

# The Rules of WTO & EPAs: Legal Infrastructure of the Global Supply Chain



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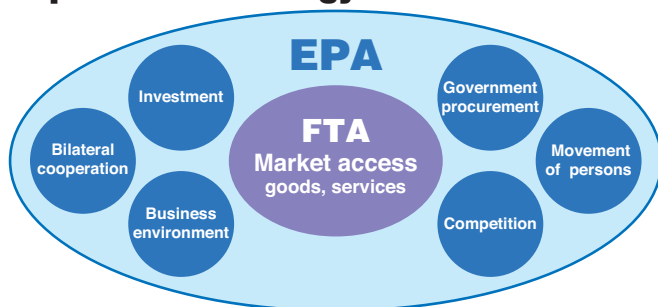
## EPAs: Japan’s Rule-oriented FTAs

The purpose of free trade agreements (FTAs) in the past was to improve market access by eliminating tariffs and quantitative restrictions, as well as reducing non-tariff barriers. However, starting with the 1989 US-Canada FTA, the scope of FTAs began to be expanded beyond the liberalization of trade in goods. NAFTA (North American Free Trade Agreement), which evolved from the US-Canada FTA, took in Mexico as an additional partner. Regarding services, NAFTA established a “negative list” approach to negotiations as opposed to the “positive list” approach used in WTO services negotiations. This led to a more radical and ambitious liberalization of the service sector. Rule-making, including the establishment of a dispute settlement mechanism, proceeded in relation to not only trade in services but also investment and government procurement.

It was in the early dawn of the 21st century that Japan mapped out its full-fledged FTA strategy for the first time in the history of its trade policy.

CHART 1

### Economic partnership agreement EPA: Japan’s FTA strategy



Source: Compiled by author

TABLE 1

### Substance of Japan’s EPA

		Trade in goods			Trade in service				Investment				Government procurement	Intellectual property	Competition	Improvement of business environment	Cooperation	Energy and mineral resources
		Market access	SPS/TBT	Mutual recognition	Market access	National treatment	MFN treatment	Movement of natural person	National treatment	MFN treatment	Prohibition of performance requirements	Dispute settlement between state and investor						
ASEAN	Vietnam	○	○		○	○		○			○				○	○	○	
	Philippines	○		○	○	○	○	○	○		○		○	○	○	○	○	
	ASEAN	○	○														○	
	Brunei	○			○	○	○	○	○	○	○	○						○
	Indonesia	○			○	○	○	○	○	○	○	○		○	○	○	○	○
	Thailand	○		○	○	○	○	○	○	○	○	○		○	○	○	○	
	Malaysia	○	○		○	○	○	○	○	○	○	○		○	○	○	○	
	Singapore	○		○	○	○	○	○	○	○	○	○		○	○	○	○	
Latin America	Chile	○	○		○	○	○	○	○	○	○		○	○	○	○	○	
	Mexico	○	○		○	○	○	○	○	○	○		○	○	○	○	○	
Europe	Switzerland	○	○		○	○	○	○	○	○	○		○	○	○	○	○	

Source: Compiled by author

Right from the beginning, in pursuing its free trade policy, Japan had an ambition to go beyond the scope of traditional FTAs – improving market access – as indicated by the fact that the country preferred to use EPAs (Economic Partnership Agreements), rather than FTAs, in referring to its free trade pacts (Chart 1). As long as an EPA covers a free trade area as defined by Article XXIV of GATT (General Agreement on Tariffs and Trade) and Article V of GATS (General Agreement on Trade in Services), it is obvious that the agreement is intended to improve market access for goods and services.

However, Japanese style EPAs go beyond single market access-focused FTAs, making rules on investment, government procurement, competition policies, improvement of the business environment, bilateral cooperation, population movements, mutual recognition, etc. (Table 1). In many cases, such rules, which assume these elements as a fundamental part of the EPA, are either not covered by current WTO rules or else, as with government procurement, they concern areas where the other country is not a signatory of the related WTO agreement. Of course, market access remains the most fundamental component of both FTAs and EPAs; however, the fact that the EPA of Japan introduced uniform disciplines and common rules regarding trade problems that the WTO did not cover in sufficient detail, is certainly something that demands greater scrutiny. Bearing these issues in mind, this article examines the roles that are played by the rules of EPAs and the WTO, which provides a framework of multilateral trade, as a legal infrastructure of international trade.

## Increasing Utilization of Japan’s EPAs

Japan has already put 12 EPAs into effect (Chart 2). Japan’s EPA policy has its roots in the establishment by Japanese manufacturers of an East Asian production network that takes advantage of the characteristics of countries in this region in response to an upsurge of the yen against the dollar that was triggered by the September 1985 “Plaza Accord.” The strong yen prompted Japanese

manufacturers in various sectors, particularly electronics and automotive parts, to start production in other East Asian countries. The parts and components manufactured there were traded across borders within East Asia, between subsidiaries of the same manufacturer and between different companies in the same industry. Such cross-border, intra-company and intra-industry trade led to a “de facto integration” of this region. Essentially, Japan’s EPA policy is an attempt to consolidate this de facto integration through legal steps in the form of the conclusion of international agreements. In other words, we may say that the trade regionalism that has become increasingly active in Japan since the turn of the century represents a shift from the “de facto Business-driven Integration” that emerged in the wake of the Plaza Accord to a “de jure Institution-driven Integration” backed by a string of EPAs concluded with Japan’s trading partners.

Let us look at some examples where Japanese EPAs have acted as the driving force behind Japanese companies’ advances abroad. Daihatsu Motor is pouring efforts into building a presence in Indonesia as a market with strong growth potential. Japan concluded an EPA with Indonesia in July 2008, and direct investment by Japan in Indonesia has been increasing steadily since then. According to a newspaper article (Nikkei Shimbun, May 30, 2011), Daihatsu is building a new factory in the suburbs of Jakarta and plans to produce 100,000 units annually of fuel-efficient, low-cost small cars in a land area of 800,000 square meters. Indonesia is the largest overseas production base for the company, with an annual production capacity of 280,000 units of small minivans and other vehicles. Daihatsu plans to raise the capacity to 330,000 units annually. Indonesia’s auto market expanded to 760,000 units in 2010, up 57% from the previous year. In this burgeoning market, Daihatsu is second only to Toyota Motor, with annual sales of 119,000 units. Daihatsu also plans to build a new R&D center on the premises of the new factory, in an attempt to devote serious efforts to the development of new cars better tailored to local needs. The R&D center is scheduled to start operation at the same time as the start of production at the new factory in late 2012. Already, some of the 70 development engineers at Daihatsu’s Indonesia subsidiary, Astra Daihatsu Motor, have started to undergo training in Japan. Daihatsu’s move to expand the range of local activities from production to R&D is an interesting case that indicates a maturity of Japanese companies’ direct investment policy for East Asia.

We will cite another example, also from the automotive industry, which relates to Mazda Motor’s plan to build a new factory in Mexico in a joint venture with major trading house Sumitomo Corp. According to a newspaper article (Asahi Shimbun, July 22, 2011), Mazda President Takashi Yamauchi revealed a plan to use this factory, which is scheduled to come on stream in fiscal 2013, as an export base of passenger cars shipped to the United States and Europe. Among factors behind this plan are Mexico’s importance as a member of the NAFTA (North American Free Trade Agreement) and the country’s trade ties with the EU based on the Mexico-EU FTA that was concluded in 2000. Moreover, the Japan-Mexico EPA went into effect in April 2005. Explaining the merits of the plan, Yamauchi stated that taking advantage of the Japan-Mexico EPA, Mazda will produce passenger

cars with parts imported tax-free to Mexico from Japan. If the company achieves a local procurement ratio of 60%, it will be able to export cars from Mexico tax-free to the United States and the EU. Such a production network will enable Mazda to bypass car tariffs of 2.5% in the U.S. and of 10% in the EU. If Japan pursues a business strategy that takes advantage of the existing FTAs and EPAs, it may be able to regain some of the ground lost to South Korea in FTA policy initiatives.

As indicated in the cases of Daihatsu in Indonesia and Mazda in Mexico, foreign direct investment (FDI) plays a vital role in the international business expansion of Japanese companies. It is extremely important that the EPAs that Japan concludes with trading partners include a separate chapter dedicated to investment-related provisions, including an explicit ban on performance demands concerning various matters. WTO’s TRIM (trade-related investment measures) also bans performance demands in some cases. However, the prohibition on performance demands by Japan’s EPAs covers a broader range of matters than the prohibition in TRIM. There is no doubt that EPAs have helped to improve the international environment surrounding investment.

## WTO’s Dispute Settlement Mechanism

On June 29, 2011, the EU decided to reduce or eliminate tariffs on digital copiers that combine various functions including printer and fax machine functions. The decision came in the autumn of 2010 after a WTO dispute settlement panel, acknowledging the claims filed by both Japan and the United States, recommended that the EU take corrective action. Under the Information Technology Agreement (ITA), which was concluded at the WTO Singapore Ministerial Conference in December 1996, the original 29 signatory countries and regions agreed to abolish tariffs on IT (Information Technology) products by the year 2000. The number of signatories has now increased to 73 countries and regions, with the signatories as a whole accounting for more than 97% of IT manufacturing trade.

The EU has imposed the same tariff rate of 6% on multifunction digital copiers as on analog models. On the grounds that copiers used with computers should be regarded as IT products, Japan and other countries filed a complaint with the WTO in 2008, alleging that the EU tariff constitutes a violation of the ITA. According to JETRO (Japan External Trade Organization), the total value of multifunction copiers imported by the EU from the rest of the world in 2009 was about 280 billion yen, while the total value of multifunction copiers exported by Japanese firms to the EU—if exports through a third country are included—was about 240 billion yen.

Given that the value of customs duties overpaid by Japanese companies is estimated at approximately 14 billion yen annually, the WTO’s ruling in favor of Japan and other complainants in this dispute is highly significant.

In another case of trade dispute, on July 6, 2011, a separate WTO dispute panel acknowledged a violation of GATT regarding Chinese export restrictions on rare earth metals. Although Japan participated in the panel’s debate as a third party, rather than being involved as a complainant, this decision likewise bears great significance for Japanese companies.

As described above, the WTO’s dispute settlement mechanism has been functioning well in trade and economic disputes. As this mechanism seeks rules-based solutions, rather than “power-oriented solutions,” it is a legal instrument that should actively be utilized. In that sense, we may characterize the WTO dispute settlement mechanism as a type of “legal infrastructure” that is valuable as an international public good.

The WTO, FTAs and EPAs provide predictability and transparency in international business, thereby enabling companies to actively invest at home and abroad and invigorating economic activities. In that sense, the WTO rules and EPAs are business tools and form a legal infrastructure essential to having a production network with improved efficiency. **JS**

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TABLE 2

### Japan’s FTA/EPA achievements to date

- **Japan-Singapore EPA** (in force since 2002.11)
- **Japan-Mexico EPA** (negotiations started in 2002.11, in force since 2005.4)
- **Japan-Malaysia EPA** (in force since 2006.7)
- **Japan-Chile EPA** (negotiations started in 2006.2, in force since 2007.9)
- **Japan-Thailand EPA** (agreement in substance 2005.9, in force since 2007.11)
- **Japan-Indonesia EPA** (negotiations started in 2005.7, in force since 2008.7)
- **Japan-Brunei EPA** (negotiations started in 2006.6, in force since 2008.7)
- **Japan-ASEAN EPA** (negotiations started in 2005.4, in force since 2008.12)
- **Japan-Philippines EPA** (agreement in substance 2004.11, in force since 2008.12)
- **Japan-Switzerland EPA** (negotiations started in 2007.5, in force since 2009.2)
- **Japan-Vietnam EPA** (negotiations started in 2007.1, in force since 2009.10)
- **Japan-India EPA** (negotiations started in 2007.1, in force since 2011.8)
- **Japan-Peru EPA** (negotiations started in 2009.5, signed 2011.5)
- **Japan-Korea EPA** (negotiations started in 2003.12, suspended in 2004.11)
- **Japan-GCC EPA** (negotiations started in 2006.9)
- **Japan-Australia EPA** (negotiations started in 2007.4)

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