development in the post-war period and the country's industrial policy. It introduced the agricultural cooperatives and spoke of the origins of their political influence. It then focused on Japan's FTA policy and its development to date. The analysis in the chapter was divided into the preferences of the ministries, including the agricultural cooperatives, the manufacturing industry, and other interest groups regarding bilateral and minilateral FTAs. The chapter argued that the agricultural sector has opposed trade liberalisation and constrained Japan's FTA policy since its early stages. It further discussed the specific provisions of the ASEAN-Japan Comprehensive Economic Partnership (AJCEP), namely the flexible clause and cumulation, and argued that this agreement is rarely utilised by the multinational corporations (MNCs) in the manufacturing sector.

Chapter 4 focused on the planned region-wide FTA and its possible membership. It discussed the desirability of the agreement from the perspective of the target groups as well as their preferences regarding its depth and scope. The chapter also presented the manufacturing industry's main concerns regarding current FTA policy and introduced the concept of lead time. It argued that both the ministries and the industries expect the region-wide agreement to have many similarities with the AJCEP. The chapter argued that Japan's MNCs have only a limited interest in a broader regional agreement, as they expect it will not include sufficient deep liberalisation provisions and help reduce lead time. Chapter 5 presented the domestic actors involved in the policy formation process. It discussed the four ministries and their roles, as well as the channels which used to collect the interest groups' preferences. It also introduced other organisations and groups involved in the process, including the business associations. The chapter discussed the impact of the change of administration to the Democratic Party of Japan (DPJ) in 2009 on the decision-making process within the ministries and the position of the agricultural cooperatives. The new compensation scheme, and its consequences for the prospects of further trade liberalisation, was also mentioned. Chapter 5 analysed the domestic decision-making process and how these decisions are presented to foreign partners during international FTA negotiations. Therefore, it demonstrated how the domestic win-set is formed. It argued that the Prime Minister's lack of strong leadership and interest groups' ability to constrain foreign policy are the main factors behind the current impasse of Japan's FTA strategy. This chapter presents a summary of conclusions to answer the research questions.

6.2 The FTA Policy Impasse

6.2.1 Japan's FTA Policy to Date and Actors' Preferences

By 2011, Japan's FTA policy was at a standstill. Chapter 5 included a quote from a former Ministry of Foreign Affairs (MOFA) official and foreign policy analyst, Sugawara (2010:2), who has claimed that Japan's FTA policy is at an impasse on many levels. The thesis argued that this impasse results from two factors: 1) the domestic balance of preferences, in particular the position of the agricultural sector, and 2) the characteristics of domestic policy formation and decision-making processes. FTAs are said to support and 'lock in' domestic economic reforms (Manger 2005:807). Trade treaties influence the distribution of gains from international trade and hence have a significant impact on domestic groups' preferences. By opening the economy to foreign competition, FTAs can lead to the restructuring of uncompetitive sectors. According to some scholars, this is an important motivation behind governments' pursuing FTAs (Urata 2003:98). Dent (2006:51) argues that this type of motivation may be particularly relevant to countries such as Japan and Korea. As discussed in Chapter 3, bilateral trade agreements may also be a way of directing foreign pressure (*gaiatsu*) in order to overcome domestic opposition to economic reforms and market liberalisation. Shujiro Urata (2003:98) points out that this role was previously fulfilled by the US and participation in international organisations, such as the WTO. Aggarwal and Koo (2005:205 cite Pempel and Urata 2005) also mention FTAs' ability to stimulate economic reforms. They (*ibidem*) argue that bilateral trade agreements and related foreign pressure are a more acceptable reason for conducting necessary reforms than participation in a multilateral agreement. Krauss (2003:319) points out that part of the Ministry of Economy, Trade and Industry's (METI) motivation for pushing for Japan's first FTAs was to stimulate economic reforms. However, in the past decade, consecutive FTAs did not bring about a significant liberalisation of the agricultural sector and many 'sensitive' products were exempt from tariff reduction in all Japan's FTAs.

A conventional explanation of why Japan names its FTAs 'economic partnership agreements' (EPAs) points to the deep scope of liberalisation, for example including provisions on trade in services, intellectual property rights and trade facilitation provisions. The name signifies a commitment to a comprehensive approach to FTAs that exceeds trade liberalisation. The fieldwork research suggested another explanation, however. MOFA's Director of the EPA/FTA Policy Division explained that part of the motivation was to widen the scope of the agreements in order to compensate for an exclusion of certain products[635]. This was confirmed during other interviews[636]. Japan's FTAs were never meant to reach full liberalisation across all tariff lines. It was expected that agriculture and other sensitive sectors would be mostly excluded. As confirmed by MOFA's Director, Japan has been signing partial economic cooperation treaties as opposed to agreements with comprehensive trade liberalisation provisions which the Ministry would like to see realised in the future[637]. This has caused Lincoln (2004) to refer to Japan's FTAs as 'so-called free trade areas'. The goal was to sign FTAs which supported the activities of the multinational corporations (MNCs) but did not lead to a policy overhaul. The special position of the agricultural sector and the Ministry of Agriculture, Forestry and Fisheries (MAFF) on the domestic political scene was the main reason behind this decision. Chapter 3 also mentioned Japan's experiences with the liberalisation of the agricultural sector under the WTO negotiations and the position of MAFF at the time.

Milner (1997:60) pointed out that while the preferences for the international cooperation of political actors are influenced by "electoral calculations", interest groups' preferences are affected by the domestic distribution of gains and losses. The signing of an FTA brings economic gains which are unequally distributed within the nation. While certain groups profit from preferential trade liberalisation, others do not. MAFF and the agricultural cooperatives are the main domestic source of opposition to trade liberalisation. Chapter 3 explained the origins of the agricultural cooperatives, their specific position in society and their connections to the government. Japan's agricultural sector is the owner of scarce factors of production within the economy and

[635] Interview no. 9.
[636] Interview no. 28, 46, 60.
[637] Interview no. 9.

produces import-competing goods, according to the trade theory models discussed in Chapter 1 (e.g. the Heckscher-Ohlin and Stolper-Samuelson models). For that reason, the preferences of the agricultural sector remain virtually unchanged when it comes to FTAs. The fieldwork indicated that it is opposed to further liberalisation under bilateral, minilateral and region-wide FTAs. The agricultural sector, supported by the agricultural cooperatives and represented by MAFF, managed to secure special treatment for Japan's products in this sector in all FTAs. Although Japan made compromises on agricultural products during subsequent trade negotiations, none of the agreements has led to a significant domestic reform. Other domestic groups, including METI, do not want to enter into an open confrontation or conflict with MAFF and the cooperatives. Schelling's conjecture (1960), discussed in Chapter 1, explains that the protests of a strong domestic group (e.g. farmers) may cause the negotiating partner to limit demands in this sector. One of the negotiating parties is significantly constrained by its domestic opposition and the other believes that an agreement that goes against such domestic protests is impossible to accomplish and hence abandons its requests. This can, perhaps, explain how the agricultural lobby groups represented by MAFF during international negotiations managed to protect tariffs in the sector.

The MNCs own abundant factors of production and manufacture export-competing goods. Therefore, they have potentially the most to gain from trade liberalisation. Chapters 3 and 4 indicated that the preferences of Japanese MNCs regarding a particular planned FTA vary between companies in different sectors as well as within the same sector. According to the fieldwork research, there are two reasons for this. First, Japanese MNCs produce and export the majority of their goods from the East Asian states where they have located subsequent stages of the production process. As a result of this internationalisation of production networks, they rely heavily on third-party FTAs. Therefore, their preferences regarding FTAs are complicated by the number of countries from which they export. The second, closely related issue is the fact that for MNCs, free trade agreements are inherently competitive. A company's position in the international markets depends on its relative position *versus* that of foreign companies in the same sector as well as *versus* domestic competitors. This means that its preferences regarding an FTA will depend on: 1) how such an agreement is expected to affect its relative position, for example will it level the playing field and reduce the negative effects of a previously signed third-party FTA, 2) how it will affect the position of domestic competitors, and 3) how it will affect foreign companies. When the proposed FTA was expected to benefit some domestic competitors more than others, opinions within a given sector were divided. This occurred, for example, in the case of the Japan-Mexico FTA, as described in Chapter 3.

Chapter 3 also explained that MNCs have had a strong interest in FTAs with Japan's trading partners, particularly in East Asia. Due to the vertical integration of production networks, the agreements with ASEAN member countries were strongly supported by companies in all target sectors. The ASEAN-Japan Comprehensive Economic Partnership (AJCEP), which overlapped with bilateral agreements with the Association's members, introduced the co-equal rule of origin and cumulation. As the rules of ASEAN's internal FTA (AFTA) changed before the AJCEP went into effect, the agreement offered little additional benefits. Tariffs for the majority of products are higher under the minilateral agreement than under bilateral ones, as explained in Chapter 3. Therefore, companies prefer to utilise bilateral FTAs for exporting from Japan and AFTA for exporting between ASEAN countries. This is possible due to the flexible clause introduced in the AJCEP. This has allowed companies to choose which of the overlapping agreements they want to trade under. As a result, the conducted research has demonstrated that the coexistence of the overlapping agreements does not cause a problem for the Japanese companies, due to a low level of utilisation of the AJCEP and the flexible provisions included in the agreement.

In regard to the proposed region-wide agreement, there has been little interest from the manufacturing industry. This sector has a clear vision of the provisions it would like to see included in all prospective FTAs. One of the main issues currently concerning Japanese MNCs is the reduction of lead time[638], as explained in Chapter 4. In order to help reduce lead time, an FTA would need to include deep liberalisation and trade facilitation provisions as well as support the convergence of rules and standards. Japanese companies are still facing several non-tariff barriers in East Asian countries and would like to see this situation improve. This could be done under a high-level minilateral, or a multilateral, agreement, for example under the WTO. The MNCs are interested in improving the quality of existing bilateral agreements and deepening regional economic integration rather than negotiating a region-wide FTA. According to the fieldwork research, companies and certain governmental officials expect that a region-wide APEC or an ASEAN-centred FTA will be a low-level, 'lowest common denominator', agreement, similar to the AJCEP.

For the ministries, FTAs were supposed to fulfil certain economic or strategic

[638] Lead time is the time from when the decision to start the production is made to when the manufacture of the final product is completed and it has arrived at its destination.

functions. Bilateral FTAs were to a large extent motivated by the economic interests of the MNCs. As demonstrated in Chapter 3, they were driven by both domestic and international economic factors and functional considerations. METI expected to serve companies in the manufacturing sector and prevent economic isolation resulting from third-party FTAs. Chapter 3 explained how the FTAs which Japan signed were shaped by this goal. For MOFA, isolation avoidance and 'FTA catch up' were important motivations[639]. The notion of 'not being left behind' and 'catching up' has been present in Japan's FTA policy since Kaoru Yosano's speech in 1998 and continued to feature in the government's rhetoric in 2010. The DPJ's 'Basic Policy on Comprehensive Economic Partnership' (2010a) mentions that Japan aims to sign agreements with major trading partners, which "will withstand comparison with the trend of other such relationships". During the APEC Yokohama Summit in 2010, Prime Minister Naoto Kan (cited by Sakamaki 2010) spoke of not being left behind. This research demonstrates the pivotal role of isolation avoidance, the economic domino effect and competition with Korea for the development of Japan's FTA strategy. Ravenhill (2009:16) argues that the proliferation of FTAs in East Asia is caused mainly by a political domino effect and refers to Munakata's (2006b) argument that FTAs in the region are signed not to reduce trade costs but as a result of competing visions of the region. This argument is repeated in his 2010 paper (Ravenhill 2010:179). Ravenhill (2009:16) also refers to Dent's (2006) survey results, stating that 'strengthening diplomatic relations with key partners' is the most quoted reason for engaging in FTA negotiations. The fieldwork conducted for this thesis offered no confirmation for this argument in relation to Japan. On the contrary, strengthening diplomatic relations was not a relevant factor, according to the respondents: instead, they mentioned isolation avoidance and economic competition. This argument was strongly reflected in Chapters 3 and 4. It has been an important factor shaping the preferences of both the government and the industries. However, Ravenhill (2010:199) views isolation avoidance as motivated by political factors and the governments' fear of "potential exclusion from a new dimension of regional economic diplomacy". The thesis argued that isolation avoidance motivation stems from economic as well as political factors: just as the isolation resulting from not being a member of an FTA would have both economic and political implications. The economic aspect of Japan's isolation avoidance motivation is particularly visible when it comes to competition with Korea. This issue, mentioned in

[639] Other issues, such as the lack of progress of the WTO negotiations, played a supporting role in facilitating the shift from a multilateral to a multi-layer foreign trade policy.

all of the 60 interviews, was defined as a result of changes in the relative position of Japanese products in international markets and not of competing conceptions of the region[640]. Competition with Korea was brought up in relation to how Japanese corporations, mainly in the electronics sector, compete with Korean firms such as Samsung, the world's biggest technology company by sales. The political factor that Ravenhill (2009) refers to could arguably have determined the shift of Japan's focus from the ASEAN+3 to the ASEAN+6 framework. However, METI was also strongly motivated by economic considerations and the fact that the latter grouping includes countries where Japanese MNCs' located their production networks[641]. As demonstrated throughout the thesis, METI and multinational corporations are the strongest pro-liberalisation group in Japan. Consecutive trade agreements, even if initially proposed by the FTA partner, were driven by one of the two METI Bureaus, depending on the motivation behind them: interests of specific industries (Manufacturing Industries Bureau) or broader trade policy issues (Trade Policy Bureau). Japanese MNCs are also highly concerned about the proliferation of FTAs and the negative effects of third-party agreements. Their preferences for particular negotiations depend on economic factors and result from a desire to gain advantage over competitors. Ravenhill (2010) argues that low utilisation rates of East Asian FTAs are an indication of the existence of a political domino effect. However, according to the understanding demonstrated in this thesis, low utilisation rates can result from the fact that during the FTA negotiation process METI is constrained by preferences of other domestic actors and of the international partner. Therefore, the final trade agreement is formed based on both domestic and international win-sets and, as such, does not necessarily fulfil the industries' expectations. This does not undermine the role the MNCs have played in supporting Japan's FTAs, in particular the Manufacturing Industries Bureau-driven ones. Nonetheless, the fieldwork findings confirm Ravenhill's (*ibidem*) argument that the lobbying efforts of pro-liberalisation groups were often offset by protectionist interests: in Japan's case mainly from the agricultural sector.

The fieldwork research indicated the importance of external factors for Japan's FTA policy. Chapter 3 argued that the domestic impasse in FTA policy causes Japan to be particularly reactive to international-level factors. The importance of external factors is even stronger for region-wide agreements. This could be explained by the larger size of the agreement and, hence, the fact that there is a wider spectrum of international actors

640 This issue is discussed later in the chapter.
641 Interview no. 7.

and preferences to accommodate. The state's preferences are more constrained. As a result, there are more potential domestic 'costs'. Moreover, it can be argued that the isolation avoidance and economic domino effect factors are stronger when it comes to wider FTAs, as the results of being excluded from such agreements are more significant. Therefore, Japan's region-wide FTA policy is more passive and reactive and is highly influenced by developments on the international stage. The fieldwork demonstrated that there is little domestic interest in a region-wide agreement in East Asia in terms of expected economic gains for the manufacturing sector. However, there is a strong pressure to avoid being left behind in the face of Korea's FTA policy, namely the EU-Korea FTA and the intensification of efforts to finalise the Korea-US agreement in the second half of 2010 culminating in the ratification of the agreement by both countries in 2011, and the progress of the TPP negotiations. The thesis has argued that economic competition with Korea is one of the main issues of Japan's current FTA policy. All of the 60 respondents mentioned Korea's FTA policy as a major economic threat to Japan. Just as competition with China has led Japan to opt for the ASEAN+6 instead of ASEAN+3 framework, Korea's FTA policy has caused Japan to focus on the TPP and the FTAs with a higher level of difficulty. This was demonstrated by the DPJ's commitment to increase efforts to finalise the Australia-Japan FTA and recent endeavours to commence the trilateral China-Japan-Korea FTA negotiations.

The MNCs' rivalry with their Korean counterparts is evidenced not only by their support for entering the TPP negotiations and signing FTAs with a higher level of liberalisation but also by recent developments, in particular in the electronics sector. Chapter 3 analysed the preferences of the manufacturers of liquid-crystal display (LCD) televisions and panels. It mentioned how competition with Korea and Taiwan has caused them to support the AJCEP. At the end of August 2011, Sony, Toshiba, and Hitachi announced a planned merger of their LCD operations and the forming of a joint venture, Japan Display (*The Japan Times Online* 2011). 70 percent of the new company's shares would belong to Innovation Network Corp., an investment fund mostly owned by the Japanese government. This merger is aimed directly at Korean competitors, such as Samsung, as well as other important players; for example, Taiwanese LCD producers. This relates to two issues discussed throughout the thesis. Firstly, it shows how, in an increasingly competitive international environment, Japanese companies are taking steps to remain competitive. Supporting FTAs can be viewed as one of these steps. Secondly, it demonstrates that the Japanese government is becoming increasingly aware of this competition and is undertaking a wide range of actions to help support MNCs' activities.

Another reason for the impasse is the fact that the policy of signing agreements with the exception of sensitive sectors is no longer sustainable. Japan has already signed all of the 'easy' FTAs where it could proceed without conducting substantial domestic reforms. Sugawara (2010) has called the finalisation of the AJCEP negotiations the end of the first stage of Japan's FTA strategy. Now that Japan has achieved what it set out to do, to reach agreements with ASEAN members, Sekizawa (2009) points out that there are three options for the future:

- Negotiating agreements with major trade partners such as Australia, the EU, and the US
- Participating in a region-wide FTA
- Signing FTAs with other, smaller trading partners, for example Peru.

The first option requires the signing of high-level agreements. Such FTAs would need to include a much higher level of liberalisation than has been achieved under the treaties signed so far. Japan has been negotiating an agreement with Australia since April 2007. As explained in Chapter 3, the lack of compromise in the field of agriculture is the main reason behind the slow progress of negotiations. Japan has also been intensifying its efforts for an FTA with the EU. As was explained in Chapter 3, there is less interest in the agreement on the European side, in particular as Japan has failed to make a sufficient commitment to removing non-tariff barriers. Chapter 4 discussed the issue of Japan's participation in a region-wide FTA initiative. The government's vision of the region-wide agreement is not clearly defined. MOFA uses the term 'dock and merge', but there are no specific ideas on how to harmonise the different levels of trade agreements. The AJCEP's solution to the coexistence of FTAs is far from perfect, and its application to a region-wide FTA is questionable. As explained in Chapter 4, in a way, coexistence, functionalism and participation in several regional frameworks is the government's *de facto* strategy. The third option allows Japan to continue FTA policy in a relatively unchanged fashion but offers little economic gains. The results of such FTAs would be limited, at best. Whether negotiating a bilateral agreement with the EU or participating in the TPP negotiations, Japan will encounter the same problems and be faced with the same constraints on the domestic level. Without solving the issue of sensitive domestic sectors, Japan will be unable to sign high-level FTAs with major economic partners or participate in the TPP negotiations which would require a series of domestic reforms. This impasse in FTA policy is even more problematic in the view of external circumstances, namely the competition with Korea that was discussed earlier.

6.2.2 The Characteristics of the Domestic Policy Formation and Decision-making Processes

In terms of establishing the domestic win-set, the fieldwork indicated that the main political actors were the four ministries: METI, MOFA, MAFF and the Ministry of Finance (MOF). As explained in Chapter 5, there is a division of labour between the four ministries when it comes to FTAs. METI and MAFF represent the two strongest interest groups discussed in this thesis. MOFA represents Japan in international negotiations. MOF is responsible for technical aspects of FTAs, such as rules of origin. Chapter 5 pointed out the specific policy coordination process within MAFF and how it was affected by the change of administration to the DPJ. It argued that there is no centralised decision-making organ when it comes to the FTA policy formation process.

Although MOFA is the ministry responsible for foreign affairs, METI is heavily involved in economic foreign policy, including FTAs. This has been previously described, amongst others, by Chalmers Johnsons (1982) and Sato (2001:14) who also points out that "despite Prime Minister Yasuhiro Nakasone's effort to enhance the standing of the Ministry of Foreign Affairs (MOFA) during his tenure in the 1980s, the MOFA's role in foreign economic policy has been limited". METI's Trade Policy Bureau is the single strongest supporter of trade liberalisation and FTAs. The thesis has stressed the role played by METI and the Trade Policy Bureau in particular in the FTA policy formation process from its inception. Japan's FTA policy can be traced back to a 1998 speech by the Minister of International Trade and Industry, Kaoru Yosano, and METI's *'The Economic Foundations of Japanese Trade Policy – Promoting a Multi-Layered Trade Policy'* (2000b) paper, as well as the Japan-Korea FTA project proposed in the same year. METI was also behind the ASEAN+6 initiative and the shift of policy priority from ASEAN+3 to ASEAN+6. Therefore, the thesis has argued that METI is leading Japan's FTA policy while MOFA is lagging behind.

Within METI, there are two separate divisions working on free trade agreements: the Trade Policy Bureau, which focuses on the overall trade policy, and the Manufacturing Industries Bureau, which represents the interests of the manufacturing sector. METI communicates with the manufacturing sector through several official and unofficial channels. The Manufacturing Industries Bureau within METI has a division responsible for industries and communicates directly with companies in this sector as well as with industrial associations. Business associations, for example *Keidanren*, *Keizai Doyukai* and the Japan Chamber of Commerce and Industry, are another platform from which the MNCs can express their interests and preferences. These organisations cooperate closely with METI and publish policy recommendations. The Trade Policy Bureau participates in this information exchange and occasionally communicates directly with the companies. As explained in Chapters 3 and 5, the preferences of the two Bureaus can differ. While the Trade Policy Bureau always supports further trade liberalisation and FTAs, the Manufacturing Industries Bureau can be ambivalent, depending on the preferences of manufacturing industries. The conducted research demonstrated that FTA projects which have had the support of both bureaus were easier to conclude and more successful in overcoming the agricultural sector's opposition. 'Failed' FTA negotiations, in particular the Australia-Japan FTA process, indicate that the difficulties of concluding an agreement without strong support from the Manufacturing Industries Bureau and with simultaneous protests from MAFF. With a low level of interest and the mounting demands of the foreign partner the costs outweighed the expected gains and there was little progress in the negotiation process. The domestic balance of preferences can be portrayed in the following way. MAFF has constantly opposed the liberalisation of the agriculture sector, especially sensitive products. The intensity of its protests has depended on the level of demands of the foreign partner in the field of agriculture. The Trade Policy Bureau has consistently supported the signing of further FTAs. The position of the Manufacturing Industries Bureau has depended on the preferences of the industries. Although the Bureau is generally in favour of FTAs, the strength of its interest depends on how much the industries are expected to gain from such an agreement. The two 'failed' FTA cases demonstrate that there needs to be a positive balance of expected gains *versus* expected costs for the agreement to take place. On the other hand, when there is little interest or expected profit but at the same time there are no serious obstacles or sensitive issues involved, an agreement can still be signed. Depending on the source of the initial interest and support, this thesis has divided Japan's FTAs into Trade Policy Bureau-driven agreements (Singapore, Switzerland, and the AJCEP) and the Manufacturing Industries Bureau-driven ones (agreements with ASEAN members). The former are examples of treaties dictated by strategic goals and not economic gains. The latter are FTAs with major trade partners or treaties supported by manufacturing industries for a particular reason, such as off-setting the negative effects of a third-party FTA.

As discussed, Ravenhill (2009:16) argues that Japan's FTA strategy is largely government-driven and the business sectors' lobbying efforts are not of great consequence. However, the fieldwork indicated that due to a close connection between the government and the interest groups, the preferences of MNCs and other domestic groups have a strong impact on the government's actions. As demonstrated in Chapter 5, METI forms its position on FTAs based on consultations with the business circles. Therefore, the fieldwork research did not confirm Ravenhill's (2009:16) claim that the Japanese government has "autonomy from societal interests" similar to many Asian governments. Interest groups' preferences are embedded in the policy formation process. They are expressed directly to the relevant part of the government, for example METI's Manufacturing Industries Bureau then passed on to the Trade Policy Bureau and outside METI to MOFA and MAFF. Therefore, domestic groups' preferences are an integral part of the domestic win-set formation process. This contradicts Ravenhill's (*ibidem*:29) argument that "regional cooperation in Asia has been overwhelmingly a top-down affair, driven by politics rather than economics".

Similarly to METI, MAFF has two departments involved in FTA policy. The International Affairs Department is responsible for the overall policy while the Agricultural Production Bureau has a division for each commodity. Under the administration of the Liberal Democratic Party's (LDP), the ministry cooperated closely with the agricultural cooperatives and the local-level LDP politicians. This ceased to be the case after the change of administration to the DPJ in 2009. Now, the agricultural cooperatives no longer communicate with the ministry. The decisions are made by the political (elected) members of the ministry, and there is little coordination with outside organisations. The Agricultural Production Bureau gathers information directly from farmers. This has been a significant change in the functioning of the Ministry's internal decision-making process. MOFA's internal dynamics have also been affected by the change of administration, as explained in Chapter 5. In comparison, METI's officials have indicated that their daily activities have remained relatively unchanged since the DPJ came into office.

Together, the four ministries coordinate FTA policy. The research demonstrated that there are two main problems on the governmental level. Firstly, there is no formal, centralised mechanism of policy coordination or decision-making. During the LDP administrations, the four ministries met only a handful of times to discuss FTA policy. MOFA was charged with the task of liaising between the other three ministries. Under the DPJ administration, the situation changed slightly and the four ministries cooperated closely in order to publish the DPJ's new FTA strategy, a *'Basic Policy on Comprehensive Economic Partnerships'* (DPJ 2010a). This strategy was developed based entirely on discussions between the four ministries, and they did not consult with interest groups. Between November 2009 and November 2010 when the document was published, several meetings took place on different levels. They were chaired by MOFA's minister. This can be seen as an attempt to introduce a new coordination system between the four ministries. Choi and Sejin (2011:253) attribute Japan's inability to liberalise the agricultural sector to the 'fragmented' coordination mechanism and domestic trade governance which "gave disproportionately larger weight to agricultural interests within the Japanese government".

The second constraint of the domestic policy formation model is the lack of strong political leadership and the relatively weak position of the Prime Minister (PM). The need for stronger political leadership by the PM was brought up during research fieldwork as well as by several scholars (e.g. Urata 2011, Lord 2010:31, George Mulgan 2004:5). This is not a new problem. Sato (2001:15) refers to Karel Van Wolferen (1990:49) who, in a 1990 *Foreign Affairs* article, wrote that there is "no centre of accountability" and that each ministry is concerned with their own interests while the PM is not in a position to speak for the entire country. George Mulgan (2005:297) mentions that the need for the PM to assume a stronger position was also discussed during Junichiro Koizumi's administration. Without a strong, centralised decision-making organ or a coordination mechanism, the domestic win-set cannot be created before the international stage of FTA negotiations. None of the ministries or organisations has sufficient authority and political influence to work out a domestic compromise to the different preferences and harmonise the conflicting demands of various interest groups. As explained in Chapter 5, on the domestic level this function has to some extent been fulfilled by MOFA. During international negotiations, as in the case of Mexico, the Prime Minister was in charge of coordinating the policy and resolving any potential conflicts of interest.

Many of Japan's FTAs, in particular the ones with ASEAN members, were negotiated on a sector-by-sector basis. This means that the agricultural sector negotiated the liberalisation of agricultural products with representatives of the same sector from the partner state. Ministries avoided entering each other's jurisdiction. As described in Chapter 5, there was no effective system for overcoming conflicts arising from cross-ministry bargaining situations. Japan's position in international negotiations has been weakened by its lack of strong political leadership and a centralised decision-making body. When decisions and negotiations are based on sector-by-sector principles and there is no cross-sector coordination, this prevents the formation of a domestic win-set. Ministries enter the international stage of negotiations as separate bodies and do not present a unified front. They act as independent organs, representing only the interests of certain groups. The domestic win-set is hence not achieved on a national level, between ministries, but on a sectoral level. In addition, with no centralised organisation responsible for FTA policy and weak political leadership, it is difficult to overcome the opposition of domestic interest groups and implement bolder policy solutions. This is another reason why external factors play such a crucial role: they help to break such domestic constraints and impasses.

6.3 Originality and Contribution

The thesis makes an original contribution in terms of: 1) empirical data and theoretical framework, and 2) new insights into the FTA policy formation process in Japan and evidence in the multilateralising bilateralism debate. As explained in Chapter 1 of the thesis, this study was based on 60 in-depth interviews. The interviewees were chosen due to their direct involvement in the FTA policy or tthe fact that they have experience in using FTAs, in the case of industry representatives. As such, they represented a fairly comprehensive sample of the main groups of actors. In accordance with the framework assumptions, the interviews were conducted with: 1) representatives of the government, mainly the four main ministries and their internal bureaus or divisions, 2) MNCs in four manufacturing industry sectors, 3) the agricultural cooperatives, representing the interests of farmers, and 4) the service sector and labour unions. As discussed in Chapter 1, individual farmers were the only group that was not represented. The originality of the theoretical approach lies in combining Putnam's (1988) two-level game metaphor with using preferences as the central concept of the thesis and the inclusion of four types of factors in the analysis of Japan's FTA policy: domestic, international, political, and economic. Putnam's model was used to separate the international and domestic levels of the policy formation process and to conceptualise the latter as bargaining between various groups of actors (domestic negotiations). The preferences of main stakeholders were used as a tool for understanding the underlying motivation behind this policy. This had several implications. First, concentrating on preferences determined which aspects of Japan's FTA policy the thesis focused on: its formation on the domestic level (level two of the game). Second, focusing on preferences allowed taking into account the differences between the interests and motivations of the main actors (the ministries and the industries). Furthermore, it drew attention to the tensions in the domestic decision-making process, resulting from the differences in preferences of each of the parties participating in this process. The thesis viewed Japan's FTA policy as a result of domestic compromise, the shape of which depends on the relative position of groups of actors and the strength of their preferences, as explained in Chapter 1. It conceptualised this policy as interplay of preferences, with the final outcome being shaped by the domestic decision-making and policy-formation processes. Bridging the gap between different preferences is an inherent part of the policy formation process. Therefore, the thesis makes a contribution to the body of knowledge on FTAs by highlighting the domestic tensions between the preferences of different actors and the importance of internal decision-making process to the formation of Japan's FTA policy.

Adopting of this framework has led to uncovering of several trends in Japan's FTA policy which would have been overlooked if the study analysed this policy through focusing on the international-level game and did not allow for the inclusion of all four types of factors. These trends, or key findings, were discussed throughout this chapter and contribute to the body of knowledge on Japan's FTA policy. The difficulties in dealing with the agricultural sector's opposition and issues with the domestic decision-making process pointed to the lack of strong political leadership in Japan's FTA policy formation. The framework has also provided the opportunity to look into the preferences of ministries and highlight any possible differences, for example, a slight difference in reasons for supporting trade liberalisation between the two METI's bureaus. As a result, the thesis distinguished between the Trade Policy Bureau-driven FTAs and the Manufacturing Industries Bureau-driven ones. Finally, as actors' preferences were the key concept of the framework, factors that influence and shape these preferences were understood to be central to the analysis of Japan's FTA policy formation process. This resulted in uncovering of certain key factors determining this policy. The importance of isolation avoidance motivation for the MNCs and the government was stressed throughout the thesis. As previously discussed, this factor could be applied both in an economic and geopolitical context. The increasing importance of competition with Korea was one of the key findings of the thesis. Apart from representatives of MAFF and the agricultural cooperatives, all of the respondents chose this factor as one of the most significant determinants of Japan's current FTA policy. Representatives of the other two groups viewed it as important as they believed that competition with Korea will cause industries to increase their lobby efforts and strengthen the pro-liberalisation rhetoric within the government. These findings demonstrate the advantages of the adopted framework. Their implication is that both the four levels of factors and preferences of domestic groups should be taken into account when analysing Japan's FTA.

The thesis offers contribution to the multilateralising bilateralism debate. The analysis of Japan's approach to overlapping and coexisting FTAs provides new evidence in this debate. The thesis analysed the technical aspects of the coexistence of Japan's bilateral agreements with the AJCEP and focused on preferences and motivations that have led to this outcome. The same was done in regards to the proposed regional FTAs. The thesis offered three main findings in the context of the multilateralising bilateralism debate. First, it assessed that Japan does not have a clear vision for harmonising or multilateralising of the overlapping FTAs, both current and prospective. Chapter 4 discussed the ideas regarding the possible consolidation of existing treaties into broader regional agreements advocated by Japanese scholars and representatives of the government and industries. However, these visions seem to be limited to discussing the order of sequencing of such consolidation (e.g. ASEAN+1 agreements would be transformed into EAFTA which would then be transformed into CEPEA). In a way, the thesis argued, coexistence is the preferred solution for harmonising overlapping agreements: for example, through implementing a flexibility clause similar to the one in the AJCEP. Second, the thesis demonstrated that the consolidation of bilateral trade agreements in not always a step forward on the path to multilateralisation. The AJCEP could be viewed as a consolidation of existing bilateral FTAs with ASEAN countries as in majority of cases it applies the same tariffs and phrase-in schedules. It also extends preferential treatment to other ASEAN countries that did not have an FTA with Japan. The conducted fieldwork demonstrated that the coexistence of multiple levels of regulations and rules of origin under this FTA does not necessarily increase the domestic pressure for harmonisation or renegotiation of the existing agreements[642]. On the contrary, signing of the AJCEP and the inclusion of the flexibility clause has convinced many of the interviewed governmental officials that overlapping regulations do not pose a problem for the MNCs. This was confirmed by the interviewed

[642] Menon (2009:1396) argued that for this reason consolidation is the least preferable solution for the Asia-Pacific region.

representatives of the multinational corporations[643]. Therefore, signing of the minilateral agreement did not create an incentive to harmonise existing treaties. Third, the thesis makes an original contribution to the multilateralising bilateralism debate by presenting the preferences of Japanese industries for future trade liberalisation. While Japan's regional FTA policy is often discussed in the subject literature, it is mainly in the context of the government's official policy: the interests of the manufacturing sector are often omitted. The thesis argues that Japanese manufacturing companies are mainly interested in the inclusion of trade facilitation provisions, as explained in detail in Chapter 4. Therefore, they would prefer to see the deepening of existing agreements than signing broader regional ones, unless this would mean being excluded from an important treaty, such as the TPP.

6.4 Conclusions and Implications

This research has found that Japan has been signing pragmatic, 'easy' FTAs motivated by economic ad-hoc factors rather than by regional community-building. At the same time, external factors, such as economic competition with Korea or the progress of the TPP negotiations, have forced Japan to rethink its FTA policy. This has caused Sugawara (2010:18) to argue that "Japan is currently standing at the crossroads, in need of a new policy agenda enabling it to tackle the huge impending shift of its international trade environment".

The issues discussed in this thesis have strong implications for Japan's current FTA policy. The systemic problems which developed during the LDP's administration were passed on to that of the DPJ. Without stronger political leadership, it will be extremely difficult to overcome the domestic opposition of the agricultural sector or conduct any necessary reforms, for example the removal of non-tariff barriers requested by the EU. This is also the case when it comes to a broader regional FTA. The empirical findings in this thesis add to the understanding of Japan's current position with regard to the TPP negotiations. As discussed, Prime Minister Naoto Kan's (2010) speech of October 2010, announcing that Japan would consider participating in the TPP agreement, was met with strong protests from the opposition as well as members of the DPJ. Former Prime Minister Yukio Hatoyama asked Prime Minister Naoto Kan to take the agricultural

643 However, the coexistence of bilateral and minilateral agreements may pose a problem for smaller companies.

sector's interests into consideration and to be 'cautious' when expressing interest in the TPP (*Kyodo News* 2010). As a result, an announcement by Prime Minister Kan at the Yokohama APEC Summit stated only that Japan would start consultations with the nine negotiating countries of the TPP and reach a decision on whether to join the agreement by June 2011. The decision was postponed due to the Tohoku earthquake in March 2011. The developments which took place in the second half of 2011 support the findings of this research. Just as in the case of Japan's overall FTA policy, when it came to deciding whether the country would enter the TPP negotiations, Japan's actions were constrained by a clash of powerful domestic interests. As discussed, the business associations strongly supported Japan's participation in the TPP. In particular, *Keidanren* has voiced its opinion that stronger political leadership is needed on this issue in order for Japan not to be left behind (*The Japan Times Online* 2011b). This is in line with the conclusions of Chapter 5 and the importance of isolation avoidance motivation discussed throughout the thesis. The business sector, in particular export-oriented industries such as those in the automotive and electronics sectors, has also shown its support for the TPP (*The Japan Times Online* 2011c). *The Japan Times Online* (Nakata 13 November 2011) quoted METI's reports stating that in 2010 alone Japan's automotive companies paid "more than ¥130 billion in customs duties to seven nations in the TPP talks". On the other hand, several members of the DPJ and the agricultural sector, represented by the *JA-Zenchu*, have continued to strongly oppose the initiative. Prime Minister Yoshihiko Noda announced that Japan will join the TPP negotiations during a press conference after a meeting of the Cabinet on 11 November 2011: a day before parting for the APEC 2011 Summit. On 10 November, during a TPP debate in the Diet, 232 members representing both parties submitted a resolution opposing Japan's participation in the negotiations (Fukue 2011). Despite the government's plans to invest in and strengthen the agricultural sector, further protests seem inevitable. In light of the analysis in this thesis, it is seems characteristic that Prime Minister Noda's announcement was followed by a discussion on whether Japan would pull out of the negotiations if the government decides they conflict with national interests. Although there has not been any agreement reached on this matter, such a move is likely to have a negative impact on the special partnership with the US (Martin 2011). The results of this research indicate that Japan's FTA policy oscillates between isolation avoidance, expressed by the interests of the business sector, and systemic constraints, namely the lack of a centralised decision making organ. With the continuous protests from the agricultural sector, the government tries to proceed with the trade liberalisation agenda while adapting safeguarding measures aimed at easing the concerns of the opposition. It would be interesting to assess the effects of the preferences of the strong domestic interest groups on Japan's FTA policy in the later stages of the TPP negotiations; in particular, to see if the planned agreement will aim to remove tariffs on sensitive agricultural products, such as rice. The protests from farmers and agricultural cooperatives might indeed cause Japan to leave the talks. Further studies might explore how the government continues to balance the agricultural sectors' protests with MNC's isolation avoidance motivation in the future years of the TPP negotiations.

As this thesis covers events up to 2011, a further study could also explore the developments of Japan's FTA policy and/or preferences of domestic actors in the upcoming years. Another potential direction for future studies is to apply the framework used in this thesis in a different setting, provided that there is an opportunity to obtain empirical data on preferences of main actors' groups. It would be interesting to assess the application of the framework for studying FTA policy in other East Asian countries and to compare how preferences are transformed into a domestic win-set. Finally, futures studies could be enriched by the preferences of individual farmers.

APPENDIX 1. Japan's Free Trade Agreements

Name of the agreement	Date of Signature	Date of entry into force
Agreement between Japan and the Republic of Peru for an Economic Partnership	31.05.2011	1.03.2012
Comprehensive Economic Partnership Agreement between Japan and the Republic of India	15.02.2011	1.08.2011
Agreement on Free Trade and Economic Partnership between Japan and the Swiss Confederation	19.02.2009	1.09.2009
Agreement between Japan and the Socialist Republic of Viet Nam for an Economic Partnership	25.12.2008	1.10.2009
Agreement on Comprehensive Economic Partnership among Japan and Member States of the Association of Southeast Asian Nations	14.04.2008	1.12.2008
Agreement between Japan and the Republic of Indonesia for an Economic Partnership	20.08.2007	1.07.2008
Agreement between Japan and Brunei Darussalam for an Economic Partnership	18.06.2007	31.07.2008
Agreement between Japan and the Kingdom of Thailand for an Economic Partnership	3.04.2007	1.11.2007
Agreement between Japan and the Republic of Chile for a Strategic Economic Partnership	27.03.2007	3.09.2007
Agreement between Japan and the Republic of the Philippines for an Economic Partnership	9.09.2006	12.11.2008
Agreement between the Government of Japan and the Government of Malaysia for an Economic Partnership	13.12.2005	13.07.2006

Agreement between Japan and the United Mexican States for the Strengthening of the Economic Partnership	17.09.2004	1.04.2005
Agreement between Japan and the Republic of Singapore for A New-Age Economic Partnership	13.01.2002	30.11.2006

Source: METI 2012, FTA/EPA/BIT, Available from: http://www.meti.go.jp/english/policy/external_economy/trade/FTA_EPA/index.html, Accessed January 2012

APPENDIX 2. List of Interviews

I. INTERVIEWS

Ministries

1. Assistant Section Chief, Economic Partnership Division, Trade Policy Bureau, METI. 10.02.2009, Tokyo.

2. (Person A) Director for FTA Affairs, Economic Partnership Division, Trade Policy Bureau, METI. 10.02.2009, Tokyo.

3. (Person B) Director for FTA Affairs, Economic Partnership Division, Trade Policy Bureau, METI. 23.08.2010, Tokyo.

4. Director for Electricity Market Division, Agency for Natural Resources and Energy, METI. Former Director for FTA Affairs, Economic Partnership Division, Trade Policy Bureau, METI. 11.05.2010, Tokyo.

5. Director for Economic Partnership (EPA/FTA), Trade Policy Bureau, METI. Responsible for FTA negotiations with India and Australia, as well as joint CJK Trilateral FTA Study Group. 12.08.2010, Tokyo.

6. Director-General for International Trade Policy, Trade Policy Bureau, METI. 17.08.2010, Tokyo.

7. Director-General for Manufacturing Industries Policy, Manufacturing Industries Bureau, METI. 03.06.2010, Tokyo.

8. Former Director-General for International Trade Policy, Trade Policy Bureau, METI. Former Director-General, Multilateral Trade System Department, Trade Policy Bureau, METI. Negotiator of the Japan-Philippines and Japan-Malaysia Economic Partnership Agreements. 22.05.2010, Tokyo.

9. Director, EPA/FTA Policy Division, MOFA. Involved in the CJK Trilateral FTA Study Group. 06.09.2010, Tokyo.

10. Director for APEC and European Affairs, International Economic Affairs Division, Minister's Secretary, MAFF. Responsible for FTA negotiations with Switzerland, former official of the Agricultural and Development Economics Division at the United Nations. 12.08.2010, Tokyo.

11. Research Director of the Canon Institute for Global Studies. Senior Fellow at Research Institute of Economy, Trade & Industry (RIETI). Senior Fellow at Tokyo Foundation. Former Deputy Director-General at the International Affairs Department, MAFF. Former Director of the GATT Affairs Division, MAFF. Member of the Japanese Committee of Deregulations. 21.05.2010, Tokyo.

12. Assistant Counsellor, Secretariat Intellectual Property Strategy Headquarters, Cabinet Secretariat. Former employee of the Customs and Tariff Bureau, MOF. 27.08.2010, Tokyo.

13. Office of Regional Cooperation, Customs and Tariff Bureau, MOF. 13.10.2010, Tokyo.

Private Sector

14. Senior Staff, Trade and Industrial Affairs, Toshiba. Chairman of the Subcommittee on Rules of Origin at the Trade Policy Committee, Japan Electronic and Information Technology Industries Association. 09.02.2009, Tokyo.

15. Senior Staff, Trade and Industrial Affairs, Toshiba. Chairman of the Subcommittee on Rules of Origin at the Trade Policy Committee, Japan Electronic and Information Technology Industries Association. 20.05.2010, Tokyo.

16. Director, Liaison Department, Sharp Co. 20.10.2010, Tokyo.

17. Acting General Manager, Sustainability Energy & Environment Strategic Planning Department, Mitsubishi Heavy Industries, Ltd. 28.05.2010, Tokyo.

18. Staff member of the Corporate Strategy & Research Department of Mitsubishi Corporation. 14.06.2010, Tokyo.

19. Senior Manager, International & Public Policy Affairs, External Relations Department and FTA Department, Sony Corporation. 16.09.2010, Tokyo.

20. Manager, General Affairs Division, Honda Motor Co., Ltd. 16.09.2010, Tokyo.

21. General Manager, General Affairs and Communication Coordination Office for VW, Global Alliance, Suzuki Motor Corporation. 31.07.2010, Tokyo.

22. General Manager, Corporate Strategic Planning Division, Toray Industries, Inc. 30.11.2010, Tokyo.

Business Associations, Interest Groups and Others

23. Managing Director, *Keizai Doyukai* (Japanese Association of Corporate Executives). 11.05.2010, Tokyo.

24. Deputy Director, International Cooperation Bureau, *Nippon Keidanren* (Japan Business Federation). 27.05.2010, Tokyo.

25. Project Leader, APEC Japan 2010 SME Summit Secretariat, Japan Chamber of Commerce and Industry, (JCCI). 28.05.2010, Tokyo.

26. (Person A) Deputy Executive Director, Support Council for ABAC-Japan, APEC Business Advisory Council (ABAC). 03.06.2010, Tokyo.

27. (Person B) Deputy Executive Director, Support Council for ABAC-Japan, APEC Business Advisory Council (ABAC). 03.06.2010, Tokyo.

28. Senior Manager, International Trade & Investment Group, Japan Machinery Centre for Trade and Investment (JMC), 04.06.2010, Tokyo.

29. Deputy General Manager, Agricultural Policy Department, *JA-Zenchu* (Central Union of Agricultural Co-operatives). 08.10.2010, Tokyo.

30. Manager, *Zenkoku-Shoko-Dantai-Rengokai, ZENSHOREN* (National Federation of Traders and Producers Organizations). 15.06.2010, Tokyo.

31. (Person A) Manager, International Trade & Cooperation Group, Market Research & International Economic Affairs Division, The Japan Iron and Steel Federation. 14.10.2010, Tokyo.

32. (Person B) Manager, International Trade & Cooperation Group, Market Research & International Economic Affairs Division, The Japan Iron and Steel Federation. 14.10.2010, Tokyo.

33. Director, International Bureau, *Zenroren* (National Confederation of Trade Unions). 24.05.2010, Tokyo.

34. Minister Counsellor, Commercial Affairs Division, Embassy of Malaysia. 12.08.2010, Tokyo.

35. Policy analyst at the Australian Commonwealth Treasury, Foreign Investment and Trade Policy Division. 06.08.2010, Tokyo.

36. Chief Staff, Business Affairs & Research Group, Japan Chemical Fibers Association. 30.11.2010, Tokyo.

37. Assistant Director General, International Department, Japan Automobile Manufacturers Association, Inc. 03.12.2010, Tokyo.

Research Institutes and Think-Thanks

38. Senior Researcher at the International Economic Research Division, Overseas Research Department, JETRO. 04.02.09, Tokyo.

39. (Person A) Deputy Director, International Economic Research Division, Overseas

Research Department, JETRO. 23.04.2010, Tokyo.

40. (Person B) Deputy Director, International Economic Research Division, Overseas Research Department, JETRO. 23.04.2010, Tokyo.

41. Senior Research Fellow and Assistant Director of International Relations and Conflict Studies Group, Interdisciplinary Studies Centre, Institute of Developing Economies, IDE-JETRO. 02.02.2009, Tokyo.

42. Senior Research Fellow, Area Studies Centre (Korea), Institute of Developing Economies, IDE-JETRO. 30.04.2010, Tokyo.

43. Research Fellow, International Relations and Conflict Studies Group Interdisciplinary Studies Centre, Institute of Developing Economies, IDE-JETRO. 26.05.2010, Tokyo.

44. Research Fellow at the Japan National Committee for Pacific Economic Cooperation (JANCPEC), the Japan Institute of International Affairs (JIIA). 06.04.2010, Tokyo.

45. Senior Analyst, Mitsubishi UFJ Research and Consulting. Former MOFA employee responsible for service negotiations under the WTO. Former Keidanren employee. 25.05.2010, Tokyo.

46. Senior Research Officer, Research Department- Public Policy, Mizuho Research Institute Ltd. Former Advisor to Japan's Permanent Delegation to the OECD. Former MOFA employee. 26.07. 2010, Tokyo.

47. President of the Centre for International Public Policy Studies. 22.11.2010, Tokyo.

Academic Institutions

48. Associate Professor of International Economics, Department of Law and Economics, Chiba University. Member of FTA Study Meeting at the Institute for International Trade and Investment. 19.04.2010, Tokyo.

49. Professor, Faculty of Economics, Senshu University. Member of FTA Study Meeting at the Institute for International Trade and Investment. 19.04.2010, Tokyo.

50. Professor and Executive Director of the Department of International Affairs, Institute of Asian Studies, Asia University. Member of FTA Study Meeting at the Institute for International Trade and Investment. 22.04.2010, Tokyo.

51. Hasegawa, S., Professor of Commerce, Faculty of Social Sciences, Waseda University. 28.01.2009, Tokyo.

52. Itoh, M., Professor and Dean of Graduate School of Economics and Faculty of Economics, University of Tokyo. President of the National Institute for Research Advancement. 18.02.2009, Tokyo.

53. Kimura, F., Professor of Economics, Keio University. Chief Economist of the Economic Research Institute for ASEAN and East Asia (ERIA). 06.02.2009, Tokyo.

54. Kimura, F., Professor of Economics, Keio University. Chief Economist of the Economic Research Institute for ASEAN and East Asia (ERIA). 06.05.2010, Tokyo.

55. Terada, T., Professor of International Relations, Institute of Asian Studies, Waseda University. Free Trade Agreements specialist. 23.01.2009, Tokyo.

56. Urata, S., Professor of Economics, Graduate School of Asia-Pacific Studies, Waseda University. Free Trade Agreements specialist. 09.02.2009, Tokyo.

57. Professor of International Political Economy, Department of Humanities and Social Sciences, Keio University. Former Chief Negotiator of the Japan-Mexico FTA. Co-author of MOFA's 2002 'Basic FTA Strategy' document. 18.02.2009, Tokyo.

58. Yamazawa, I., Professor Emeritus, Hitotsubashi University. Former President of the International University of Japan. Former President of the IDE-JETRO. Former coordinator of the Japan-Korea FTA Study Group. Chair of an FTA Study Meeting at the Institute for International Trade and Investment. 24.01.2009, Tokyo.

59. Yamazawa, I., Professor Emeritus, Hitotsubashi University. Former President of the International University of Japan. Former President of the IDE-JETRO. Former coordinator of the Japan-Korea FTA Study Group. Chair of an FTA Study Meeting at the Institute for International Trade and Investment. 06.06.2010, Tokyo.

60. Professor of Economics, Department of Humanities and Social Science, Tokyo Denki University. Member of the Economic Planning Agency under PM Koizumi. Involved in the CJK Trilateral FTA project. 10.06.2010, Tokyo.

II. PRESS CONFERENCES

Press Conferences at the Foreign Correspondents' Club of Japan (FCCJ), Yurakucho Denki North Building 20F, Yurakucho 1-7-1, Chiyoda-ku, Tokyo, 100-0006

Masayuki Naoshima, Minister of Economy, Trade and Industry, METI, 15.01.2010

Dominique Strauss-Kahn, Managing Director, International Monetary Fund (IMF), 18.01.2010

Osamu Suzuki, Chairman & CEO, Suzuki Motor Corporation, 21.01.2010

Jim Adams, World Bank Vice President for East Asia and Pacific, 15.03.2010

Haruhiko Kuroda, President of Asian Development Bank (ADB), 17.03.2010

Katsuya Okada, Minister for Foreign Affairs, MOFA, 25.08.2010

Kent E. Calder, Director of the Edwin O. Reischauer Centre for East Asian Studies, School of Advanced International Studies, Johns Hopkins University, 09.12.2010

III. OTHER EVENTS

ADBI-OECD Roundtable on Asia's Policy Framework for Investment: Investing in a

Stronger, Cleaner, and Fairer Asian Economy, the Asian Development Bank Institute (ADBI), Tokyo, 6-8.04.2010

What Next for Asia-Europe Economic Ties? A Panel Discussion organized by ADB and ADBI, Tokyo, 12.05.2010

Achieving the Bogor Goals and Beyond, 2010 APEC Study Centres Consortium (ASCC) Conference, IDE-JETRO, Tokyo, 8-9.07.2010

The Political Economy of Asian Regionalism, Annual Conference, Asian Development Bank Institute, Tokyo 3.12.2010

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