

**FTA Policies of Northeast Asian Countries and  
Possibilities of Northeast Asian FTA(s):  
Japanese Perspective  
Preliminary draft**

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**Summary**

This paper provides a Japanese perspective on the possibility of Northeast Asian FTA. From the pure economic view point, some framework of integration in this region (including FTA) is beneficial for the three countries as well as for other Asian countries. However, there are several factors blocking the realization of FTA in this region. One of these blocking factors is obviously the chilly political relation between Japan and other two countries based on Yasukuni-shrine issue. The lack of summit meeting among the three made it difficult for serious talk to initiate any kind of economic cooperation in this region. New Abe cabinet has taken a different approach to this region from the previous Koizumi cabinet, and there are some chances that FTA policies are considered in this region. Secondly, all three countries have given priorities to ASEAN countries for their FTA policies. This made it difficult for FTA to be discussed among the three. In the case of Japan this emphasis of ASEAN are based on its previous investment commitments to this region and its Asian policies after the currency crisis. The current process of Asian integration is moving toward ASEAN + 1 + 1 + 1, that is, each of three countries have FTA arrangement with ASEAN. This trend is not appropriate for the true integration process of the Northeast Asian region. Efforts must be made to transform ASEAN + 1 + 1 + 1 to ASEAN + 3. Thirdly, it should be noted that FTA is not necessarily what Japan considered the most appropriate approach to regional integration. Here is the issue of the appropriate approach to trade and investment liberalization. One always has to compare bilateral and regional approach (FTA) with multilateral approach (WTO) to achieve liberalization and integration. Japanese government seems to think the realization of commitments China made for its entry into WTO is more important than initiating new FTA project. Furthermore, non-tariff issues such as investment treaties, service trade, and intellectual properties are more complementary to current transformation of China under WTO than simple tariff reductions.

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**Theoretical introduction to the issue**

Free Trade Agreement (FTA) policies have attracted increasing attention in the last 15 years, and the number of FTA is increasing rapidly. The conclusion of NAFTA in the beginning of 1990s was a critical turning point from multilateral negotiation only approach to coexistence of multilateral, regional and bilateral liberalization process. Although there are some concerns among economists on the proliferation of FTA policies due to various distorting effects of discriminatory liberalization of FTA<sup>1</sup>, most nations are increasingly inclined to FTA negotiation.

Classical discussion on pro and con of FTA (and customs union) is about trade creation vs. trade diversion effects<sup>2</sup>. While FTA provides more opportunity for increasing trade between the countries forming FTA, FTA may diminish import from countries outside the circle of FTA. The former is called trade creation effect, while the latter is called trade diversion effect. It is theoretically possible that trade diversion effect is larger than trade creation effect and so that FTA harms the economic welfare of the countries forming FTA.<sup>3</sup>

This discussion of trade creation vs. trade diversion was raised in the 1950s and 60s when European nations were moving toward customs union. Many extended analysis have been raised on the pro and con of FTA (and customs union) since then. Kemp and Wan<sup>4</sup> claimed that customs union can make all countries better off (or at least not worse off) if appropriate tariff rates are chosen between the countries in a customs union and other countries,

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<sup>1</sup> Bhagwati et. al. [1996] provides various economic reasons against preferential trade agreements.

<sup>2</sup> This concept originated from the classical study of Jacob Viner [1950].

<sup>3</sup> Theoretically, it is not possible to determine which of the two opposing effects is larger. So, simulation models based on computational general equilibrium models have been used to examine whether the actual FTA treaties have positive welfare effects. According to these studies FTA seems to enhance economic welfare for most cases.

<sup>4</sup> Kemp and Wan [1976] initiated this analysis and many extended researches have been conducted since then.

and the analysis was later extended to the case of FTA. This analysis is important not only for theoretical curiosity but also for the interpretation about what has happened in the real world. The reason why trade diversion effect can arise is because trade barriers with the outside of FTA become relatively higher, even though they are not raised in the absolute levels, after FTA member countries remove tariffs among them. If tariffs on imports from the countries outside FTA are lowered when FTA is formed, trade diversion effect can be made smaller. What Kemp-Wan analysis showed is that FTA will be better from the view point of economic welfare if tariffs with non-member countries are lowered at the same time. Note that GATT Article 24, which requests that tariffs should not be raised vis-à-vis nonmember countries after the formation of FTA, is not enough for this purpose<sup>5</sup>. So, international legal framework does not support the Kemp-Wan mechanism to be realized. However, what happens in the real world is increasing number of FTA with increasing partner countries and with various overlap of countries. For example, the countries like Singapore and Mexico signed FTA treaties with so many countries. When Mexico had FTA with the United States and with EU but not with Japan, possibly diminished trade between Mexico and Japan may cause some trade diversion effects on Japan and Mexico. Then, Japan signed FTA treaty with Mexico, and trade between the two has expanded rapidly since then, which implies that trade diversion effect was eliminated by this new FTA.

Kemp-Wan argument has some important implication for Northeast Asian FTA, since neither of the three countries, Japan, Korea and China, has signed any FTA treaties among them, while each signed various FTA treaties with ASEAN countries as well as other countries. These FTA will generate trade creation effects with ASEAN countries, while non-existence of FTA in this region may generate trade diversion. Considering the fact that economic interdependence among these three countries is very strong, the possible trade diversion effect may be substantial.

Let me continue more on the theoretical development of regional preferential policies (FTA, customs union and the like). Coexistence of multilateral negotiation in WTO and increasing number of FTA induce economist to initiate more serious consideration of political economic aspects of FTA negotiation. The following questions are often raised; "Are FTA policies building blocks or stumbling blocks for the achievement of global liberalization?", or "Are domestic protectionist pressure obstacles for the realization of FTA, or are FTA policies effective to change political structure in such a way to liberalize domestic market?"<sup>6</sup>

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<sup>5</sup> Article 24 is the only article in GATT which refers to the rule concerning preferential trade agreements. It seems to be inserted in the GATT agreement, since Benelux countries had already formed customs union when GATT was established.

<sup>6</sup> There is vast literature on the dynamic issue of preferential trade agreements. See Bhagwati et. al. [1999] for some results on this issue.

It is not possible to find clear and simple answers to these questions. All depend on what assumption we make. Depending on the assumptions and the structure of the model, one can obtain very different results. However, consideration of these questions provides various useful insights on the developments of actual FTA policies in this region. For example, in Japan, the balance between FTA and multilateral negotiation has been an important element determining the timing and speed of FTA negotiation. There are many government officials in Japan believing that pushing FTA policies too much may damage WTO regime. Japan was far behind the United States and European nations in the timing of starting FTA policies. Existence of many foreign affairs bureaucrats in the past, who believed FTA was harmful for the achievement of global and multilateral liberalization process, made the timing for Japan to initiate FTA policies very late. Late entry of Japan into FTA races may be one of the reasons why Northeast Asian economy is far behind in the world trend of regional trend. It is interesting to note that at the turn of the century, there were only four nations/regions among the top 30 nations/regions in their size of GDP which were not in any FTA; they were Japan, China, Korea, and Taiwan. The situation in Japan changed substantially after it decided to start FTA negotiation with Singapore.

Several factors are behind this changing attitude of the Japanese government. One factor is the difficulties of negotiations in WTO, which force the government to work with alternative channel for trade negotiation. Second reason for the changing attitude is increasing number of FTA policies in various parts of the world. FTA policies have become “the game of the rule” in the liberalization process of the world. Under this trend Japan must enter the game, whether it likes the rule or not. If Japan does not pursue FTA policies with its trading partners, it will be left outside the network of FTA. Thirdly, the voice of business community was very critical. With or without FTA, Japanese firms have made large amounts of investment in the region and FTA policies with Asian countries will be critical for these firms to expand their operation in the region. The cases of automobiles and electronic products are good examples. These products consist of many parts and production locations of these parts are spreading over many countries in Asia. FTA policies between Japan and Asian countries will support the cross border division of labor across Asian regions.

The other question on political economy, which I raised above, is also important to interpret the developments of FTA policies in Japan. The question is, “whether domestic interests group such as farmers are barriers to FTA policies, or pursuing FTA policies may change the domestic political structure of these sectors?” This question is perhaps more important for the case of Japan than other countries, since Japan is now in the interesting process of political system change. Oversea observers often have a very simple stereotype view on Japan; “Farmers in Japan are so strong that it is impossible to liberalize Japanese

market”. Several facts suggest that this stereotype view is very dubious. Compare the average tariff rates on agricultural products of Japan with other countries such as Korea, China or even Thailand. Although one can raise an academic question about how can we measure “the average”, officially used simple average tariff rates show that the figure of Japan is lower than those in other countries mentioned above<sup>7</sup>. Note also that the value of farm product import of Japan is larger than any other countries and import content of domestic food consumption of Japan is still rising. I will discuss below that although domestic farmers are serious barriers to FTA policies, FTA policies are very effective to reform domestic agricultural policies. This logic will apply for various reform areas, not only for agricultural area but also for medical care, immigration policies, labor policies and so on.

### **The position of Japan's FTA policies**

Recently FTA policies in Japan have been upgraded in its priority ranking among various policy issues faced by the Japanese government. This changing attitude toward FTA policy by the government is important for analyzing future perspectives on regional integration in the Northeast Asia.

It was only a few years ago when FTA policies were still given only a secondly position in the ranking order of various policies in spite of occasional mentioning of the importance of FTA policies by the prime minister and by various ministers. The neglect of FTA policies by the government was symbolized by the fact that negotiations were delegated to individual ministries and no effort was made by the prime minister office to coordinate negotiation process. A negotiator in ASEAN countries described the situation like negotiating with many “countries” in Japan such as “agricultural country”, “labor country”, “industry country” and so on with no serious coordination being made<sup>8</sup>. This negotiation style of the Japanese government caused frustration in the countries negotiating with Japan, and it was natural that the speed of negotiation was slow.

Leadership of the prime minister is vital for successful negotiation of FTA since individual ministry has very different attitude toward FTA. For example, agricultural sector has been in a strong position against liberalization of the sector and it is not easy for other ministries to persuade agricultural sector to liberalize its market without some strong leadership of the prime minister.<sup>9</sup>

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<sup>7</sup> I am writing this sentence based on my memory, so I must check the data later.

<sup>8</sup> This is based on my private conversation with an official in a ASEAN country.

<sup>9</sup> When Japan opened its domestic rice market following the Uruguay round agreement, the government offered a large amount of subsidies to the agricultural sector. This kind of compensation by subsidies is not easy to implement due to the present difficult budget deficit

There are several factors behind the upgrading in the priority of FTA policy in Japan. One of them is increasing FTA cases by neighboring countries such as China and Korea. When Japan started its first FTA negotiation with Singapore, neighboring countries such as China and Korea were not negotiating any FTAs. The northeast Asia was far behind other parts of the world in the pace of FTA negotiation. Although Japan changed its trade negotiation attitude from WTO centered one to the one including FTA negotiation, its incentive to speed up FTA negotiation was still weak at the time. The entry of China and Korea into FTA games has changed the environment, since it was thought by many government officials as well as politicians that being behind neighboring countries in FTA negotiation games implies Japan's weaker status in Asia.

Business community has been increasingly inclined to voicing up the importance of FTAs. This is again due to increasing number of FTAs outside of Japan, not only by neighboring countries but also by various countries in the world. Failure in FTA negotiation implies that Japanese firms are excluded from overseas markets. The case of Mexico was a good example of this. Mexico was aggressively engaged in FTA negotiation with many countries, and it had FTA with the United States and EU. Thus, products from the US and EU face no tariff barriers to the Mexican market, while Japanese products faced high tariffs. Japanese business community as well as the Ministry of Economy and International Trade had strong concern for this kind of discrimination, which induced them to raise stronger voices for FTAs.

By the final period of Koizumi cabinet, FTA policies were updated to one of the highest priority. Fundamental policy plan of 2006 by Koizumi cabinet included FTA policies and concrete schedule for FTA negotiation process with ASEAN countries was set by the government. Countries like India, GCC countries, Chile, and Australia were included in the list for possible partners for FTAs. Furthermore, region wide FTAs including ASEAN + 3 countries (Japan, China and Korea) or additionally another three countries (India, Australia, and New Zealand) were planned by the government.

Abe cabinet, which succeeded Koizumi cabinet, put stronger emphasis on regional integration policy for Japan. The Economic and Fiscal Council, the most important decision making body of economic policies in the government, chaired by the prime minister, started project team for accelerating FTA negotiation. The prime minister office also started another special project team, called Asian Gateway Strategy Meeting, again chaired by the prime minister, to discuss integration of Japan with neighboring countries. The results from these councils and meeting will be reflected in the fundamental policy for 2007. One has to wait and see whether the changing attitudes of the Japanese government will generate visible changes in

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problem.

the actual liberalization of the Japanese market and its integration with neighboring countries.

The FTA strategy of Japan in the early stage was characterized by an approach to give priorities to the negotiation with ASEAN countries. Singapore was the first partner for the negotiation of FTA<sup>10</sup> and other ASEAN countries such as Thailand, Malaysia, Philippines, and Indonesia were chosen successively for the targets for FTA negotiation. Although Japan now has expanded its targets of its FTA policy to wider regions and countries other than ASEAN countries, the early stage of the negotiation was concentrated in ASEAN countries. In spite of the fact that trade volumes with Northeast Asian countries such as Korea and China are large, no serious initiative was taken from Japanese side to initiate FTA negotiation with China. For the case of Korea, FTA negotiation has stopped and any more serious efforts have not been observed so far in the Japanese side to continue FTA negotiation.

Japanese government consider ASEAN region as a critical area for its economic and political security. Cumulative investment made by Japan in this region is larger than those in China and Korea. A large amount of official development aids (ODA) has been made to this region. Asian currency crisis in the latter half of 1990s was also a critical turning point for Japan's policy toward ASEAN countries.

Assisting stability, growth and integration of ASEAN countries has been important policy issues for Japan after the Asian currency crisis. Japan made various efforts to promote currency cooperation; some idea such as establishing Asian Monetary Fund was not realized, but other projects such as building swap scheme for exchange rate stability, nurturing Asian bond markets, and establishing Asian currency unit have been continuing.

Emphasis on FTAs with ASEAN countries should be interpreted as a part of Japan's efforts to increase the linkage with the region and to support further integration of the region. It is interesting in this respect to note that there were debates in the government several years ago concerning the choice between the two different approaches of FTAs with the ASEAN countries, one is to follow the sequence of FTA negotiation with individual countries in ASEAN, and the other is to negotiate FTA with ASEAN region as a whole. Korea, China and Australia take the latter approach, while Japan takes the two approaches at the same time. Some ministry which emphasize the importance of negotiation with ASEAN as a whole notes the importance of supporting integration process of ASEAN countries.

Japan does not put much effort to promote Japan-China, or Japan-China-Korea FTA. Although some efforts were made to initiate Japan-Korea FTA, the negotiation has stopped and either government has not shown any strong sign of desire to restart the negotiation. Before

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<sup>10</sup> There is an old saying in Japan, "when one carries a baby, it is better for the baby to be small to carry and to become bigger after he/she gets out of the mother's body. One of the reasons why Singapore was chosen as a first partner for FTA negotiation was the small size of Singaporean economy.

the Asian summit of 2006, Chinese government requested to start a formal study project of trilateral FTA with the participation of government officials, but Japanese government did not respond positively to that request. Japanese government, in turn, suggested official meeting to investigate the possibility of investment treaty rather than FTA<sup>11</sup>.

There are several factors behind the low key on the possibility of trilateral FTA among the three countries, Japan, Korea and China. One is the lack of opportunity of summit meeting among the three countries in the last few years following the several visits by Mr. Koizumi to Yasukuni-shrine.<sup>12</sup> Although this situation seems to change when Mr. Abe visited the two countries shortly after he succeeded Mr. Koizumi, it is still uncertain whether the change in the prime minister will induce any serious efforts for trilateral FTA to be discussed among the three.

Japan and Korea entered into FTA negotiation. This follows series of events changing diplomatic relation between the two countries. Japan took FTA negotiation as a good opportunity for further strengthening the economic and social relation between the two countries. However, it was revealed, after the sudden termination of negotiation, that economic interest to initiate FTA is not as strong as in the case with ASEAN. When Korean government suddenly stopped the negotiation, Japan's side did not have very strong will to endeavor to continue the negotiation. Since this issue is still continuing, it is too early to give any conclusive interpretation on this issue. However, one can raise several reasons for the lack of will to continue the negotiation. First of all, Korean market is not considered as important as ASEAN market. Korea has closed its market to various Japanese products in such areas as automobiles in the past. Furthermore, Japanese past investment to Korea was not very successful; very difficult labor-management relation was one reason for Japanese investors not to be attracted to the Korean market. The perception in Japan about Korean market of being difficult to penetrate into and low level of economic activity of Japanese firms in Korean discouraged Japan to make more efforts to continue negotiation. It is interesting to note that business communities in Japan which play an important role for promoting FTA negotiation with ASEAN countries and with Mexico has not show strong enthusiasm for FTA with Korea, which may reflect their perception of Korean market.

The economic relation between Japan and China has become stronger and stronger in spite of chilly political relation between the two countries in recent years. The volume of trade

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<sup>11</sup> The Asia summit meeting was postponed.

<sup>12</sup> At the Manila meeting of ASEAN plus three in 1999, the leaders of the three governments agreed to start joint research projects on the possibility of further strengthening of economic cooperation of the three countries, and three institutions, NIRA in Japan, KIEP in Korea, and DRC in China, have been continuing joint research projects. However, this research project cannot yet be upgraded to the one with formal participation of government officials.



between the two now exceeds that between Japan and the United States, and China has attracted the largest amount of investment of Japan. Chinese economy is not only an important location for production and for exporting to the rest of the world, but it is an important market for the Japanese goods. Japanese firms have increased their commitment to the Chinese market. From the pure economic view point, FTA will provide good opportunities for the two countries to harvest further economic gains from trade and investment. However, Japanese government so far does not show strong interests in FTA negotiation with China.

Chilly political relation due to Yasukuni Shrine issue is perhaps one of the reasons for the reluctance from the Japanese side to initiate FTA negotiation. However, there are some other reasons behind the reluctant attitude toward FTA with China. One of the reasons is the issue of multilateral vs. bilateral liberalizations mentioned before. Realizing the commitments China made when it entered WTO is more important for Japan than having FTA with China. China's entry to WTO was an important event for the trading partners of China, including Japan. The commitments China made were substantial and it was a good opportunity for Japan to expand its trade and investment to China. The crucial point here is to make sure that these commitments are actually implemented. The commitments China made will cause substantial transformation of the domestic economic and social structure. This transformation is more critical than possible change in trading opportunity from FTA.

Different view on the contents of FTA between Japan and China may be another reason for Japan's reluctant attitude toward FTA with China. Since it negotiated with Singapore, the Japanese government emphasized that what it was negotiating was Economic Partnership Agreement (EPA), not just FTA. EPA means FTA plus other arrangements, such as service trade, movements of people, investment treaty, economic cooperation, and so on. Tariff rates of Japan are very low, except some agricultural goods, as a result of sequence of GATT=WTO negotiations. So, what Japan is interested in, according to the government view, is to seek deeper integration with neighboring countries rather than simply lowering border tariffs. On the contrary, China was seeking FTA (tariff reduction part) in its negotiation with ASEAN countries. So, if Japan and China negotiate FTA, the two must decide first whether they negotiate FTA or EPA. Japan will not take the position of tariff only approach, but to negotiate non-tariff issues with China will not be easy. It will overlap with many of the commitments China made when it entered WTO.

So, it is not easy to find in the government any strong will to start FTA negotiation with China. One must look for other channel in Japan for the initiative for FTA. Business community is one candidate for taking the initiative due to its strong interest in penetrating further into Chinese market through trade and investment. Another chance for starting FTA

negotiation with China, and possibly with Korea, comes from non-economic reasons. As has already mentioned, Abe cabinet shows strong interest to rehabilitate its diplomatic relation with China and Korea. Northeast Asian FTA can be utilized as a symbolic project for constructing closer relations among the three countries. In this case initiatives must come not from bureaucracy but from the prime minister office. The projects in prime minister office in such vehicles as Economic and Fiscal Counsel and Asian Gateway Strategy Meeting may be used for promoting Northeast Asian FTA.

### **Domestic Issues; are they obstacles for FTA?**

It is widely believed that agricultural sector in Japan is a serious obstacle for any liberalization policies including FTA. It is true that farmers have always been against liberalization of their sector and their political influence has been a barrier for GATT=WTO negotiation or FTA negotiation. However, looking farmers as an unmovable obstacle to FTA is not a correct picture of the present state of the politics in Japan. The realities of the agriculture sector are changing and the relation between FTA and domestic reform should be viewed from many different angles.

Political influence of agricultural lobbying is changing in Japan due to several reasons. First of all, it should be noted that farmers in Japan are rapidly aging; the average age of farmers is around 65. The share of agricultural sector in the whole economy continues to fall due to the transformation of the economy toward more industry and service based economy. Smaller number of farmers and smaller economic activities make political influence of farmers smaller and smaller. This trend will continue.

It should be noted, however, that in spite of diminishing share of the agricultural sector, it has had too much political influence. This is a phenomenon one can observe in any industrial nations. For example, textile industry in the United States has a strong political influence in spite of its small share in the market. Political theory teaches us that this is due to concentration of interests in a limited number of people and these people have strong incentive to move politically. In Japan farmers have a strong interest to stop liberalization and majority of consumers do not have incentives to move politically on the issue.

Although this interest group theory is still true in any country including Japan, political reform in Japan has been gradually changing the picture of politics. It is beyond the capacity of my knowledge to discuss this issue here, but it may be useful to refer to the case of privatization of postal saving under Koizumi cabinet as an example.<sup>13</sup> Here, the issue was

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<sup>13</sup> In Japan this phenomena is often linked with the unique character of the former Prime Minister Koizumi. Although Mr. Koizumi played an important role for changing the political scene in Japan, many experts in Political sciences point out that the changing structure of the Japanese politics cannot be attributed only to Mr. Koizumi's personal character, but it should be

whether voters are for or against privatization, and the vast majority of voters voted for privatization. This kind of change cannot be imagined in the previous political system. It is pointed out by various political observers in Japan that such changes as the single-seat electoral district system invited the changing attitude of political decision mechanism. It now becomes more difficult for small groups to control political decision through elections.

It should be also pointed out that some farmers now have very different view on the future of the agricultural sector in Japan. Japan's agriculture industry was characterized by very small farmers who obtained their land at the time of land reform policy after World War II.<sup>14</sup> The government established various measures to support these small and uncompetitive farmers. Now, these farmers get very old. From the view point of the efficient use of agricultural land, the farm land owned by these small and aged farmers should be transferred to younger and more competitive farmers through selling or leasing these lands. Increasing voices are raised to introduce more competition-promoting policy measures in the agricultural sector; so there must be shifts from protecting small farmers to supporting competitive farmers, from import restriction to production promotion, and from protection of small farmers to the promotion of entry of new style management for farming activities. It is too early to say that these developments will change Japan's trade policy for agricultural sector, but there is some hope that agricultural policy will become more forward looking in future.

It should be noted that series of FTA negotiation has changed people's view on the domestic issue of Japan. Without difficult trade negotiation various protection policies in the agricultural sector would not be revealed to the eyes of many ordinary citizens. FTA negotiation with Mexico revealed import protection of pork, and FTA negotiation with Thailand revealed protection on chicken. Negotiation with Philippines on immigration of medical staffs (nurses) and resistance from the nurse association in Japan revealed very conservative attitude of the nurse association on the eyes of Japanese people. Strong voices are occasionally raised that small interest groups such as farmers of certain products or the nurse association should not be so aggressive to stop liberalization process. This situation is very similar to so called "bicycle theory of trade negotiation"<sup>15</sup>. According to this view, trade negotiation is like riding on a bicycle. One should keep moving bicycle, otherwise bicycle will fall down. Similarly, one should continue trade negotiation; otherwise protectionist policies will raise their heads. FTA negotiation has revealed various protectionist measures to ordinary people and arguments for more liberalization and deregulation have been stimulated.

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understood as fundamental changes undergoing in recent years.

<sup>14</sup> In order to support small farmers, the government did not allow entry of corporation into agricultural activities. Deregulation on this issue is now discussed in the government.

<sup>15</sup> I utilized this concept to discuss postwar liberalization process of Japan in Komiya and Itoh [1988].

It should be noted that one of the most important reasons for FTA policies is to promote domestic reforms. Liberalization through FTA policies is effective to change domestic system. It is not easy to change existing domestic system from within. Many of the existing systems have been built on the balance of various forces in the domestic system. This kind of political equilibrium is difficult to perturb from inside.<sup>16</sup> Some pressure from the outside is quite effective to change the equilibrium balance. FTA policies are useful not only for having better trade access but also for promoting domestic reforms. Such sectors as agriculture, education, medical service and retail can be transformed by exposing them to international competition.

### **The steps toward Northeast Asian FTA**

As we have seen so far, Northeast Asia FTA does not seem to be realized soon. Many people recognize the existence of economic and social gains from the FTA, but there are many political obstacles for FTA negotiation. In this section, I want to explore the possible steps towards Northeast Asian FTA.

Note that each of the three countries, Japan, China, and Korea, is now in the process of FTA negotiation with ASEAN. If these negotiation lead to FTA agreement, we will have three types of FTA with ASEAN countries (so called ASEAN + 1 + 1 + 1 agreement). One can then consider the possibility of transforming regional FTA covering ASEAN plus the three countries. Asian summit has announced the possibility of ASEAN + 3 or plus 6 (six implies Japan, Korea, China, India, Australia, and New Zealand). This is the most possible channel for the realization of Northeast Asia FTA.

Needless to say, to move from ASEAN + 1 + 1 + 1 to ASEAN + 3 is not easy at all. It implies trade barrier among the three countries are removed, which is almost equivalent to creating Northeast Asian FTA from zero. Furthermore, since FTA with ASEAN will take different forms among the three countries, adjusting the existing three FTA agreements must be made. This is not an easy task. So far, no coordination has been made among the three FTA agreements. Having said various difficulties with the change from ASEAN+1+1 to ASEAN + 3, the change, however, will be very beneficial for the three countries as well as for the region as a whole considering that the largest trade and investment are made among the three countries. It is also useful to note that ASEAN+1+1+1 is a regional arrangement with ASEAN countries as the center of the network, but that ASEAN + 3 is an arrangement where the Northeast countries will be the center, since actual volume of trade and investment of the three countries

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<sup>16</sup> So called *Gaiatsu* (foreign pressure) is well known in the literature of trade conflicts between Japan and the United States. *Gaiatsu* was quite effective to change domestic regulations in Japan. It is often said that the effectiveness of *Gaiatsu* shows the lack of ability in Japan to reform itself from inside. However, this is a rather naïve view.

are far larger than ASEAN countries.

Another channel for Northeast Asian FTA is through Japan-Korea FTA. Although negotiation is now in halt between the two countries, the two countries should find a way for starting negotiation again. The negotiation of FTA between Korean and the United States will have critical effects on the motivation for restarting negotiation between Japan and Korea. Japanese government has been quite sensitive to any FTA results in neighboring countries. It is not easy to see what influence can be expected if Korea fails the negotiation with the United States. I would like to delegate this question to the Korean participants in this meeting.

Third channel is starting from investment agreement of the three countries. Although the Asia summit was postponed, it is reported that the three countries had reached to the agreement that they will establish formal study group for investment treaty. Investment treaty does not touch on tariff reduction, but it can be complementary to trade liberalization. China is now in the process of trade liberalization following its entry in WTO. So, investment treaties among the three can play an important complementary role with trade liberalization of China. Investment treaties can be expanded to other areas such as service trade, intellectual property treaties, cooperation in the area like energy and environment. Such cooperation and coordination are quite effective to promote trade and investment among the three. If trade and investment among the three further expand, then political momentum for FTA negotiation will become much stronger. Furthermore, if the three countries take this route for FTA negotiation, then EPA not FTA will be achieved.

As I have mentioned before, the leadership of prime minister is essential to accomplish any FTA, and it is particularly so for the case of Northeast Asian FTA considering various factors I mentioned above which make it difficult to start FTA negotiations in this region. From the view point of Japan Prime Minister Abe's initiative is essential. His cabinet started special taskforces for further integrating Japan with neighboring countries, but so far no mention has been made about Northeast Asian FTA. The actual FTA negotiation and study project have been conducted based on the planned schedule of FTA negotiation determined during the period of Koizumi cabinet. However, it is too early to predict future perspective of Northeast Asian FTA, since Mr. Abe has taken the prime minister office for only three months yet. There will be series of summit meetings of the three countries from now on, and any decision at the summit meeting will be the most effective channel for starting FTA negotiation in this region.

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