A Comparison of the FTA Strategies of Japan and China and Their Implications for Multilateralism

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Abstract

Japan and China’s trade policy has historically centered on multilateralism. Over the past ten years, however, these two countries have shifted course somewhat by pursuing a number of free trade agreements (FTAs) and Economic Partnership Agreements (EPAs). As the two largest economies in Asia, the actions and interactions of China and Japan have a direct impact on the global trading system. This paper investigates the divergent motivations and strategies of these two countries in negotiating FTAs and its impact on regional integration and multilateralism.

摘要

日中贸易政策正在前所未有地向多边主义发展。然而，在过去十年加入自由贸易协定和经济伙伴协定的选择中，两国进程不尽相同。作为亚洲两个最大经济体，中日两国的一举一动及相互作用都将对地区一体化和全球贸易系统产生直接影响。本篇论文研究了两国在自由贸易协定谈判中趋异的动机与战略，以及它们对区域一体化和多边主义的影响。
1. Introduction

Japan and China are the two largest economies and the two most important political powers in Asia. In the past decade, along with the bottom up efforts to build up trade and investment links, there has been an effort to consolidate and facilitate these developments through formal agreements and the governments facilitated the processes. However, the conduct of China and Japan is distinctly different in course of their FTA negotiations. Whilst Japan sought to negotiate a comprehensive FTA with selective countries bilaterally, China adopted a more pragmatic and flexible approach to negotiate ‘shallow’ FTA agreements. Asia as a consequence is creating a system of overlapping trade regimes--- or a noodle bowl.

This paper examines the process of the FTA negotiations conducted by Japan and China, the domestic and external factors that have contributed to the formation of their distinctive FTA strategies, and the terms of the FTA agreements concluded, and the implications for the multilateral trading order. Specifically, this paper will address the following questions: what are the domestic and external motivations and constraints of the FTA strategies of Japan and China? What are the major characteristics of the strategies of Japan and China? What are the implications of their FTA strategies for multilateralism? Could this noodle bowl in Asia, created largely by the parallel FTA negotiations by Japan and China, induce harmful trade diversion and fragment rather than integrate the regional economy?

Section two and three briefly review the FTA negotiations of Japan and China, the domestic factors that can explain the policy shift from multilateralism to FTAs, their FTA partner selection criteria, the content of their FTA agreements and the characteristics of their negotiation strategies respectively. Section four conducts a comparison between the FTA strategies of Japan and China, followed by the next section to deliberate on the future directions of their FTA strategies. Section 6 concludes.

2. Japan’s FTA (EPA) strategy

In the early 2000s, Japan finally caught up with the global boom of FTAs. It had long preferred multilateral trade liberalization to preferential trade arrangement. It criticized FTAs as discriminatory against non-parties and detrimental to the GATT/WTO-based multilateral trading system from which it had substantially benefited during its post-war growth. However, it
finally made a policy shift toward preferential trade arrangement in the early
2000s. Japan signed its first Economic Partnership Agreement (EPA) with
Singapore in January 2002, and it has since concluded EPAs with Mexico
(2004), Malaysia (2005), the Philippines (2006), Chile (2007), Thailand (2007),
Brunei (2007), Indonesia (2007), ASEAN (2008), Viet Nam (2008), Switzerland
(2009), Peru (2011) and India (2011). Currently, it is negotiating EPAs with
the Gulf Cooperation Council (which includes Saudi Arabia, Kuwait, the
United Arab Emirates, Qatar, and Bahrain), Korea and Australia.

Japan also accelerated negotiation of BITs in the early 2000s. Before 2000 it
had concluded eight BITs since its first BIT with Egypt in 1977. However, since
2000, it has concluded BITs with Mongolia (2001), Korea (2002), Viet Nam (2003),
Cambodia (2007), Laos (2008), Uzbekistan (2008), Peru (2008), Papua New Guinea
(2011) and Columbia (2011). These recent BITs provides for not only investment
protection but also investment liberalization and an enhanced investment
protection. Japan is currently negotiating BITs with Saudi Arabia, Kuwait, Angola,
Kazakhstan and Iraq, and a trilateral investment agreement with China and
Korea.

What were the major factors that contributed to Japan’s policy shift from
multilateralism to bilateral/regional EPA and BIT negotiations? What are the main
characteristics of Japan’s EPA and BIT strategy? This section will deal with these
questions. It will also draw some lessons learned from Japan’s EPA and BIT
negotiation so far, and elucidate some policy implications for the future.

2.1 Japan’s policy shift to EPAs and BITs: why and how?

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1 The text of this and the other EPAs which Japan concluded are available from the following website of the Japan Ministry of Foreign Affairs (MOFA).

2 They were BITs with Egypt (1977), Sri Lanka (1982), China (1988), Turkey (1992), Hong Kong (1995), Bangladesh (1998), Pakistan (1998) and Russia (1998). The texts of these and the other BITs which Japan concluded are available from the following website of the Japan Ministry of Economy, Trade and Industry (METI).

3 See METI, Tōshi kyōtei no gaiyō to Nihon no torikumi (Outlines of BITs and Japan’s BIT policy), p.12 (in Japanese), available at

4 An earlier version of this and the next sub-sections has been published as Junji Nakagawa, “Japan’s FTA (EPA) and BIT strategy in the light of competitive dynamics”, Ross P. Buckley, Richard Weixing Hu & Douglas W. Arner eds., East Asian Economic Integration: Law, Trade and Finance,
Why did Japan change its policy and join the global boom of FTAs and BITs in the early 2000s? We argue that competitive dynamics best explain Japan’s policy shift towards EPAs and BITs.\(^5\) Japan has used EPAs and BITs to respond to multiple competitive challenges, comprising economic, political and legal challenges.

First of all, Japan had to restore the competitiveness of its businesses abroad which had been deteriorated by the trade/investment diversion caused by preceding FTAs. This was most salient in the case of Mexico after the NAFTA and later the Mexico-EU FTA.\(^6\) Also, Japanese companies became interested in using EPAs to revamp their production networks in East Asia in order to integrate their regional production networks, and to forestall the advances of rival foreign companies in Southeast Asian countries, which in the aftermath of the Asian financial crisis had courted aggressively FDI and export production.\(^7\) Finally, the failure of the Multilateral Agreement on Investment (MAI), sponsored by the OECD in 1998, and the failure of the 1999 Seattle Ministerial Conference to incorporate “trade and investment” into the agenda of the first negotiating round of the WTO led Japanese companies to lobby for investment rule-making at bilateral/regional levels. Keidanren (the Japan Business Federation) published a policy statement titled “Challenges for the Upcoming WTO Negotiations and Agenda for Future Japanese Trade Policy” in May 1999.\(^8\) While expressing expectations of the upcoming WTO negotiations, it emphasized the importance of strengthening Japan’s efforts to develop a network of EPAs with investment chapters and BITs because they were “extremely important in terms of the foreign business activities of Japanese companies.”\(^9\)

In sum, Japan’s policy shift toward EPAs and BITs was much influenced by the economic interests of its businesses facing competitive challenges abroad.

Ministry of International Trade and Industry, or MITI (renamed METI in 2001),

\(^9\) Ibid., Section 3(1).
supported this. On the other hand, the agricultural lobby opposed the substantive liberalization of agricultural trade through bilateral negotiation. This was the major reason for the Japanese government to start negotiation of its first EPA not with Mexico, which had approached Japan to explore a bilateral trade deal as early as in the summer of 1998, but with Singapore, as it offered to exclude agriculture from the negotiation. Japan had to deal with the opposition of its agricultural lobby when it negotiated its second EPA with Mexico, which exports a substantive amount of agricultural products to Japan. However, a compromise was made on agriculture by excluding a number of sensitive agricultural products from liberalization commitments, and by applying tariff rate quotas on pork, oranges, etc. This became a precedent for Japan’s EPA negotiation with those countries exporting agricultural products to Japan, such as Thailand and Chile.

Japan’s policy shift to EPAs and BITs was also influenced by two central concerns of its foreign policy in the early 2000s: the maintenance of the security alliance with the US, and the need to respond to China’s rise in the region. As Japan shaped its EPA policy, it had to aim for a delicate political compromise between maintaining its key security alliance with the US, displaying a commitment to the construction of Asian regional integration, and striking a balance between competition and cooperation with China. These considerations influenced Japanese EPA policy in three important aspects: (1) the selection of EPA partners, notably the bypassing of China in the negotiation of bilateral EPAs by the Koizumi government (2001 to 2006); (2) the competitive courting of Southeast Asian nations, from the Japan-Singapore EPA to China’s November 2001 announcement to establish an FTA with ASEAN, and to Japan’s response in January 2002 with the proposal for a Japan-ASEAN Comprehensive Economic Partnership; and (3) the attempt to define the contours of an East Asian Trade bloc, with China insisting on the ASEAN+3, and Japan calling for ASEAN+6 with Australia, New Zealand and India.


12 Sekizawa notes that by this compromise “the taboo was broken” that Japan would not negotiate EPAs which cover agricultural products. See Yōichi Sekizawa, Nihon no FTA seisaku: Sono seiji katei no bunseki [Japan’s FTA Policy: an Analysis of its Political Process], Institute of Social Science, University of Tokyo, ISS Research Series No.26 p.48.

13 Solís, supra n.5, pp.207-211.
Finally, Japan’s policy shift to EPAs and BITs was also influenced by its determination to achieve a high level of legalization\textsuperscript{14} through bilateral/regional channels. The aforementioned failures of multilateral investment rule-making through the MAI and the Doha Development Agenda motivated the Japanese business sector to lobby the government to shift the forum for investment rule-making to EPAs and BITs. Japanese foreign direct investment (FDI) in East Asia rapidly increased in the 1990s. This trend continued after the Asian financial crisis. For Japanese companies investing in the region, protection of investment through a clear and transparent rules and their enforcement through investor-state arbitration are of critical importance. As these were not provided through multilateral forum, they lobbied the government to secure them through investment chapters of EPAs and BITs with the host countries in the region.\textsuperscript{15}

The rivalry between multilateral and bilateral rule-making raises the possibility that a new rule adopted and disseminated by several FTAs will later on be incorporated at the multilateral level. Such bottom-up standard setting by bilateral channels is particularly prominent in the areas of trade rules currently under negotiation within the framework of the Doha Development Agenda. The most salient example is the rules on intellectual property protection (TRIPS plus).\textsuperscript{16} We will see such examples in Japan’s EPAs in the following sub-section.

\subsection*{2.2 Characteristics of Japan’s EPA/BIT strategy}

What are the main characteristics of Japan’s EPA/BIT strategy? As for the criteria to pick the target countries, as we have seen in 2.1, two concerns seem to have dictated the choice of the target, namely, enhancing business interest and

\textsuperscript{14} By “legalization” we mean obligation, precision, and delegation. Obligation means that states are legally bound by a rule or a commitment in the sense that their behavior thereunder is subject to scrutiny under the general rules, procedures, and discourse of international law. Precision means that rules unambiguously define the conduct they require, authorize, or proscribe. Delegation means that third parties have been granted authority to implement, interpret, and apply the rules: to resolve disputes, and possibly to make further rules. See F.M. Abbott, R.O. Keohane, A. Moravcsik, A.-M. Slaugher, & D. Snydal, “The Concept of Legalization,” in J. Goldstein, M. Kahler, R.O. Keohane, & A.-M. Slaughter eds., \textit{Legalization and World Politics}, The MIT Press, 2001, pp.17-35, at 17-18.


\textsuperscript{16} Ibid., pp.82-83.
minimizing negative impact on agriculture. On the one hand, Japan’s businesses, notably big businesses, have been lobbying for securing their competitive edge in global trade and investment by concluding EPAs and BITs with their major counterparts. On the other hand, the agricultural lobby has been opposing the substantive liberalization of agricultural trade. As a result, Japan chose the target countries primarily because they are major trade and investment targets, and also because they are not major exporters of agricultural products. This is the major reason why Japan has not negotiated an EPA with China and the US, both being major exporters of agricultural products. This is also the reason for the comparatively low ratio\(^{17}\) of Japan’s EPAs of its global trade (export and import combined).\(^{18}\)

Agriculture has not been a major concern in BIT negotiation. Promoting and protecting Japan’s investment has been a primary criterion to pick the target countries. Energy security has also been a motivation to negotiate BIT with oil producing countries such as Saudi Arabia, Kuwait and Kazakhstan.

As for the content of Japan’s EPAs and BITs, they have three major characteristics: moderate trade liberalization, relatively aggressive investment liberalization and investment protection, and moderate legalization on rules covered by the WTO.

\(\text{(a) Moderate trade liberalization}\)

GATT Article XXIV.8 provides that the duties and other restrictive regulations of commerce are eliminated on “substantially all the trade” between the constituent members of free trade areas and customs unions. While neither the GATT nor the WTO has been able to agree on what is meant by “substantially all the trade,” the EU set a precedent for excluding sensitive sectors from bilateral agreements by excluding most agricultural products from its FTAs with Mexico and South Africa. These precedents were seized upon by Japan in its EPA negotiation.\(^{19}\) It made no liberalization commitments on many sensitive agricultural products (e.g.,

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\(^{17}\) An EPA (FTA) ratio is the ratio of the amount of trade (export and import) covered by EPAs (FTAs) that a country has concluded to the total amount of its external trade.

\(^{18}\) As of October 2010, Japan’s EPA ratio was 16%, while that of Korea, US and EU is 36%, 38% and 30% (excluding intra-EU trade), respectively. See Japan’s Cabinet Office, Development of Japan’s EPAs, p.2, (in Japanese) available at [http://www.mofa.go.jp/mofaj/gaiko/fta/pdfs/siryou20101106.pdf](http://www.mofa.go.jp/mofaj/gaiko/fta/pdfs/siryou20101106.pdf)

\(^{19}\) John Ravenhill, “The New Bilateralism in the Asia Pacific,” 24(2) Third World Quarterly 299 (2003), at 308.
rice, wheat, starch, etc.) in all of its EPAs. Even in its EPA with Singapore, whose agricultural exports to Japan is negligible, the few products in the sensitive agricultural sector, principally cut flowers and goldfish, were excluded from the liberalization commitments of Japan. As a result, the liberalization ratio of Japan’s EPAs is relatively low, with 84.4% (Japan-Singapore EPA) to 88.4% (Japan-Philippines EPA), while those of FTAs by the US are higher than 95.21

In addition to the exclusion of sensitive agricultural products from its liberalization commitments, Japan has made a significantly low level of commitments in agricultural trade liberalization. While it made commitments on agricultural products which are mostly imported (e.g., tropical fruits, fish, etc.), it made limited commitments on some products which are produced domestically (e.g., chicken, pork, beef, sugar, wine, etc.), mainly through import quotas.23

In comparison with the low level of agricultural liberalization, Japan’s liberalization commitments on manufactured products have been at a high level. First, it abolished tariffs on a wide range of industrial products, whose rates were already low.24 Secondly, on sensitive manufactured products of its counterparts, Japan has adopted a flexible approach, which corresponded to the aforementioned flexible approaches with respect to the sensitive agricultural products for Japan. For instance, Japan-Thailand EPA adopted a phasing out of Thai tariffs on steel products and auto parts. It also provided for the renegotiation of tariff reduction on autos with engines of less than 3000cc. All these were sensitive manufactured products of Thailand. Japan-Viet Nam EPA adopted a similar phasing out of tariffs on steel products, auto parts and electronic appliances. On the other hand, Japan maintained high tariff rates on a small number of sensitive manufactured products such as leather products, petroleum products and petrochemical products.

Japan’s liberalization commitments in services trade have also been moderate. Acceptance of nurses and care workers as movement of natural persons,

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20 A liberalization ratio is the ratio of items whose tariffs will be abolished within 10 years.
22 See Japan’s commitments in its EPAs with Malaysia, Philippines, Brunei, Indonesia, ASEAN and Viet Nam.
23 See Japan’s commitments in its EPAs with Mexico, Chile, Thailand and Switzerland.
24 The simple average MFN concessional rate of Japan’s tariffs on non-agricultural products was 2.5% in 2008, and its trade weighted average rate was 1.2% in 2007. See WTO/UNCTAD/ITC, World Tariff Profiles 2009, p.98.
or mode 4, has been the major area of Japan’s liberalization commitments through its EPAs. Japan made such commitments with the Philippines and Indonesia, and made commitments to negotiate on the liberalization of the same sector at a later time with Thailand\textsuperscript{25} and Viet Nam.\textsuperscript{26} However, Japan opened the market for these service providers to a much more limited extent, due mainly to the strong opposition from its domestic service providers. For instance, the Japan-Philippines EPA made the following conditions.\textsuperscript{27} First, those who are granted entry as nurse candidates shall be qualified as a nurse with work experience in the Philippines for at least three years. Secondly, after granted entry as nurse candidates, they will have to pursue a course of training including Japanese language training for six months, and after completion of the training, acquire necessary knowledge and skills at hospitals in Japan through the training under the supervision of certified nurses for a maximum period of three years. Thirdly, they shall have to pass the national examination for certified nurses in Japan so as to extend their stay in Japan as nurses. Finally, Japan set the quota of 1,000 persons during the first two years after the entry into force of the Agreement. Similar conditions were applied to candidates of care workers from the Philippines, and to those from Indonesia EPA.\textsuperscript{28} Japan accepted 438 candidates of nurses and care workers from the Philippines from 2009 to 2011, and 793 of those from Indonesia from 2008 to 2011,\textsuperscript{29} both of which were far below the quota set by Japan.

\textbf{(b) Relatively aggressive investment liberalization and investment protection}

In contrast to the BITs that Japan concluded before the early 2000s, Japan’s BITs and investment chapters of its EPAs after the early 2000s (hereinafter referred to as “new-generation BITs”) adopt a relatively aggressive stance toward investment liberalization and investment protection. First, Japan’s new-generation BITs provide for national treatment at pre-investment stage. For instance, Article 2, paragraph 1 of the Japan-Korea BIT provides that each Contracting Party shall

\textsuperscript{25} Annex 7 to the Japan-Thailand EPA, in its Part 1.C, provides that Japan shall enter into negotiations with Thailand on the possibility of accepting Thai certified care workers within one year, if possible, but not later than two years after the entry into force of the Agreement.

\textsuperscript{26} Japan made a commitment to start negotiations with respect to Vietnamese nurses and care workers not later than two years after the entry into force of the Japan-Viet Nam EPA. See Annex 7 to the Agreement, Part 1. B.

\textsuperscript{27} See Annex 8 to the Japan-Philippines EPA, Part 1, Section 6.

\textsuperscript{28} See Annex 10 to the Japan-Indonesia EPA, Part 1, Section 6.

accord national treatment with respect to the establishment, acquisition and expansion of investments. Investors of Contracting Parties are, thus, secured access to the market of the host country insofar as access is secured to the nationals of the host country, except in the sectors or with respect to the matters specified in the Annex to the Agreement.30

Secondly, Japan’s new-generation BITs provide for prohibition of performance requirements with respect to a broad range of investment activities. Prohibition of performance requirements is stipulated under the WTO Agreement on Trade-related Investment Measures (TRIMs Agreement). However, the prohibition of performance requirements under Japan’s new-generation BITs covers much broader range of investment activities. For instance, Article 9, paragraph 1 of the Japan-Korea BIT prohibits Contracting Parties from imposing any of the following requirements: (a) to export a given level or percentage of goods or services; (b) to achieve a given level or percentage of domestic content; (c) to purchase goods produced or services provided domestically, (d) to relate the volume or value of imports to the volume or value of exports; (e) to restrict sales of goods or services of investors by relating them to the volume or value of its exports or foreign exchange earnings; (f) to transfer technology; (g) to locate the headquarters of the investor in its territory; (h) to achieve a given level or value of research and development in its territory; (i) to hire a given level of its nationals; or (j) to supply one or more of the goods or services that the investor produces or provides to a specific region or the world market, exclusively from the territory of the Contracting Party. Activities which fall within the categories (a) to (e) above are also proscribed under the TRIMs Agreement, but the others are not. This provides investors a wider range of freedom in their investment activities than the one provided under the TRIMs Agreement.

Thirdly, Japan’s new-generation BITs provide enhanced protection to foreign investors at post-investment stage through (a) an umbrella clause and (b) institutional arrangements for the improvement of business environment. An umbrella clause is a provision of a BIT whereby a host country commits itself to perform the obligations it has assumed for individual investments based on the contracts with foreign investors. Such contracts are often concluded with respect to massive investment projects such as infrastructure building, natural resources

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30 Annex I to the Japan-Korea BIT enumerates sectors excluded from the application of national treatment under Article 2 for each Contracting Party. This include defense industry, broadcasting industry, fisheries and tobacco industry, among others, for Korea, and nuclear energy industry, space industry, broadcasting industry, among others, for Japan.
development, etc. As a result of an umbrella clause, host government’s breach of an obligation in an investment contract automatically establishes a breach of obligation under the BIT, and the dispute settlement mechanism under the treaty (including investor-state arbitration) becomes available in addition to the dispute settlement mechanism under the contract.

Japan’s new-generation BITs establish institutional arrangements for the improvement of the business environment. First, many of them establish a sub-committee on improvement of the business environment under the bilateral joint committee for the implementation and operation of the BIT. Such sub-committees comprise representatives of government officials and investors of both contracting parties. They meet regularly, discuss a wide range of issues to improve business environment, and make recommendations and advisory opinions for the solution of the issues. Secondly, some of them establish liaison offices or contact points on improvement of business environment within the government, which receive complaints from foreign investors, transmit them to the relevant authorities, and provide the investors with necessary information and advice in collaboration with the relevant authorities. These institutional arrangements enable foreign investors to consult with host governments through low-profile and informal channels for the improvement of business environment, with the support from their home governments. They cover a wide range of issues with respect to the improvement of business environment, such as public safety, improvement of infrastructure, labor relations and intellectual property protection.

(c) Moderate legalization on rules covered by the WTO

At the end of 2.1 above, it was pointed out that Japan’s policy shift to EPAs and BITs was partly motivated by its determination to achieve a high level of legalization through bilateral/regional channels. In particular, Japan’s EPAs

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31 See, for instance, Article 4, paragraph 2 of the Japan-Cambodia BIT, which provides: “Each Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party.”

32 See, for instance, Article 25 of the Japan-Peru BIT on “Sub-committee on Improvement of Investment Environment.”

33 See, for instance, Article 109 of the Japan-Indonesia EPA on “Liaison Office.”

34 On the achievements of Japan’s institutional arrangements for the improvement of business environment under its BITs, see Trade Policy Bureau, METI, 2010 Report on Compliance by Major Trading Partners with Trade Agreements – WTO, FTA/EPA, BIT, pp.1020-1032, available at [http://www.meti.go.jp/english/report/data/gCT10_1coe.html](http://www.meti.go.jp/english/report/data/gCT10_1coe.html)
contain provisions which secure higher level of legal protection than the one provided under the WTO Agreements. Such “WTO plus” is most salient with respect to (a) technical barriers to trade, (b) protection of intellectual property rights, and (c) competition law and policy.

On technical barriers to trade, many of Japan’s EPAs provide for reaffirmation of the rights and obligations under the WTO Agreement on Technical Barriers to Trade (TBT Agreement). However, some provide for mutual recognition, whereby the contracting parties mutually accept the accreditation of the conformity assessment body (CAB) of the exporting country, based on the criteria and procedure provided by the importing country. This enables exporters to acquire an accreditation on their export products ex ante in the exporting country, and thus to save their cost and time.

Some of Japan’s EPAs provide for a higher level of intellectual property protection than the WTO Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreements). For instance, the Japan-Malaysia EPA provides for the following “TRIPS plus” protection: (a) simplified procedure, (b) strengthened protection, and (c) strengthened enforcement. With respect to procedural simplification, it provides for the application of international classification system on patents under the Strasbourg Agreement and on trademarks under the Nice Agreement (Article 116, paragraph 2), and the publication of patent application after the expiration of 18 months from the filing date (Article 119, paragraph 5), among others. With respect to strengthened protection, for instance, it provides for an enhanced protection of well-known trademarks by obliging Parties to refuse or cancel the registration of a trademark which is identical or similar to a trademark well-known in either Party, if use of that trademark is for unfair intentions, inter alia, intention to gain an unfair profit (Article 121, paragraph 2). Finally, with respect to strengthened enforcement, for instance, it provides for the prohibition of re-exporting goods infringing trademarks or copyrights or related rights (Article 125, paragraph 3).

Trade and competition policy was among the Singapore issues, which were proposed as among the new agenda items of the first negotiating round of the WTO and were later dropped from the agenda. Some of Japan’s EPAs resuscitate them by

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35 See, for instance, Chapter 6 of the Japan-Singapore EPA on “Mutual Recognition,” in particular Article 46.

36 Article 59 of the TRIPS Agreement prohibits re-exporting goods infringing trademarks, but it does not prohibit re-exporting goods infringing copyrights.
incorporating (a) commitment to implement each contracting party’s competition law domestically, (b) cooperation on notification and information sharing with respect to the application and enforcement of competition law and policy, and, occasionally, (c) positive comity.37

Japan is also seeking WTO plus commitments from its EPA counterparts in trade facilitation and government procurement. With respect to trade facilitation, some of Japan’s EPAs contains the following WTO plus provisions: (a) cooperation for the promotion of paperless trading,38 (b) cooperation for simplification and harmonization of customs procedures,39 and (c) cooperation and information exchange between customs authorities of contracting parties.40 EPA negotiations with countries not partaking in the WTO’s plurilateral Agreement on Government Procurement are frequently the only way in which Japanese companies can gain access to their government procurement markets, which was the case in the Japan-Mexico EPA.41 However, Japan was unable to secure substantial commitment on government procurement in its EPA with Malaysia and the ASEAN.42

Japan’s legalization strategy through WTO plus provisions of its EPAs is located between the US FTAs and the Chinese FTAs. Compared to the US, Japan has not made binding obligations in such areas as liberalization in financial services, and labor and environmental standards. On the other hand, Japan’s EPAs are more comprehensive in terms of issue coverage and more legalistic in terms of defining precise obligations and establishing formal dispute settlement mechanisms than Chinese FTAs, which have been characteristic of brief, vague, and with an emphasis on conciliation rather than formal dispute settlement, as we will see in section 3 below. Solís thus argues that the dissemination of a distinct Japanese approach to preferential trading is a central concern in Japan’s competitive FTA strategy, especially toward China.43

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37 See, for instance, Articles 103 and 104 of the Japan-Switzerland EPA and Articles 9 to 21 of the Implementing Agreement of the Japan-Switzerland EPA.
38 See, for instance, Articles 57 to 61 of the Japan-Thailand EPA and Article 8 of the Implementing Agreement of the Japan-Thailand EPA.
39 See, for instance, Article 53 of the Japan-Thailand EPA.
40 See, for instance, Articles 55 and 56 of the Japan-Thailand EPA and Articles 1 to 7 of the Implementing Agreement of the Japan-Thailand EPA.
41 See Articles 119 to 130 of the Japan-Mexico EPA.
42 See Solís, supra n.5, p.206.
43 Ibid., p.207.
2.3 Policy Implications

Domestically, Japan’s EPA strategy was shaped as a compromise between the two conflicting sectors, namely export and investment oriented businesses and the highly protective agricultural sector. As we saw in 2.2, this dictated the choice of targets and the relatively moderate liberalization ratio of its EPAs. However, it is not certain whether Japan will take a similar stance in its future EPA strategy. As many of Japan’s future EPA counterparts\(^{44}\) are exporting agricultural products, moderate liberalization with a number of exclusions of agricultural products from liberalization commitment might not satisfy them. This is the major reason for the standoff of Japan’s EPA negotiation with Australia.\(^{45}\) By the same token, Japan may not join the negotiation of the TPP (Trans-Pacific Economic Partnership Agreement), unless it agrees on trade liberalization including that of sensitive agricultural products, because the TPP negotiation is allegedly premised on such overall trade liberalization. The future direction of Japan’s EPA strategy will, therefore, depend on whether it can strike a new balance between its business interests and agricultural interests, so that the latter may accept an overall trade liberalization in exchange for, say, a substantive amount of compensation or support for structural adjustment. Advance of the Japan-Australia EPA negotiation and Japan’s participation in the TPP negotiation will be the first test of whether Japan will take a new direction in its EPA strategy.

As an EPA is a comprehensive agreement, with many subject matters to be negotiated, Japan may opt for a lighter agreement such as BIT, double taxation treaty\(^{46}\) and/or social security treaty\(^{47}\) with its major counterparts of trade and

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\(^{44}\) Japan has not concluded EPAs with its major trading partners. According to the data of 2009, following are the top five trading partners of Japan’s exports and imports: On exports, China (with 18.9% share of total exports), US (16.4%), EU (12.5%), Korea (8.1%), and Chinese Taipei (6.3%); on imports, China (22.2%), US (11.0%), EU (10.7%), Australia (6.3%), and Saudi Arabia (5.3%). See WTO, Country Profile – Japan, available at [http://stat.wto.org/CountryProfiles/JP_e.htm](http://stat.wto.org/CountryProfiles/JP_e.htm)

\(^{45}\) Japan and Australia agreed to start negotiation of an EPA in December 2006, and held 12 meetings since April 2007. However, the negotiation has practically been stalled since April 2010, due to the conflict as to whether to exclude a number of sensitive agricultural products (rice, wheat, beef, dairy products, sugar, etc) from liberalization commitment. See, for instance, “Japan-Australia EPA negotiation stayed off the course”, *Asahi shimbun* (Asahi newspaper), 2 February 2011.

\(^{46}\) As of June 2011, Japan has concluded 48 double taxation treaties. As it concluded a double taxation treaty with the USSR, which has been succeeded by the member countries of the CIS, it covers 12 countries. See Japan, Ministry of Finance (MOF), *Wagakuni no sozei jōyaku nettowāku* (The tax treaty network of Japan), available at [http://www.mof.go.jp/tax_policy/summary/international/182.htm](http://www.mof.go.jp/tax_policy/summary/international/182.htm)

\(^{47}\) Japan has signed social security agreements with Germany, UK, Korea, US, Belgium, France, Canada, Australia, Netherlands, Czech Republic, Spain and Italy, and is negotiating social security agreements with Ireland. See Japan, Social Insurance Agency, *International Social Security
investment. Japan’s Ministry of Foreign Affairs (MOFA) announced a policy on the strategic utilization of BITs in June 2008. It enumerated several criteria for selecting counterparts of Japan’s BITs, including (a) countries where Japan has been made a substantial amount of investment or where it is likely to make such investment, (b) countries whose business environments need improvement, and (c) countries which are important to Japan as providers of energy resources and other mineral resources. Based on the criteria (a) and (b) above, it enumerated Brazil, Poland, Czech Republic and Hungary. Based on the criterion (c), it enumerated UAE, Oman, Algeria, Nigeria, Bolivia, Ukraine, Bahrain, Kazakhstan, Angola, and South Africa. Even though this was a “wish list,” it suggested a direction of Japan’s BIT policy in the near future.

Let us conclude this section with a few remarks on the implications of Japan’s EPA and BIT policy for multilateralism. Japan’s policy shift to bilateral/regional EPAs and BITs was partly due to the failure of the Doha Development Agenda to cover investment rule-making. Japan has also been trying to agree on WTO plus rules in such subject matters as technical barriers to trade, intellectual property rights and competition law. These should be regarded as Japan’s effort to complement multilateral rule-making by EPAs and BITs, and they should not be regarded as abandonment of multilateral rule-making and trade liberalization via the WTO. Japan has been a dedicated supporter of multilateral trade negotiation via GATT/WTO, as it has enjoyed a substantive trade benefit from GATT/WTO. EPAs and BITs have been positioned as complementary to the multilateral trading system. The fact is that the Doha Development Agenda has been stalled over an extended period of time, and Japan simply cannot break the impasse.

3. China’s FTA Negotiation

Arguably, during its course of economic reform, China has followed the Japan development model in a milieu of protection and controls, as well as heavy dependence on the US market for its exports. Japan and China have, without exception, greatly profited from an open world economy and hence for a long time

49 As of August 2011, Japan is either negotiating BITs or preparing for negotiation of BITs with the following countries that were on the “wish list” of June 2008: Kazakhstan and Algeria. It is also preparing for negotiation of BITs with Qatar and Ukraine. See METI, supra n.3, p.12.
have been strong believers in multilateralism. This explains why East Asia is a late comer in the move toward FTAs compared to the Americas, Europe, and Africa. As of 2000, only three FTAs had been concluded. By the end of 2002, of the 30 leading economies in the world, only five were not members of any such FTAs: Japan, China, South Korea, Taiwan and Hong Kong.\(^5\) But the process has been accelerated in the new century

The policy shift took place in late 1990s, when China witnessed the Asian financial crisis and its prolonged WTO accession negotiation were about to be completed. China officially proposed its first FTA negotiation with ASEAN members in November 2000. China has entered into a number of regional and bilateral trade agreements ever since, or is in the process of doing so. China signed its first FTA agreement (trade in goods) with ASEAN in 2004, and it has concluded FTA negotiations with Hong Kong (Effective in 2004), Macao (effective in 2004), ASEAN (effective in 2005), Chile (2006), Pakistan (2007), New Zealand 2008), Singapore (2008), Peru (2009), Costa Rica (2010), Taiwan (2010). China’s trade with these countries in 2010 together totaled $574.5 billion, or 19.3% of China’s global trade. China is also in the process of negotiating FTAs with the Gulf Cooperation Council, Australia, Iceland, Norway, and the Southern African Customs Union (which includes Botswana, Lesotho, Namibia, and Swaziland). China is also considering reaching FTAs with India, South Korea, Japan, and Switzerland.\(^5\)

What were the major factors that contributed to China’s policy shift from multilateralism to bilateral/regional FTA negotiations? What are the main characteristics of China’s FTA strategy? This section will deal with these questions. It will also draw some lessons learned from China’s FTA negotiation so far, and elucidate some policy implications for the future.

3.1 China’s Policy Shift From Multilateralism to FTAs: How and Why

China’s extensive and growing trade interest left it with little option but to fully participate in the multilateral trading system with the WTO as its focal point. It did so at the end of 2001, accepting terms that have been imposed on no other

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nation before or since.\textsuperscript{52} In fact, China unilaterally liberalized its trade during its fifteen-year prolonged accession negotiation. Beginning in 1992, tariff levels fell in a series of adjustments that brought the average tariff level down by two-thirds, to roughly 15 percent on the eve of WTO accession. In addition to tariffs, the government dismantled most of the quotas and import licenses in 1990s. By 2001 the Chinese imports regulated by licenses or quotas fell dramatically to about 8.45% from nearly 50% in the 1980s.\textsuperscript{53} Among a number of motives behind China’s decision to join the WTO and its willingness to bind itself to the global trade regime, its commitment to multilateralism should be an important one. It was clear from the very beginning of its economic reform that China should fully integrate itself into the global economy. The best way to achieve this goal is through its WTO accession. No matter how prolonged and frustrating the negotiation process turned out to be, joining the WTO was always the policy priority of the Chinese leadership. Furthermore, joining the WTO was seen as a strong political commitment made by the Chinese government to the western countries that its open-door policy was irreversible.\textsuperscript{54}

Why did the policy shift take place in late 1990s and early 2000s? The initial policy consideration was more political than economic. First, since China’s rapid economic growth in 1990s, there have been great concerns of the “China threat” raised by the Southeast Asian countries. Politically, these smaller countries in Southeast Asia were not sure the true intention associated with China’s increasing national power. Economically, China has become the competitor to their exports in the US and EU market, and to their capacity to attract foreign direct investment. Especially China’s joining of the WTO would inevitably intensify the economic competition as they all exported similar labor-intensive products and all relied on the markets in the developed countries. Furthermore, the outbreak of Asian financial crisis also reminded China of the importance of developing a regional policy as after all, China is an Asian country and it would be difficult for China to evade the contagion of Asian financial crisis, even though it had a low level of intra-regional trade with other Asian neighbors and a tight capital control policy in 1990s. Within this context, in the Ninth Five-Year plan published in 1996, Chinese government for the first time raised that “China shall actively participate and develop regional economic cooperation”, as well as “strengthen South-South


\textsuperscript{54} Interview with Chinese trade officials, summer 1999.
Cooperation,” and promote and develop the economic and trade cooperation with developing countries.” The same plan, however, also calls for China to “actively participate and defend the global multilateral trading system, develop both bilateral and multilateral trade, so that they can promote each other and the market can be diversified.”\textsuperscript{55} It has been a well-established domestic consensus in China, first developed by Deng Xiaoping, that a peaceful and harmonious external environment is an important condition for China’s economic development and prosperity. A well thought out FTA strategy will help to assure China’s Asian neighbors of the cooperative aspects of China’s “peaceful development,” signaling to regional partners the non-predatory nature of the country’s rapid economic growth and the joint economic gains that FTAs can potentially deliver.\textsuperscript{56}

Second, as China deeply integrated itself into the global production network, its unique trade patterns and heavy dependence on processing trade, determined by its comparative advantage in global market, has made itself a major trading country in the world. The scope of China’s processing trade and consequently its ever increasing demand on raw materials, energy products and intermediate inputs has turned China’s attention to secure its import markets from the developing countries in Africa, Latin America and Asia. In this respect it has been argued that an important motivation of China’s decision’s to pursue FTAs with such partners as Australia, ASEAN, and the Gulf countries is to secure essential primary materials in order to hedge against potential supply shortages, including those created by increases in commodity prices. The pursuit of FTAs in this perspective again reflects the Chinese leadership’s desire for ensuring the achievement of its key national security goals particularly the long-term sustainability of its economic development strategy.\textsuperscript{57} The table\textsuperscript{1} shows a significant change, and the fact that, the direction of China’s trade has changed substantially over the 10 years 1998-2008. First, there is a visible shift in China’s trade from the developed to the developing economies, in imports as well as in exports. The share of developed economies in China’s imports has moved down from 82 per cent of the total to about

\textsuperscript{55} Shuchao Henry Gao, "China’s Strategy for Free Trade Agreements: Political battle in the name of trade" (2011). Research Collection School of Law: Paper 966.

\textsuperscript{56} Katada, Saori N. and Mireya Solís. “Cross-Regional Trade Agreement in East Asia: Findings and Implications.” a chapter in Saori N. Katada and Mireya Solís (eds.), Cross Regional Trade Agreements: Understanding Permeated Regionalism in East Asia, (Berlin: Springer, 2008): 147-159

59 per cent from 1998 to 2008. This is a change of some 23 per cent, and implies that China relies that much less on developed economies for its imports. Similarly, China’s exports too have diversified away from developed economies; the latter’s share in China’s exports has fallen from 84 per cent to 71 per cent during the same period: a fall amounting to 13 per cent of China’s exports. To get a proper perspective on these numbers one has to keep in mind that China’s exports have been growing very rapidly over these years. It would therefore be a safe inference to say that China relies much less on the developed economies as its trade partners today than was the case ten years back. Developed economies though remain China’s more important trade partners for now. China’s reliance on developing economies as trade partners has increased significantly over the ten-year period. Consequently, improving its economic partnership with those resource-rich countries has become the second main motivation behind China’s initiation of FTA negotiations.

3.2 Characteristics of China’s FTA Strategy

What are the main characteristics of China’s FTA Strategy? As for the criteria to choose the target countries, as we have seen in 3.1, two concerns seem to have dictated the choice of the target, namely, enhancing China’s political relations with its developing Asia neighbors and to secure its ever-increasing energy and raw materials demand by building closer business ties with those resource-abundant developing countries in Asia, Latin America and Africa. Among the ten FTA agreements China signed, the agreements with Taiwan, Hong Kong, Macao, ASEAN, Pakistan, Singapore were primarily driven by geopolitical concerns (Taiwan, Hong Kong, Macao as part of greater China, to be good neighbors with ASEAN, and Pakistan as its political ally); its agreements with Peru, New Zealand, Chile and Costa Rica, instead, were primarily resources driven. As a result, China has signed most of its FTA agreements with small and medium sized economies, the negotiation process has been very flexible, pragmatic, and gradual and the scope of agreements tend to be shallow and less controversial to its partners.

(a) Moderate trade liberalization

The GATT Article XXIV.8 provides that the duties and other restrictive regulations of commerce are eliminated on “substantially all the trade” between the constituent members of free trade areas and customs unions. China’s FTA strategy has been criticized by many scholars as “low quality” and “economically less
meaningful.” Why did China prefer these ‘shallow’ agreements over the comprehensive ones? It is easy for China domestically to agree on these less demanding and less “painful” trade concessions, especially after China made considerable concessions over its WTO accession negotiation. As many in China feel that China is still in the process of adjusting to its WTO concessions (and it is still a quite controversy on if China made more than necessary concessions to join the WTO), Beijing is not ready to make deeper cuts on trade liberalization. Therefore, China prefers not to make many “WTO-plus” concessions in most of the FTA agreements China signed (with its FTA agreements with Hong Kong, Macao and Taiwan as exception). As noted by Antkiewicz and Whalley, China’s FTA agreements are featured by “diversity in terms of both form and coverage; brevity and “hence the inevitable vagueness of the texts involved;” and “the absence of explicit and clear dispute resolution procedures with conciliation between the parties being relied upon.”

Many of the FTA agreements China negotiated have excluded sensitive sectors and issues that may be difficult to deal with in the short term such as intellectual property protection, dispute settlement mechanisms, special sectoral liberalization, environment, and labor standards. For instance, China and ASEAN have placed a wide range of important industrial products (such as automobiles, appliances, chemical products, iron and steel, and textiles) as well as farm goods (such as rice and palm oil) on the sensitive track.

(b) Politicized FTA Agreements

China negotiated more than half of its FTA agreements by placing geopolitical/security/strategic goals over economic considerations. China’s efforts with China-ASEAN FTA (CAFTA) are widely seen as an example of the primacy of geopolitical considerations in its engagement of Southeast Asia. A troublesome and uneasy neighborhood can only be a distraction from a focus on economic development. In fact, Chinese government officials admitted that geopolitical considerations trump any economic benefit when China is negotiating economic issues with its neighboring countries. Before the negotiation was launched, China already expressed its willingness to make more economic concessions. China’s

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60 Interview with Chinese trade officials, Summer 2008.
Deputy Economic Minister and chief WTO negotiator Long Yongtu promised that ASEAN would be among the first to benefit from China’s further opening up. At a meeting of senior ASEAN and Chinese economic officials in Brunei in August 2001, Premier Zhu Rongji of China made a strong push, proposing tariff reduction and other measures to be phased in over seven years from 2003-09. China offered to open its own market in some key sectors to the ASEAN countries five years before they reciprocate. It would also grant special preferential tariff treatment for some goods from those less developed ASEAN states, i.e., Cambodia, Laos and Myanmar, including early harvest and special and differential treatment (S&D) of new ASEAN members, Laos, Cambodia, Myanmar and Vietnam, allowing them five more years to join the FTA. China accorded the three non-WTO ASEAN members — Vietnam, Laos and Cambodia — the most-favored-nation status. Under CAFTA, which covers trade in goods, services and investment, a free trade zone will be established among the developed ASEAN countries and China by year 2010, and extended to less developed ASEAN nations by year 2015. Some scholars contend that “for the Chinese government the CAFTA is clearly as much a political accord as it is an economic agreement” and that China’s FTA negotiations have an explicit “political dimension” to it. In order not to upset its ASEAN trading partners, China allowed the ASEAN countries to determine under what pace their trade would be liberalized and what should be included (or excluded) in the trade liberalization scheme. As a result, the initial CAFTA agreement is far from comprehensive, with only 40% of goods subject to a reduction in tariffs to 5% or less. The accord seeks to broaden the range of goods to 60% of imports within two years, but the agreement has also incorporated many exceptions for sensitive products.

China also accepts very flexible plan, requested by its FTA partners, to reach FTA agreements. As with China’s FTA negotiation with Pakistan (trade in goods agreement signed in 2005 and trade in services agreement signed in 2009), China agreed to negotiate trade in goods agreement (signed in 2004) separately from trade in services agreement (signed in 2007) with ASEAN members to ease the political

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61 Jason Leow, “Asean-China FTA talks get under way”, Straits Times (Singapore), 15 May 2002
tensions in some of the ASEAN countries. The greater flexibilities demonstrated by China unilaterally also shows that reaching agreements with these countries will meet primarily its political and foreign policy objective.

Furthermore, all economies that have entered FTA with China have recognized the market economy status of China. The recognition of China’s market economy status has become a prerequisite for China to negotiate FTAs. Upon China’s WTO accession, China agreed to be labeled as non-market economy (NME) for 15 years (until 2016). The adoption of NME status for the AD investigations has meant the imposition of many more antidumping duties than would have been the case otherwise. The Chinese leadership has sought to use FTA negotiations to foster recognition of China as a “market economy” in trade negotiations. This could help to set precedents and pressure for other WTO members, particularly the U.S., EU and Japan to consider granting China “market economy” status before the 2016 timeline. For example, the FTA between China and New Zealand helps to illustrate this point as New Zealand was the first developed country to grant China market economy status. By granting China this status, New Zealand agreed to waive its right to apply discriminatory AD measures against China. By June 2011 97 countries already recognized China’s market economy status, but the largest economies such as the U.S., EU, Canada and Japan have not done so. Recently, Chinese leaders even tried to link its financial effort to save the debt-ridden Eurozone with the granting of China’s market economy status from the EU. However, even if this prerequisite of recognizing market economy status would not be a barrier to China’s FTA negotiation, its ability to help China finally gain its market economy status in the WTO is still limited. In the meantime, many

65 China accession terms permit other WTO members to use NME methodology in their AD investigation against China until 2016. This NME methodology provides both the traditional AD users (developed countries) and the new AD users (developing countries) with considerable discretion to choose surrogate countries and surrogate values as the basis for calculating the cost of Chinese firms, therefore increasing the probability that their AD investigation will yield sufficient evidence in favor of a ruling against China. In 2008 China accounted for as much as 35% of all new antidumping investigations initiated and 41% of new AD measures applied. See detailed discussion in Ka Zeng and Wei Liang, “U.S. Antidumping Investigations Against China: Does China’s WTO Membership Restrain the U.S.’ Use of Discriminatory Antidumping Practices?”, Review of International Political Economy, Vol. 17, Issue 3, August 2010, pp.562-588.


countries would see this effort as a way to unnecessarily politicize China’s FTA negotiations.

(C) Resources-driven FTA Strategy

Given its increasing energy needs, Beijing has adopted a global strategy of securing energy and natural resources. A categorically different kind of case is presented by China’s FTA with Chile, signed in 2005, and which serves as an example of using the FTA as an instrument to assure supplies of inputs essential for its continued development. Copper, a critical industrial input, accounted for 30 percent of China’s imports from Chile and this may significantly increase under the new FTA agreement, which underlines the assurance of uninterrupted supplies. China’s FTA with Chile also brings surety of energy supplies. Similarly, China has great interest in securing a deal with GCC countries to improve its access to oil and with Australia to have better access to iron ore and other minerals. In addition to Chile, China has also completed FTA negotiations with other resource abundant countries such as Costa Rica, Peru, and New Zealand. Other countries which have ongoing FTA negotiations with China, including Australia, GCC, and South Africa, also fall into this category.

In general, China’s approach to FTAs has been very flexible and pragmatic. China has different goals in negotiating these agreements and strongly believe that this approach reflects the nature of China’s globalized economy and its intention to expand its influence in Asia. Chinese Premier Wen Jiabao stated that China’s FTA agreements should “be open and inclusive and achieve mutual benefit and common progress”.

3.3 Policy implications

The tendency for China to negotiate moderate trade deals has also made China difficult to negotiate FTAs with developed countries, which more likely will ask for comprehensive terms of agreement to include trade in goods, trade in services and other Singapore issues beyond the existing WTO rules such as competition policy, environmental and labor standards, IPR and investment policy, etc. Under the circumstances that China had to negotiate on these issues, China

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has largely chosen not to include these issues in the main agreement of the FTA, but preferred to address them in stand-alone side agreements or MOUs. This not only can partially explain why China so far has negotiated most FTAs with developing countries, but also why China-Australia FTA negotiation is still stalled. Another important consideration for Chinese government to choose these smaller sized economies for FTA negotiation is that China is still a new player in the FTA negotiations and needs to learn and accumulate more skills and experiences before it can comfortably negotiate with more diversified and larger economies.69

China has the preference on signing the “shallow” FTA agreements, especially at the early years of its FTA negotiations (before 2008). China can continue to evade the above-mentioned WTO rules on substantial trade liberalization by claiming its developing country status (and the special and differential treatment granted to developing countries). However, as the second largest economy and the largest exporter in the world, it is hard to justify the negative impact of China’s FTA negotiations on the global trade system. It has provoked the international strains, particularly when many countries are moving toward greater trade protectionism under today’s financial crisis. In response to a warning by WTO Director-General Pascal Lamy that China’s pursuit of separate bilateral and regional free trade agreements may negatively affect its long-term economic interests, the spokesman of China’s Ministry of Commerce (MOFCOM) responded that “bilateral free trade agreements and the multilateral World Trade Organization are both important channels to facilitate global trade and liberalize investment” and that the two mechanisms should be combined as FTAs can be considered as “important supplements” to the WTO.70

4. The Comparison between China and Japan’s FTA Approaches

The comparison of the FTA strategies of Japan and China is noteworthy. Japan tends to use FTA as a tool to build production networks that benefit its largest industries while China uses it as a foreign policy tool to promote economic and political partnership.71 Japan focuses more on trade in services and investment policy and tries to protect its agriculture sector. So Japan’s FTAs are more robust

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69 Interview with trade officials from MOFCOM, summer 2010.
70 “China to Advance Bilateral and Regional Free Trade Negotiation.” Xinhua News Service, September 15, 2006
than China’s, though they are still viewed as ‘selectively comprehensive’ compared with the gold template of the US and EU FTAs with high level of trade liberalization. Japan also negotiated FTAs with more developed countries than China, which has negotiated FTAs with only Singapore and New Zealand so far. China focuses more on trade in goods and tariff reduction of manufacturing products, so that its FTAs are narrower in terms of the scope covered. China’s incremental approach is uniquely open to the continuous negotiation to further trade liberalization after its early harvest programs. For example, the initial CAFTA agreement was far from comprehensive with only 40% of goods subject to a reduction in tariffs. But the negotiation continued after the signing of the trade in goods agreement of CAFTA. The subsequent negotiations deepen and broaden the extent of liberalization. The average tariff on ASEAN exports to China is slashed to 0.1 per cent in 2010, while the average tariff on China exports to older ASEAN-6 members is slashed to 0.6 per cent. Currently, around 7,000 items traded between China and ASEAN are zero rated.72 Trade in services agreement was also added to the package later in 2007 and investment agreement was completed in 2009.

Both China and Japan signed many “low risk, low return” FTA agreements. To Japan, its ability to promote its economic interest through an aggressive FTA program is constrained by the need of protecting its agricultural sector and rigid immigration policy.73 To protect its agricultural sector, Japan has chosen its FTA partners either has little agriculture trade with Japan (like Singapore), or is willing to exempt a large number of agricultural products from tariff cuts (like Mexico and Malaysia). To China, its geopolitical or resources-driven FTA strategy determines its soft approach in the negotiation by not to push hard for trade liberalization. Hence, these two countries have ended up with many watered-down FTAs that neither harm nor energize their economies respectively.

Similar to Japan, most of China’s FTA partners are not China’s top trade partners. Among the top ten trading partners of China, only Hong Kong, Taiwan and Malaysia are China’s FTA partners. If Japan’s partner selection criteria are to look at the potential business interest of the Japanese companies in the target countries without seriously damaging its domestic agriculture, China tends to negotiate with those countries that depend more on Chinese market. Not only

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China holds trade deficit with most of its FTA partners, China is their number one or two export destination. With this asymmetric trade relationship, China could have more bargaining power in the FTA negotiations. However, one principle that has guided China’s FTA negotiations is “to give more and receive less, be equal partners to achieve win-win outcome (多予少取, 平等互利). The policy implication of this negotiation principle is two-fold. First, FTA negotiation is more political than economic. Second, China has failed to reach more economically meaningful (more demanding) FTA agreements with its important trading partners by taking advantage of its ever increasing influence and market leverage.

5. Shaping the future path

Will Japan and China be able to take the initiative in establishing regional integration in the Asia Pacific? We can only speculate a few possible scenarios due to a number of policy options and uncertainties. One possible scenario is the formation of an East Asian Community. Another possible scenario is the formation of a broader regional integration in the Asia Pacific. Yet another possible scenario is the formation of a trilateral free trade agreement among China, Japan and Korea. Each scenario has different options, which will lead to different results.

The idea of an East Asian Community was first proposed by the then Prime Minister Koizumi in January 2002. It originally meant the formation of a comprehensive economic partnership agreement between Japan and the ASEAN. It was intended that the formation of a formal Community in East Asia would strengthen the deeply interdependent business relationship in the region. Japan has since been advocating the idea of an East Asian Community. As we saw in Section 3 above, China also started to promote the idea of East Asian Community around the same time, soon after its accession to the WTO. However, the two countries have taken different approaches as to the geographical coverage and the subject matter coverage. China has been promoting the idea of an East Asian Community consisting of the ASEAN plus three (China, Japan and Korea). The coalition government after Prime Minister Koizumi, while endorsing the ASEAN plus three concept, advocated the idea of a Comprehensive Economic Partnership in East Asia (CEPEA), where ASEAN plus six (China, Japan, Korea, Australia, New Zealand, and India).
Zealand and India) should be involved. With respect to the subject matter coverage, Japan opted for a full-set negotiation, consisting of financial and monetary cooperation, liberalization of trade in goods and services, investment liberalization and protection, intellectual property rights, competition and government procurement. On the other hand, China put priority on liberalization of trade in goods, and negotiation on the liberalization of trade in services and investment promotion has been postponed.

The rivalry between the two countries has so far been at the level of competition of visions, none of which has gained enough political support for realization. The Democratic Party of Japan won the general election of August 2009. Its Manifesto sets out the formation of an East Asian Community as one of the priority goals in diplomacy. However, it is too early to regard this as a major breakthrough. The Manifesto does not specify the geographical coverage and subject matter coverage of the East Asian Community. At the same time, it emphasizes the economic cooperation in the Asia Pacific region and does not exclude the possibility of forming an East Asian Community on the basis of open regionalism among ASEAN plus six, which may not be acceptable to China. China has adopted a different approach from Japan’s in Asian integration. China began with its regional negotiation with ASEAN first (CAFTA signed in 2004) and then moved to the negotiations with the individual ASEAN members. In contrast, Japan began its negotiation with individual ASEAN members first and signed its FTA agreement with Singapore in 2002. By negotiating with the ASEAN as a group, China aimed to expand its political influence to the region. While Japan believed that it would be more feasible for Japan to negotiate with the developed members of ASEAN as it insists a higher level of FTA agreement to include trade in services, investment and other trade-related issues. Consequently Japan signed FTA agreements bilaterally with many ASEAN members, including Singapore, Malaysia, Indonesia, Thailand and Vietnam. However, after the formation of a de-facto “Greater Chinese Economic Zone (GCEZ) that would place Hong Kong, Macao, Taiwan and ten Southeast Asian countries under the umbrella of the Chinese economy since the CAFTA took into effect, Japan felt the pressure to be excluded from the vast developing Asian market. Hence, it changed its policy preference of bilateral FTA negotiation to reach a Japan-ASEAN FTA agreement in 2008. With the existence of two parallel FTA negotiations of China and Japan, it has added difficulty and complexity to further regional integration of Asia. Korea under the President Roh’s

77 Democratic Party of Japan, Manifesto 2009, item 52.
administration had the ambition to make Korea the “Economic Center in East Asia” by concluding the China-Japan-Korea FTA. But it turned out to be ineffective as Korea-Japan FTA negotiation stalled in 2004 and Korea-China FTA is still under the stage of joint-study. Chinese government openly promoted ASEAN’s leadership role in East Asia, particularly through the East Asia Summit (EAS). Given the different level of economic development and political system among the ASEAN ten members and their relatively smaller size of economy compared with China, Japan and South Korea, ASEAN may not become the effective leader in the region. The missing internal leadership in East Asia has made the US a motivated candidate for leading regional economic integration. The recently concluded US-Korea FTA, in addition to several other bilateral FTAs which the US signed with Singapore and others can be interpreted as means of “encirclement” against the assertive China or Japan.

While Japan and China has been competing with their own visions for an East Asia Community, there have appeared a few initiatives for the formation of a broader regional integration in the Asia Pacific: (a) a Free Trade Area of the Asia Pacific (FTAAP), and (b) the Trans-Pacific Partnership (TPP).

The idea of FTAAP was proposed at APEC Summit meeting in November 2006, and has since been discussed within the framework of APEC. Most recently, the meeting of APEC trade ministers, held in June 2010 in Sapporo, welcomed the progress made to explore possible pathways to achieve an FTAAP. The negotiation to form a Trans Pacific Partnership was started in 2002 among Chile, New Zealand and Singapore. Brunei joined it at the end of negotiation in April 2005, and the four countries reached an agreement on a Trans Pacific Strategic Economic Partnership Agreement in June 2005. Negotiations to expand the TPP to include the US, Australia, Peru and Viet Nam began in March 2010.

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79 See APEC, Free Trade Agreements and Regional Trade Agreements. [http://www.apec.org/apec/apec_groups/other_apec_groups/FTA_RTA.html](http://www.apec.org/apec/apec_groups/other_apec_groups/FTA_RTA.html)


Japan needs to decide whether to join these new initiatives in regional integration in the Asia Pacific. With respect to the FTAAP, Japan has no reason to oppose it. The FTAAP is still in the process of discussing ideas and visions. Japan has been an ardent promoter of APEC, and it endorses the idea of the FTAAP, and is likely to promote its realization within the framework of APEC. The situation is different with respect to the TPP. The original agreement on the TPP already entered into force, and it “is open to accession on terms to be agreed among the Parties, by any APEC Economy or other State.” (Article 20.6.1)\(^82\) Although the original TPP looked a minor trade agreement to Japan, the US’s decision to join it dramatically increased the economic and political significance of the TPP. As the nine countries have already started negotiation of the enlarged TPP, Japan will have to decide whether it will be able to join the negotiation over the wide range of subject matters such as comprehensive tariff eliminations including agricultural products and liberalization of trade in financial services, both of which might pose political challenges to the government of Japan.

From Chinese perspective, Japan’s proposal of ASEAN+6 is a policy compromise to the US proposal and more importantly, displays a reluctance on the part of Japan to form any kind of FTA with China at this stage, given the lack of political trust, even though an ASEAN+3 may make good economic sense.\(^83\) By proposing an “Asia only” arrangement, China seeks to secure its trade ties with East Asian countries and push for China-led regional integration. As Beijing believes that the TPP has the potential to become the substitute of APEC and reflects US interest of its continued economic presence in the region and encirclement against China, China has felt a sense of discomfort. There is no plan for China to participate in TPP in the short run. Clearly, China is not ready to commit to such a high level of trade liberalization required by TPP negotiation and it goes against China’s longstanding FTA strategy to be flexible and pragmatic.

To China, TPP potentially serves as an instrument to contain China. First, this proposal will fundamentally undermine Beijing’s efforts in the past ten years to integrate regional economy. China built the concept for the framework centered on ASEAN Plus 3, but it would be difficult for this frameworks to grow concurrently with the TPP. Second, other Asian countries are economically benefiting from China’s ascent through expanding their trade with China, but they are also


\(^{83}\) Interview with MOFCOM officials, July 2010.
concerned about China's growing clout. Bringing US into the region will help ease this “China threat” by strengthening security ties with the US. In addition to Vietnam and Malaysia, Thailand and other countries are leaning toward the TPP to secure a competitive edge in the U.S. market when it is liberalized. Third, if Japan opts for the TPP, momentum for an FTA between China, Japan and South Korea (CJK FTA) would be lost. When the three countries got together in Beijing in October 2010 discussing a trilateral FTA, they identified five major hurdles to be cleared: agriculture, differences among the three countries over their stands on regional security, the U.S. presence, the history issue between Japan and South Korea and jockeying for the leadership between Japan and China. Apparently, it is the lack of political trust that has impeded the negotiation, which is hard to overcome. However, if Japan decides not to join the TPP due to its domestic resistance (especially from agricultural sector), TPP may become a motivating factor for the three countries to move forward with their CJK FTA, which will become the backbone of an “Asia only” regional arrangement. After all, China has the lowest level of agricultural tariff among the three (please see table 4). In another word, Japan’s decision will show Japan’s thinking in its foreign policy—to reinforce its role as an Asian power or to reconnect with US economically. Consequently, it will also shape the future of Asia’s regionalism (to be Asia only or Asia pacific). Forth, China runs the risk of being isolated or excluded from this and any future regional arrangement. As suggested by Li Xiangyang, director with the Institute of Asia-Pacific Studies under China's government-affiliated leading think tank, the Chinese Academy of Social Sciences, “even if China expressed its intention to join by saying that it fulfilled all the requirements, I am afraid that the United States would maneuver to block China's participation by making an unreasonable demand.”

If China joins the TPP, it is a de facto China-US FTA agreement. Considering the growing domestic criticism against China’s trade surplus with US, its currency policy and other political frictions, it is not very likely that US Congress will approve such an agreement. If this is the case, TPP would drive the region apart with systematic exclusion of non-members, including potentially China. According to China’s General Custom, China-TPP members trade accounted for 22.8% of China’s total foreign trade in 2010 (to become 32.8% if Japan is included).

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Economically, Vietnam will benefit most out of its TPP membership to take over some of China's existing market share in the US and Australia, as well as their investment in China. Some China analysts already warned that if Chinese government adopts the delay strategy, China will have to face a tough one-by-one negotiation with all TPP members to join TPP, similar to what China experienced over its WTO accession negotiation.87

Finally, there may be a third possible scenario in establishing regional integration in the Asia Pacific, namely, a trilateral FTA among Japan, China and Korea. In May 2011, the leaders of the three countries met in Tokyo and declared their decision to accelerate the joint study on a trilateral FTA so that it may be concluded within the year 2011 and follow-ups will be taken thereafter.88 A preliminary study on a trilateral FTA was started by a group of private researchers in 2003, and it was promoted to a joint study of business-government-academia in 2010.89 Conclusion of a joint study has been an ordinary step before the formal launch of an FTA negotiation, and the decision to accelerate the Joint Study on a trilateral FTA means that the three countries may start negotiating a trilateral EPA in 2012. Regardless of which form China and Japan will finally agree on pursuing regional integration in East Asia (ASEAN plus three or ASEAN plus six), a trilateral EPA among China, Japan and Korea would be an important first step for further integration in the region. In light of the fact that Japan and EU agreed to start a preliminary negotiation to determine the scope of an EPA in May 2011,90 and also in light of the fact that Japan may decide whether to join the TPP negotiation by the APEC Hawaii Summit of November 2011, the year 2012 might

89 See Nobuhide Hatasa, “Nicchūkan FTA no teiketsu de Ajia tiiki kyōryoku no kakudai wo (Expansion of Asian regional cooperation through the early conclusion of a Japan-China-Korea FTA)”, a column on the website of the Japan Institute of International Affairs. (in Japanese) http://www.jiia.or.jp/column/201006/21-Hatasa_Nobuhide.html
“Summit leaders agree to start the process for … negotiations for: a deep and comprehensive Free Trade Agreement (FTA)/Economic Partnership Agreement (EPA), addressing all issue of shared interest to both sides including tariffs, non-tariff measures, services, investment, Intellectual Property Rights, competition and public procurement; … Summit leaders decided, to this end, that the two sides would start discussions with a view to defining the scope and level of ambition of … negotiations. Such scoping would be carried out as soon as possible.”
become an epoch for Japan in its EPA strategy. Here again, the key factor will be whether it can mitigate the strong opposition from its agricultural sector.

Conclusion

Though Japan and China traditionally exhibited preference for multilateral approaches to trade liberalization, the options of FTAs have acquired new significance and urgency since the beginning of the 21st century. The factors that seem to be influencing the recent trade policies of Japan and China include geopolitical considerations as well as the risk of being excluded from regional and bilateral arrangements that are taking place, and the desire to ensure steady supplies of critical raw materials. The two countries are increasingly pursuing FTAs with their neighbors in South and Southeast Asia, as well as with the world at large. Though they have developed distinctive FTA strategies in the process, both countries have insisted that FTAs are supplementary and complimentary to multilateralism. Given the difficulties to negotiate a region-wide FTA in East Asia or Northeast Asia, both countries will continue their approach to embrace both multilateralism and open regionalism.

As the two largest economies in Asia (and the second and third largest economies in the world), the actions and interactions of China and Japan have a direct impact on global trade norms. Their FTA strategies may not be as robust as the U.S. and European FTA strategies, but their FTAs have also resulted in freer trade, if not complete free trade. On the other hand, WTO has many advantages that neither FTA nor BITs can provide. The result of liberalization negotiation will be applied to all the members of the WTO on an MFN basis. Also, the dispute settlement mechanism of the WTO secures implementation of legal obligations of each member, which is practically very hard to secure via a dispute settlement procedure of an FTA or a BIT. Neither FTAs nor BITs can replace the WTO as a mainstream forum for trade liberalization and rule-making. As two major beneficiaries of the multilateral trading system, Japan and China should make their utmost efforts in reinvigorating the system.
Table 1: China: Direction of trade 1998-2008
(as a percentage of total exports and imports)

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th></th>
<th>Imports</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Advanced economies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>20.68</td>
<td>17.69</td>
<td>12.10</td>
<td>7.22</td>
</tr>
<tr>
<td>EU</td>
<td>16.37</td>
<td>20.51</td>
<td>14.87</td>
<td>11.74</td>
</tr>
<tr>
<td>Japan</td>
<td>16.17</td>
<td>8.13</td>
<td>20.16</td>
<td>13.32</td>
</tr>
<tr>
<td>Korea</td>
<td>3.41</td>
<td>5.17</td>
<td>10.70</td>
<td>9.91</td>
</tr>
<tr>
<td>Singapore</td>
<td>2.12</td>
<td>2.26</td>
<td>3.01</td>
<td>1.78</td>
</tr>
<tr>
<td>Emerging, developing economies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Western Hemisphere</td>
<td>2.81</td>
<td>4.88</td>
<td>2.06</td>
<td>6.21</td>
</tr>
<tr>
<td>Africa</td>
<td>1.84</td>
<td>3.00</td>
<td>1.02</td>
<td>4.94</td>
</tr>
<tr>
<td>Europe</td>
<td>2.68</td>
<td>7.40</td>
<td>3.34</td>
<td>3.71</td>
</tr>
<tr>
<td>Developing Asia</td>
<td>5.72</td>
<td>9.08</td>
<td>7.06</td>
<td>10.57</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ASEAN (less Singapore)</td>
<td>3.89</td>
<td>5.74</td>
<td>5.97</td>
<td>8.53</td>
</tr>
</tbody>
</table>

Source: International Monetary Fund, Direction of Trade Statistics, December 2009

Table 2: China’s Top Trade Partners, 2010 ($ billion)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country/region</th>
<th>Volume</th>
<th>% change over 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United States</td>
<td>385.3</td>
<td>29.2</td>
</tr>
<tr>
<td>2</td>
<td>Japan</td>
<td>297.8</td>
<td>30.2</td>
</tr>
<tr>
<td>3</td>
<td>Hong Kong</td>
<td>230.6</td>
<td>31.8</td>
</tr>
<tr>
<td>4</td>
<td>South Korea</td>
<td>207.2</td>
<td>32.6</td>
</tr>
<tr>
<td>5</td>
<td>Taiwan</td>
<td>145.4</td>
<td>36.9</td>
</tr>
<tr>
<td>6</td>
<td>Germany</td>
<td>142.4</td>
<td>34.8</td>
</tr>
<tr>
<td>7</td>
<td>Australia</td>
<td>88.1</td>
<td>46.5</td>
</tr>
<tr>
<td>8</td>
<td>Malaysia</td>
<td>74.2</td>
<td>42.8</td>
</tr>
<tr>
<td>9</td>
<td>Brazil</td>
<td>62.5</td>
<td>47.5</td>
</tr>
<tr>
<td>10</td>
<td>India</td>
<td>61.8</td>
<td>42.4</td>
</tr>
</tbody>
</table>

Source: PRC General Administration of Customs, China’s Customs Statistics
### Table 3: Comparison of China/Japan FTA Negotiations by September 2011

<table>
<thead>
<tr>
<th>Country</th>
<th>Signed Agreement</th>
<th>FTA under Negotiation</th>
<th>FTA Joint Study</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>Hong Kong (Effective in 2004)</td>
<td>SACU (since 2004)</td>
<td>China–Japan–Korea</td>
</tr>
<tr>
<td></td>
<td>Macao (effective in 2004)</td>
<td>GCC (since 2005)</td>
<td>China–Korea</td>
</tr>
<tr>
<td></td>
<td>ASEAN (effective in 2005)</td>
<td>Australia (since 2005)</td>
<td>China–India</td>
</tr>
<tr>
<td></td>
<td>Chile (2006)</td>
<td>Iceland (since 2007)</td>
<td>China–Switzerland</td>
</tr>
<tr>
<td></td>
<td>Pakistan (2007)</td>
<td>Norway (since 2007)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>New Zealand (2008)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Singapore (2008)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Peru (2009)</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Costa Rica (2010)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Taiwan (2010)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>Singapore (effective in 2002)</td>
<td>Korea (since 2003)</td>
<td>Japan–China–Korea</td>
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<tr>
<td></td>
<td>Chile (2007)</td>
<td></td>
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<tr>
<td></td>
<td>Thailand (2007)</td>
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<td></td>
<td>Indonesia (2008)</td>
<td></td>
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<tr>
<td></td>
<td>Philippine (2006)</td>
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<tr>
<td></td>
<td>ASEAN (2008)</td>
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<tr>
<td></td>
<td>Vietnam (2008)</td>
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<tr>
<td></td>
<td>Switzerland (2009)</td>
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<tr>
<td></td>
<td>Brunei (2010)</td>
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<td></td>
<td>Peru (2011)</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>India (2011)</td>
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</tbody>
</table>

Table 4: A Comparison of Average Tariffs and Agricultural Tariffs in Japan, China and South Korea

<table>
<thead>
<tr>
<th></th>
<th>Overall</th>
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<th>Overall</th>
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<tbody>
<tr>
<td></td>
<td>China</td>
<td>Japan</td>
<td>Korea</td>
<td>China</td>
<td>Japan</td>
<td>Korea</td>
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<tr>
<td>Simple average</td>
<td>9.6%</td>
<td>4.9%</td>
<td>12.1%</td>
<td>15.6%</td>
<td>4.9%</td>
<td>48.6%</td>
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<tr>
<td>MFN applied</td>
<td></td>
<td></td>
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<tr>
<td>Trade weighted</td>
<td>4.3%</td>
<td>2.0%</td>
<td>8.3%</td>
<td>10.3%</td>
<td>21.0%</td>
<td>119.8%</td>
</tr>
<tr>
<td>average</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imports (billion US$)</td>
<td>1036</td>
<td>751</td>
<td>431</td>
<td>54</td>
<td>56</td>
<td>19</td>
</tr>
</tbody>
</table>

Source: China Statistics Yearbook.