

Regionalism, the New WTO Round and Japan's New Trade Policy

By *Urata Shujiro*

Globalization of economic activities has been accelerating rapidly as cross border movements of goods, money and people have expanded remarkably in recent years. Although globalization has brought some negative consequences such as widening income gaps among the countries as well as within countries, on the whole it has brought positive impacts such as rapid economic growth and technological progress. One factor that contributed to globalization is substantial trade liberalization, which was carried out under the auspices of the GATT/WTO.

Up against rapid globalization, regionalization has emerged in various parts of the world in recent years. Regionalization takes two forms. One type of regionalization arises as a result of natural economic developments in that the benefits of agglomeration including economies of scope, scale and speed outweigh the costs of agglomeration such as congestion. The other type of regionalization involves institutional arrangements such as regional trade agreements (RTAs) including free trade agreements (FTAs) and customs unions. RTAs are discriminatory trade agreements, providing only members with preferential treatment, and as such this may be characterized as regionalism.

In light of these seemingly contrasting developments, globalization on the one hand and regionalization on the other, it is important to examine their relationship and clarify their impacts on the world economy. In this paper I attempt to give my views on these issues by examining the recent developments on RTAs and by relating the RTA issues to the WTO. In the discussion I focus on Japan's shift in its trade policy from the GATT/WTO-based single-track approach to a multiple-track approach, which includes not only the WTO-based multilateral approach but

also the APEC (Asia-Pacific Economic Cooperation)-based regional approach and the FTA-based bilateral approach. The focus on Japan's trade policy stems from the observation that Japan is one of the few major countries that are not yet participants in any RTAs.

Rapid Expansion of Regional Trade Agreements

Recent years have seen a sharp increase in the number of RTAs. (Figure 1) During 1948-1994, the GATT received 124 notifications of RTAs, and since the creation of the WTO in 1995, over 100 additional arrangements have been notified. Among RTAs, the FTA is the most common type of agreements in recent years.

Several notable characteristics may be identified from the recent developments on RTAs: i.e. widening, deepening and diversifying. The examples of "widening" include the European Union (EU) and the ASEAN (the Association of Southeast Asian Nations) Free Trade Area (AFTA). The EU started as a customs union under the name of the European Economic Community (EEC) with six member countries in 1958. Later new members joined and at present it has 15 member countries. Currently the EU is negotiating with 12 countries, mostly those in Eastern and Central Europe, for their accession. The AFTA was formed by six ASEAN member countries in 1992 as a common effective preferential tariff agreement, under which tariff rates on intra-member trade were to be reduced to 0-5% within 15 years. Toward the end of the 1990s the AFTA was expanded to 10 countries by accepting four new members.

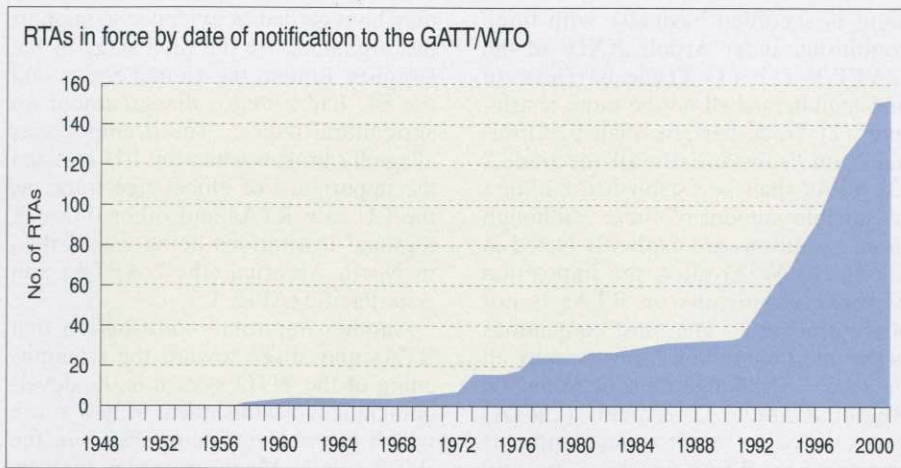
The most remarkable example of "deepening" is found in the EU. As noted above, the EU began as a cus-

tom union. During the 1990s several substantial developments took place to deepen regional integration among the EU members. In 1993 the EU became a common market, in which free movement of not only goods but also services, capital and people was realized. In 1999 a common currency, the Euro, was created for 11 EU members. ASEAN also deepened its integration, as its members agreed to establish the ASEAN Investment Area (AIA) in 1998, where free movement of capital in the form of foreign direct investment (FDI) is to be realized among its members by 2010.

Various new types of RTAs, or diversification of RTAs, can be detected in recent years. Traditionally, RTAs dealt with the elimination of trade barriers such as tariff and non-tariff barriers. However, new types of RTAs, which include not only the elimination of trade barriers but also the elimination of barriers on service trade and FDI, have been increasing. For example, the North America Free Trade Agreement (NAFTA) includes rules on FDI, intellectual property rights, environment and others. Moreover, some RTAs go beyond free trade and FDI arrangement to include various kinds of cooperative programs. One such example is the Japan-Singapore FTA, which is under negotiation. If this FTA is realized, it is likely to have some new features such as joint research and economic cooperation.

It is worth noting that new types of regional arrangement, which do not fall under RTAs, have emerged in recent years. APEC represents such new regional arrangements. APEC was established in 1989 with an objective of pursuing inter-governmental dialogue on economic issues. One of the special characteristics of APEC is the diversity in its members. Its 21 members span all or parts of four continents: Asia,

Figure 1



Source: World Trade Organization

Oceania, North and South Americas, and they include developed countries such as the United States and Japan and underdeveloped countries such as Papua New Guinea. In 1994 the APEC leaders adopted a vision of free trade and investment in the region. APEC is not a rule-making organization, and therefore, to achieve the vision, voluntary actions are adopted. It should be emphasized that not only liberalization in trade and investment but also facilitation in trade and investment and economic and technical cooperation have been given the utmost importance for APEC.

Factors behind the Rapid Expansion of RTAs

Various factors have been behind the rapid expansion of RTAs in recent years. First, trade liberalization has become increasingly difficult to pursue on a global scale, making RTAs an alternative for pursuing liberalization. A large number of countries have come to realize the benefits of trade liberalization for the promotion of economic growth, as it has brought the expected outcome of rapid economic growth. Despite the desire of many policy makers for promoting trade liberalization, it has become apparent that trade liberalization under the GATT/WTO has become increasingly difficult. As the number of GATT/WTO members

increased, their views on the pace and the extent of trade liberalization have diverged. Indeed, the fact that it took the GATT members eight years, twice as long a period as initially planned, to conclude the Uruguay Round negotiations indicates the increasing difficulty in reaching a consensus on trade liberalization. The increasing difficulty in reaching a consensus was a factor that led to a failure by the WTO members to initiate a new round of trade negotiations in Seattle in 1999. Faced with the difficulty in carrying out trade liberalization on a global scale, many countries have opted to form RTAs among the like-minded countries to pursue trade liberalization.

Second, the desire to maintain or increase market access on the part of business has contributed to the formation of RTAs. Having access to a large market is undoubtedly important for successful business. As a result of the expansion of RTAs, the companies from a country without RTAs are discriminated against in many markets. To overcome this problem and to be able to compete against companies from other countries on the same conditions, companies strongly desire to form RTAs. For example, Japanese companies are said to be in disadvantageous position vis-à-vis EU companies in terms of tariff treatment in the NAFTA, because the EU has an RTA with Mexico but Japan does not. To

overcome this disadvantage, Japanese companies argue strongly for establishing an RTA with Mexico.

Third, somewhat related to the point just made, some RTAs have been promoted to increase bargaining power against outsiders. The increased size of the unified European market, which resulted from successful economic integration in the EU, had substantial impacts on other regions in the world. Indeed, the United States was eager to form the NAFTA partly because of the need to build a balancing power in North America against the EU.

A similar motive for creating a counterbalance may be behind the formation of the AFTA and AIA by the ASEAN members. Faced with the emergence of China as a very attractive FDI recipient in Asia, ASEAN members, who were keenly aware of the importance of attracting FDI for their economic development, decided to improve the business environment by establishing the AFTA and AIA.

Expected Economic Impacts of RTAs

As RTAs have proliferated, it is important to examine the expected impacts of RTAs. As to the economic impacts of RTAs, one may expect both static and dynamic impacts. To begin with the static impact, it is well known in the economic literature that RTAs give rise to trade creation and trade diversion effects. The trade creation effect is observed when trade among RTA members expands as a result of the elimination of trade barriers. Since the creation of trade leads to better resource allocation, the trade creation effect is deemed beneficial to RTA members. The trade diversion effect is realized when trade with non-members is replaced by trade with RTA members. The trade diversion effect has a potentially negative impact on the members. If the loss in tariff revenue, which results from tariff elimination, outweighs the benefit of a greater amount of lower priced imports, the net impact of the trade diversion effect is negative. It should be emphasized that the trade diversion effect has a definite-

ly undesirable impact on non-members, as RTAs reduce the export opportunities for non-members.

In addition to the possible negative impact from the trade diversion effect, one also has to be concerned with the negative impact, which may arise from possible retaliation from non-members, who are placed in a disadvantageous situation. Once the retaliation is acted upon, it is likely to trigger trade wars, whose consequences can be devastating. One should be reminded of the disastrous consequences of the closed trading blocs during the inter-war period, which resulted in a worsening world recession, and thus eventually led to World War II.

Turning to the dynamic impacts of RTAs, one may expect benefits in the form of increasing productive efficiency, which may arise from two sources. One is the realization of scale economies in production because of the enlarged market through RTAs. Thanks to the greater business opportunities in the enlarged market, companies may be able to reduce the cost of production by expanding the scale of production. The other type of dynamic effect may arise as expanded trade, resulting from the formation of RTAs, gives rise to greater competition. To deal with the increased competitive pressure, companies have to improve productivity.

In summing up the discussions on the economic impacts of RTAs, the net impact of RTAs is ambiguous, because they have both positive and negative impacts. However, the net impact is likely to be beneficial, if dynamic impacts dominate static impacts. These observations indicate the importance of forming RTAs in such a way that dynamic impacts may be realized. We will come back to these issues later in this article.

The WTO and RTAs

Being discriminatory, as noted above, RTAs are regarded as an exception to the GATT/WTO trading system, which is built upon the non-discrimination principle. The exceptional treat-

ment is accorded basically with three conditions under Article XXIV of the GATT/WTO; (1) Trade barriers on non-members shall not be more restrictive, (2) Trade barriers shall be eliminated on "substantially all the trade," (3) RTAs shall be established within a reasonable amount of time. Although these conditions are explicitly stated in the GATT/WTO rules, the imposition of these conditions on RTAs is not straightforward. The most contentious is the interpretation of "substantially all the trade." Although the Committee on Regional Trade Agreements (CRTA) was created to monitor developments concerning RTAs in the Uruguay Round, no rules as to the definition of "substantially all the trade" have been established.

There is a consensus among policy makers, business circles, and academics that the optimal trade arrangement is global free trade under the WTO. However, as discussed above, various obstacles do exist to achieving that objective. In light of the increase in RTAs, an important question then is if RTAs will promote global trade liberalization under the WTO or not. Two opposing views have been presented. One view states that RTAs would become an obstacle to achieving global free trade. Closed trade blocs during the inter-war period, which was noted above to have led to a substantial decline in world trade, are often presented as the likely outcome from RTAs. Somewhat along the similar line of arguments, it can be said that RTAs reduce world trade, as they lead to a complex trading system. Noting the limit for the human resources available for trade negotiations, some argue that RTAs may divert the resources and attention from multilateral negotiations, resulting in delays in such negotiations.

Proponents of RTAs argue that RTAs promote trade liberalization. The increase in RTAs, which gives rise to discrimination, may make policy makers realize the importance of global free trade. The developments in the final stage of the Uruguay Round, which was stalled due to the differences in the opinions among the major participants,

may be regarded as evidence to support this argument. In the final stage of the Uruguay Round, the United States and the EU had a major disagreement on agricultural issues. The deadlock was allegedly broken when the EU realized the importance of global free trade, as the EU saw RTAs and other types of regional institutions being established in North America (the NAFTA) and Asia-Pacific (APEC).

Another important contribution that RTAs may make toward the strengthening of the WTO system is the development and establishment of new rules, which are not yet incorporated in the WTO rules. Many examples may be given in this regard. The NAFTA has a rule on trade and environment, and the U.S.-Jordan FTA has a rule on labor. The rules in the new areas, which have been formulated and implemented in RTAs, would prove useful models for the formulation of rules under the WTO.

The preceding discussions point out several important policy implications for the WTO members. First, it is of crucial importance for the world trading system to ensure that RTAs will not become closed and protectionist trading blocs. One way to achieve this objective is to remove the ambiguity regarding the rules on RTAs in the WTO and to have CRTA closely monitor the developments on RTAs. Second, the momentum for multilateral trade negotiations has to be maintained, so that the efforts and attention toward global free trade and FDI will not be diminished.

Japan's New Trade Policy

Japan had pursued trade policy under GATT's global framework until the early 1990s, when Japan as a member of APEC began to seek trade liberalization on a regional basis in the Asia Pacific. This shift in Japan's trade policy may be characterized as a shift from a one-track approach based on the GATT/WTO multilateral/global trading framework to a multiple-track approach, comprised of global and regional approaches. Although this is an appar-

ent shift in Japan's trade policy, it may not be regarded as a drastic shift in that its new policy was not a major departure from the GATT/WTO. This is because APEC is not a discriminatory RTA. Specifically, in APEC trade liberalization is carried out in such a way that a reduction in import barriers is applied to APEC members as well as to non-members on a non-discriminatory basis. Besides, trade liberalization is carried out on a voluntary basis. As such, APEC can be considered as an organization fully consistent with the GATT/WTO principle.


The late-1990s saw a major shift in Japan's trade policy, as it began to consider RTAs formally. Japan is currently negotiating an FTA with Singapore, and it is studying the possibilities of FTAs with other countries including South Korea, Mexico, Chile, Canada and others. Although RTAs seem to have become major trade policy tools for Japan, it is important to note that multilateral framework under the WTO is undoubtedly the most important trading system to Japan. Trade liberalization on a global scale would bring the maximum benefits not only to Japan but also to the world. Indeed, Japan holds the view that RTAs will complement the WTO framework. These new developments indicate that Japan has adopted a multiple-track trade policy approach, i.e. multilateral, regional and bilateral approaches.

Several factors contributed to Japan's shift in its trade policies from a single-track approach to a multiple-track approach. First and foremost, policy makers in Japan realize the importance of trade liberalization to revitalize its economy, which is suffering from a long recession. Indeed, economic reforms including fiscal, financial and other areas have been attempted but they have not been effectively implemented yet. Trade liberalization could play a catalytic role in implementing economic reforms. Given the difficulty in getting a new round of trade negotiations started under the WTO, Japan realized that RTAs could be a useful policy tool for promoting trade liberalization.

Expecting to use RTAs as a tool to promote economic reforms via RTAs, Japan wants to make the Japan-Singapore FTA, which is under negotiation, cover many areas ranging from traditional trade liberalization in goods to liberalization in new areas such as services and FDI. Furthermore, it is likely to include cooperation programs such as joint research and student exchange, not only to promote economic growth but also to deepen mutual understanding. The study group, which was organized to study the establishment of the Japan-Singapore FTA, named it the Japan-Singapore Economic Partnership Agreement, and not an FTA.

Another reason that Japan is interested in FTAs is their possible contribution to the rule-making process at the WTO. As was indicated above, many FTAs including the possible Japan-Singapore FTA have rules, which have not yet been established in the WTO. Indeed, the proposed Japan-Singapore FTA is likely to include the rules on new areas such as competition policy and trade facilitation. The new rules established under FTAs can be used as a model for the WTO.

Having discussed the factors that contributed to Japan's adoption of multiple-track trade policies including RTAs, I would like to emphasize some important policy decisions that Japan has to make in order to carry out its newly adopted multiple-track approach effectively and to contribute to achieving global free trade. First, to begin with the RTAs, it is important for Japan to satisfy the three conditions for RTAs under Article XXIV of the GATT/WTO. Specifically, Japan should not exclude agricultural trade from the agreement by giving in to pro-

tectionist pressures. The Japan-Singapore FTA may satisfy the condition of "substantially all the trade," even if agricultural trade is excluded because of its small size. However, such an agreement would give rise to criticism of its inward-orientation, or condoning protectionism, since Japan's agricultural trade policy is regarded as a symbol of protectionism. Second, the negotiations on RTAs should be concluded speedily. One of the merits of RTAs is their relative ease in negotiation, because the negotiation involves a small group of countries with similar views on trade liberalization. Third, as one of the objectives of RTAs should be to facilitate or promote trade liberalization on a global scale, it is important to ensure that the efforts toward multilateral liberalization should not be diminished at the cost of RTAs. Furthermore, it is also important to make effective linkages among RTAs within the WTO framework. In this regard, Japan should contribute to making the rules on RTAs in the WTO unambiguous and comprehensive, and to enforce these rules strictly. 

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Former prime minister Mori Yoshiro (right) and Singapore's Prime Minister Goh Chok Tong attending the Japan-Singapore FTA negotiations