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Evolution of Japan's Policy toward Economic Integration

MUNAKATA Naoko
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Naoko MUNAKATA*

Abstract

This paper looks back on the process that led to the Japan-Singapore Economic Partnership Agreement (JSEPA) negotiations and explores what it takes for a new external economic policy framework to take root. In Section I and II, it analyzes the changing environment, including increase in regional integration in other areas, that surrounded Japan's trade policy, which had been solely dependent on the GATT/WTO system, and how Japan started to shift its trade policy in the wake of the Asian financial crisis and improved relations with Korea as well as ensuing proliferation of studies and negotiations of bilateral free trade agreements (FTAs) in Asia. Section III describes the new conceptualization, prompted by Japan's economic problems as well as Singapore's proposal for a bilateral FTA, of Japan's external economic policy, which is consistent with Japan's efforts toward economic restructuring. Finally Section IV discusses the challenges ahead for Japan in pursuing economic integration.

Key words: Economic integration; Free trade agreement; Japan-Singapore Economic Agreement for a New Age Partnership (JSEPA); Asia Pacific Economic Cooperation (APEC); Asian financial crisis

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* Senior Fellow, Research Institute of Economy, Trade and Industry (E-mail: munakata-naoko@rieti.go.jp)

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On October 22, 2000, Japanese Prime Minister Yoshiro Mori and Singapore Prime Minister Goh Chok Tong agreed to formal negotiations for the Japan-Singapore Economic Agreement for a New Age Partnership (JSEPA) in January 2001,¹ in light of the September 2000 report from the Japan-Singapore Free Trade Agreement (JSFTA) Joint Study Group.² It was the first time Japan entered into negotiations concerning regional economic integration.³ With a strong emphasis on the need to address the new challenges globalization and technological progress pose; the Joint Study Group explored a possible “New Age FTA”⁴ between the two countries, which Prime Minister Goh proposed in December 1999.⁵ Thus, for Japan the JSEPA marked a major turning point in promoting regional economic integration.

This paper looks back on the process that led to the JSEPA negotiations and explores what it takes for a new external economic policy framework to take root. Sections I and II analyze the changing environment surrounding Japan’s trade policy and introduce various issues, based on the author’s experience in the Japanese government,⁶

¹ “Joint Announcement of the Japanese and Singapore Prime Ministers on the Initiation of Negotiations for Concluding a Bilateral Economic Partnership Agreement,” October 22, 2000 in Tokyo, <http://www.meti.go.jp/english/infor2gmation/data/cJ-SFTA2e.html>

² Joint Study Group Report, “Japanese-Singapore Economic Agreement for a New Age Partnership”, September 2000

³ Agreements for regional economic integration or regional economic integration agreements in this paper, in line with the definition by the paper by the World Trade Organization (WTO) Secretariat, refers to agreements such as customs unions or free-trade areas referred to in Article 24 of the General Agreement on Tariffs and Trade (GATT), which reduce barriers to trade among member economies to the level lower than that for trade with non-member economies, and includes agreements between economies in different areas in the world, in addition to those between economies in the same region. See The WTO Secretariat (1995), *Regionalism and the World Trading System*.

⁴ “Transcript of Prime Minister Goh Chok Tong’s Interview with Mr. Osamu Kobayashi, Editor-in-Chief of Nikkei Business, on 19 December, 2000 at the Istana”, <http://www.gov.sg/sgip/intervws/0101-03.htm>

⁵ While it is not possible to prejudge results of negotiations between the two countries, negotiators, many of whom had also been the participants of the Joint Study Group, are expected to draw heavily on the report.

⁶ The author served as advisor to the International Trade Policy Bureau, MITI (METI’s

which arose when the “New Age FTA” was first conceived. Section III describes the new conceptualization of Japan’s external economic policy. Finally Section IV discusses the challenges ahead for Japan in pursuing economic integration.

I. Japan’s Traditional Policy on Regional Economic Integration and Its Shift

Dependence on GATT/WTO and Avoidance of Regional Integration

Japan has been one of the most significant beneficiaries of the multilateral trading system throughout its post-war economic growth. Japan’s trade policy has been based on the GATT, its successor the WTO, and the principle of unconditional most-favored-nation (MFN) treatment.⁷ In addition, Japan has not participated in any preferential regional trade agreement and continued to criticize other countries’ moves toward regional economic integration even after the mid-1980s, when many regional initiatives became active. There were several reasons for Japanese disapproval. First, for many years Japan and the Asia-Pacific region enjoyed higher economic growth rates than other areas and thus did not feel any need to secure markets through discriminatory economic integration agreements. Especially after the Plaza Accords, East Asian countries experienced high export-led growth driven by foreign direct investment from Japan, and subsequently, Korea and Taiwan. Growing trade, investment and business networks led to increased economic interdependence in East Asia (see Figure 1 in appendix). Market forces promoted “economic integration without agreements” in the region and Asian

predecessor) on the Japan-Singapore FTA from October 1999 through October 2000 when I was Director for Policy Planning, Economic Policy Unit, Minister’s Secretariat, MITI.

⁷ Article 1 of the GATT.

countries began to have confidence in a regional economic dynamism that was independent of legal frameworks.⁸ In addition, the diverse, and sometimes divergent, developmental stages and political regimes in East Asia make it difficult for the region to come together under a unified legal framework. Thus, to Tokyo, East Asian economic integration agreements appeared impractical.

Second, Tokyo did not have an active role in formulating the post-World War II international trading system. During the Cold War, Japan was merely a passive participant in the international system, concentrating on economic reconstruction under the protection of the US security. In addition, Tokyo has had difficulties liberalizing agricultural trade, particularly rice. It was widely assumed that Japan could not realistically conclude a regional trade agreement in conformance with Article 24 of the GATT. History suggests that proponents of multilateral liberalization also actively promote regional liberalization.⁹ Indeed, Tokyo's exclusive devotion to GATT and the WTO could even be interpreted as a negative attitude toward liberalization.

In light of its wartime legacy, Japan has refrained from taking the initiative in formulating regional frameworks.¹⁰ In addition, negative reaction to Malaysian Prime

⁸ Speech by Ryutaro Hashimoto, Minister of International Trade and Industry, "Challenges for the World Economy in a Transitional Period and Development in the Asia-Pacific Region," Vancouver, in May 1995. Ryutaro Hashimoto, "Next Task for the WTO System and the APEC Process," *Journal of Northeast Asian Studies*, Winter 1995, 14(4), p.25-32.

⁹ Richard E. Baldwin, "The Causes of Regionalism", *The World Economy*, 1997, Vol. 20, No. 7, 865-888.

¹⁰ Other Asian countries exhibited resistance to Japan's increased influence in the decision to locate the headquarters of the Asian Development Bank (ADB) in Manila, not in Tokyo, anti-Japan riots at the time of Prime Minister Kakuei Tanaka's visit to the southeast Asian countries in 1974 and cold reactions to Prime Minister Masayoshi Ohira's pan-Pacific design in 1980. "Japan has for years shunned the concept of regionalism and the strategy of approaching Asia as a whole" as Japan recognized "the danger that a coherent Asia policy could be mistaken for a resurgence of prewar 'Asianism' and evoke painful memories of political domination by an ambitious hegemon." Yoichi Funabashi, *Asia Pacific Fusion, Japan's role in APEC*, Institute for International Economics, September 1995. For example, Japan also avoided publicity of its proposal on APEC and, instead, supported the Australian

Minister Mahathir's proposal for the East Asian Economic Caucus (EAEC) reveals that other regions are leery of regional cooperation frameworks consisting exclusively of Asian countries, even when such proposals did not originate from Japan.¹¹ Since the Asian ministerial meeting held in November 1995 (in preparation for the first Asia-Europe Meeting (ASEM) convened in 1996), however, it became much less controversial for East Asian countries to hold regional meetings among themselves. And the first ASEAN + 3 (Japan, China and Korea) leaders' meeting was held in 1997.

Under these constraints, the main thrust of Japan's Asia policy in the 1990s was in support of integration within the Association of Southeast Asian Nations (ASEAN). In 1992, the ASEAN Economic Ministers (AEM) and the Japanese Minister of International Trade and Industry started to hold meetings (AEM-MITI) on the fringe of AEM meetings to share views on economic issues and to discuss specific areas for cooperation. MITI held a series of seminars on the ASEAN Free Trade Area (AFTA)¹² in a confidence building effort between ASEAN and Japanese investors. MITI also provided a range of development advice to ASEAN policymakers. It was hoped that once serious about developing these certain industries, ASEAN countries would realize the need for

proposal from these considerations.

¹¹ The EAEC initiative didn't have consensus among the ASEAN countries at the time it was proposed, aside from meeting, after it was proposed, objections from outside the region and hesitation in Japan, which, in turn, hindered momentum for consensus building within ASEAN. Therefore, no strong push was made from ASEAN for realizing the initiative.

¹² The Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area was signed at the Fourth ASEAN Summit held in Singapore on 27-28 January 1992. The AFTA was proposed because the ASEAN countries recognized the need for enhancing their attractiveness in light of East European countries drawing attention as investment destinations from developed countries after the Cold War ended, moves for regional integration were active in Europe and America and they were keen to have an effective framework for ASEAN cooperation after the EAEC setback.

integration among themselves in order to achieve economies of scale to become internationally competitive.¹³

Increase in Regional Integration in Other Areas and Its Positive Effects

As described above, Japan has not participated in any preferential regional trade agreement, including customs unions and free-trade areas, and has even criticized moves toward regional economic integration by other countries through the Working Parties for reviewing their conformity with GATT/WTO and other fora. The WTO review mechanism, however, has not been very effective.¹⁴ Examination of agreements under paragraph 7 of Article 24 have almost never led to a unanimous conclusion as to their GATT consistency. On the other hand, no regional trade agreement has been found to be in violation of WTO rules.¹⁵ As Figure 2 shows (see appendix), regional agreements increased worldwide particularly after the Cold War ended,¹⁶ leaving only Japan, Korea,

¹³ MITI (1993), "Prospects and Challenges for the Upgrading of Industries in the ASEAN Region," chapter three.

¹⁴ According to WTO (1995), "The most obvious sign that the rules and procedures are not working properly is the fact that, of the 69 working parties that had completed their examinations by the end of 1994, only six were able to reach a consensus on the question of the conformity of individual customs unions or free trade areas with the conditions laid down in Article XXIV." No reports have been finalized on the examinations on 81 regional agreements in process in the CRTA established in 1996 by the WTO General Council. See GATT, *Analytical Index: Guide to GATT Law and Practice, Updated 6th Edition* (1995), p.817.

¹⁵ Remarks made by Chairman of the Working Party on the Canada-United States Free Trade Agreement (CUFTA) when he introduced the report to the GATT Council in 1991. See GATT, C/M/253 (Council of Representatives, Minutes of Meeting held on 12 November 1991).

¹⁶ "In the period 1948-1994, the GATT received 124 notifications of RTAs and since the creation of the WTO in 1995, 90 additional arrangements covering trade in goods or services have been notified. Not all RTAs notified are still in force today. Most of the discontinued RTAs have, however, been superseded by redesigned agreements among the same signatories. Out of the total of 214 agreements or enlargements so far notified to the GATT/WTO, 134 are deemed to be currently in force." See

http://www.wto.org/english/tratop_e/region_e/not_gt_e.htm

China, Hong Kong and Taiwan alone among the world's major economies not engaged in one of these regional arrangements.

These regional agreements have had a positive impact on participating economies by promoting deregulation and competition in regional markets. In addition, by promoting free trade interests through industrial adjustment within the region; inducing economies outside the region to initiate new regional integration; providing an incentive for global liberalization efforts to reduce margins of preference; increasing the speed of rule-making, and providing an opportunity to experiment with new models for global use; regional agreements seemed instrumental in promoting world trade and investment liberalization. As a result, the positive benefits shown by actual cases, together with the fact that WTO negotiations have become more complicated and prolonged due to the growing number of WTO members and wider scope mitigated Japan's rejection of regional economic integration.

Impact of the Asian Financial Crisis

The Asian financial crisis, which broke out in the summer of 1997, brought about major economic and political changes in Asia. These changes significantly influenced Tokyo's policy toward regional economic integration. First, there was a loss of confidence in Asia's economic dynamism and a rising sense of unease about the progress of regional integration elsewhere. The Asian economic crisis brought down regional domestic markets. The engine behind Asia's rapid recovery was electronics exports, particularly to the booming US market (see Figure 3 in the appendix). It was important,

therefore, for countries in the region to secure stable export markets. There were strong incentives to overcome the disadvantage of exporting to countries engaged in other economic integration agreements by securing free trade agreements with them.¹⁷ In their push for integration with the major world markets, Asian countries found that the negotiating power necessary, especially for small and medium-sized economies, largely depended on the attractiveness of the region as a whole. The desire for stronger negotiating power generated momentum for economic integration among neighboring economies (regional integration in a narrow sense).¹⁸

Secondly, the “contagion” of the currency crisis reminded Asian countries of how interdependent they really are. In addition, the International Monetary Fund’s (IMF) initial prescription of inducing economic contraction, did not address the basic problem: a capital account crisis. Instead the result was a full-fledged economic crisis. Asian countries began to recognize the need for a regional framework to complement the IMF’s global function. Although, the Asian Monetary Fund (AMF),¹⁹ proposed in August 1997, was vetoed by the U.S. and China, in November 2000, the ASEAN+3 countries agreed to a currency swap as a mechanism to prevent another currency and financial crisis.²⁰ In

¹⁷ Chung, Eui-Yong, Deputy Minister for Trade, Ministry of Foreign Affairs and Trade, “The Background of the Decision to Promote Free Trade Agreements, Progress Made and the Future Plan,” December 17, 1998 (speech texts written in Japanese).

¹⁸ “Transcript of Prime Minister Goh Chok Tong’s Interview with Mr. Osamu Kobayashi, Editor-in-Chief of Nikkei Business, on 19 December, 2000 at the Istana”, <http://www.gov.sg/sgip/intervws/0101-03.htm>

¹⁹ According to the Subcommittee on Asian Financial and Capital Markets, Council on Foreign Exchange and Other Transactions, *Lessons from the Asian Currency Crises -Risks Related to Short-Term Capital Movement and the "21st Century-Type" Currency Crisis-*, May 19, 1998 (<http://www.mof.go.jp/english/tosin/e1a703.htm>), proposals for an AMF “took shape at the meeting of supporting countries for Thailand” hosted by the IMF in Tokyo on August 11, 1997, “where a heightened interest was expressed in examining the feasibility of a permanent institution created by Asian countries. This matter had been already discussed among ASEAN countries in the spring of 1997.”

²⁰ The so-called Chiang Mai Initiative was put forward at the ASEAN+3 Finance Ministers Meeting in May 2000. See “The Joint Ministerial Statement of the ASEAN+3 Finance

this way, the Asian currency crisis increased the momentum for East Asian regional cooperation in the currency arena and ultimately contributed to a more comprehensive idea of regional integration.

Thirdly, the crisis aroused, particularly among countries with strong political leadership, a sense of urgency regarding economic reform. In order for these countries to obtain IMF financial assistance, they had to implement unpopular structural reform measures.²¹ Foreign investors were also watching with keen interest of how far some Asian governments were willing to go. Korean President Kim Dae Jung was particularly open to structural reform as a means to attract foreign investment and overcome the crisis.²² The need to restructure domestic economies and attract FDI became one of the driving forces behind FTA promotion.

Fourth, ASEAN's power was on the decline. China's relatively stable economic performance throughout the East Asian economic crisis (see Figure 4 in the appendix), the surge of FDI into Korea, and the collapse of domestic demand and slow progress of economic reform in ASEAN tempered the commonly held perception of ASEAN member countries as attractive investment destinations(see Figure 5 in appendix).

Ministers Meeting," May 6, 2000, Chiang Mai, Thailand
(<http://www.mof.go.jp/english/if/if014.htm>).

²¹ For reform measures related to trade and investment in particular, see, for example, paragraph 5 of the Letter of Intent of the Government of Korea, December 3, 1997, paragraph 26 of Memorandum on Economic Policies of the Royal Thai Government, May 26, 1998 and paragraphs 38-40 of the Letter of Intent of the Government of Indonesia, October 31, 1997.

²² President Kim's determination is exhibited in, for example, Inaugural Address by Kim Dae Jung, February 25, 1998, "Foreigners will invest when reform succeeds: President Kim" 1998-03011, "All-out reforms, this year's administration target" 1998-04-28, and "President Kim urges cabinet to step up reform", press releases from the Office of the President, Republic of Korea. Major economic reform measures were actually implemented. In 1998, for example, the employment adjustment system was introduced to allow layoffs for managerial reasons, mergers and acquisitions (M&As) and other forms of investment by foreign investors were liberalized and encouraged (see, for example, the Korean Ministry of Foreign Affairs and Trade (MOFAT), "The Road to Recovery in 1999," May 27, 1999).

Northeast Asian domestic demand for IT-related goods and services appeared to become the driving force behind future economic development in the region and IT related start-ups flourished. On the other hand, while ASEAN countries exported some IT-related products, overall they were characterized by a low level of IT diffusion, which lowered their presence in the region (see Figure 6 in appendix). The addition of new members widened the intra-regional economic gap, and compounded with the diversity of political systems, put pressure on ASEAN's cohesiveness.

In Indonesia political turmoil caused economic stagnation, and the lack of Indonesian leadership and members' preoccupation with domestic economic problems dealt a severe blow to proactive ASEAN initiatives present before the crisis. Thus the decline of ASEAN's influence in these aspects prompted Singapore to strike out on its own and strengthen relations with countries outside ASEAN.

Moreover, Asian countries' perception of Japan seemed to have changed following the crisis. Economic downturn in Japan caused concern that Japanese business commitment in Asia might wane in the following years, creating a growing perception that Japan has lost its attractiveness as an economic model and concurrently eliminated the threat of Japanese economic dominance in the region.²³

Furthermore, regional concerns that the deterioration of the Japanese economy would deepen the Asian economic crisis²⁴ grew and Japan's passivity in the face of a

²³ See, for example, Clyde Prestowitz, "What happened to the Japanese Economic Model?," *The Washington Post*, December 14, 1997

²⁴ Since the early stages of the crisis when speculators were looking for selling opportunities, there was an argument that the Japanese economy was the cause of the crisis. It was reported in *Financial Times*, November 21, 1997, "S Korea says Japanese banks are cutting credit" that Korean finance minister said, "Japanese financial institutions are calling back loans instead of rolling them over, " which had raised fears of a liquidity crisis since one third of Korea's short-term debt of \$68bn must be paid by year-end. Japanese Ministry of Finance (MOF) immediately offered a refutation "that European banks had a higher proportion of

bleak regional economic environment drew much criticism.²⁵ Senior Asian and U.S. officials, made remarks to the effect that it was Japan's responsibility to support Asia's economic recovery.²⁶

From the outbreak of the crisis, Japanese manufacturing companies in the region tried to maintain their Asian offshore operations and keep well-trained local employees. The Japanese government also took various measures to aid crisis-hit countries as well as Japanese companies.²⁷ By pledging substantial financial assistance, and attempting to

lending in South Korea than Japanese groups," which was carried in *Financial Times*, November 22, 1997, "Tokyo washes hands of blame." After the currency crisis developed into a real economic crisis, a new version of arguments that blamed Japanese economy became prevalent, such as the idea that stagnant domestic demand in Japan was deteriorating Asian economy.

²⁵ See, for example, *The Washington Post*, January 18, 1998, "Where's Japan?," which argues, "the time has come for Japan to stimulate its economy in a major way, in order to reduce its surplus with the world, provide an additional market for southeast Asia and do its part as a major world power," and *The Straits Times*, February 14, 1998, "Asia will not forget," to the effect that Japan should pump up demand, stabilize its banks and finance and not to abandon southeast Asia as a production base and that "any lack of sincerity and urgency in wanting to help the rest of Asia get over this difficult phase will be noted and remembered."

²⁶ See "Secretary Robert E. Rubin testimony before the House Banking Committee," Treasury News, January 30, 1998, RR-2186, <http://www.treas.gov/press/releases/pr2186.htm>, "Deputy Secretary Lawrence H. Summers testimony before the Senate Finance Committee," Treasury News, February 4, 1998, RR-1295, <http://www.treas.gov/press/releases/pr2195.htm>.

²⁷ The Japanese government's assistance immediately after the crisis broke out was mainly currency stabilization support in cooperation with the IMF. As the currency crisis deteriorated into a full-blown economic crisis, it took more comprehensive emergency measures. There were a series of economic packages such as Cabinet Decision, "Emergency Measures for the Economic Stabilization in South East Asia," February 20, 1998, Ministerial Meeting on Economic Measures, "Comprehensive Economic Measures," April 24, 1998 (<http://www5.cao.go.jp/98/b/19980424b-taisaku-e.html>), Ministerial Meeting on Economic Measures, "Emergency Economic Package," November 16, 1998 (<http://www5.cao.go.jp/98/b/19981116b-taisaku-e.html>) as well as individual measures such as 30 Billion financial package by "the new Miyazawa initiative" in October 1998. In those packages and measures, specific programs were implemented such as a loan program (The main purpose was to help improve the financial condition of crisis-hit Japanese companies in Asia and help them maintain their operations overseas in the region.) by the Japanese Export-Import Bank (EXIM, the predecessor of Japan Bank For International Cooperation (JBIC)), increase in the flexibility of the trade insurance facilities (The measure was not taken by Japan alone but implemented jointly by export credit agencies of developed countries with the Export Insurance Division (EID) of MITI urging others to join in.), assistance for Japanese overseas companies (The main purpose was to help Japanese manufacturing companies in the region that were trying to maintain their operations overseas in the region and keep well-trained local employees. Specific measures include loans

reach an agreement for a currency stabilization package the Japanese government took the initiative to stabilize the region early on. When the currency crisis became a full-blown economic crisis, the Japanese government provided significant financial assistance for economic recovery on a bilateral basis. While in the midst of its own economic crisis, Tokyo's assistance to other Asian countries beginning in late 1997, demonstrated Japan's deep commitment to the region.²⁸ These countries, however, seemed to share the view that Japan could best facilitate regional recovery by expanding imports from its regional trading partners. Japan's assistance, for which they were thankful, did not absolve Japan of its perceived responsibilities in the region. Consequently, resistance to an increased Japanese role in Asia was replaced by an expectation that Japan would lead the region out of the crisis and spearhead efforts to create a stable regional economic environment.

A Setback in APEC Liberalization

In Vancouver, APEC leaders agreed to early voluntary sectoral liberalization (EVSL), that is, trade liberalization before the agreed-upon deadline (the Bogor goal²⁹) of 2010 for industrialized economies and 2020 for developing economies, in fifteen sectors. Among the fifteen there were nine priority sectors: environmental goods and services, the energy sector, fish and fish products, toys, forest products, gems and jewelry, medical

to help small and medium-sized enterprises (SMEs) finance their investment and technical assistance in managing and retraining employees to help them boost exports.)

²⁸ In the Japan-ASEAN summit meeting held on December 16, 1998, some of the leaders of ASEAN countries stated that they were grateful for Japan's assistance to ASEAN countries in need provided in the middle of its own difficulties. While these statements might include diplomatic elements, their gratitude has been repeatedly expressed on various other occasions.

²⁹ "APEC Economic Leaders' Declaration of Common Resolve," Bogor, Indonesia, November 15, 1994

equipment and instruments, chemicals, telecommunications mutual recognition agreement (MRA). The six remaining sectors were oilseeds and oilseeds products, the food sector, natural and synthetic rubber, fertilizers, automotive, and civil aircraft.³⁰ The aim of EVSL was to complement the Osaka Action Agenda³¹ and to create a specific program for joint action.

Some members, however, did not have an adequate domestic political base upon which to forcefully promote liberalization under this framework. The United States, which advocated promoting EVSL-based liberalization, did not have fast-track authority and avoided choosing sectors, which for various domestic political reason, it found difficult to liberalize. All the while the U.S. continued to push other members for substantive liberalization in key sectors. Other members, particularly Japan, also encountered political difficulty liberalizing sensitive items. Ultimately, all that was agreed upon was that the tariff elements of the EVSL exercise should be negotiated within the auspices of the WTO, not as an APEC initiative, and that APEC should make efforts to start the process in the WTO.³² The failure of EVSL exposed APEC's limited effectiveness for promoting trade and investment liberalization in the region.

Frustrated by some APEC members' reluctance to engage in across-the-board tariff reduction, the USTR began focusing APEC members who were more enthusiastic about trade liberalization. It floated a proposal for an FTA among five countries (the

³⁰ "APEC Economic Leaders Declaration: Connecting the APEC Community," Vancouver, Canada, November 25, 1997. For the 15 areas, see the Joint Statement of the 9th APEC Ministerial Meeting, Vancouver, Canada, November 21-22, 1997.

³¹ The Osaka Action Agenda; Implementation of the Bogor Declaration, adopted by the leaders' meeting in Osaka on November 19, 1995, <http://www.apecsec.org.sg/virtualib/history/osaka/agenda.html>

³² The Joint Statement of the 10th APEC Ministerial Meeting, Kuala Lumpur, Malaysia, November 14-15, 1998.

U.S., Australia, New Zealand, Singapore and Chile) called the “P5 (Project 5)” in November 1997. While not formulated into an official US proposal, the idea was later taken up by New Zealand, Singapore and Chile in November 1999. Negotiations began soon after the initial proposal for free trade agreements between New Zealand and Singapore, and between Singapore and Chile. Thus, APEC’s setback with trade liberalization led to renewed interest in FTAs. Since APEC was originally devised partly to preempt the proliferation of bilateral FTAs centered around the U.S., this result seems only natural.³³

A Surge of Interest in Regional Integration Policy

The changing environment described above raised awareness of regional integration issues among some Japanese government officials. Tokyo was concerned about the steady development of regional trade integration in Europe and America; Japan’s role as an absorber in revitalizing the post-crisis Asian economy; and the possibility of capitalizing on Asia’s abundant workforce and growing markets as a way to revitalize the Japanese economy. At MITI, for example, the International Trade Policy Planning Office, took the initiative to study worldwide trends of regional economic integration, its merits and weaknesses, and to prepare a policy suggesting that Japan

³³ In the latter half of the 1980s, the U.S., with huge trade deficits, often mounted pressure on Asian economies to open markets under the threat of unilateral measures of retaliation based on Section 301 of the Trade Act of 1974 and the "Super 301" provisions of the Omnibus Trade and Competitiveness Act of 1988. At the same time, the U.S. was considering entering into free trade agreements with Asian countries, which feared that the network of bilateral agreements with the U.S. as its hub might become a new vehicle of the U.S. unilateral pressure. Economies in the Asia Pacific region hoped that APEC can alleviate friction with the U.S. as a forum for small and medium-sized economies to unite in dealing with the U.S. See Funabashi, p.58-61 for these considerations in the mind of the policy makers in the region involved in conceiving APEC.

should also pursue regional economic integration. While most assumed that neighboring countries with existing production linkages with Japan would be the most natural partners, no specific policy proposals emerged at that time. However, it was relations with South Korea that led Tokyo to reevaluate its stance on FTAs.

II. Japan-Korea FTA Study: A Turning Point

In October 1998, President Kim Dae Jung of the Republic of Korea (ROK) visited Japan.³⁴ President Kim stressed forgiveness and reconciliation, particularly the need for reconciliation within the South Korean political arena, between North and South Korea, and in its bilateral relationship with Japan. During a visit to Japan, President Kim told Prime Minister Obuchi that the problems of the 20th century should be resolved within this century,³⁵ a statement which deeply moved many Japanese people. His visit to Japan marked a dramatic turning point in bilateral relations. Seoul hoped that improvement of relations would result in increased economic cooperation with Japan, especially in the form of investment. While for the ROK Japan's economic resources

³⁴ For the Korean point of view on the Free Trade negotiations see, Chungsoo Kim's Brookings CNAPS 2001 Working Paper, "Perceptions on Free Trade: The Korean Debate Over the Japan-Korea Free Trade Agreement" at http://www.brook.edu/fp/cnaps/papers/Kim_01.htm

³⁵ *Yomiuri Shimbun*, October 8, 1998 (the evening edition). In the joint press conference with Prime Minister Obuchi, President Kim stated, in answering to a question, "the 20th century was the era of ethnocentric nation-state while the 21st century will be the era of globalism. The legacy of the 20th century has to be cleared off here." ("Record of the joint press conference of Prime Minister Keizo Obuchi and Korean President Kim Dae Jung," October 8, 1998 (in Japanese, see <http://www.kantei.go.jp/jp/souri/981008nikkan.html>)) In an address to the Japanese Diet, President Kim also stated that he was sure that Japan-Republic of Korea Joint Declaration (see footnote 36), which he and Prime Minister Obuchi had made public, would put an end to the history problem between the two governments. ("President Kim Dae Jung's address to the Japanese Diet," October 8, 1998. (in Japanese))

were necessary to provide assistance to North Korea, for Tokyo it was critical that Japan and Korea jointly deal with the North Korean threat.³⁶

Before President Kim's visit to Japan, hopes for renewed bilateral relations were high, and a proposal for a bilateral FTA was floated as a symbol of new relations. A Japan-Korea FTA seemed a very natural enterprise given their geographical proximity, OECD membership and common values and interests. The integrated Japan-Korea economic area would represent a substantial market of close to 200 million people, and appeal to many investors. Businesses in both Japan and Korea would enhance their competitiveness through progress in industrial adjustment. Furthermore, the FTA would promote regional stability, allowing the two nations to overcome their historic animosity and forge relations as economic allies.

While the issue of FTA was not taken up in the leaders' meeting, serious consideration began soon after their epoch-making meeting. On November 4, 1998, Korean Minister of Trade Han Duck-Soo announced that the ROK government had decided to promote FTAs with major trade partners, Chile being the first candidate.³⁷ Korea and Chile reached an agreement to explore the possibility of an FTA at a separate bilateral summit held on the occasion of the November 1998 APEC Leaders' Meeting.³⁸ Korea, long insistent that free trade be pursued via an open and multilateral approach, thus made a concrete step toward utilizing FTAs as a real policy option.

³⁶ Japan-Republic of Korea Joint Declaration: A New Japan-Republic of Korea Partnership towards the Twenty-first Century, 8 October 1998 (<http://www.mofa.go.jp/region/asia-paci/korea/joint9810.html>)

³⁷ The International Economy Coordination Committee approved the Korean MOFAT's plan to promote free trade agreements on November 5, 1998. See "Explanation for Kookmin Daily's November 5th Article on Free Trade Agreement, November 5, 1998 (<http://www.mofat.go.kr/>)."

³⁸ MOFAT, "Korea's Trade Policy and its Achievements in 1998", February 3, 1999 (<http://www.mofat.go.kr/>).

On November 13, 1998, Minister Han met with Japanese MITI minister Kaoru Yosano in Kuala Lumpur on the fringe of an APEC ministerial meeting. Han proposed, *inter alia*, a joint examination of future Japan-Korea economic relations, which would also cover the possibility of establishing a bilateral FTA. At a joint government-private sector investment promotion conference held in Seoul on December 5, 1998, at the time of Minister Yosano's visit, it was also confirmed that the study would not exclude the possibility of an FTA. Tokyo and Seoul adopted an incremental approach in order to avoid a backlash against the proposed FTA, which was a politically sensitive topic in both countries.

In March 1999, then Prime Minister Obuchi visited the ROK and held a summit meeting with President Kim. The leaders announced the Japan-Republic of Korea Economic Agenda 21, listing priority measures to be taken to strengthen bilateral economic relations. Subsequently, the results of a study on closer Japan-Korea economic relations conducted by government-affiliated think tanks was published in May 2000.³⁹

The idea of a Japan-Korea FTA has yet to be widely accepted by industry or the public in either country, and it would still be premature to start negotiations. For example, Korea's trade deficit with Japan was predicted to increase further as Korea's average tariff rate on Japanese products is higher than Japan's average tariff rate on

³⁹ Institute of Developing Economies, Japan External Trade Organization (JETRO) and Korea Institute for International Economic Policy (KIEP), "Towards Closer Japan-Korea Economic Relations: Proposal for Formulating a 21st Century Partnership (Joint Communiqué)", May 23, 2000 (<http://www.ide.go.jp/English/Lecture/pressmenu/pressE00060601.PDF>), Institute of Developing Economies (IDE), JETRO, "Toward Closer Japan-Korea Economic Relations in the 21st Centuries," March 2000 (<http://www.ide.go.jp/English/Lecture/pressmenu/pressE00060602.PDF>) and Korea Institute for International Economic Policy (KIEP) "Economic effects of and Policy Directions for a Korea-Japan FTA," May 2000. (<http://www.ide.go.jp/Japanese/Lecture/pressmenu/press00060604.PDF>)

Korean products. In relation to this, Seoul has strong concerns that, in addition to the possibility that the Japanese machinery and chemical industries would dominate the Korean market, Japanese agriculture and fishery industries may not undergo sufficient liberalization, thus limiting the gains for Korea. Japan must be prepared to overcome strong domestic resistance, since many of the items that Korea would export to Japan are politically sensitive for Tokyo. Thus, both sides are encountering many challenges to the realization of a bilateral FTA. Nonetheless, this very debate in Japanese policy circles represents a sea change in terms of official attitudes towards FTAs and prompted the emergence of various ideas about possible FTAs or economic integration.

The Aftermath: An FTA Spiral

When Prime Minister Obuchi visited Korea in March 1999, he delivered a policy speech at Korea University. In this speech he referred to a vision for future Asian economies: a free trade zone in this region equivalent to that of Europe's.⁴⁰ Although this speech was not in itself a proposal for an Asian free trade area, it drew significant regional attention as a positive message about Asian economic integration.

The business community quickly responded to the changing government atmosphere. Following a proposal from Mexican President Zedillo in November 1998 for a bilateral FTA, the Japan-Mexico Economic Committee of Keidanren (Japan Federation of Economic Organizations) established a working group to examine the possible effects of an FTA on Japanese industry. In the same month, the EU and Mexico

⁴⁰ Keizo Obuchi, "Japan-Korea Relations in the New Century: Creation of a New History", March 20, 1999 (in Japanese) (http://www.mofa.go.jp/mofaj/press/enzetsu/11/eos_0320.html)

began negotiations on a bilateral FTA. To reduce its economic dependence on the U.S., Mexico was actively pursuing FTAs.⁴¹ The working group's April 1999 report, urged the government to accelerate its efforts to initiate an FTA with Mexico to counteract the discriminatory effects of Mexico's other FTAs.⁴² The main points of the Working Group report were incorporated into the Keidanren report published the following month.⁴³

Following a December 1998 agreement,⁴⁴ Korea and Chile held the first high-level working group meeting on the Korea-Chile FTA in April 1999 in order to prepare for ensuing negotiations. Subsequently, in June 1999, New Zealand, the APEC Chair at the time, proposed a bilateral FTA with Singapore, seeking to utilize bilateral FTAs to promote the new WTO round and to achieve the Bogor goal. Acknowledging the strategic significance of FTAs as a method to cope with growing regionalism in the Americas and Europe, and the rise of China in the post-Cold War environment, Singapore accepted New Zealand's offer. In September 1999, at the fringe of the APEC Leaders' Meeting in Auckland, the two countries agreed to start FTA negotiations. Singapore, having decided to actively pursue FTAs, also proposed bilateral FTAs to Chile, Mexico and Korea. New Zealand, Singapore and Chile agreed "to work together

⁴¹ Mexico concluded an Economic Complementation Agreement with Chile in 1992 (amended to be an FTA), NAFTA in 1994 and an FTA with EU in 2000 and has so far concluded FTAs with 31 countries.

⁴² Working Group on Japan-Mexico Bilateral Treaties, Japan-Mexico Economic Committee, Keidanren, "Report on the Possible Effects of a Japan-Mexico Free Trade Agreement on Japanese Industry", April 20, 1999. (<http://www.keidanren.or.jp/english/policy/pol099.htm>).

⁴³ Keidanren, "Challenges for the Upcoming WTO Negotiations and Agendas for Future Japanese Trade Policy", May 18, 2000 (<http://www.keidanren.or.jp/english/policy/pol102/index.html>).

⁴⁴ Inkyo Cheong, Korea Institute for International Economic Policy, "Korea-Chile FTA: Korea's Position," May 27, 1999.

to pursue the broader P5 free trade initiative.”⁴⁵ Moves to explore bilateral FTAs became very active from this point on.

In the middle of this FTA boom, Singapore took note of the change in Japanese perceptions of FTAs. Singapore saw that Japan, surprisingly, was no longer fundamentally against the FTA idea. At the same time, Singapore was concerned that Japanese commitment in Southeast Asia would ebb as Japan began to focus on Northeast Asia, where IT-related manufacturing capabilities and markets were growing rapidly. While pursuing an FTA with New Zealand, Singapore unofficially sounded out the possibility of a bilateral FTA with Japanese politicians, businesspeople and government officials.⁴⁶

Three weeks after the agreement with New Zealand, Singapore proposed an FTA between the ASEAN Free Trade Area (AFTA) and the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA or CER) at the meeting of ASEAN Economic Ministers and Ministers from CER countries (AEM-CER) held on October 1, 1999 in Singapore. ASEAN and CER ministers agreed to establish a high-level task force to look into the feasibility of an AFTA-CER free trade area. It was a significant accomplishment from Singapore’s perspective, considering the initial backlash from other ASEAN members against Singapore’s move to negotiate an FTA with New Zealand on its own. This incident gave momentum to Singapore’s drive for FTAs with non-ASEAN economies.

⁴⁵ Jenny Shipley, post-APEC address to Auckland Chamber of Commerce, Carlton Hotel, Auckland, New Zealand, 23 September 1999.

⁴⁶ “Transcript of Prime Minister Goh Chok Tong’s Interview with Mr. Osamu Kobayashi, Editor-in-Chief of Nikkei Business, on 19 December, 2000 at the Istana”, <http://www.gov.sg/sgip/intervws/0101-03.htm>

III. JSEPA

Singapore's Proposal for an FTA and Japan's First Reaction

In late October 1999, the government of Singapore started to seriously explore the possibility of an FTA with Japan. At first Tokyo's reaction was negative and, at best, skeptical. In Japan, there was a conceptual problem regarding FTAs. Some were not convinced that Japan should change its course of pursuing liberalization solely through the WTO. In relation to this, Singapore does have some agricultural and fishery exports to Japan, and if the sensitive sectors were to be completely excluded, the resulting FTA would not be in compliance with WTO rules.⁴⁷ As a free port with little domestic demand, an FTA with Singapore alone would only be worthwhile as the first step to an FTA with ASEAN, which was considered very difficult, given agricultural production in ASEAN countries. Also, an FTA with Singapore would alienate other ASEAN members and nullify years of Japanese support for ASEAN integration and unity. In addition, a Japan-Singapore FTA could be regarded as a precursor to an exclusive Asian trade bloc and evoke backlash from other regions.

Singapore's Goal

Tokyo's examination of Singapore's proposal aimed to identify and articulate its potential benefits and risks. Through a series of intensive exchanges with Singaporean

⁴⁷ Some were concerned about inflow of agriculture goods from ASEAN countries via Singapore. This issue, however, is not a matter of whether to conclude an FTA but a matter of rules of origin.

officials and academics in the first half of November 1999, the following points became clear in terms of Singapore's motivation:⁴⁸

First, Singapore believes that it should pursue a dual-track approach in responding to global FTA developments. On the one hand, Singapore places its primary emphasis on the multilateral trading system, ensuring that this remains relevant to the global trading community. On the other, Singapore will pursue its own FTAs to avoid marginalization and to provide the region with some leverage against other trading blocs. Thus, Singapore genuinely believes that FTAs with the intention of contributing to global trade liberalization are not detrimental to the multilateral trading system.

Singapore is not pursuing an Asia-only trading bloc, however, and is seeking FTAs with the U.S. and EU as well. It fears that the Americas and Europe will become exclusive and inward-looking groupings, effectively dividing the world into three major blocs. It also envisions that the accumulation of FTAs among APEC members as signatories will eventually develop into an APEC-wide free trade area and considers FTAs to be a fast-track method to achieve the Bogor goals of APEC liberalization.

Second, Singapore sees itself as the future hub of business networks in the region and would like to utilize FTAs to make itself more attractive to businesses. As for relations with Japan in particular, Singapore is worried about Japan's reduced economic power and investment in Southeast Asia. It would like to encourage Japanese presence in the region as a way to balance U.S., China and Japanese influence.

Third, after the Asian economic crisis the relationship between ASEAN members became more ambivalent. This prompted Singapore to act more independently of other

⁴⁸ Prime Minister Goh argued some of these points in public. See "Transcript of Prime Minister Goh Chok Tong's Interview with Mr. Osamu Kobayashi, Editor-in-Chief of Nikkei Business, on 19 December, 2000 at the Istana", <http://www.gov.sg/sgip/intervws/0101-03.htm>

ASEAN members in order to advance its economic agenda. Singapore has thus concluded that it has waited long enough for ASEAN and cannot wait any longer. Regardless of external initiatives, however, Singapore is a member of ASEAN and has a large stake in ASEAN's success. It hopes that its efforts will stimulate other members to actively pursue liberalization and economic reform so as to increase the attractiveness of the region as a whole to outside investors.

Gains for Japan

Singapore's explanation of its view of FTAs helped Tokyo overcome some resistance to FTAs. Many officials were further convinced that Japan should also secure policy options to complement the WTO. They realized that the speed of change in the business environment, further accelerated by globalization as well as information and communications technology, is too rapid for the WTO or other multilateral organizations to keep pace in creating new rules and that regional efforts to complement such multilateral negotiations are becoming a critical sub-system that can enhance the stability of the global system.⁴⁹ Tokyo ultimately concluded that negative reactions from other countries, if any, would be manageable. As for sensitive items, they comprise a very small share of total bilateral trade, and therefore, the problem of WTO consistency could be solved by excluding individual items, rather than by excluding sensitive "sectors" as a whole. The remaining problem was whether or not Japan could identify benefits significant enough to justify a JSFTA.

⁴⁹ Remarks by Takeo Hiranuma, Minister of International Trade and Industry. "*Challenges of the New Age and the Japan-Singapore Free Trade Agreement*," Singapore, October 9, 2000 (http://www.meti.go.jp/policy/trade_policy/jsepa/pdf/speech001009e.pdf)

Incidentally, among academics, businesspeople and government officials in Japan there emerged a trend to reconsider the country's Asia policy in the post-economic crisis environment. While the Japanese government provided assistance to help Asian economies deal with the crisis and get over the worst of it, what really facilitated Asian recovery were exports to the booming U.S. market. It became generally accepted that Japanese economic revitalization was necessary for an economic turnaround in the rest of Asia. A report submitted to Prime Minister Obuchi on Japan's future role in the revitalization of the regional economy gave recognition to economic interdependence in Asia and stressed the urgent need for Japanese liberalization to promote the flow of people, goods, money and information in the region.⁵⁰ All of which was crucial for revitalizing the Japanese economy as well as nurturing Asia's confidence in Tokyo. The report reads, in part:

The currency crisis has underscored just how deep economic interdependency is in the East Asian region. The recovery of the Japanese economy is extremely important for the recovery of Asian economies, and conversely, the recovery of Asian economies is also important for the recovery of the Japanese economy.

Opening Japan is urgent to the revitalization of our society and economy, to ensuring that we do not miss the historical trend of globalization. Opening Japan will also enable us to be a true and trusted friend to Asia.

What the twenty-first century will require is not unilateral assistance and investment...Japan must actively accept goods and people from Asia.

The movement of people, goods, money and information is mutually complementary; if one of them stops, it creates large distortions in the others. But it is human resources that hold a particularly important place.

⁵⁰ Mission of Revitalization of Asian Economy, *“Report of the Mission for Revitalization of Asian Economy – Living in Harmony with Asia in the Twenty-first Century,”* November 1999

This line of thinking illustrates the limits of traditional FTAs focused on preferential tariff reduction⁵¹, where the margin of preference is clear and political significance attached accordingly. With the impact of globalization and technological development, it seemed necessary that the JSFTA should have the following characteristics in order to be relevant and attractive to Japan. First, it has to promote the trans-border flow of not only goods but also of people, money and information. In addition, relevant measures should be taken, including not only liberalization but also facilitation and cooperation. Second, it has to encourage innovation and competition, not just liberalization of trade and investment. Third, it has to have a focus on solving specific problems relevant to both countries, a creative process that will allow experimentation with new elements, and a flexible structure to facilitate timely upgrading to deal with the accelerated speed of change in the business environment. The JSFTA took the concept beyond the traditional notion of a free “trade” agreement to address broad economic integration.

From this wider perspective, Singapore came to be considered a particularly appropriate partner for Japan’s first FTA, one that could help Japan overcome its lingering hesitation in pursuing FTAs and achieve a breakthrough in trade policy. Specifically, Singapore was considered a desirable partner in the following respects: First, Singapore’s size reduces the threat to domestic industries afraid of international competition. This could allow bold experimentation in various new elements to be

⁵¹ In fact, border measures have been reduced through a series of trade liberalization efforts. According to World Trade Organization (WTO) (1995), *Regionalism and the World Trading System*, WTO Secretariat, successive GATT tariff-cutting rounds have brought MFN tariffs of OECD countries down from an average of more than 40% in 1947 to a pre-Uruguay Round level of 6.3%. Once the Uruguay Round tariff cuts are fully implemented, the average tariff will be 3.8% on total imports. Naturally, differences in domestic regulations and standards come into focus as important obstacle for cross-border business activities.

incorporated in an FTA. Second, its policy of maintaining an internationally competitive business environment would stimulate regulatory reform in Japan. As a “sparring partner”, Singapore could help address recurring criticism from other Asian economies that the Japanese market was still closed, despite low tariffs and deregulation, and that the Japanese would never be willing to accept a different state of affairs. As the Japanese people come to understand the importance of Asia, friendly advice from Asian economies could help Japan overcome political difficulties. In this context, Tokyo recognized that, in designing a possible FTA with Singapore, the focus should be on what Japan stands to learn from Singapore, and to enhance Japan’s capacity to learn from its neighbors.

In addition, as a matter of practical importance, because Singapore does not have a significant agricultural industry or fishery products, a FTA could safely cover “substantially all the trade” if tariffs on almost all the industrial goods were eliminated. The Singapore proposal raised awareness of FTAs as a real policy option for Japan that could possibly be realized in the near future.

In order to elaborate on the above idea and to identify new elements that would have tangible commercial benefits, the government conducted a series of interviews with businesspeople to identify the problems they encountered in either Japan or Singapore. These interviews addressed a wide variety of issues. Ranging from issues of trade in goods and services, the flow of people across national borders, improving the availability of international alternative dispute resolution (ADR) services, cutting Japanese transportation costs, boosting the use of English in Japan, joint investment or joint cooperation in other regional economies, and so on. While some of these issues were not

directly within governmental reach, responses from business interests indicated the need for a holistic approach rather than applying a legal template of existing trade agreements.

These preliminary thoughts from Japanese policymakers were well received by the Singaporean side. Prime Minister Goh coined the term, “New Age FTA” to express the desire to develop a model for future FTAs.⁵² In his meeting with Prime Minister Obuchi on December 8, 1999, he specifically referred to services, information technology, education and exchange of students as possible elements of the New Age FTA he then officially proposed.⁵³

Following the leaders’ agreement, a joint study group (JSG) was set up to study the feasibility of an FTA. The JSG process was not the Japanese side versus the Singapore side, but rather one of FTA advocates versus the more hesitant groups. In this regard, the JSG was more constructive and creative than past formulations because its members included academics and businesspeople and the research and analysis process was separated from official negotiations.

IV. Challenges Ahead

In January 2001, Japan took a concrete first step by starting negotiations with Singapore. This does not, however, signal a complete policy shift to one of actively utilizing regional economic integration in addition to the WTO to improve the domestic and external business environment. Rather, the JSEPA is just an experiment in the

⁵² “Transcript of Prime Minister Goh Chok Tong’s Interview with Mr. Osamu Kobayashi, Editor-in-Chief of Nikkei Business, on 19 December, 2000 at the Istana”, <http://www.gov.sg/sgip/intervws/0101-03.htm>

⁵³ Background information provided on METI’s web site (in Japanese) (<http://www.meti.go.jp/policy/fta/keii-1.html>)

overall process of a policy paradigm shift, and Japan will have to overcome many challenges in order to firmly establish new policies and ensure their implementation.

The immediate issue concerned the extent to which Japan can liberalize agriculture, forestry and fisheries trade. Although these industries comprise only a fraction of Japan's economy, they have taken on a disproportionate weight within Japan's overall trade policy. Unless Japan can substantially reduce tariffs on items in these sensitive sectors, any FTA other than the one with Singapore will encounter problems with GATT Article 24 requirements to cover "substantially all the trade." Tokyo has to analyze the costs associated with an inability to conclude FTAs and compare it with the benefit derived from protecting sensitive items. Merely insisting on liberalization, however, cannot solve the problem. Tokyo must decide what its overall goal for the agricultural industry and whether it can design a set of agricultural policies that encourages viable agricultural business while effectively addressing other related concerns, such as preserving the environment and the landscape.

Sensitive areas are not restricted to trade in agriculture, forestry and fishery products. For example, a recent surge of textile imports from China prompted the affected industries to request safeguard measures. Unless Japan is ready to promote industrial adjustment in sectors where developing economies are catching up, it will be difficult to reduce tariffs in those sectors. In addition, the economic integration cannot be realized unless Tokyo can accept foreign businesses and individuals in many of the services sectors where deregulation and competition are long overdue.

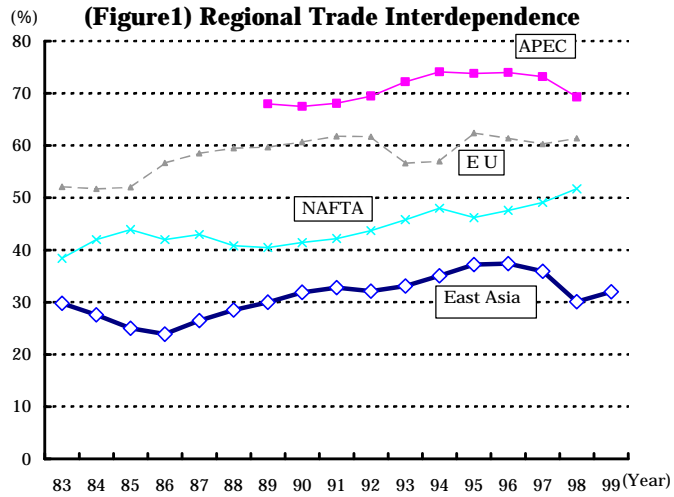
The most serious challenge for Japan is political leadership. Is Japan equipped with the political will to define national goals and to overcome the difficulties in realizing

its goals? Without political leadership, no country can play an effective international role. Tokyo's policy toward economic integration has evolved basically by reacting to given situations. While Japan has occasionally contributed to the creation of collective entities such as APEC, it has failed to follow through on these efforts by implementing politically controversial reform and providing momentum to regional initiatives.

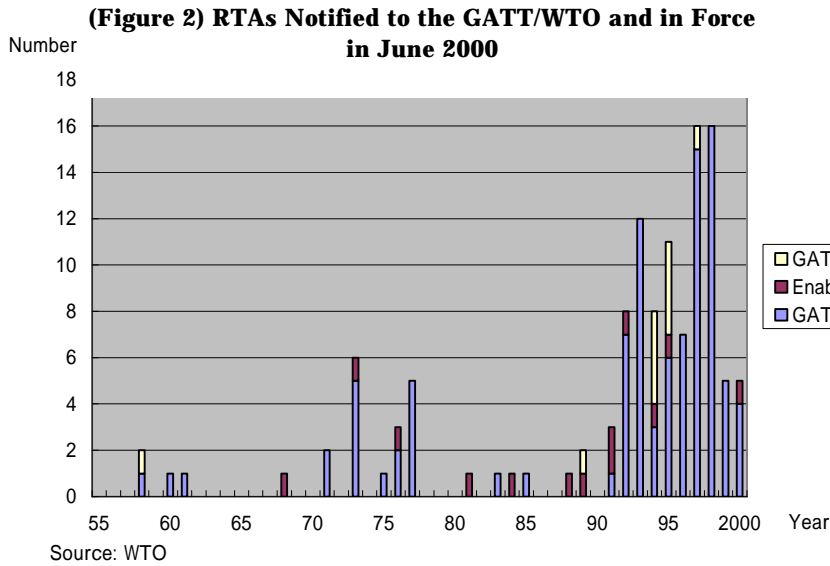
Also, if Japan aims to actively promote economic integration in Asia, it must resolve its "history problem" with neighboring countries. Japanese political leaders have to play a significant role in clarifying the differences in perceptions of "history" with its neighboring countries and come to a mutual understanding based on these differences.

In the meantime, some intellectual homework remains to be done. Economic systems have to be examined to identify where there is room for improvement in order to facilitate trans-border business activities and to attract competent people and other productive corporate resources. Energy and environment will be key areas for regional cooperation. Most Asian countries have similar problems in handling resource constraints and protecting the environment, and economic assistance should be more integrated with these regional efforts. Synergy in reaching these goals can be gained from pursuing closer economic relations, in various forms, with economies in and outside the region.

--Appendix--



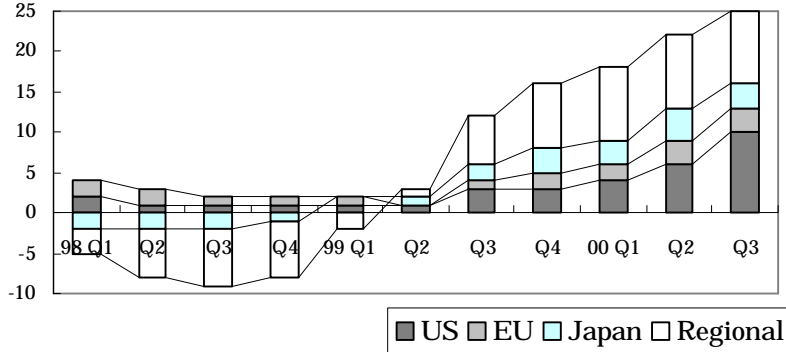
Source: IMF, *Direction of Trade Statistics*



Source: WTO

(Figure3) Contribution of Major Markets to Non-Japan Asia Export Growth

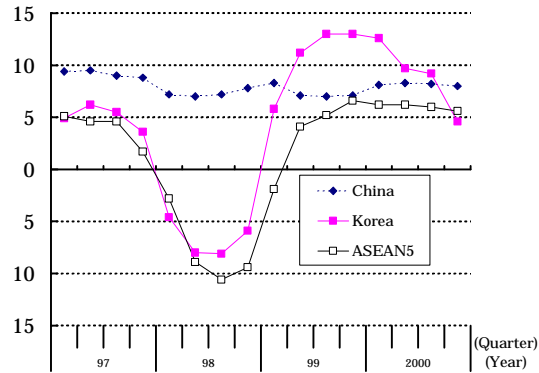
(% year on year)



Source: IMF, *Direction of Trade Statistics*

(Figure 4) GDP Growth Rate of East Asian Economies

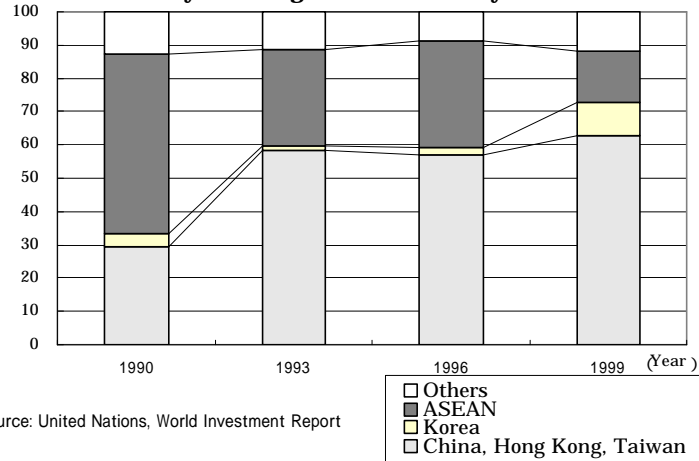
(% year on Year)



Source: National statistics

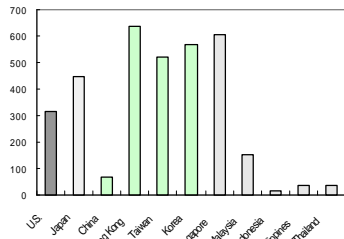
(Figure 5) Share of FDI inflows in East Asia by host region and economy

(%)



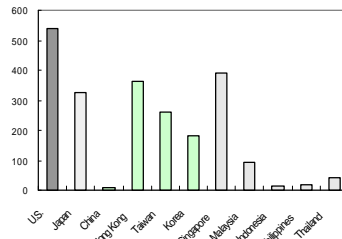
Source: United Nations, *World Investment Report*

Number of Cellular Telephone Subscribers per 1000 Inhabitants (2000)



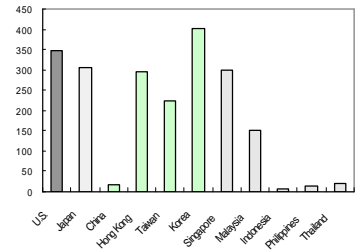
Source: International Telecommunications Union (ITU)

Number of Computers per 1000 Inhabitants (1999)



Source: International Institute for Management Development (IMD), The World Competitiveness Yearbook 2000

Number of Internet Users per 1000 Inhabitants (2000)



Source: ITU