

Japan's FTA Strategy and Its Implications for Korea

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Since 2013 the Japanese government has actively engaged in Mega-FTA negotiations such as the TPP (Trans-Pacific Partnership), Japan-EU FTA, RCEP (Regional Comprehensive Economic Partnership), and China-Japan-Korea FTA. As of December 2014, Japan's FTAs with Singapore, Mexico, Malaysia, Chile, Thailand, Indonesia, Brunei, ASEAN, Philippine, Switzerland, Vietnam, India, and Peru have entered into effect. Japan's engagement in the TPP and Japan-EU FTA negotiations are expected to strongly impact national trade policy and global value chains, especially since Japan's FTA coverage rate at present is extremely low compared with that of the U.S., EU, Korea, and China. This paper examines Japan's FTA strategy by focusing on Japan's 13 bilateral FTAs, as well as ongoing

negotiations on the TPP and Japan-EU FTA. It primarily reviews the differences between Japan's 13 existing FTAs and two ongoing Mega FTA negotiations within the context of Japan's FTA strategy. Furthermore, the paper analyzes global value chains (GVCs) to understand the relationship between the Japanese government's FTA strategy and the role and strengths of domestic manufacturing firms.

1. Japanese Manufacturing Firms' Global Value Chains

An analysis of value-added exports reveals that RCEP members, including China, are the most important economic cooperation partners for Japan, as is the case for Korea. In 2011, the RCEP-5 (South Korea, China, Australia, Indonesia, and India) accounted for 27.7 percent of Japan's total value-added exports, larger

than the 21.7 percent accounted for by the TPP-4 (the U.S, Australia, Mexico, and Canada), according to Table 1. This implies that concluding a regional FTA in East Asia involving China will be highly beneficial for Japan.

Table 1. Value-Added Exports of Japan and Korea (2011)

(Constant 2005 US \$ million, %)

	Value-Added Exports				Exports (UN Comtrade Database)			
	Japan		Korea		Japan		Korea	
	Amount	Weight	Amount	Weight	Amount	Weight	Amount	Weight
TPP-4	156,584	21.7	61,227	18.8	164,626	20.0	118,921	21.4
(U.S)	115,554	16.0	43,474	13.4	127,675	15.5	56,421	10.2
EU-27	94,732	13.1	56,717	17.4	95,904	11.7	54,460	9.8
RCEP-5	199,715	27.7	108,346	33.3	274,837	33.4	208,247	37.5
(China)	131,092	18.2	65,778	20.2	162,035	19.7	134,185	24.2
(Japan)	-	-	24,661	7.6	-	-	39,679	7.1
(Korea)	28,682	4.0	-	-	66,174	8.0	-	-
Total	721,963	100.0	325,586	100.0	823,184	100.0	555,209	100.0

Note 1. TPP-4 : U.S, Australia, Mexico, and Canada.

2. RCEP-5: Korea, China, Australia, Indonesia, India for Japan, and Japan, China, Australia, Indonesia, India for Korea.

3. EU-27: EU-28 less Croatia.

Data: European Commission's World Input-Output Tables (EC-WIOT 1995-2011) and UN Comtrade Database

Table 2 shows the estimates of global supply chains (GSCs) and GVCs indicators which respectively measured how much intermediate goods and their value-added were produced at a global level by final goods exports of Japan and Korea. According to this analysis, most of Japan's exports of final goods contribute to producing their domestic intermediate goods. In 2011, 291.8 billion dollars of Japan's final goods exports led to the direct and indirect production of 485.9 billion dollars worth of global intermediate goods. The production of foreign intermediate goods accounted for only

22.1 percent of the total amount, whereas the share of Japanese goods was 77.9 percent. In value-added terms, 255.2 billion dollars or 85.7 percent returned to Japan, whereas 61.9 percent returned to Korea. This result implies that Japan's domestic intermediate goods production network is better than that of Korea, and that the Japanese government has put an emphasis on tariff elimination and cumulative rules of origin in their FTA negotiations to increase exports of its domestic manufacturing firms.

Table 2. GSCs and GVCs indicators for Japan and Korea (2011)

(Constant 2005 US \$ million, %)

	Japan				Korea			
	GSCs indicator		GVCs indicator		GSCs indicator		GVCs indicator	
	Amount	Weight	Amount	Weight	Amount	Weight	Amount	Weight
TPP-4	16,573	3.4	8,202	2.8	23,313	6.0	11,877	6.8
(U.S)	8,889	1.8	4,338	1.5	13,292	3.4	6,766	3.9
EU-27	11,547	2.4	4,300	1.4	19,482	5.0	7,483	4.3
RCEP-6	417,132	85.8	268,236	90.1	302,176	77.5	134,093	77.0
(China)	28,952	6.0	8,012	2.7	44,007	11.3	12,426	7.1
(Japan)	378,647	77.9	255,150	85.7	21,001	5.4	7,336	4.2
(Korea)	9,161	1.9	2,421	0.8	225,022	57.7	107,774	61.9
Total	485,906	100.0	297,566	100.0	389,758	100.0	174,075	100.0

Note 1. GSCs indicator measures the volume of global goods production induced directly and indirectly by individual country's final goods' exports.

2. GVCs indicator measures the value-added amount of the above GSCs indicator.

3. TPP-4: U.S, Australia, Mexico, and Canada.

4. RCEP-5: Korea, China, Australia, Indonesia, India for Japan, and Japan, China, Australia, Indonesia, India for Korea.

5. EU-27: EU-28 less Croatia.

Data: EC-WIOT 2011.

According to Table 3, Japanese manufacturers' revealed comparative advantage (RCA) indicator based on value-added exports has remained around 0.76 to 0.79 since 1995. This means Japanese manufacturing firms have maintained their strong competitiveness even in the late 2000s. Furthermore, Japan's value-added ex-

ports are 2.22 times bigger than those of Korea, although its total exports are only 1.48 times bigger. This indicates that Japanese exports create more domestic value-added, and implies that Japan's FTAs bring more value-added to their domestic production.

Table 3. RCA based on the Value-Added Exports of Japan and Korea

	1995	2000	2005	2006	2007	2008	2009	2010	2011
Japan	0.772	0.766	0.760	0.758	0.762	0.770	0.794	0.786	0.785
Korea	0.900	0.842	0.745	0.734	0.735	0.738	0.732	0.727	0.734

Note 1. Traditional RCA indicator is based on gross exports.

Data: EC-WIOT 1995-2011.

2. Japan's FTA Strategies in its 13 Bilateral FTAs

The analysis of the Japanese government's FTA strategies in its 13 bilateral FTAs clarifies how Japan concluded bilateral FTA negotiations to expand domestic firms' GVCs and protect the domestic agricultural sector, and what prevented manufacturing firms from fully taking advantage of the signed FTAs in their foreign trade. The results can be summarized as follows:

First, although the Japanese government emphasizes comprehensive coverage and high levels of liberalization in its 13 FTAs, the actual level of liberalization is low since Japan chose FTA partners from the perspective of protecting their domestic agriculture, fisheries and livestock markets. However, it is unclear whether the Japanese government can successfully maintain its 'traditional' FTA strategy in the ongoing TPP negotiations.

Second, the Japanese government has put a great deal of emphasis on the services, investment, and intellectual property rights (IPRs) chapters in its bilateral FTA negotiations to broaden and deepen Japanese firms' GVCs while vigorously protecting its domestic services sector, including electricity, gas, construction, legal and accounting services.

Third, the FTA utilization rate of Japanese firms is still low, although the number of certificates of origin issued by the Japanese Chamber of Commerce and Industry increased sharply and the JETRO survey shows that the growth of Japanese firms' FTA utilization rate jumped to 42.9 percent in 2013 from 36.2 percent in 2009. This is mainly due to the fact that the liberalization level of signed FTAs is low. In fact, goods often do not benefit from FTAs' preferential tariffs due to the complex

rules of origin or the lack of information on the FTA procedure.

Lastly, the fact that the Japanese government already laid out 72 types of rules of origin (ROO) in its 13 effective bilateral FTAs increases the burden on Japanese firms to obtain certificates of origin, and ultimately impedes Japanese firms from taking advantage of FTAs. To lighten that burden, the government introduced the 'Autonomous Certificate System for Customs Approved Registered Exporters' in the Japan-Switzerland FTA and adopted the same system in the Japan-Peru and Japan-Mexico FTAs. Nevertheless, challenges still lie ahead for the Japanese government to unify or harmonize complicated rules of origin and develop an effective way to utilize cumulative rules of origin.

3. Japan's Strategy in the TPP-12 Negotiations

The TPP negotiations missed the end of 2014 deadline mainly due to the 'conflicts of interest' between developed countries, especially between the U.S. and developing countries, such as Vietnam and Malaysia. They could not reach a basic agreement on four chapters – i.e., market access, IPR, competition (state-owned enterprises), and environment.

Furthermore, talks between the U.S. and Japan conducted several times in parallel to the TPP-12 negotiations have not concluded as of the end of 2014. Japan's TPP strategy can be summarized as opening up the U.S. automobile market in return for liberalizing its agricultural market. The Japanese 'exchange strategy' seemed to be effective until Japan's official declaration of participation in the TPP in March of 2013. At that time, the Japanese government seemed to be confident that they

could exclude the so-called five sacred items (586 HS-9 tariff lines) in agriculture, fishery, and livestock sectors from tariff concessions in the TPP negotiations. Table 4 shows that the Japanese tariff system of the agricultural and

manufacturing sectors is very asymmetric, which drives the Japanese government strongly towards the protection of the agricultural sector in the TPP negotiations.

Table 4. MFN applied tariffs by product groups for Japan (2012)

(%)

Product groups	AVG	Duty-free in % ¹⁾	Max	Product groups	AVG	Duty-free in % ¹⁾	Max
Animal products	18.1	46.6	189	Fish & fish products	5.7	3.2	15
Dairy products	89.6	6.3	692	Minerals & Metals	1.0	70.4	10
Fruit, vegetables, plants	12.5	19.6	337	Petroleum	0.7	64.7	8
Coffee, tea	16.1	227	182	Chemicals	2.2	38.9	7
Cereals & preparations	27.5	18.1	610	Wood, Paper, etc.	0.8	80.6	10
Oilseeds, fats & Oils	11.0	46.1	580	Textiles	5.4	8.1	25
Sugars and confectionary	27.5	12.0	93	Clothing	9.1	1.8	13
Beverages & tobacco	15.3	31.1	54	Leather, footwear, etc.	12.1	54.1	463
Cotton	0.0	100.0	0	Non-electrical machinery	0.0	100.0	0
Other agricultural products	6.2	67.5	415	Electrical machinery	0.1	97.8	5
				Transport equipment	0.0	100.0	0
				Manufactures, n.e.s.	1.2	75.7	8

Note 1. The share of duty-free products is based on the HS-6 code.

Source: WTO-ITC-UNCTAD, *World Trade Profiles* 2013.

However, as of the end of 2014, the strategy seems to be losing momentum. For instance, even though the Japanese government seems to have withdrawn the strategy of excluding all of the five sacred agricultural items (586 HS-9 tariff lines) from tariff concession, the U.S.-Japan negotiations for tariffs and safeguards on pork, beef, and dairy products are facing difficulties even at working-level consultations. The Japanese government's tough stance on agricultural tariff eliminations is attributable in part to the fact that the U.S. congress has yet to grant Trade Promotion Authority (TPA) to the U.S. government.

For Korea, the costs of not participating in the TPP will be huge when Japan concludes a

high level of liberalization with the U.S. and the other ten TPP members¹. In particular, the outcome of U.S.-Japan negotiations can be critical for Korea's decision on its formal participation in the TPP negotiations, given that the TPP, a pluri-lateral FTA, may be a "back-door" bilateral FTA between Korea and Japan. In this regard, if Korea decides to participate in the TPP, Korean manufacturing sectors cannot but intensely compete with Japanese

¹ Petri, A.P. et al. (2013) estimated the costs will amount to the 0.1% of GDP (U.S 2,800 million \$) in 2025, and KIEP (2013) also estimated the costs as 0.11-0.19% of GDP. See Petri, A. P., Michael G. Plummer, and Fan Zhai. 2013. "Adding Japan and Korea to the TPP," *Asia-Pacific Trade* (March 7), and KIEP. 2013. *The Analysis on the economic impacts of TPP* (in Korean).

counterparts in its domestic market because of much bigger tariff reduction or elimination on

Korea's end. Table 5 shows the asymmetry of tariffs of Japan and Korea.

Table 5. Tariffs Comparison of Japan with Korea (2012)

(%)

	Simple Average		Duty-free in % ¹⁾		Binding coverage
	Final bound	MFN applied	Agricultural products	Non-Agricultural products	
Japan	5.2	4.6	47.0	83.0	99.7
Korea	16.6	13.3	10.3	37.6	94.6

Note 1. The share of duty-free products is based on the HS-6 code.

Source: WTO-ITC-UNCTAD, *World Trade Profiles 2013*.

4. The Main Issues and Japanese Strategy in the Japan-EU FTA Negotiations

The Japanese government officially began FTA negotiations with the EU in April of 2013. The Japan-EU FTA is expected to be more comprehensive than recently concluded FTAs such as the Korea-EU and EU-Singapore FTAs because they cover a wider scope of areas –i.e. overall commodity trade including tariffs, TBT, sanitary and phytosanitary measures (SPS), service trade, e-commerce, investment, government procurement, IPR, competition, trade and sustainable

development, non-tariff measures, rules of origin, customs clearance facilitation, geographical indications, animal welfare, corporate governance, and business environment.

However, in the fifth round of negotiations in April of 2014, the Japanese government offered only an 88 percent level of tariffs elimination which excludes all five sacred items (586 HS-9 tariff lines) in agriculture from tariff concession, while the EU offered a 92 percent liberalization level. The EU's high tariffs on manufacturing products and Japan's high tariffs on agricultural and dairy products as shown in Table 6 are a major obstacle to concluding their FTA negotiations.

Table 6. The Main Disputable Issues in the Japan-EU FTA negotiations

Sectors	Japan's Requests	EU's Requests
Market Access	<ul style="list-style-type: none"> - Tariffs reduction or elimination on truck (22%), automobile (10%), automobile parts (3-4.5%), and flat panel TV (14%) etc. - Clarifications on customs classification of IT products 	<ul style="list-style-type: none"> - Tariffs reduction or elimination on cheese (22.4-29.8%), ham (high-quality products 8.5%, low-price products, 614yen/kg(max)), wines(15% or 125yen/l, lower of the two), butter(360%) etc.
Standards	<ul style="list-style-type: none"> - Unification of Regulation Markets such as REACH. 	<ul style="list-style-type: none"> - Harmonization and Mutual Recognition of standards on automobiles and medical devices etc.
Competition/Public Procurement	<ul style="list-style-type: none"> - Eliminations of entry barriers in public procurement 	<ul style="list-style-type: none"> - Permit of entry into public procurement in railway and transportation.

IPR		<ul style="list-style-type: none"> - Protection of EU brands on cheese, ham etc. - Strengthening control on counterfeit, pirated or smuggled goods
Investment and Services	<ul style="list-style-type: none"> - Mutual recognition of professional licenses such as accountant. - WTO-GATS plus liberalization on service trade. 	<ul style="list-style-type: none"> - Elimination of entry regulations on public utility sector. - Equal competition in telecommunication, financial services, distribution, transport sectors.

Source: Tomoyoshi Tanaka (2014), "Towards conclusion of the Japan-EU FTA (part 2)" (in Japanese), Flash 178, Institute for International Trade and Investment (ITI).

Another outstanding issue in the Japan-EU FTA negotiations is the reduction or elimination of Japanese non-tariff barriers. In weighing costs and benefits against Japan, which

imposes low tariffs on manufacturing sectors, the EU may need to demand that Japan remove its non-tariff barriers.

Table 7. Japanese Non-tariff barriers (Number in force, June of 2014)

Anti dumping	Countervailing	Quantitative Restrictions	SPS	Special Safeguards	TBT	Sum
4	0	21	27	52	25	129

Source: WTO-ITIP.

However, regulatory reform in the Japanese government is limited to regulatory harmonization, trade facilitation and streamlining customs procedures. Ultimately, the conclusion of the Japan-EU FTA negotiations will hinge upon Japan's reduction of non-tariff barriers and EU's acceptance. Therefore, Japan needs to especially promote regulatory reform through the growth strategy known as the 'third arrow' of Abenomics.

For Korea, the economic effects of the Japan-EU FTA would be negative due to the fade-off of the Korea-EU FTA, since the Japan-EU FTA will allow the EU's tariff elimination on Japanese manufacturing products such as automobiles, shipbuilding, and electronics. Furthermore, Korea could face additional requests by the EU on non-tariff measures. Nonetheless,

elimination of non-tariff barriers in both Korea and Japan will ultimately contribute to the promotion of trade and economic growth through domestic regulatory reform. **KIEP**