



24

Japan's Trade Policy:

Advancing Multilateralism Through
Mega-FTAs

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Introduction

Reflecting on recent history, 2016 proved to be a watershed year for the international economic landscape, one that was characterized by major stumbling blocks. Key among these were the June referendum in the United Kingdom, which prompted the country's "Brexit" decision to leave the European Union (EU), and the victory of Donald Trump in the United States presidential election that November. Fueled by a blend of nostalgia for past glories and misleading rhetoric about immigration, the Brexit discourse tragically undermined the merits of economic integration. Today, the decision to leave the EU has left the UK grappling with the consequences of high inflation and stagnant growth. In parallel, Trump's "America First" trade policies unnecessarily escalated a trade war with China, causing disruptions in the global supply chain. These events precipitated a paradigmatic shift in international trade from a rule-based order to a "power-based disorder." The subsequent emergence of the COVID-19 pandemic and the outbreak of the Ukraine war have only compounded these complexities, plunging the global situation into deeper uncertainty.

This article deliberates on the appropriate trade strategy that Japan should pursue in this era of unprecedented uncertainty.

The historical development of Japan's trade diplomacy

(1) The TPP agreement, 60 years after Japan's accession to GATT

Japan's entry into the General Agreement on Tariffs and Trade (GATT), which is regarded as the cornerstone of its trade policy, took place in September 1955. 60 years later, the conclusion of the agreement on the Trans-Pacific Partnership (TPP) in October 2015 represents another moment of considerable significance.

Japan's accession to GATT was far from straightforward. Although the country finally managed to attain provisional membership as an observer in 1953, it had to wait until 1955 to secure full membership. This achievement, largely facilitated by the support of the United States, was met with resistance from several Western nations, notably the UK, France, and the Benelux countries, who invoked Article XXXV of GATT against Japan. This provision allows for a type of "discrimination" whereby existing members may recognize a new member while reserving the right to withhold key GATT privileges such as most-favored-nation (MFN) status and national treatment, effectively amounting to a veto. Consequently, Japan found itself essentially excluded from GATT relations with Western nations, with the exception of the United States, until the early 1960s.

To escape this predicament, Japan was compelled to accept various “grey-area measures” that either violated GATT rules or circumvented GATT principles, including quantitative restrictions and voluntary export restraints intended to stave off the market disruption that Western nations feared would be caused by Japanese products. This situation persisted until the conclusion of the Uruguay Round (1986–1994).

In the wake of the first oil crisis in October 1973, a growing demand for energy-efficient and resource-conserving products such as the improvement in car fuel efficiency emerged among Western consumers. This shift led to a significant transformation in manufacturing industries, which began to move away from heavy industries into lighter production on a smaller scale. Japan's electrical, electronics, and automotive sectors adeptly rode this wave of change. Subsequently, Japan's major industries made advances in terms of technology and knowledge intensification. However, this evolution sparked intense trade friction with the United States and the European Community (EC).

The essence of these trade frictions lay in the superior competitiveness of Japanese products in the international market, which led to significant trade imbalances. However, matters were complicated even further by various non-tariff barriers stemming from differences in business practices, particularly the perceived “closed” character of

the Japanese market. Japan was often labeled as a country that employed unfair trade practices, seemingly enjoying the benefits of a free trade system while not actively opening its own market. In September 1986, at the GATT ministerial meeting in Punta del Este in Uruguay, the EC came close to targeting Japan for its lack of a balance of benefits. Japan countered by arguing that GATT was a system designed to realize a balance of rights and obligations through negotiations; it sought the equalization of competitive conditions in trade, but not in terms of competition outcomes. This rebuttal effectively quashed the balance of benefits argument, thereby thwarting the EC's attempt to escalate the issue of Japan into a formal agenda item in the Uruguay Round.

At the time, Japan's trade policy was solely supportive of a multilateral trade system, while it exhibited marked skepticism towards regional integration. This stemmed from the view that customs unions and free trade agreements (FTAs) represented departures from GATT's MFN principle and were only reluctantly accepted as exceptions within the framework of regional integration. However, as the Uruguay Round a large-scale multilateral trade negotiation, expanded to include services and intellectual property rights, significant developments in regional integration were already underway, notably with the EC's third expansion in 1986 (with the accession of Spain and Portugal) and the establishment of the US-Canada FTA in 1989.

In particular, the United States' gradual pivot towards regional integration had a powerful impact on subsequent expressions of regionalism. In 1985, the US concluded an FTA with Israel. While negotiating in the Uruguay Round, it was simultaneously engaged in discussions for the US-Canada FTA, which evolved into the North American Free Trade Agreement (NAFTA) with the addition of Mexico in 1994. This was the same year the agreements reached during the Uruguay Round were ratified at the Marrakesh Ministerial Meeting in April. By this time, it was evident that the United States, once the leading advocate of the post-WWII free trade regime, had shifted its trade policy in favor of the dual strategy of balancing GATT's multilateralism with a regionalist stance epitomized by NAFTA's "hub and spoke" FTA system. Following the stagnation of the World Trade Organization's (WTO) Doha Development Agenda (DDA), also known as the Doha Round, US trade policy increasingly leaned towards FTA-focused regionalism. A case in point is the Trump administration's signing of the United States-Mexico-Canada Agreement (USMCA) to replace NAFTA, which President Trump had openly disdained. Despite being a trade agreement, some of the USMCA's stipulations, such as a 2.6 million car import quota from Canada and Mexico, respectively, into the US market, seem more indicative of a managed trade rather than a purely free trade approach.

(2) Japan's response to regional integration as a global trend

The core of globalization is encapsulated in the cross-border movement of four key elements: goods, services, capital, and people. The European Economic Community (EEC), now the EU, began as a customs union in 1958 before deepening its market integration after 1993 to establish a single market that promotes the free movement of these four elements. Inspired by the EU's success, regional economic integration has emerged as a global trend, even among countries in the developing world. This kind of economic integration predominantly takes the form of FTAs, where member countries reciprocally abolish trade barriers, including tariffs and non-tariff measures. According to JETRO's "World FTA Database," 476 FTAs existed worldwide as of December 2023.

In the face of a global trend toward bilateral and regional market integration, Japan has also increasingly embraced market integration since the turn of the 21st century. Preferring the term Economic Partnership Agreements (EPAs) to signify a broader scope than traditional FTAs, as of December 2023, Japan had enacted and signed 21 EPAs with 24 countries and regions since its first EPA negotiations with Singapore in 2001. These EPAs comprise approximately 80% of Japan's total trade volume (See Table 1 "A list of Japan's EPAs").

Table 1: A list of Japan's EPAs (As of January 2021)

In Force or Signed	<ul style="list-style-type: none"> • Japan-Singapore Economic Partnership Agreement • Japan-Mexico Economic Partnership Agreement • Japan-Malaysia Economic Partnership Agreement • Japan-Chile Economic Partnership Agreement • Japan-Thailand Economic Partnership Agreement • Japan-Indonesia Economic Partnership Agreement • Japan-Brunei Economic Partnership Agreement • ASEAN-Japan Comprehensive Economic Partnership Agreement • Japan-Philippines Economic Partnership Agreement • Japan-Switzerland Economic Partnership Agreement • Japan-Viet Nam Economic Partnership Agreement • Japan-India Economic Partnership Agreement • Japan-Peru Economic Partnership Agreement • Japan-Australia Economic Partnership Agreement • Japan-Mongolia Economic Partnership Agreement • Trans-Pacific Partnership Agreement (TPP12) • Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP11) • Japan-EU Economic Partnership Agreement • Japan-US Trade Agreement • Japan-US Digital Trade Agreement • Japan-UK Comprehensive Economic Partnership Agreement • Regional Comprehensive Economic Partnership (RCEP) Agreement
Under Negotiation	<ul style="list-style-type: none"> • Japan-Turkey Economic Partnership Agreement • Japan-Colombia Economic Partnership Agreement • Japan-China-Republic of Korea Free Trade Agreement
In Suspension	<ul style="list-style-type: none"> • Japan-GCC Free Trade Agreement • Japan-Republic of Korea Economic Partnership Agreement • Japan-Canada Economic Partnership Agreement

Source: Compiled by the author from Ministry of Foreign Affairs website and others.

The single most distinguishing feature of Japan's EPAs is their role in reinforcing the outcomes of Japan's foreign direct investment (FDI). Essentially, these agreements seek to increase the competitiveness of Japan's manufacturing networks, particularly in East Asia, by reducing trade barriers and fostering a more favorable investment environment in its partner countries. Following the Plaza Accord in September 1985, the Japanese yen

strengthened significantly. In response, many manufacturing businesses shifted their component production bases to countries in the Association of Southeast Asian Nations (ASEAN). These manufactured components are traded internationally, assembled into final products, and then exported to various countries, including those in the West, as well as back to Japan. In this sense, Japan's EPAs are instruments that serve

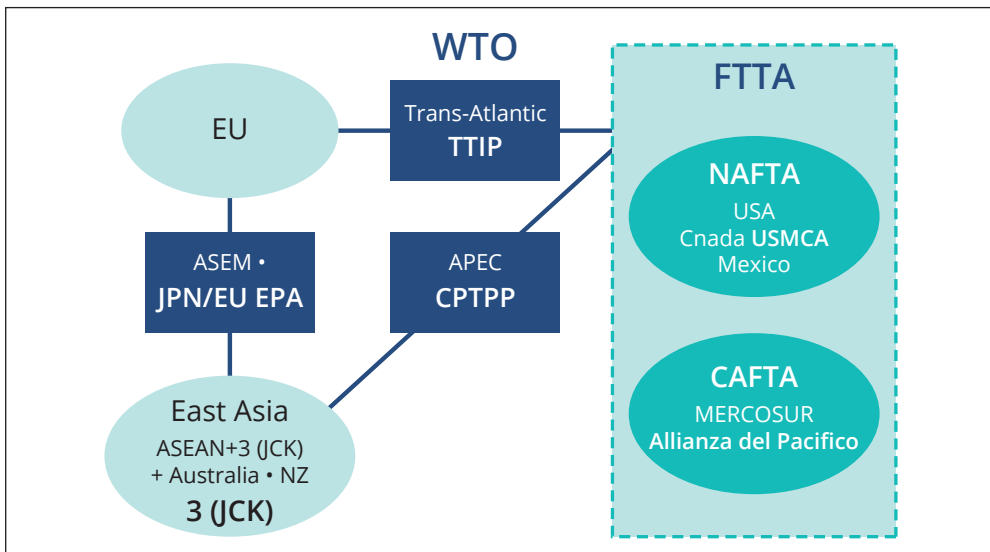
to safeguard and advance the overseas production activities of Japanese companies, formalized through treaties with foreign nations. Put another way, EPAs can be seen as legal instruments that maintain and strengthen the *de facto* integration that has evolved from the production and distribution networks resulting from Japanese FDI. The EPAs with the ASEAN countries are pioneering examples of this.

Japan's EPAs may thus be understood as consolidating the *de facto* integration formed by the combination of active FDI and local production by Japanese enterprises into a formal international treaty that provides legal stability. Accordingly, Japan's EPAs can be considered tools for achieving *de jure* integration.

(3) Japan's leadership role in three mega-FTAs: The CPTPP, Japan-EU EPA, and RCEP

In my view, there are three "poles of growth" now driving the global economy. First among these is the EU, where economic integration is most advanced, with 20 of its 27 member countries using the euro as a common currency. Second is the North American region, centered around the United States and including Canada and Mexico under the USMCA. The third is the rapidly growing East Asian region, home to the 15-nation Regional Comprehensive Economic Partnership (RCEP), comprising the 10 ASEAN countries as well as Japan, China, South Korea, Australia, and New Zealand (See Figure 1 "The three mega-regions and regional FTAs").

Figure 1: The three mega-regions and regional FTAs



Source: Prepared by the author.

While each of these three mega-regions continues to experience further internal integration, there have also been notable developments in inter-regional mega-FTAs. Of particular interest in this context has been the TPP (initially known as P4), which originated as an FTA among the four nations of Singapore, Brunei, Chile, and New Zealand. During the Asia-Pacific Economic Cooperation (APEC) meeting in November 2008, interest in joining this FTA was expressed by the host country, Peru, as well as Australia, while the United States showed interest in the services sector. The US, concerned about increasing market integration in East Asia in which it played no part, had actively supported the idea of a Free Trade Area of the Asia Pacific (FTAAP), which was proposed at APEC 2006 as an APEC-wide FTA. This move evolved from P4 to P9, then P11, and eventually included Japan in July 2013, forming a critical mass in the Asia-Pacific region. The TPP reached an agreement in Atlanta in October 2015. However, in January 2017, then-President Trump withdrew the United States from the agreement.

The US withdrawal from the TPP was regarded as a significant setback for the establishment of a robust trade order in the Asia-Pacific region. Nevertheless, Japan was able to lead the remaining 11 countries to maintain momentum with the launch of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), or TPP11, in December 2018.

In addition to the CPTPP, another significant regional mega-FTA is the Japan-EU Economic Partnership Agreement (Japan-EU EPA). This monumental agreement, which came into effect in February 2019, covers about a quarter of the world's GDP and a third of global trade. The Japan-EU EPA is seen as a testament to the joint leadership of Japan and the EU in fostering free trade. Accompanying this economic partnership is a Strategic Partnership Agreement (SPA) emphasizing political cooperation and promoting the sharing of the universal values of democracy, human rights, the rule of law, and market principles.

Finally, there is RCEP, which came into effect in January 2022. The origin of the RCEP dates back to a proposal made by Japan in 2006 for an "ASEAN+6" arrangement comprising ASEAN, Japan, China, South Korea, Australia, New Zealand, and India, which was initially framed as the Comprehensive Economic Partnership in East Asia (CEPEA). This proposal was essentially a counter to China's proposed East Asia Free Trade Area (EAFTA), which had been conceived as "ASEAN+3" (i.e., ASEAN with Japan, China, and South Korea). Japan's strategic inclusion of India in its proposal was intended to counter-balance China's growing influence. The "ASEAN+6" framework was eventually adopted as a model for East Asian free trade, a decision that was reinforced at the ASEAN summits held in Cambodia in 2012. RCEP negotiations, which began in May 2013, took a significant turn when

India withdrew in the final stages, citing concerns over the influx of Chinese products. Although this development disrupted Japan's initial expectation of countering China's influence, the RCEP still represented a crucial framework for Japan, marking its first FTA relations with both China and South Korea.

Current situation and challenges

On September 16, 2021, shortly after the conclusion of the RCEP agreement, China formally applied to join the CPTPP. Japan, which participates in a security alliance with the United States while being deeply intertwined economically with China, especially in terms of trade and investment, finds itself in a delicate position amidst escalating US-China tensions. The announcement of China's intention to join the TPP has led to widespread analysis of Japan's challenges in navigating this diplomatic dilemma. In my view, however, this development presents an excellent opportunity for Japan to demonstrate its real prowess in trade diplomacy.

Firstly, Japan has concluded 21 EPAs to date, including one with the EU, its world's largest trade partner. Japan has also signed a trade agreement with the United States, although this arrangement is confined to trade in goods only. Furthermore, Japan played a pivotal role in building a consensus to establish the RCEP, which comprises 15 countries,

including China. Most notably, Japan was instrumental in saving the TPP from disintegration after the withdrawal of the United States in January 2017. Japan's success in maintaining the TPP agreement by persuading countries such as Vietnam and Malaysia to remain committed despite their diminished interest following the US withdrawal has earned it widespread respect for its negotiating skills. This prowess will be crucial in ensuring China's strict adherence to the existing TPP terms without any relaxation. Specifically, this means taking a firm stance against any concessions regarding the regulation of state-owned enterprises and the transparency and fairness of data circulation.

Secondly, although there is some apprehension on Japan's part regarding the United States' reaction, this concern hinges primarily on the level of mutual trust in the Japan-US relationship. From Japan's perspective, it is simply a matter of making it clear to the US that its negotiations with China are conducted "on behalf of the US."

Thirdly, it's important to remember the unpredictable nature of negotiations. A crucial aspect in this regard is the power dynamic between Japan, an original signatory to the TPP, and China, an aspiring member. This relationship does not place the two on an equal footing. Newcomers must either accept the rules established by the original members or opt to leave the negotiations. In essence, China faces a "take it or leave it" scenario.

It is highly unlikely, and indeed inappropriate, for China to seek amendments to the existing rules as a new aspirant. China's application to join the TPP at this juncture is informed by its understanding that a swift US re-entry into the TPP under the Biden administration is unlikely. Moreover, even should negotiations with China over TPP membership get underway, they are not expected to be concluded swiftly, within two to three years.

Developments on the part of the United States can most likely be expected following the US presidential election in the fall of 2024. Barriers to the US rejoining the TPP, which it already agreed to in 2015, are likely to be resolved more swiftly than the negotiations concerning China's potential membership. As a result, there is a high probability of the US re-entering the TPP prior to China's accession. From Japan's perspective, it might be prudent not to pre-judge the outcomes of these negotiations. Adopting an "all are welcome" approach to China's application and offering technical support to China on the more challenging aspects of the agreement could be a strategic move for Japan to build goodwill with China.

Conclusion

On May 23, 2022, during his visit to Tokyo, US President Biden announced the launch of a new economic initiative, the Indo-Pacific Economic Framework (IPEF). This marked the first major US-led

venture since the country's withdrawal from the TPP under former President Trump, five years earlier in January 2017. The IPEF was founded with the participation of 14 countries, including Japan and the US.

The IPEF is composed of four main pillars: 1) trade, 2) supply chains, 3) the "clean economy" (i.e., clean energy, decarbonization, and infrastructure), and 4) the "fair economy" (i.e., tax and anti-corruption measures). While the IPEF does not extend to trade liberalization measures like tariff removal, it does encompass elements that could be considered as "TPP Plus," such as cooperation in the digital economy, strengthening supply chain resilience, and collaboration in sustainable infrastructure development.

What is China's perspective on the IPEF? Despite the enactment of the RCEP, China has formally applied for membership in the CPTPP, possibly perceiving the IPEF as a relatively feeble "paper tiger." China clearly recognizes the significant hurdles it faces in joining the CPTPP, which has much higher standards than the RCEP, particularly in terms of tariff elimination. China is likely to sideline the US proposal of the IPEF in favor of hastening its efforts to start negotiations for CPTPP membership. Singapore's Prime Minister Lee Hsien Loong already expressed his welcome for China's participation. With China actively seeking to initiate negotiations with the capitals of CPTPP member

countries, its diplomatic overtures are making Japan's somewhat reluctant stance appear somewhat conspicuous.

Even once China's negotiations for CPTPP membership get underway, it is expected that the process will take at least five years. As the United Kingdom joined the CPTPP before China, Japan could leverage this opportunity to coordinate with the UK to adopt a firm stance in its dealings with China. The UK, drawing on its challenging experiences with China over Hong Kong, could prove to be a formidable ally for Japan in these negotiations.

For Japan, the dilemma of choosing between the US and China presents a dichotomy that will have to be circumvented. The current confrontational and divisive state of US-China relations is not necessarily permanent. There is a substantial possibility for the easing of tensions between the two, especially on the economic front. This is evidenced by the expansion of US-China trade even amidst ongoing sanctions. Japan should strategically employ trade as a catalyst for peace. On the one hand, Japan should advocate for the US to reconsider early rejoining of the TPP, using the IPEF as a platform. On the other, Japan should engage in proactive negotiations with China, focusing on ensuring its compliance with rules-based trade in its negotiations to join the TPP. In doing so, Japan should take the initiative to integrate both the US and China into the Asia-Pacific economic

sphere, thereby contributing to regional peace and prosperity.

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