



# **FREE-TRADE AGREEMENTS IN THE ASIA-PACIFIC: COMPETITIVE ASPECTS OF SUB-REGIONAL TRADE INSTITUTION BUILDING**

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## **INTRODUCTION**

Many scholars are now questioning APEC's efficacy in achieving free trade. The Asia-Pacific Economic Cooperation forum's 'open regionalism' and the extension of trade concessions to non-members were praised in the years following APEC's 1989 founding as a model of good regionalism that was consistent with global free trade. However, slow progress and a lack of significant trade concessions have frustrated free-trade hopefuls in academia and the business world alike. The lack of progress is a result of diverse interests and differing approaches in the region toward free trade. Rather than focusing on and pursuing an 'APEC model', the region is characterized by several competing approaches to free trade, reflecting diverse domestic interests and complex strategic and tactical alliances. This chapter identifies key differences in the domestic interests of the major actors and analyzes how these differences have shaped the patterns of free-trade areas and proposals in terms of partners and contents.

## **FREE TRADE AND TRADE BLOCS**

Economists are increasingly in agreement that free trade will bring long-term overall benefits to the world economy. These benefits will not be shared equally, and some countries in the short term will suffer more in the process of structural adjustments. However, the assumption is that all countries in the long term will find some industries in which they have a comparative advantage. The ideological triumph of neo-classical capitalism and its belief in free trade has been underlined by the bankruptcy of the Soviet Union, Eastern Europe, and state-interventionist Latin America, and later by the conversion of state-guided capitalism in East Asia—following the Asian economic crisis—to a more market-oriented model. The neo-liberal conversion has largely been promoted by developed Western countries, but the increasing acquiescence of

developing countries is evident as they attempt to lure foreign investors into their countries.

Global free trade, envisioned in the immediate post-war period as a promoter of peace, never materialized. Only Western capitalist countries joined the framework of the General Agreement on Tariffs and Trade (GATT). Even among GATT members, differing interests and politically significant protections delayed tariff reductions and blocked removal of non-tariff barriers (NTBs). The transformation of economies in the most developed countries from manufacturing to the service and technology sectors has also expanded the focus of trade negotiations to include these industries. The newly launched World Trade Organization deals not only with the merchandise trade envisioned by GATT, but also service trade (dealt with under the General Agreement on Trade in Services—GATS) and intellectual property rights under its Trade-Related Intellectual Properties (TRIPs) rules.

On the lower-end of the industrial progression, agriculture remains a politically sensitive area for many countries in both the developed and developing worlds. Generally, developed countries in the temperate zone with large territory and low population density (such as North America and Australasia) have industrialized agriculture that is internationally competitive. In contrast, many Western European countries, Japan, and the newly industrialized Asian economies (with the exceptions of Hong Kong and Singapore, which have little arable land anyway) have protected their agriculture sectors. Among the developing countries, there is a division between those with inefficient semi-subsistence agriculture (like India) and those with highly competitive export agriculture (such as Argentina). The Cairns Group within the WTO (the group of agricultural exporting countries promoting free trade and a reduction of subsidies in agriculture) is made up of both developed and developing countries.

### **TRADE CREATION AND TRADE DIVERSION**

The GATT Uruguay Round was launched in 1986 (seven years after the conclusion of the previous Tokyo Round in 1979) to tackle *inter alia* the difficult issues of agriculture and service trade liberalization. The fact that the Uruguay Round took a further eight years to conclude indicated that global free trade was clearly facing very difficult obstacles. In this circumstance, two important developments took place. The first was the creation of an integrated European market in 1992, and the second (partly in response to the first) was the creation of the North American Free Trade Area (NAFTA) in 1993.

The creation of regional trade blocs at a time when global trade liberalization faced difficulties signaled a possible return to the closed trade blocs and mercantile rivalries of the pre-war era. Based on the lesson that this approach was partially to blame for the start of the World War Two, GATT encompassed provisions to contain ‘bad’ regionalism, while leaving room for ‘less bad’ regionalism. Regional trade blocs are by definition discriminating and inconsistent with the non-discriminatory principle of GATT. Even a lowering of tariffs limited to the bloc members has a ‘trade-diverting’ effect, favoring in-bloc exporters over outside exporters. Nevertheless, for practical reasons, trade blocs are accepted under GATT so long as they do not raise the existing tariff levels, thereby encouraging overall growth of trade.<sup>1</sup>

### **GATT RULES AND EFFECTIVENESS**

In accepting regional trade blocs, GATT required that such agreements be consistent with its rules. However, enforcement of GATT compliance was rather weak until the WTO came into existence, and its enhancement is yet to be seen under the WTO.

GATT, being an inter-state agreement without its own large bureaucracy, simply responded to voluntary requests to evaluate the consistency of regional agreements with GATT rules. Without such requests, many regional agreements have not been evaluated at all. Under GATT, complaints against regional agreements that were deemed to be in violation of GATT had to be handled with the consent of the accused party—an unlikely proposition. It was only after the WTO dispute settlement body (DSB) was given additional power to impose mandatory dispute-resolution mechanisms that a more thorough evaluation of regional trade blocs became technically possible. (Whether this newly given power will be sufficient is yet to be seen.)

### **EMERGING ISSUE AREAS AND TRADE BLOCS**

There is no concise and universally accepted definition of what constitutes a ‘free’ trade agreement. To avoid mushrooming of ‘partially-free’ or ‘not-so-

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<sup>1</sup> This ‘building blocks’ versus ‘stumbling blocks’ debate is found in almost any discussion of regional FTAs. Cohn gives a brief overview of this debate and GATT’s (legal) treatment of the FTAs in Theodore H. Cohn, *Global Political Economy: Theory and Practice* (New York: Longman, 2000), pp.238-240. Frankel, in Jeffrey A. Frankel, *Regional Trade Blocs in the World Economic System* (Washington, D.C.: Institute of International Economics, 1997), pp.207-227, provides a detailed economic examination of the FTAs from both positive and negative perspectives, with a focus on inclusion/exclusion of countries.

free' trade agreements, GATT Article XXIV requires that such agreements must eliminate tariffs and trade barriers on 'substantially all trade'. As developed economies have transformed, new industries and services have emerged and the concepts of properties expanded. Now there is growing disagreement as to what must be covered by a 'free trade' agreement.<sup>2</sup>

Regional trade agreements may deliberately exclude certain sectors because of domestic opposition in the member countries. Exclusion of the agricultural sector in some regional and bilateral free-trade agreements is most problematic in the view of GATT consistency, and such moves are opposed by most progressive trade liberalizers. On the other hand, including enhanced service sector access and/or intellectual property provisions in bilateral free-trade agreements has become a common tactic for more developed countries, whose similar attempts in the multilateral WTO negotiations have been blocked by the more numerous developing countries. Developed countries also tend to demand higher local-content ratios, stricter environmental and labor standards, and limited labor mobility provisions in their dealings with less-developed partners.

### **APEC AND GLOBAL FREE TRADE**

It is now well known that APEC was a joint creation of Japan and Australia, despite the former's 'leadership from behind' that gave full credit to Australia. Having considerable trade relations, not only in Asia, but also with the European Union (EU) and North America, the two countries' interests lay in bridging the Asian and North American markets, thereby creating the largest market which, the two countries hoped, would dissuade the EU from retreating into its own closed market. Despite its initial scepticism about APEC, the United States has judged that its interests in access to the fast-growing Asian market and creating a counterweight to the EU also coincided with the aim of APEC. In addition to competing against the EU in promoting free trade with Latin America, the United States seeks free trade on its own terms with the Asia-Pacific, prioritizing its relations with key free traders, such as Australia, New Zealand, and Singapore. Thus, on a fundamental level, key APEC members share common interests in creating the world's largest market and preventing the EU from isolating itself.<sup>3</sup>

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<sup>2</sup> Cohn, *op. cit.*, pp.247-251.

<sup>3</sup> Regionalism is viewed as a launching base into global competition. See Christopher Brook, 'Regionalism and Globalism', in Anthony McGrew and Christopher Brook, *Asia-Pacific in the New World Order* (London and New York: Routledge, 1998), pp.231-232.

**VOLUNTARISM/NON-BINDING APPROACH**

Within the broad and general agreement, however, there is a growing division among APEC members in regard to how to approach free trade. At the core of APEC are the members of the Association of Southeast Asia Nations (ASEAN), whose preference for the preservation of state sovereignty has posed a large obstacle to adopting a supranational institutional approach. Even the GATT/WTO-like multilateral bargaining process was viewed with scepticism by these younger states. The fact that Japan took the initiative from early on, whereas the United States committed itself to APEC at a much later stage, also made APEC more sensitive to the voices of the ASEAN countries, with which Japan has carefully nurtured relations throughout the post-war period.

Major differences remain between the NAFTA countries, Singapore, and the Australasian states on the one hand, and Japan and most of the East Asian states on the other. Within the latter camp, a growing political and economic rivalry between Japan and China also has impacts on the course of East Asian integration.

What has emerged as the APEC approach is a combination of highly publicized annual summit meetings, less publicized but more tangible trade ministers' meetings, and numerous and sectionalized technical meetings. At each stage of meetings, voluntarism and consensus building are emphasized as the appropriate method of decision-making.

**OPEN REGIONALISM**

In order to ensure that other trade blocs will not close their markets in anticipation of APEC becoming closed and adopting protectionist measures, APEC extends its agreed liberalization measures to non-members. Therefore, APEC does not even amount to a customs union like the European Community was before full EU market integration.<sup>4</sup> Since most APEC members are also WTO members (with the notable exception of Russia), the Most Favored Nation principle governs tariff and quota concessions made during the APEC negotiations. At the same time, various Non-Tariff Barrier (NTB) reductions and standardization of import procedures also aim at not only smoothening intra-APEC trade, but also at setting the standard for global trade.

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<sup>4</sup> *Ibid*, p.233.

**BOGOR TARGETS**

The voluntary and consensus-oriented approach by APEC has been criticized by the more progressive trade liberalizers as ineffective and time-consuming. These states, notably with the United States in the forefront but with some others on its coattails, prefer a more contractual approach to trade liberalization. The 1995 meeting in Bogor, Indonesia, resulted in a declaration of target years for complete free trade, 2010 for the developed countries and 2020 for developing countries. The target years were differentiated to allow more time for developing countries to adjust their industrial structures, but no penalty was stipulated for non-implementation.

**ASSESSMENT**

Critics of the APEC approach point to a lack of progress in achieving increases in regional trade. The EU's success was measured by some by its increasing intra-EU trade, where national markets were fully integrated. In APEC, complete market integration has not been achieved, and APEC's aim is not a closed economic bloc. (The EU does not espouse such a closed system either, at least officially, but it has various protective measures, such as its Common Agriculture Policy, that form a *de facto* closed system).

Some assessments, focusing on average tariff rates, have also disappointed trade liberalizers. Japan's average tariff rates indeed went up recently. However, tariff rates alone are not a good indicator of trade liberalization, as import quotas are often replaced by high initial tariff rates as a result of the tariff scheme under the GATT Uruguay Round.

APEC's various working groups address import procedures and NTBs. However, quantitatively measuring these achievements is extremely difficult as causes of trade increases or decreases cannot be easily isolated. It seems that to measure the overall success of APEC, it suffices to look at the trade volume per GDP of each APEC member. In this measurement, most APEC members have shown a significant increase in trade dependency. Indeed, it seems that the declining trade dependency of the entrepot economies of Singapore and Hong Kong is attributable to trade diversion by other economies to new open markets within APEC.

## **SUB-REGIONAL FREE-TRADE PROSPECTS WITHIN APEC**

As pan-regional free trade becomes ever more difficult, there are increasing moves for sub-regional agreements. These are being promoted within and between sub-regions and seem to have two motivations. The first is to compensate for the lack of progress at APEC and the second to attempt to protect groups of economies in case other groups develop closed trade blocs rather than the 'open regionalism' that APEC is supposed to promote. The final size and shape of the regional economic groupings is not yet clear, but it seems likely that by about 2015 East Asia and North America could have developed into 'super blocs' and that there will be a periphery of smaller groupings around and connected to these. The dominant question is the degree to which these groupings will be open or closed.

### **The NAFTA Bandwagon and the PACFIVE**

The North American Free Trade Area (NAFTA) entered into force in 1994 with the United States, the world's second-largest economy (after the European Union), at its core. NAFTA was a product of both globalization and domestic compromise. For major US manufacturers, Mexican and (to a lesser extent) Canadian firms had become major suppliers of technologically less-sophisticated parts, as well as an assembly base from which to export the final products back to the US market and to Europe and Asia. Free trade binding the three North American countries was to further enhance the regional production, integration and division of labor. In the United States, however, the agreement faced fierce opposition from labor unions and congressional Democrats. A particular fear was that Mexico would become a cheap assembly base for non-US firms as well, using imported non-US components. As a result, NAFTA included tough local-content requirements, making sure that to qualify for free trade, products must meet high locally produced values.

Because of its size and proximity, NAFTA attracts a large amount of interest from South American countries and has the potential to develop into a Western Hemisphere free-trade zone, a concept known as the Free Trade Area of the Americas (FTAA). This alarms countries outside the Americas because of the possibility of their exclusion. This fear is further exacerbated by NAFTA's relatively high local-content requirements, which tend to divert US imports from non-NAFTA countries to NAFTA members. The United States is still cautious about further expansion of NAFTA, especially into the developing countries of South America. For the United States, as the largest

market in the Americas, having prospective members come to its own terms is a logical strategy. For the same reason, most of South America (except Chile) is cautious in approaching the United States on this matter. The United States aims to realize the FTAA by 2005, but this prospect is increasingly in doubt due to the financial crisis that spread from Argentina to other South American countries and increasing criticism of US farm subsidies and steel safeguard tariffs.<sup>5</sup>

The US strategy in FTA talks in the Asia Pacific is to start with the most liberal traders: Singapore and Australia. The addition of Canada (already a NAFTA member), Chile (which recently signed FTAs with the United States), and New Zealand (which is not yet formally negotiating an FTA with the United States, but is a progressive free trader), would make up the so-called Pac Five grouping.

### **Related Agreements**

In the face of NAFTA's delayed expansion, NAFTA's smaller partners, Canada and Mexico, are considered stepping stones for those countries that wish to join free trade with the United States, but seek better terms than the United States would accept. Since the early stage of NAFTA's inception, Chile has demonstrated its willingness to join NAFTA. Chile has already signed bilateral free-trade agreements with Canada and Mexico, and these agreements include service sector liberalization—a prerequisite for membership in NAFTA as it stands. Chile also signed a bilateral FTA with the United States in June 2003<sup>6</sup>, and an FTA with Korea, though ratification in Korea is still pending due to the political sensitivity of anticipated fishery imports.

### **Mercosur**

MERCOSUR (*Mercado Común del Sur*, or the Southern Common Market Treaty), which comprises Argentina, Brazil, Paraguay, and Uruguay, currently stands as a customs union, but not a free-trade area. Development efforts of the 1970s were backed by socialist ideologies and did not lead to the creation of competitive export-manufacturing industries in most of South America, but instead left massive debt burdens for these countries. As the countries re-engaged US capital and markets in the 1980s, MERCOSUR served two objectives. First, consistent external tariffs across the region assured some continued protection against imports without hindering the adjustments of each national economy and the relocation of industries within the region. Second, by providing a united front, MERCOSUR members try to avoid being

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<sup>5</sup> *Yomiuri Shimbun*, 28 July 2002.

<sup>6</sup> *Yomiuri Shimbun*, 7 June 2003.



swallowed one by one into a Western Hemisphere free trade on NAFTA's terms rather than their own. Chile has joined MERCOSUR as an associate member (because its voluntary tariff reduction had already achieved lower tariff levels than the MERCOSUR's common tariffs), and is positive about a greater Latin American integration. However, Chile's 'overzealous approach' in FTAA negotiations is a source of disunity among the South American states. As the FTAA negotiation stalls over US farm subsidies, and the United States pursues bilateral FTA talks with smaller central American countries, MERCOSUR has countered such move by signing an FTA with three members of the Andean Community in December 2003.<sup>7</sup>

### **EAST ASIAN CAUTION AND COMPETITION**

East Asia as an economic group demonstrates great diversity. The degree of industrialization and economic development varies from rich Japan to the poor Indochinese trio. In addition, the most industrialized countries in the region (Japan, Korea, Taiwan) have politically significant agriculture sectors, constituting an 'Achilles heel' in their pursuit of free trade. This problem is shared by several less-developed countries such as Malaysia, Indonesia, and China. This, however, contrasts with the most competitive agricultural exporters of the region, such as Thailand, and the city economies (Singapore and Hong Kong), which have no farm sector to protect.

Regional trade growth has largely reflected increasing Foreign Direct Investment (FDI), regional integration of the production processes, and their interdependence. Following the Japanese model, earlier import substitution industrialization gradually gave way to export promotion, resulting in steady reduction of tariffs on industrial material and goods. Each country has politically favored sectors that have resisted liberalization, and this has occasionally collided with the regional approach.

A consensus-oriented approach, long practiced in ASEAN and incorporated into APEC, has allowed trade liberalization to proceed at a pace tolerable to the least efficient countries. However, pressure from the more competitive farm producers, domestic industrial sectors that promote free trade, and competitive demands of globalization on national economies have all forced the ASEAN countries to revise this approach and seek more proactive liberalization. An informal meeting of ASEAN economic ministers in August 2002 abandoned the traditional convoy system of trade and investment liberalization, and adopted a new approach to allow early

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<sup>7</sup> *Yomiuri Online*, 17 December 2003.

liberalization by some members.<sup>8</sup> Thus, the consensus approach of the APEC, first challenged by the Pac Five nations, is now threatened from its ASEAN core.

### **ASEAN Free Trade Area**

The ASEAN Free Trade Area (AFTA) was set up to promote economies of scale and division of labor in industrial production among the ASEAN countries. Beginning in 1993, tariff reductions were to be implemented on all tariff rates on manufactured products to between zero and five percent by the end of 2007 (the target year was later moved forward first to 2003 and later, for many items, to 2002).<sup>9</sup> AFTA deliberately excluded unprocessed agricultural products and services from its liberalization scheme. While the approach was consistent with the needs of the region's main investor, Japan, preparation for further integration and accommodation of new members (Vietnam, Laos, Cambodia, and Myanmar) required that free trade be extended to cover non-processed agricultural products. Therefore, a new protocol was signed in 1999 to phase in sensitive and highly sensitive products into the previously agreed FTA scheme by 2010 (2013 for Vietnam, 2015 for Laos and Myanmar, and 2017 for Cambodia).

### **East Asian Economic Caucus**

Frequent confrontation between the East Asian states and non-Asian members of APEC (notably the United States, Canada, Australia, and New Zealand), combined with Malaysian Prime Minister Mahathir Mohammad's frequent calls for 'Asianism' led to proposals for an East Asian Economic Caucus (EAEC) within APEC. The United States, fearing the creation of an illiberal trade bloc that would undermine aggressive American efforts to promote free trade, opposed such a sub-regional trade bloc. Japan also was not eager to offend the United States, despite their disagreement over treatment of the farm sector. The compromise outcome was a sub-regional caucus, which only loosely bundled ASEAN states with Japan, Korea, China, Hong Kong, and Taiwan. While the idea of free trade in this format has been proposed and is said to produce the most attractive market for both the EU and the NAFTA members to engage with, both political divisions and economic gaps within the

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<sup>8</sup> *Yomiuri Shimbun*, 8 July 2002.

<sup>9</sup> However, the final tariff rate on highly sensitive products for Malaysia and Indonesia was set at 20 percent, considerably higher than the 0-5 percent target on other goods, with the rate for the Philippines to be determined.

grouping are likely to necessitate that an integration of this scale start with smaller units. This will probably be through the so-called ASEAN + 3 grouping which links the ASEAN states with Japan, Korea and China, initially through a series of bilateral free-trade agreements.

### **ASEAN-China**

Within the East Asia grouping of states, China has demonstrated an increasing desire for leadership. Sub-regional unity has been tested since the 1997 Asian monetary crisis, and China has constantly asserted itself as a leader to challenge Japan's predominant status. While China cooperated with Japan and other Southeast Asian countries in starting the Chiang Mai Initiative establishing a regional joint currency reserve (after opposing Japan's proposal for an Asian Monetary Fund in which Japan would play a more dominant role), it claimed credit for not devaluing the yuan during the Asian financial crisis, overshadowing Japan's assistance to stricken nations. China's proposal in 2002 for free trade with ASEAN to be achieved within ten years was announced in this context. The first concrete Chinese proposal offered tariff removal on selective agricultural products that ASEAN members produced (meat, fish and seafood, fruits, dairy products, flowers, and animals and animal products, including material for Chinese medicines) by 2007, and China continues to negotiate on other farm products of concern to ASEAN members, such as rice, palm oil, and lumber, with a possibility of early liberalization on a bilateral basis.<sup>10</sup> Gradual expansion of trade liberalization on most other products is proposed to take place beginning in 2005 and conclude between 2010 and 2016, according to the framework agreement signed in November 2002. The alternative deadlines are set due to possible conflicts with the previously agreed AFTA among ASEAN members, especially in regard to the delayed liberalization schedules for Vietnam, Cambodia, Laos, and Myanmar. Considering China's own problems with state-owned enterprises in the manufacturing sector, inefficient agriculture, and the protected financial sector, its free-trade agreements may diverge from the 'significantly all trade' provision of GATT.

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<sup>10</sup> *Asahi Shimbun*, 13 September 2002.

## JAPAN'S GLOBAL, REGIONAL, AND BILATERAL TRADE STRATEGIES

During the Uruguay Round of the GATT negotiations, in which agricultural trade liberalization became an agenda item, Japan's complete ban on rice imports continued to be an obstacle to Japan's proactive trade policy stance and one of the major obstacles to conclusion of the whole round. Agricultural negotiations continued under the newly established WTO, although launching of a new comprehensive round was not yet in sight. Japan adopted a policy of minimum access for foreign rice, allowing progressively increasing imports from four percent of domestic consumption to eight percent between 1995-2000. In 1999, Japan decided to forego the minimum-access arrangement and shifted to a tariff-based import with a 1,000-percent markup. The agriculture minister announced prior to a WTO agriculture negotiation in December 2000 that Japan would negotiate on the basis of maintaining controlled imports of rice through a tariff-rate quota, minimum access, and state trade systems.<sup>11</sup> Japan continued to withhold its farm card and demanded an early start of a new comprehensive round.

At the Doha meeting of the WTO in 2001, Japan's efforts focused on linking the concessions Japan has floated on farm products with other issues, including further reduction of tariffs on industrial products, enhancing WTO discipline against national anti-dumping and safeguard rules, and enhancing multilateral investment rules.<sup>12</sup> In the aftermath of the Doha ministerial meeting, Japan's Ministry of Foreign Affairs was satisfied with the comprehensive coverage of the coming round, while agricultural sector bureaucrats implicitly suggested that the achievements in negotiations on agriculture since the Uruguay Round did not necessarily set a bottom line for negotiations in the coming round.<sup>13</sup>

In submitting a proposal to the WTO on negotiations on non-agricultural market accesses, Japan reiterated that a comprehensive range of products be considered and no exception should be set in advance. In regard to tariff

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<sup>11</sup> *'WTO nogyo kosho nibon teian no kettei ni atatte'*, speech by Minister of Agriculture, Forestry, and Fishery, 8 December 2000. [www.maff.go.jp/wto/wto\_daijin\_danwa.htm]

<sup>12</sup> *International Herald Tribune*, 27 January 2001; *'WTO Doha kakuryo kaigi ni muketa nibon seifu no tachiba'*, November 2001. [www.mofa.go.jp/mofaj/gaiko/wto/tachiba.html].

<sup>13</sup> MAFF, *'Dai yonkai WTO kakuryo kaigi no kekka ni tsuite'*, speech by Minister of Agriculture, Forestry, and Fishery, 14 November 2001. [www.maff.go.jp/wto/wto\_mc4th\_daijindanwa.htm]; MOFA, *'WTO shin raundo (Doha kakuryo kaigi ikou no kongo no mitooshi)'* [www.mofa.go.jp/mofaj/gaiko/wto/d\_iko.html]

cutting, Japan proposed a ‘formula cut’ by which member states would cut their tariff rates depending more on each country’s stage of development than on the existing level of tariffs.<sup>14</sup> This proposal aimed at easing developing countries’ fears of cutting tariffs on industrial goods, while urging developed countries (mainly the United States and EU) to bring their tariff levels on industrial goods lower and closer to those of Japan.

### Japan in APEC

While Japan has been criticized for not making sufficient concessions on market access in APEC’s Early Voluntary Sectoral Liberalization (EVSL) talks, particularly in regard to its agricultural sector, Japan also views APEC as losing efficacy in achieving its earlier objectives. APEC’s successes have shifted from liberalization of trade and investment to other areas, such as standards and conformance, customs procedures, and competition policy that smoothen trade transactions by reducing associated costs.<sup>15</sup> Japan sees the positive outcome of the 2002 APEC trade ministers meeting as being its agreement to set a deadline to decide the processes for non-agricultural product negotiations for future WTO rounds and its acceptance of the ‘path-finder’ approach, in which plural economies would accelerate implementation of the Bogor target of complete liberalization.<sup>16</sup> The sugar-coated language masks the crude reality. The former is a *de facto* admission that APEC has not only failed to promote agricultural trade liberalization, but also deferred the non-farm products to the WTO. The ‘path-finder’ approach, moreover, is a *post hoc* admission that some countries (possibly including Japan itself) will not be able to meet the Bogor target.

### Japan-ASEAN

Japanese Prime Minister Junichiro Koizumi’s visit to ASEAN members in 2002 followed China’s surprise announcement of the free-trade proposal to ASEAN. Japan quickly announced its own version of free trade with ASEAN, yet lack of domestic consensus prevented Japan from proposing more specific measures beyond rhetoric during his visit. However, competition between

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<sup>14</sup> MOFA, ‘*Hi-nousanbutsu shijo akusesu kousho ni kansuru nibon no teian (kouken bunsho)*’, 2 August 2002. [[www.mofa.go.jp/mofaj/gaiko/wto/sgstn020802.html](http://www.mofa.go.jp/mofaj/gaiko/wto/sgstn020802.html)]

<sup>15</sup> Speech by MOFA Economics Bureau Chief (Sasae), 5 September 2002. [[www.mofa.go.jp/mofaj/press/enzetsu/14/sei\\_0905.html](http://www.mofa.go.jp/mofaj/press/enzetsu/14/sei_0905.html)]

<sup>16</sup> MOFA, ‘*APEC boueki tantou daijin kaigo*’, 30 May 2002. [[www.mofa.go.jp/mofaj/gaiko/apec/2002/boeki\\_gh.html](http://www.mofa.go.jp/mofaj/gaiko/apec/2002/boeki_gh.html)]

China and Japan may accelerate free trade with ASEAN by both, and eventually throughout East Asia.

Japan is playing catch-up with the AFTA free-trade process in that AFTA has accelerated its pace of liberalization due to the Pac Five's aggressive free-trade promotion and the need to compete for foreign direct investments vis-à-vis China. On the other hand, there still is resistance against complete liberalization of the farm trade within ASEAN. Therefore, it is likely that Japan will not rush free trade with ASEAN, despite China's recent initiative, until the prospect of tougher discipline on agriculture trade and related policy at WTO negotiations appears imminent, at which stage Japan is expected to propose moderate measures to open its farm markets, closer to the AFTA standard.

The course of Japan's action will also be influenced by who in Japan holds initiatives. The economic and trade ministry (METI), with little regard for the farm sector, is more willing to pursue 'significantly all' free trade with ASEAN collectively, whereas MOFA, having to listen to the Agriculture Ministry, prefers to minimize farm trade liberalization and pursue bilateral FTAs with ASEAN member countries to enhance Japan's bargaining power for this end. Based on a recommendation of the joint expert group, the ASEAN-Japan Economic Ministers meeting in September 2002 agreed to recommend that their leaders develop and consider a framework of future talks, including the guiding principles, establish a committee of senior economic officials within 2003 and complete an FTA 'as soon as possible within 10 years'.<sup>17</sup> In November 2002, following the China-ASEAN framework agreement for an FTA, Prime Minister Koizumi and ten ASEAN leaders signed a joint declaration to seek an FTA within ten years, based on the agreement at the economic ministers meeting.<sup>18</sup> Following the first official governmental discussions in March 2003, the parties agreed to finalize the negotiation framework in August to be signed at the summit meeting in October 2003.<sup>19</sup>

## OTHER BILATERAL RELATIONSHIPS

The bilateral agreement between Singapore and Japan gives the latter a bridgehead into the ASEAN market. At the same time, the selection of

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<sup>17</sup> ASEAN, 'The Ninth Consultation Between the ASEAN Economic Ministers and the Minister of Economy, Trade and Industry of Japan', 13 September 2002, Bandar Seri Begawan, Brunei Darussalam, Joint Statement. [[www.asean.or.id/print.asp?file=newdata/aem34\\_doc5.htm](http://www.asean.or.id/print.asp?file=newdata/aem34_doc5.htm)]

<sup>18</sup> 'Japan, ASEAN sign deal to pursue 'economic partnership', *Japan Times*, 6 November 2002.

<sup>19</sup> *Yomiuri Online*, 10 March 2003.

Singapore and the agreement's complete exclusion of agricultural products indicate Japan's reluctance to open up its agriculture market.

Thailand and Japan have entered preparatory discussions toward an FTA, but access to Japan's rice market has been the major obstacle. Thailand proposed a three-staged negotiation framework in which liberalization of politically sensitive products to be dealt with in the third stage can be delayed by ten years or even indefinitely.<sup>20</sup> Japan's senior economic organizations announced their preference for an early start of the official FTA negotiation.<sup>21</sup> However, the Koizumi-Thaksin meeting in June 2003 failed to launch an official negotiation.<sup>22</sup> Likewise, the meeting between Prime Minister Koizumi and President Arroyo of the Philippines in the same month to discuss progress toward a Japan-Philippines FTA only established an enlarged working group including industry, government, and academic representatives. The Philippines' request that Japan open its health-care services sector has met opposition in Japan.<sup>23</sup> Malaysia has been a reluctant player in the recent FTA bonanza, but it chose Japan as the first negotiation partner. The two countries started preparatory discussions in 2003. In December 2003, a special Japan-AEAN summit meeting produced an agreement to start bilateral FTA negotiations with these three ASEAN countries in early 2004 and between Japan and ASEAN as a community from 2005 with completion by 2012, two years later than the earliest likely date for a China-ASEAN free trade agreement.<sup>24</sup>

Japan and Korea have informally discussed free-trade area concepts since the mid-1990s. However, progress has been limited, partly due to the already deep interaction between their economies, which inevitably involves complex calculations of sectoral loss and gains.<sup>25</sup> After a summit meeting between Korean President Kim Dae-jung and Japanese Prime Minister Yoshiro Mori in 2000, business leaders from Korea and Japan launched the Korea-Japan Business Forum, discussing among other things a possible FTA.<sup>26</sup> Japanese Prime Minister Koizumi's meeting with Kim in Seoul in March 2002 further produced an agreement to launch a joint study group made of industrialists, academics, and policymakers. The group will work for the next two years to

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<sup>20</sup> *Yomiuri Online*, 11 March 2003; 12 May 2003.

<sup>21</sup> *Yomiuri Online*, 21 May 2003.

<sup>22</sup> *Yomiuri Online*, 7 June 2003.

<sup>23</sup> *Asabi.com*, 4 December 2002; 17 January 2003; *Yomiuri Online*, 7 June 2003.

<sup>24</sup> *Yomiuri Online*, 11 December 2003.

<sup>25</sup> *Korea Times*, 22 March 2002.

<sup>26</sup> *Asia Times Online*, 8 September 2001.

produce its recommendation.<sup>27</sup> In June 2003, Korean President Roh Moo-hyun visited Japan and met Koizumi, but they only agreed to ‘an effort to start the official negotiation as early as possible’.<sup>28</sup> The first official negotiation with Korea was held on 22 December 2003, and the two countries aim at concluding agreements in six areas (rules and dispute resolutions, merchandise trade tariffs, non-tariff measures—such as quarantine and labor issues, services and investments, other issues—such as intellectual properties, government procurements, and competition policies, and economic cooperation) by 2005.<sup>29</sup>

In June 2001, Japan and Mexico established a panel of Japanese and Mexican experts to conduct a feasibility study for a Japan-Mexico FTA. The group released a report in July 2002, recommending the governments of Mexico and Japan start FTA negotiations. The Japanese motivation is that it has already invested in the US-Mexico border area special export-processing zone (known as *Maquiladora*), but the Japanese factories there have suffered a comparative disadvantage *vis-à-vis* the Americans and Europeans, who signed FTAs with Mexico in 1994 and 2000, respectively. Expiration of the tariff-free imports of raw material and components (to be assembled and exported into the US market) in 2001 is pushing Japan’s manufacturers to seek free trade with Mexico.<sup>30</sup>

Japan, however, does not appear to be ready to fully embrace free trade with NAFTA. Unlike Chile, Japan is not ready to quickly conform to the various NAFTA standards, including liberalization of agricultural and some service-sector trade. Even in the proposal on an FTA with Mexico alone, ambiguous wording was used on agriculture.<sup>31</sup> Such a proposal is defensive of the *status quo* interests and reactive in nature, rather than proactive. At the APEC summit meeting in Mexico in October 2002, the two countries agreed to start the bilateral FTA negotiation in the following month to be concluded in approximately one year.<sup>32</sup> In December 2003 negotiations were continuing after disagreements over market access for several specific products.

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<sup>27</sup> *Korea Times*, 22 March 2002; *Dawn*, 24 March 2002 (internet edition); *Mainichi Shimbun*, 30 June 2002.

<sup>28</sup> *Yomiuri Online*, 7 June 2003.

<sup>29</sup> *Yomiuri Online*, 22 December 2003.

<sup>30</sup> *Japan Times*, 23 July 2002.

<sup>31</sup> *Ibid.*

<sup>32</sup> Japan-Mexico Joint Statement, 27 October 2002 [[www.mofa.go.jp/mofaj/kaidan/s\\_koi/apec\\_02/jm\\_kyodo.html](http://www.mofa.go.jp/mofaj/kaidan/s_koi/apec_02/jm_kyodo.html)].



## AUSTRALASIAN AMBITIONS

The geographical isolation of Australia and New Zealand and their small domestic markets have hindered the growth of strong domestic manufacturing. Their economic integration with Asia has been slow, partly due to the preferential trade relations they enjoyed with Britain prior to that country's entry into the European Economic Community, which worked as disincentive against developing deeper economic relations with Asia. Although Japan became the most important trade partner for Australia, this was largely because of Japan's imports of raw material (such as coal and iron ore) from Australia. By the mid-1980s, the prolonged economic slump and protectionism was replaced by reform-minded policies, which emphasized enhanced integration with Asia and removal of economic protections.

The Closer Economic Relations (CER) pact between Australia and New Zealand is already '95 per cent of the way there'.<sup>33</sup> In addition to the free-trade agreement that covers both agriculture and services, free investment relations and free labor movement are already in place, and there is an ongoing study of currency integration.

Unlike many developing countries that have political difficulties with free trade with the United States both in the manufacturing and agricultural sectors, Australia and New Zealand stand to gain in agricultural-sector trade liberalization. Both countries are vehement and sincere opponents of the recent US farm subsidy law, unlike the Europeans who also protect their agriculture. New Zealand and (to a lesser extent) Australia have become resigned to not having mass manufacturing industries, such as consumer electronics and automobiles, due to the small sizes of their domestic markets and geographical disadvantages. The United States, on the other hand, holds some reservation about anticipated increases in agricultural exports from Australasia, as demonstrated during the lamb trade dispute of 1998-2001.<sup>34</sup> While fruit markets, such as the apple market, are often compatible due to the opposite harvest season in the Southern Hemisphere, meat and processed food like wine (a growing industry in both Australia and New Zealand) pose competition to American producers. The United States and Australia are

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<sup>33</sup> Kevin Taylor, 'Expert queries CER priorities', *New Zealand Herald*, 14 May 2002.

<sup>34</sup> Yoichiro Sato, 'The United States- New Zealand Lamb Dispute', *New Zealand International Review* XXV (6), November/December 2000, 9-12; Yoichiro Sato and Stephen Hoadley, 'US Import Restraints and the Asia-Pacific: Politics and the Lamb Tariff', *Asian Perspective* 25(3), 2001, pp.113-134; Yoichiro Sato, 'The Lamb Import Dispute Revisited', *New Zealand International Review* XXVII (3), May/June 2002, pp.25-27.

negotiating an FTA. New Zealand hopes to piggyback on an Australian deal via CER, but due to their differing trade-item priorities, Australia has an incentive to sign free-trade agreements with the United States bilaterally. New Zealand's advantage is its more liberal manufacturing import policy compared to Australia, but its non-nuclear stance is a significant obstacle to any new deal with the United States.<sup>35</sup> Both Australia and New Zealand face tough US demands to strengthen intellectual property protection, especially parallel import laws.

For Australia and New Zealand, the closest markets of significant size are in Southeast Asia. Indeed, both countries consider free trade with ASEAN countries important. It appears that lack of progress on CER-AFTA free trade is due to the division within ASEAN, especially some members' weak domestic agriculture. These states prefer to prolong protection of domestic farmers and exclude farm products from free-trade arrangements—a direct assault on Australasian states' interests. Awkward security relations between Indonesia and Australia, and Malaysian Prime Minister Mahathir's political problems with Australia, do not help either. As Australia and New Zealand proceed with liberal FTAs with the United States, ASEAN members may feel left out.

Australia and New Zealand have pursued the possibility of an FTA between CER and MERCOSUR, but realized that their priorities and more realistic prospects lie with Asia. Australia and Singapore signed an FTA in February 2003, and Australia and Thailand concluded their joint FTA study and agreed in May 2002 to launch official negotiations.<sup>36</sup> Australia has also started framework negotiations with Japan and China.

New Zealand's small economy is uniquely placed in the game of trade alliances. Its attraction as a progressive liberalizer is not matched by domestic market large enough to attract trade partners. New Zealand targets bilateral agreements with small yet strategically placed markets that set precedents for larger regional trade agreements that might follow. Singapore is small and has little farm production to protect. At the same time, Singapore provided a foothold into ASEAN. New Zealand hopes its liberal FTA with Singapore will set a precedent to follow for later deals with all ASEAN. Negotiations with

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<sup>35</sup> Greg Ansley, 'Howard cautious on pact with US', *New Zealand Herald*, 22 June 2002; Brian Fallow, 'Sutton planning US juggling act', *New Zealand Herald*, 14 May 2002; Frank O'Sullivan, 'Free Trade and naval-gazing', *New Zealand Herald*, 2 April 2002.

<sup>36</sup> Purnendra Jain, 'Australia-US trade pact easier said than done', *Asia Times Online*, 11 June 2002.

Chile, a prospective new member into NAFTA, also aim at eventual access into the US market. New Zealand's negotiations with Hong Kong have made little progress, as New Zealand's concern over lax rules of origin enforcement (against Chinese exports via Hong Kong) has not been adequately met.

### **SOUTH ASIA**

In South Asia, the India-Pakistan dispute has precluded regional cooperation in most policy areas, including promotion of free trade. However, India's economic reforms and growing inward foreign investments have spurred its interest in free-trade agreements with countries and entities outside South Asia. India has proposed an FTA with ASEAN, Thailand, and Singapore. A declaration of intent to start negotiations has been signed with Singapore, which India considers to be a gateway into ASEAN and greater East Asia. The proposal encompasses a broad range of areas, including services, investments, and trade-facilitation measures.<sup>37</sup>

### **CONCLUSIONS**

Diverse interests in the Asia-pacific region have contributed to a proliferation of sub-regional free-trade agreements and proposals. This has made trade negotiations a complex three-layered bargaining process with the WTO, APEC, and sub-regional arrangements both complementing and competing with each other. Although a lack of progress in the global and regional arenas has accelerated the sub-regional formations, the existing global and regional rules have also provided a stopgap against proliferation of sub-regional FTAs that are totally inconsistent. Such a stopgap is far from ideal from a global free trader's perspective. Nevertheless, it is yet to be seen whether the evolution of global and regional rules in line with neoclassical liberal capitalism will keep both regional and sub-regional FTAs straight.<sup>38</sup> Alternately, a new global trade paradigm sensitive to non-trade factors, such as food security, development needs, and environment, will emerge to accommodate diverse regional and sub-regional FTAs.

On the question of agricultural trade liberalization, both the developed and the developing countries are divided among themselves, even within the Asia-Pacific region. Added to this complexity are the South Asian countries that are

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<sup>37</sup> 'Singapore deal new territory for India', *Economic Intelligence Report*, May 2003.

<sup>38</sup> Islam and Chowdhury emphasize the APEC principle of 'open regionalism' as a condition for the regional FTAs to be 'building blocks' for globalism. Iyanatul Islam and Anis Chowdhury, *Asia-Pacific Economies: A Survey* (London and New York: Routledge, 1997), p.14.

active members of WTO and are interested in joining APEC. India, for example, is reluctant to remove its agricultural subsidies and engage in a new round of multilateral talks unless developed countries show more willingness to negotiate the protected textile sector.

In the Asia-Pacific, three layers of competition are currently taking place. At the global level the forces of regionalism are based on the three pillars of Europe, the Americas, and East Asia and the globalization effects that connect them are operating simultaneously for all. With the APEC region, East Asia and the alliance of Americas and Australasia compete to promote differing paradigms of regional cooperation, especially in regard to agriculture (there is a somewhat more diffused division in regards to the service sector; in addition to Singapore and Hong Kong, Japan has an interest in promoting its service industry's interests in Asia). Within East Asia, ASEAN and China compete for foreign investments, and China and Japan compete for leadership. However, competition inside East Asia is more orderly, for many of the countries have pursued similar development paths of simultaneously promoting manufacturing industries and protecting some segments of the domestic agriculture. Those countries which did not fit the model (such as Singapore), could unilaterally pursue free trade in farm products without insisting that others to do the same. The competitive agricultural producers (Thailand) and would-be followers (such as Vietnam and Cambodia) within ASEAN have been persuaded by the simultaneous growth model of other East Asian countries and accepted delayed and limited liberalization of agricultural trade and exemption of this sector from complete liberalization, in return for delayed application on them of the tariff-reduction scheme for manufactured goods.

Overall, despite the differing pace of preference for free-trade progression, competition in East Asia and the Asia-Pacific can be a promoting factor for free trade, as long as the global tripolar competition remains an 'open' process.