

Free Trade Agreements as Constructive Regionalism

By Kojima Akira

In recent years, regionalism has been emerging as a new global move and stealing the spotlight in international trade policy making. As symbolized by the violent demonstrations against a ministerial meeting of the World Trade Organization (WTO) in Seattle in late 1999, multilateralism (or globalism) as steadfastly promoted by the WTO for the past decade has provoked a strong backlash. Against such a background, regionalism, once considered incompatible with multilateralism or globalism, is now being recognized as something that is never exclusive but rather capable of complementing and reinforcing the still immature multilateralism.

Global arguments over multilateralism and changes in global situations have triggered changes in the policies of Japan, which has long championed the cause of multilateralism. Japan has already agreed with Singapore to start negotiations on concluding a bilateral Free Trade Agreement (FTA). Japan has also been exploring the possibility of concluding a similar agreement with South Korea while upholding the moves already launched by the private sectors of the two countries in that direction.

Since the end of World War II, multilateralism has consistently been the basis of Japan's foreign policy. Japan has identified itself with the General Agreement on Tariffs and Trade (GATT), the predecessor of the WTO, and the Organization of Economic Cooperation and Development (OECD). Politically, it placed the top priority of its external policy on the United Nations. Such a policy line reflected the feeling of Japanese people who wanted to see their nation, vanquished in the war, quickly return to the international community. From that standpoint, Japan has intentionally avoided, as its international trade pol-

icy, the conclusion of FTA-like bilateral agreements or multilateral agreements among a small number of countries. Instead, it pursued multilateralism and the principle of non-discrimination enshrined in the GATT and the WTO.

Japan, however, began to change its policy in the latter half of 1998, more specifically in October 1998 when the late Japanese Prime Minister Obuchi Keizo and South Korean President Kim Dae Jung, in their summit talks during Kim's visit to Tokyo, made a political commitment to the building of a bilateral partnership. As a follow-up, Obuchi agreed with Singaporean Prime Minister Goh Chok Tong, during the latter's visit to Tokyo in December 1999, to have their governments start joint studies on the conclusion of a bilateral free trade agreement. Though the two foreign leaders' visits to Tokyo directly triggered Japan's policy shift, a behind-the-scenes reappraisal of regionalism, including free trade agreements, had already been going on in the Japanese government, the business sector and academic circles.

The White Paper on International Trade 2000 released by the Ministry of International Trade and Industry (MITI) in May 2000 testified to the policy shift. It pointed out that regional integration had globally picked up momentum since the early 1990s, with the number of regional trade agreements reported to the WTO increasing to 78. The MITI report also noted that a large number of countries, both advanced and developing, have already acceded to regional trade agreements



Demonstrators tried to block an entrance to the WTO conference on the first day of meetings in Seattle, on November 30, 1999

Photo : REUTERS • SUN

one way or another, and that only a small number of countries or regions, such as Japan, China and South Korea, have remained aloof from such agreements.

Regionalism cannot be generalized because it has various types. Bela Balassa, a member of the research staff at the Institute for International Economics in Washington D.C., classified regional integration into five categories depending on the degree of association: 1) a free trade area, where regional tariffs have been abolished, 2) a tariff customs union, where offshore tariffs have been standardized, 3) a common market, where flows of capital and labor have been liberalized, 4) an economic union, where taxation, regulations and economic policies have been unified, and 5) a full economic union, where budgets and even monetary policies have been unified.

Regional integration had previously been implemented in the form of the lowering of tariffs, which were applied only to cross-border commodity trade. But regional integration has lately been extended to wider spheres – investments, services, labor markets, regulations, economic policies, and

currencies. The “deepening” of integration is advancing in the form of the lowering or removal of internal barriers.

The European Union (EU) is expanding its membership and geographically advancing eastward. Even the U.S., which had long advocated multilateralism, has begun to accommodate regionalism by enacting the North American Free Trade Agreement (NAFTA) in 1994. Former socialist countries in Eastern Europe fell into step with the move by launching the Central European Free Trade Agreement (CEFTA) in 1992 as a means of inducing more investments from foreign countries. CEFTA originally consisted of only four countries – Poland, the Czech Republic, Hungary and the Slovak Republic, but the membership has since expanded to include Romania in 1997 and Bulgaria in 1998. The East European grouping is now weighing the accession by the three Baltic countries of Lithuania, Latvia and Estonia.

Regional integration is essentially aimed at removing trade barriers among countries of a region, which amounts to discrimination against outside countries. Such a character of regionalism was criticized as contradicting the principle of non-discrimination adopted by the WTO. However, recent regionalistic moves do not necessarily contradict the WTO’s basic concept and this is the feature of new regionalism emerging recently. Rather, economic specialists are giving positive assessment to regionalism. As Professor Kimura Fukunari of Keio University put it, reciprocity, which is the principle of WTO negotiations, functions better on a regional basis than on a multilateral basis, and so regionalism could become an effective tool for a country to pursue internal reform beyond the framework of politico-economics.

From this viewpoint, the regionalism currently emerging globally does not run counter to the basic direction of the WTO but would rather accelerate the liberalization pursued by the WTO and even uphold the harmonization of vari-

ous domestic systems. Eventually it could even accelerate the deepening of globalism and mutual dependence.

Indeed, Japan’s departure from multilateralism, which was the basis of its traditional trade diplomacy, was prompted by the recent global moves as well as various circumstantial changes, such as the transformation of multilateralism itself, and the positive international evaluation of regionalism.

Economists point to the following five economic effects of free trade areas and other forms of regionalism:

- 1) Removal of internal barriers expands internal trade.
- 2) Removal of internal barriers limits imports from low-cost, efficient countries outside the area, replacing them by imports from within.
- 3) Introduction of common tariffs will boost the purchasing power of countries joining regional integration and subsequently lower the costs of imports from outside the area.
- 4) Removal of barriers expands internal markets, produces profits through economies of scale and cuts down on costs.
- 5) Removal of barriers strengthens competition pressures in internal markets of the area and improves productivity.

The first to third effects concern the distribution of resources and thus are static effects. The fourth and fifth effects factor in changes in the market mechanism and thus are dynamic effects.

Previously, static effects drew more attention than dynamic effects, with the result that the negative effects of free trade areas vis-a-vis the GATT/WTO regime were overemphasized. However, the fourth and fifth effects help expand markets and change competition conditions within the area, resulting in the expansion of export markets for countries outside the area and attracting more direct investments from outside. This in turn deepens mutual dependence among countries in the area and that between the area and the outside world.

In addition to the five effects, the White Paper on International Trade 2000 noted what it called the “policy reform effect” and gave a positive assessment to free trade areas. The “policy reform effect” refers to the effect on a country’s domestic reform brought on by partners of integration. For example, it noted that if a country’s competition policy was strengthened by regional integration, it would in turn enable companies outside the area to gain profits within the area as long as the principle of non-discrimination is maintained. It pointed out in this regard that market integration in the EU and other regions is prompting deregulation in member countries of free-trade areas.

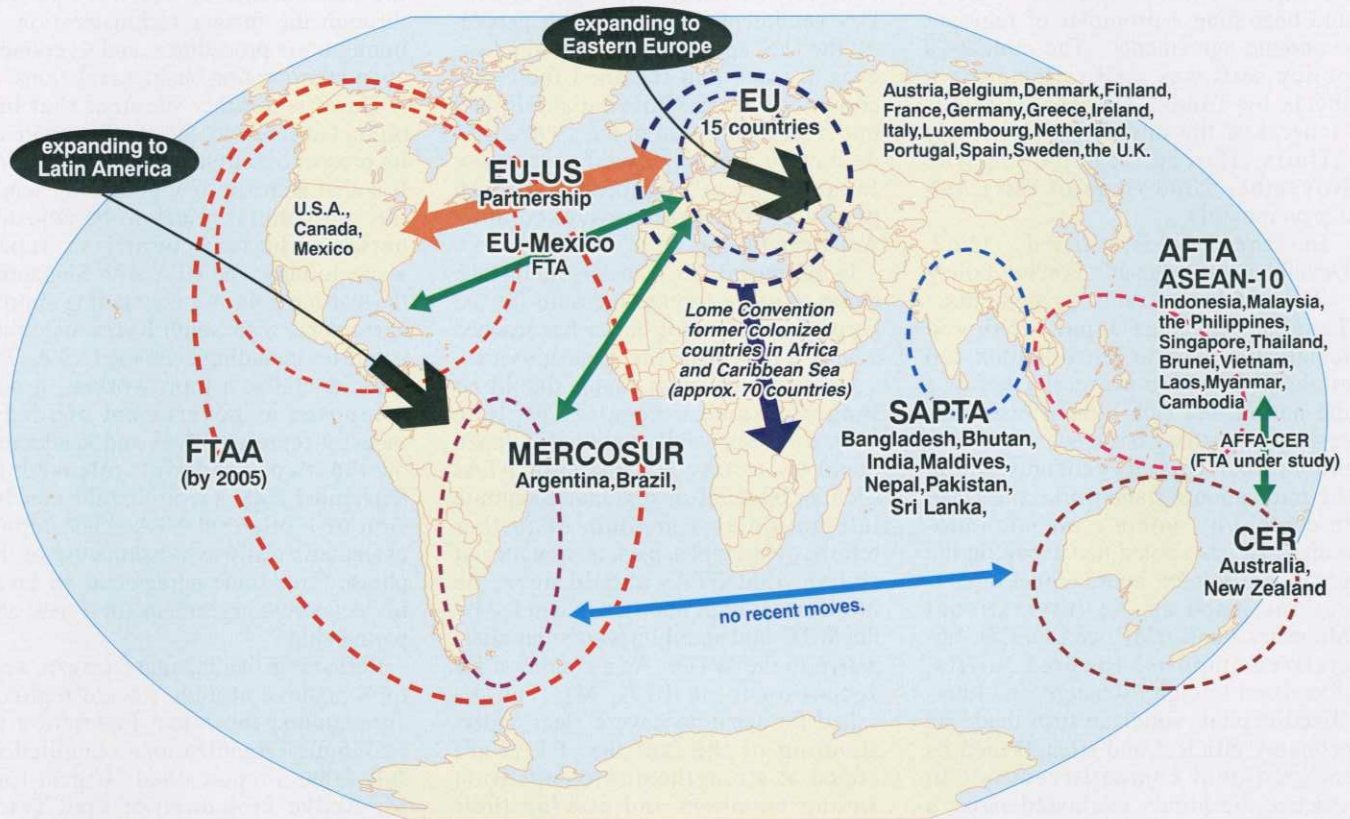
At an international seminar on the role and task of free trade agreements in the new era held in Singapore in October 2000, Japanese Minister of International Trade and Industry Hiranuma Takeo outlined Japan’s concept of a free trade agreement with Singapore. The seminar brought together government officials and industrial leaders from both countries.

He said in part, “Countries around the world are exploring new ways of regional cooperation adapted to the world economy that is becoming more integrated and rapidly changing due to globalization and the spread of information networks.”

“In this new age of rapid changes, companies are producing and developing locally in the world’s major markets to cut the lead-time from product development to shipment in response to the shorter lifecycle of manufacturing technology. These companies obviously wish to see a quick resolution to the new issues they face in various parts of the world. It seems, however, that we have reached a point where the speed of change in the business environment is too rapid for the WTO to keep pace in creating new rules.”

“As the world becomes increasingly globalized, regional economic integration in the form of the exclusionary blocs of the pre-World War II era has ceased to be an option. Historically

Major Regional Economic Integrations in the World



Source: Ministry of International Trade and Industry

too, those countries which have most keenly pursued world trade liberalization have also worked to strengthen their bilateral and regional FTA networks in an effort to adapt to the changing times ahead of multilateral frameworks. Their achievements have later been gradually incorporated into multilateral frameworks, and thereby have made a substantial contribution to the development of world trade.

Given the enormous diversity in culture, politics and levels of economic development, Asian countries are not yet in a position to step immediately into the same kind of regional integration as North America and Europe. The dramatic development of IT (Information Technology) industries is, however, rapidly consolidating production networks across the region, and we all share a common interest in the envi-

ronment, energy and other areas which form the basis for stable economic development. I hope the Asian nations with their enormous potential can push the world to a new level of economic growth, developing to the point where they can demonstrate an autonomous problem-solving capacity and effectively contribute to the global system."

Hiranuma's speech gave clues to the Japanese government's stance on regional economic agreements. Within the Japanese government, the Ministry of Foreign Affairs used to be more committed to the principle of multilateralism than the MITI. The difference resulted not only from the unique position Japan was placed in after its defeat in World War II, as I mentioned earlier, but also the Foreign Ministry's position within the government. MITI and the Ministry of Finance have their own

specific responsibilities in the Japanese government's economic management, the former handling international trade and the latter in charge of financial and monetary affairs. While the two ministries have substantial powers in handling economic matters in their respective spheres, the Foreign Ministry has no responsibility for any specific economic matters and has no rights to hold negotiations with foreign countries on specific economic matters. In pursuing economic diplomacy, the Foreign Ministry thus had no alternative but to focus on multilateral international organizations, in particular the United Nations, which is the symbol of multilateralism. The ministry's U.N.-centered diplomacy also reflected the Japanese people's strong postwar desire to return to the international community.

Now, even the Foreign Ministry is shifting its stance, in varying degrees, and becoming a promoter of regional economic agreements. The ministry's policy shift was well reflected in a thesis by Tanaka Hitoshi, Director General of the ministry's Economic Affairs Bureau, carried in the November 2000 issue of the *Chuo Koron* monthly.

In the thesis, titled "New Development in Japan's Foreign Policy – Toward Free Trade Agreements," Tanaka said that Japan achieved remarkable postwar rehabilitation and attained economic prosperity because the nation had rich human resources serving as a strong basic economic condition; liberalized its economy within the international framework; and acted in conformity within economic rationality. He also noted that Japan, in the process of joining international organizations, such as the International Monetary Fund (IMF) and OECD, liberalized imports, lowered tariffs, liberalized foreign exchange, and liberalized capital, which in turn made its economy efficient and strengthened its international competitiveness. In essence, he highly evaluated Japan's accession to multilateral international organizations, which presupposed various domestic reforms.

Japan now needs further structural changes and reform of various systems to regain its own vitality and to achieve new development. But multilateral international organizations alone will not be strong enough as a force for bringing about such changes.

Pressure from multilateral international organizations used as a lever for Japan's domestic changes has been taken over by pressure from the U.S. for the past decade. However, Japan's reform under U.S. pressure is rapidly losing momentum with decreasing return.

While struggling with economic stagnation and weakening industrial competitiveness due to its twin deficits (budget deficits and trade current-account deficits) during the 1980s, the U.S. made various demands to Japan. The U.S. move struck Japan as blaming

Japan's healthy economy for its own unhealthy economy, and triggered anti-U.S. sentiment among Japanese people. As the U.S. economy returned to a fast-growth track and regained industrial competitiveness while Japan slipped into a long recession in the 1990s, U.S. demands were viewed by many Japanese as a "hegemonic foreign pressure" and again provoked anti-American feeling.

In this regard, Mr. Tanaka said that the tactic of using foreign pressure for the purpose of reforming Japan has reached a limit. I fully share Mr. Tanaka's view.

He contended that Japan should no longer assume a negative attitude toward reform, and wondered if Japan could try to take advantage of FTAs such as bilateral or regional economic integration as a medium of further reform. He emphasized, as a matter of course, that FTAs should never be inconsistent with multilateralism led by the WTO and should never be an alternative to the WTO. As a condition for accession to an FTA, Mr. Tanaka called for Japan to have a clear understanding of the fact that FTAs are aimed at strengthening competition among members and making their economies more efficient.

Tanaka's point is that 1) FTAs represent an attempt to accelerate economic liberalization, 2) FTAs are not aimed at forming an exclusionary regional grouping in Asia, and Japan should not limit its FTA approaches to East Asian countries, 3) regionalism is an intermediate process for attaining the final goal of multilateralism or globalism, and 4) the purpose of FTAs is to activate the Japanese economy and society through the promotion of domestic reform.

Some people may wonder why Singapore has been chosen to be Japan's partner. Minister of International Trade and Industry Hiranuma said in his speech in Singapore that Japan would explore a number of new elements in an FTA with Singapore. Specifically, he emphasized 1) harmonization of e-Commerce systems, 2) speeding up trade procedures through the use of

information technology, 3) facilitating the movements of business people through the further rationalization of immigration procedures, and 4) cooperation in promoting business relations.

There is another element that has prompted Japan to choose Singapore as its prospective first partner of an FTA. It is that there are few politically sensitive agricultural issues to be adjusted between the two countries. Japan wants to make the FTA with Singapore the starting point for concluding similar agreements with South Korea and other countries including even the U.S.A.

Incidentally, a joint working group composed of government officials, industry representatives and academics of the two countries released in September 2000 a report on the conclusion of a bilateral FTA. The report characteristically avoided the use of the phrase "free trade agreement" in favor of "economic agreement for a new age partnership."

Reflecting the Japanese private sector's positive attitude toward regional agreements, the Japan Federation of Economic Organizations compiled in July 2000 a report titled "Urgent Call for Active Promotion of Free Trade Agreements – Toward a New Dimension in Trade Policy." The report noted that FTAs are being concluded globally at an unprecedented speed, pointing out that FTAs reported to the WTO and already in force totaled about 120. It warned that Japan, which has failed to conclude regional agreements with any country, risked being placed in a disadvantageous position in international competition. It called on the nation to conclude regional agreements because they would prompt competition within the Asian region and prompt economic structural reform of the country. JTI

Kojima Akira is a Managing Director and Editor-in-Chief of the Nihon Keizai Shimbun. He is also a Chairship Professor at the Graduate School of Business & Commerce, Keio University.