Japan's FTAs:
Farm Reform Vital for Better Trade Regime

By Naoyuki HARAOKA

Amid the ongoing global economic crisis, concern is growing about a possible rise of trade protectionism, as seen during the Great Depression in the 1930s. The World Trade Organization (WTO), whose mission is to fend off protectionism and promote multilateral free trade, has not fully played its role, with the WTO-sponsored Doha Round of trade talks stalled since late 2008. If trade protectionism flourished around the world, global trade would shrink further amid the economic tailspin caused by the global financial crisis, and national economies could fall into a spiral of balanced contraction. As poor countries would be affected most severely in that event, the spread of trade protectionism could threaten their political stability as well. In this sense, how to ward off protectionism is extremely important to ensure the world's political and economic stability. For the new US administration of President Barack Obama busy with domestic economic management, world trade does not appear high on its policy agenda.

FTA Effects Initially Doubted

Under these circumstances, it is necessary to make multilateral efforts to restore confidence in the Doha Round. What is needed in particular is to establish new WTO rules requiring member countries not to take fresh protectionist trade and investment measures during the financial crisis. At the same time, it is also important to actively conclude bilateral and regional free trade agreements (FTAs). When FTAs were first concluded in the 1990s, they were often seen as arrangements running counter to the WTO-led multilateral trade regime.

Doubts on bilateral FTAs were raised at such international forums as the Trade Committee of the Organization for Economic Cooperation and Development (OECD). Discussions at those forums were made without questioning consistency between bilateral FTAs and WTO rules. On that assumption, suspicions were raised that bilateral FTAs might bring about larger effects in terms of trade diversion than in trade expansion, even though those arrangements would not run counter to the multilateral trade mechanism. (Trade diversion effects mean that an increase in trade between two countries involved in a bilateral FTA reduces their trade with third countries.)

In this sense, both the European Union (EU) and the North American Free Trade Agreement first raised international concern they could adversely affect the global economy. However, an increasing number of economies have come to pay attention to the advantages of FTAs since the start of the 21st century as the Doha Round has made little headway. This is because FTAs can realize tariff cuts, which are most important to trade, in a relatively short period of time. If a country concludes an FTA with an important trade partner, it will lead to mutual tariff cuts that could strengthen the international competitiveness of each other's export industries. At the same time, it will also entail reductions in import prices, bringing about domestic economic benefits in each country.

FTAs Spur Freer Trade As Doha Round Stalls

Moreover, the United States and South Korea have concluded an FTA that is now pending at the two countries' legislatures for ratification. South Korea is also in FTA talks with the EU. After South Korea's FTAs with the United States and the EU come into force, third countries (Japan in particular in this case) could be affected greatly. Outside the FTA regimes, ordinary tariffs will be imposed on products of Japan's export industries to their disadvantage in terms of price competition. To tide it over, third countries will be required to conclude FTAs with the partner countries concerned. Thus, many countries would rush to conclude FTAs in a bid to achieve equal terms of competition. As a result, considerable trade liberalization can be achieved before the WTO-led trade talks come to a conclusion.

Currently, Japan has signed or concluded FTAs with Singapore, Malaysia, Chile, Brunei, Mexico, the Philippines, Thailand, Indonesia, Vietnam and Switzerland. Japan has also concluded a regional FTA with the Association of Southeast Asian Nations (ASEAN). In addition, talks are under way to sign FTAs with South Korea, India, Australia and the Gulf Cooperation Council (GCC) comprising the United Arab Emirates, Bahrain, Kuwait, Oman, Qatar and Saudi Arabia. In East Asia, Japan is one of the countries that have concluded or continued talks to sign the biggest number of FTAs. In East Asia, South Korea and Singapore are also active toward concluding FTAs, as is Japan.

South Korea has already concluded FTAs with Singapore, ASEAN and the European Free Trade Association (EFTA). And those FTAs have already come into force. South Korea has also concluded FTAs with India and the United States, but they have yet to come into effect. South Korea and the EU have reached provisional agreement on all issues at the level of chief negotiators. South Korea is also in FTA talks with Mexico, Canada and the GCC. In addition, South Korea is considering signing FTAs with China, New Zealand and the Mercosur bloc that groups Argentina, Brazil, Paraguay and Uruguay.

Singapore has already concluded FTAs with Japan, South Korea, India, the United States, New Zealand, Australia, EFTA, Jordan and Panama. Those pacts have already gone into force. In addition, Singapore, Chile, Brunei and New Zealand have concluded the Trans-Pacific Strategic Economic Partnership Agreement. Singapore has also signed FTAs with China, Peru and the GCC that have yet to come into practice. The city state is also conducting FTA talks with Mexico, Canada, Pakistan and Ukraine.

FTAs Substituting for WTO Process

As stated above, a great number of FTAs have been concluded in East Asia, and competitive trade liberalization is going on there. Under such circumstances, it is not so important any more to question consistency between bilateral FTAs and the WTO. This is because an increasing number of FTAs will eventually replace the WTO-led liberalization process.

But whether this is true or not is considered to depend on the quality of each FTA. The quality of an FTA can be measured by the rate of liberalization in terms of tariff lines (categories) or trade value. (Under this formula, all items covered by an FTA are broken down into the following tariff lines – immediate tariff abolition, tariff removal within five or 10 years, tariff quotas, and exemption from tariff reduction or abolition. It then works out the ratio of either the number or trade value of items in each tariff line to the total number or trade value of all tariff line items. The rate of liberalization can be called high – hence the quality of an FTA is also high – if the proportion of items subject to tariff abolition immediately or within five to 10 years is large. In contrast, the rate of liberalization is low – as is the quality of an FTA – if the number or trade value of items exempted from tariff abolition is large.)

Chart 1 indicates the rates of liberalization under the FTAs that Japan has concluded with eight countries (Brunei, Chile, Indonesia, Malaysia, Mexico, the Philippines, Singapore and Thailand) and that have already produced some results. The rates were calculated on the basis of tariff lines. A comparison of Japan's tariff reduction commitments with those by its trade partners indicates something interesting. The ratio of items subject to immediate tariff abolition to all items (both farm and industrial products) covered by the FTAs is around 80% for Japan. The figure tops similar ratios for the eight trade partners. It is thus safe to say Japan and its trade partners have maintained favorable performance under those FTAs as a whole.

Japan Needs Farm Reform to Boost Quality of FTAs

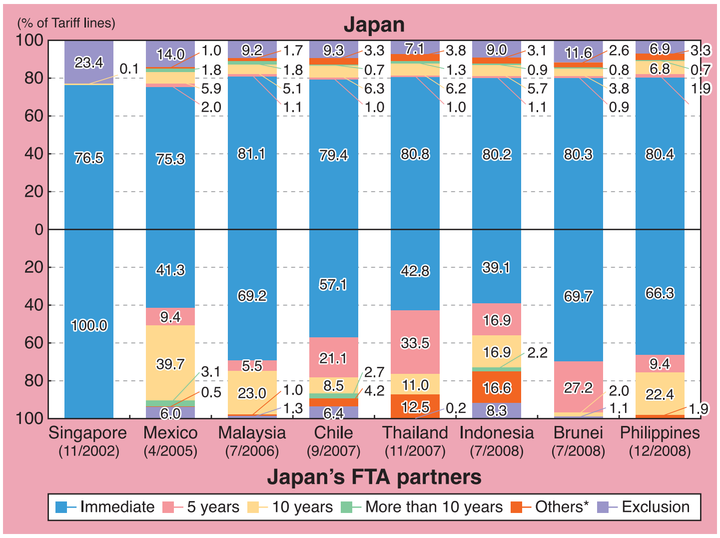
However, Japan's ratio of agricultural products subject to immediate tariff removal is less than 30% compared with more than 30% for the trade partners except Indonesia. Moreover, Japan's FTAs include a number of items exempted from tariff reduction or abolition. Japan's trade partners are committed to scrapping tariffs for almost all agricultural items eventually even though they are given grace periods of five to 10 years or even longer in some cases. *(Chart 2)*

In contrast, Japan's proportion of agricultural items subject to exemption from tariff removal is much higher across the board than that for its trade partners. Separate calculations for farm and industrial products show that Japan's ratio of industrial items exempted from tariff abolition to all industrial products is very low at 1%-2%. But a similar ratio for agricultural products exceeds the 30% mark as a whole. Japan's ratio of agricultural items exempted from tariff abolition to all farm items is much higher than similar ratios for the eight trade partners.

This clearly shows what features Japan's FTAs – high rates of liberalization for industrial products and extremely low rates for agricultural products. In addition, it is evident that Japan's ratio of liberalization in farm items is lower than those of some developing countries among the eight trade partners. As stated earlier, FTAs can play the role of a flag-bearer of free trade as long as their quality is high. Japan is required to undertake a sweeping reform of its agriculture and establish a powerful farm industry that can maintain competitiveness under a higher rate of liberalization. JS

CHART 1

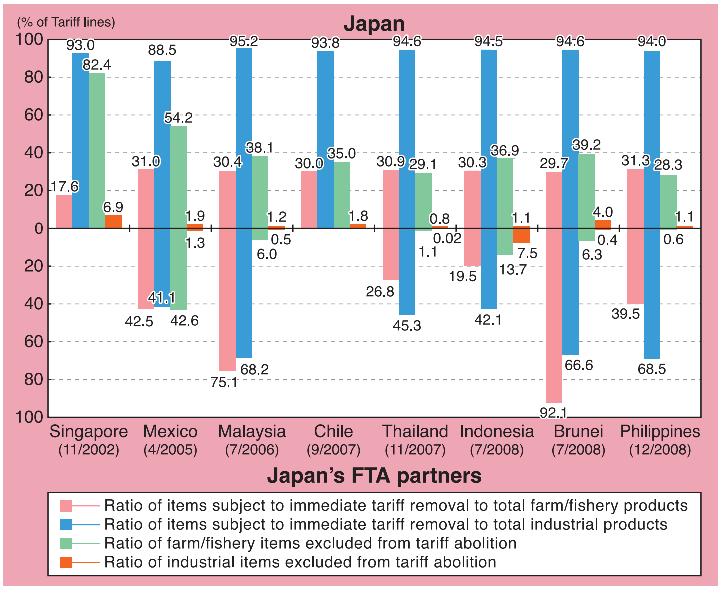
Comparison of each country's FTA in levels of liberalization (goods)



Note : "Others" mean either tariff quotas or being subject to further consultations.
Source : Prepared by Ms. Noriko Endo, Haraoka's assistant, based on FTAs & tariff concession schedules of FTA partners

CHART 2

Ratios of farm/fishery/industrial products subject to immediate tariff removal/exclusion from tariff abolition



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Naoyuki Haraoka is Editor-in-Chief, Japan SPOTLIGHT.