

Section 2 How the promotion of WTO, EPA/FTAs, etc., helps improve the international business environment

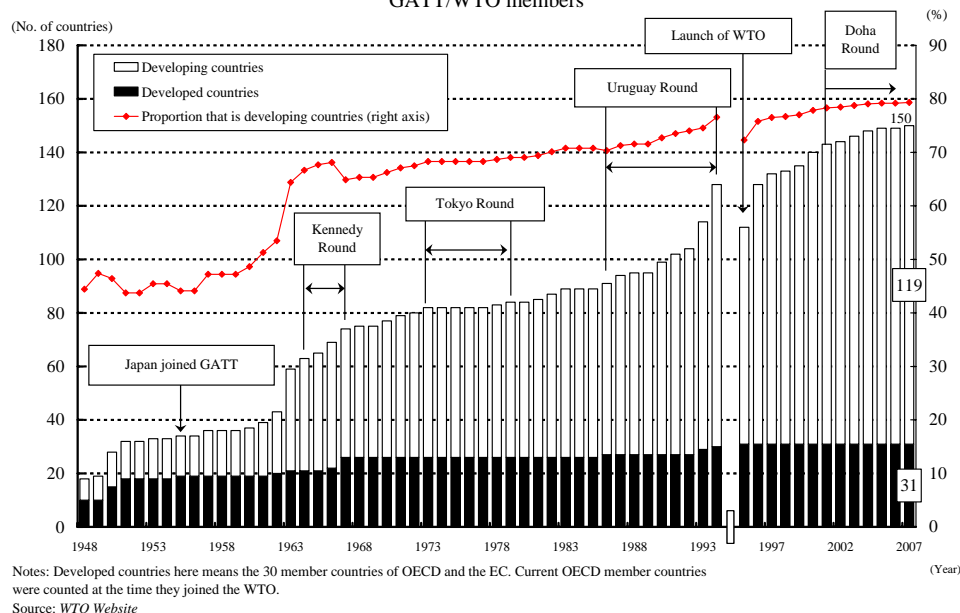
1. Significance of WTO

(1) Progress of trade liberalization in the GATT/WTO system

Much has been contributed by the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) to strengthening a multilateral trade system and checking protectionism. The world has seen not only trade barriers reduced and eliminated through multilateral negotiations (“Rounds”), but also trade rules strengthened and enhanced to stabilize international trade and secure its predictability, made possible the initiatives of the GATT system, founded in 1948, and WTO, started in 1995 based on the achievements of GATT. The GATT/WTO scheme has attracted new member countries almost constantly since the GATT foundation, with developing countries largely attributing to the increase (Figure 4-2-1). China joined in 2001, followed by Cambodia in 2004 and Vietnam in 2007, summing up to a total of 150 member countries as of April 2007. Russia and 29 other countries have also applied for entry, suggesting a further increase of the membership.

WTO also intends to expand the scope of its regulation, by handling trade of services and trade-related aspects of intellectual property rights (TRIPS), in addition to its traditional GATT-based pursuits of reducing tariffs and non-tariff barriers imposed on traded goods.

Figure 4-2-1 Changes in the proportion of developing countries to the total number of GATT/WTO members



(2) Initiatives based on the WTO Doha Round

(Development initiatives)

WTO members declared the launch of a new round of negotiations (the Doha Development Agenda)

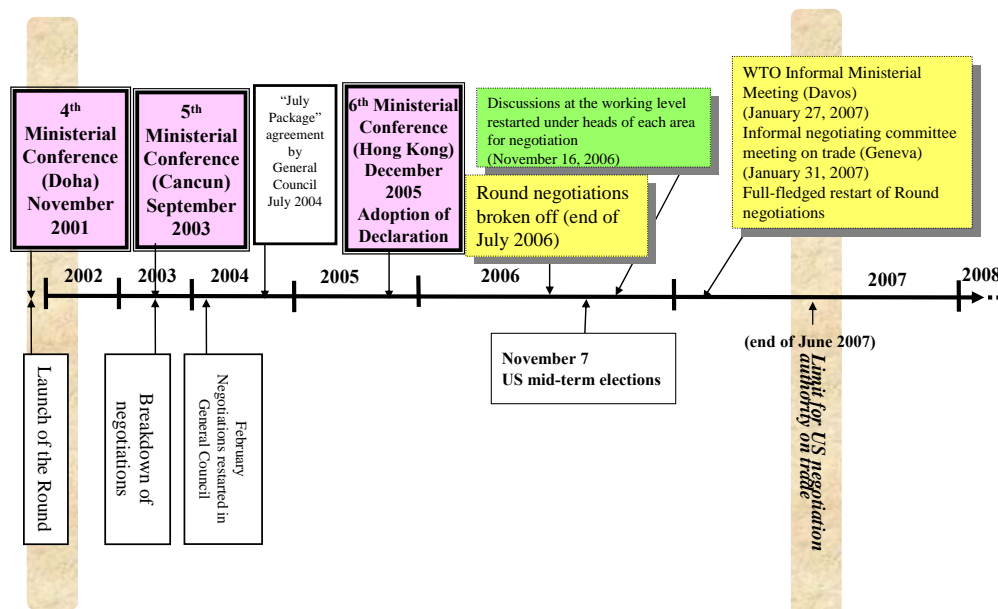
at their fourth Ministerial Meeting in Doha, Qatar in 2001 and began the negotiations in early 2002. The Doha Development Agenda (hereinafter called the “Doha Round”) covers a wide range of themes including: non-agricultural market access (NAMA); agriculture; services; development; rules (including those regulating anti-dumping and subsidies); measures to facilitate trade; and intellectual property rights. The Doha Round is aimed at strengthening rules and approaching new fields such as services and intellectual property rights, in addition to further liberalizing trade. Yet, the Doha Round’s defining characteristic lies in its emphasis on the perspective of “development,” clarifying the importance of the consideration for developing countries’ interest in the course of promoting free trade. In line with this characteristic of the Doha Round, Japan set forth a Development Initiative for Trade ahead of the Sixth Ministerial Meeting of December 2005 in Hong Kong. This Initiative covers a comprehensive set of measures to contribute to the development of developing countries through trade. The Initiative is based on the stance to assume the importance of establishing a system in which developing countries can fully benefit from free trade. Many member countries acclaimed the Initiative, proposed by the then Prime Minister Junichiro Koizumi. Specific actions based on the Initiative include the enhancement of the duty-free and quota-free arrangements for least developed countries (LDCs) and the promotion of the international version of Japan’s domestic One Village, One Product campaign.

Based on the Hong Kong Ministerial Declaration, adopted in the Hong Kong Ministerial Meeting, member countries led by the group of six (G6: Japan, the U.S., EU, Brazil, India and Australia) promoted active discussions, but failed to narrow their differences. Negotiations were thus suspended at the end of July 2006. Member countries sought hard for an early resumption of talks, seeing that stagnated negotiations would put the multilateral free trade system at risk and hamper the development of developing countries to no small extent. Japan, too, called for the resumption of negotiations on the occasions of bilateral talks and various international conferences. Japan tied up with the corporate circle to urge on the other members of G6, thereby contributing to enhancing the motivations to resume talks in government-private joint efforts. Following these moves and a statement issued in November 2006 by the leaders of the member economies of the Asia Pacific Economic Cooperation (APEC), WTO Director-General Pascal Lamy declared the resumption of working-level talks.

After that at the end of January 2007, when WTO held an informal ministerial meeting in Davos, Switzerland, Japan stressed the need for a full resumption of negotiations, which was met with the agreement by the ministers of 25 countries and areas. Subsequently, an informal trade negotiation committee resumed negotiations on a full-fledged basis (Figure 4-2-2). While no formal period for negotiations has been set, member countries agree on the need for an early concession among themselves, which is reflected in negotiation meetings at Geneva and other intensive negotiation talks among member countries. In April, Japan and the other G6 countries met in New Delhi, India, announcing a joint statement that showed their strong determination to reach an agreement by the end of the year. The Doha Round was furthermore deliberated at the OECD Ministerial Council Meeting (MCM) in May as a theme for ministerial-level talks and bilateral discussions. Japan actively

participated in these moves, hosting G6 ministerial meetings and discussions with major developing countries as part of its sincere commitment to achieving an early agreement.

Figure 4-2-2 Negotiation schedule of the Doha Round



Source: Ministry of Economy, Trade and Industry

(Non-agricultural market access (NAMA))

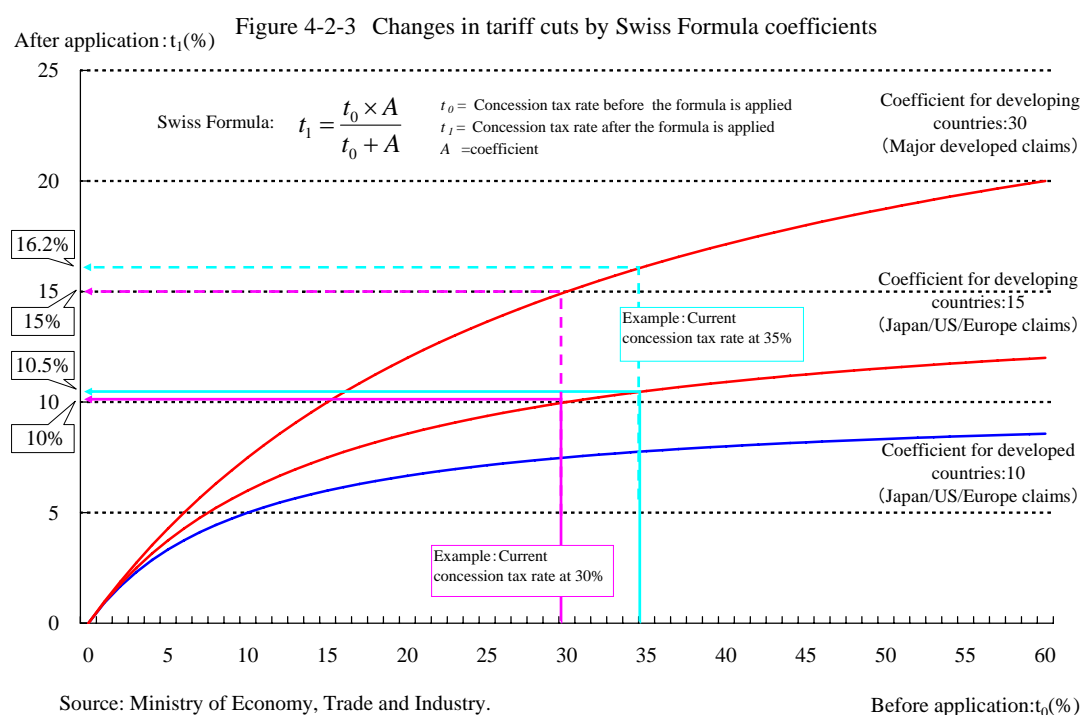
The NAMA negotiations focus on the elimination and reduction of tariff and non-tariff barriers imposed on non-agricultural items (industrial, forestry and fishery products). On the agenda are three major issues related to: ways to reduce tariffs (formulas); flexibility applied to developing countries; and the handling of products free of the tariff bindings imposed by WTO. Developed and developing countries take differing positions in that developed ones generally maintain lower tariffs for imports and are interested in the lowering of the tariffs imposed by developing countries, which, in contrast, maintain high tariffs for imports and seek flexibility in tariff reductions from the viewpoint of each country to protect its industries and maintain room for its own policies.

In the previous Uruguay Round, member countries sought a goal of reducing tariffs as a whole by the average of one-third the current levels. As a notable achievement in the latest Doha Round, members have agreed on the Swiss Formula that applies different numeric factors of tariff cuts for developed and developing countries (the higher the maximum tariff ceilings a country maintains, the greater the reduction rates it must fulfill)(Figure 4-2-3)⁶. At issue now are the specific levels of the factors that should be applied to developed and developing countries, respectively. Discussions are also underway about the flexibility applied to developing countries, specifically concerning the alleviation of the cuts

⁶ Suppose a factor of 10 is applied to developed countries and 15 to developing countries, the reduction rate of the average tariff ceiling for non-agricultural products is around 50% for both developed countries and major developing countries to which the Swiss Formula is applied (METI estimate based on the data prepared by the WTO Secretariat).

by the Swiss Formula and the breadth of exemptions, about which opinions vary between developed and developing countries. Concerning items free of the tariff bindings, a principle is applied that all items should be subject to such bindings. Member countries have agreed to establish standard tariff rates, that represent the existing tariff rates applicable on a base date plus certain additional rates and to apply the Swiss Formula to such standard tariff rates.⁷ At issue now is how wide the additional rates should be.

Efforts are also made being made to complement the Swiss Formula-based reductions of tariffs and to further improve market access. Interested member countries promote discussions to negotiate the tariff cuts by sector and the reduction and elimination of non-tariff barriers.



(Prevention of abuse of anti-dumping (AD) measures)

The major agenda of the Doha Round negotiations includes rules, in particular anti-dumping (AD) measures. AD measures are approved under WTO rules in order to remove damage caused to importing countries' domestic industries by acts of exporters to sell goods more cheaply than at home (acts of dumping). Still today, more than 100 cases a year are subject to the AD measures, although the numbers marked a mild decrease in recent years (Figures 4-2-4 and Table 4-2-5). Any possible abuse of the AD measures could risk undermining the effects of market access improvements, such as tariff reductions. Thus in the Doha Round, member countries have been negotiating ways to clarify the rules governing the AD measures and strengthen discipline.

⁷ For example, if an additional rate of 5% is added to an existing tariff rate of 25% applicable to the base date, the standard tariff rate is 30%: if the Formula is applied to this rate with a factor of 15, the resultant tariff binding is 10%, based on the calculation $(30 \times 15) / (30 + 15) = 10\%$

For example, to avoid a possible perpetuation of the AD measures, a sunset review has been required every five years based on decisions resulting from the Uruguay Round negotiations. However in reality, a sunset review hardly succeeds in ending the AD measures in a given country, so long as its domestic industries support the continuation of the measures. Japan thus has been seeking to strengthen the rules of the sunset review at negotiations. Given that the rules became hollowed out during the Uruguay Round, member countries need to reach a concession, while securing the feasibility of the rules.

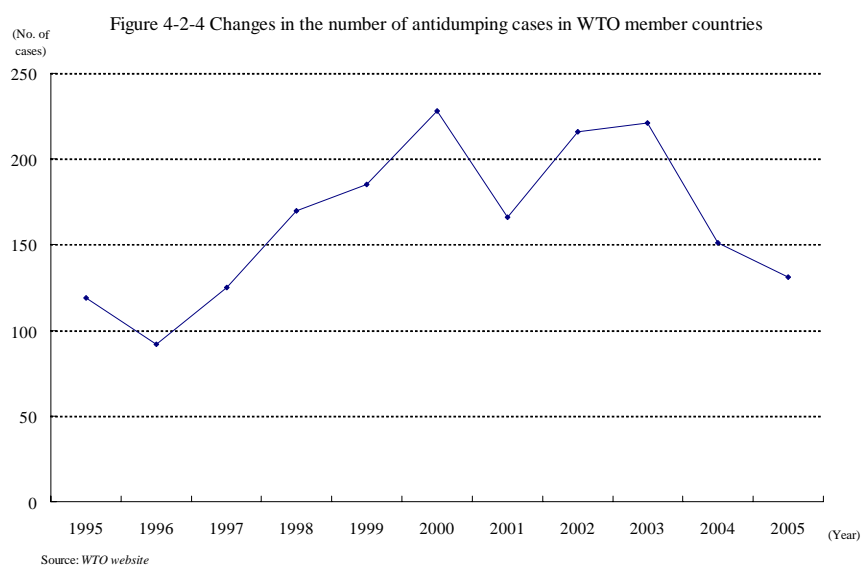


Table 4-2-5 Top 10 users and targets of anti-dumping measures and number of measures (1995-2005)

Users of anti-dumping			Targets of anti-dumping		
1	India	316	1	China	338
2	US	234	2	South Korea	127
3	EC	219	3	Taiwan	99
4	Argentina	147	4	US	95
5	South Africa	113	5	Japan	89
6	Turkey	86	6	Russia	82
7	Canada	84	7	Thailand	68
8	Mexico	76	8	Brazil	64
9	China	68	9	India	63
10	Australia	67	9	Indonesia	63

Source: Website of WTO.

Japan has been leading the negotiations to seek stricter regulation for AD measures, by submitting bills from time to time to amend provisions of the rules. On the other hand the United States remains passive about making the regulation stricter, reflecting the strong calls to mobilize the AD measures from its Congress and the industrial circle.

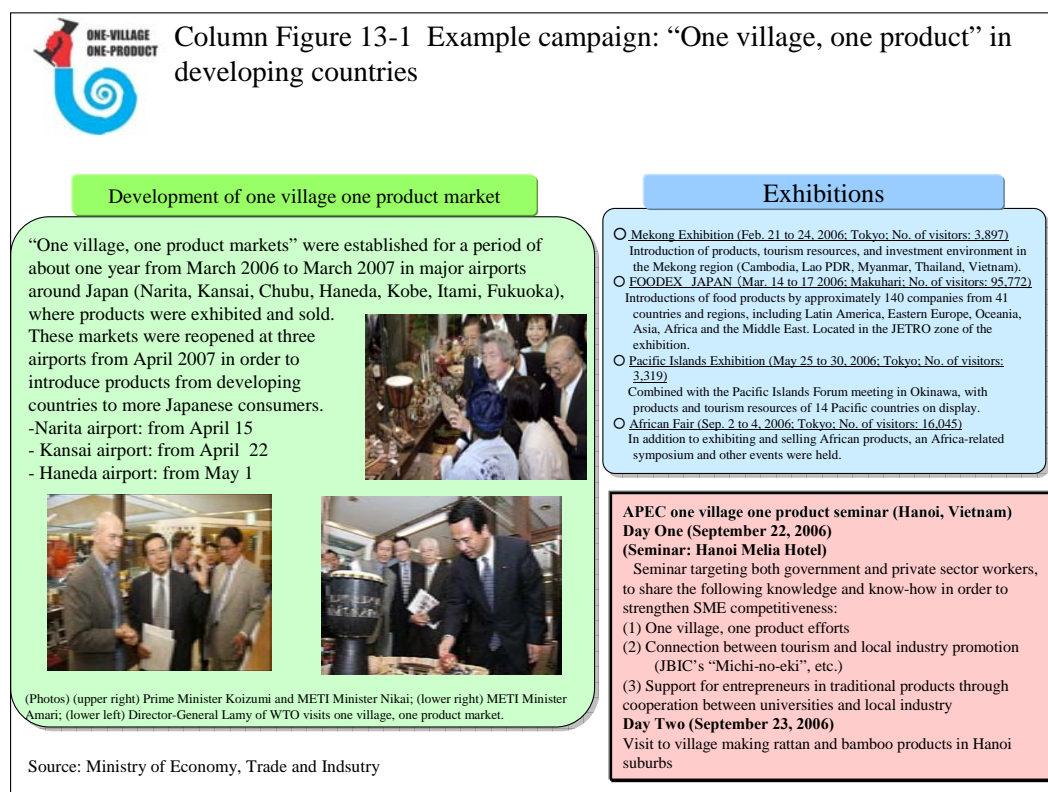
(Effects of multilateral trade liberalization)

As stated before, WTO is expanding its scope of regulation to service sectors, while seeking to reduce tariff and non-tariff barriers imposed on goods. These efforts are expected to deliver significant effects to countries in the world, upon the progress of multilateral trade liberalization. In an estimate Japan is to gain about \$400 billion (about ¥48 trillion) in economic effects, when liberalization is achieved for goods and services traded not only by Japan but also by the whole world. Japan, as such

being a beneficiary of a multilateral trade system, needs to further play active roles at WTO to seek a global scale trade liberalization and to establish relevant rules.⁸

[Column 13] International version of the One Village One Product campaign

The One Village One Product campaign is aimed at finding local products in rural areas that residents can be proud of and assisting efforts to develop them into commodities competitive in the international market as well as domestically. Specifically, products of developing countries were put on display and sale corners set up at Japan's major airports in tie-up programs with JETRO and other entities. Events such as exhibitions of the Mekong and Pacific islands, and an African fair were also held. Furthermore, a training program for the One Village One Product campaign was held from August to September 2006 by the Association of Overseas Technical Assistance. Eighty participants took part from 45 developing countries. In September 2006, an APEC One Village One Product seminar was held in Hanoi, Vietnam, indicating that the campaign was being promoted by APEC as well (Column Figure 13-1).

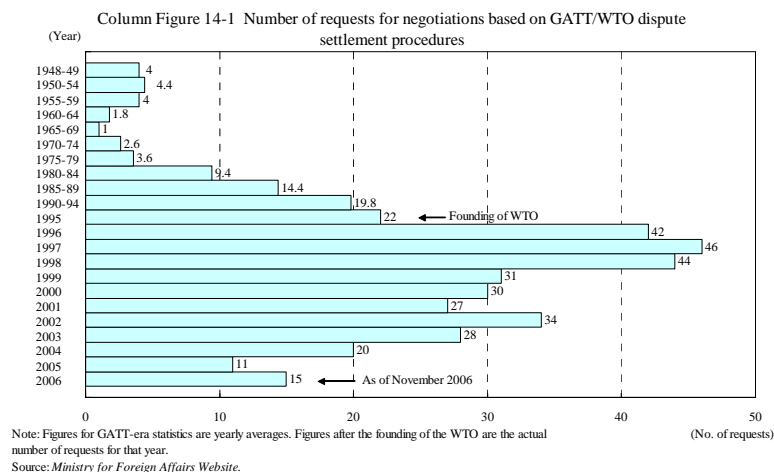


⁸Kiyota (2006) NIHON NO NIKOKUKAN, CHIIKITEKI BOUEKI KYOUTEI TO TAKAKUTEKI BOUEKI JIYUUKA NO KOUKA: MICHIGAN MODEL NIYORU BUNSEKI (WAGAKUNI NO ZAI, SERVICE BOUEKI OYOBI TOUSHI NO JIYUUKA NO KEIZAI KOUKA TOU NI KANSURU CHOUSHA KENKYUU HOUKOKUSHO) (The Research Institute of Economic, Trade and Industry (RIETI)).

[Column 14] Utilization of WTO Agreements (rules)

The WTO Procedures Governing the Settlement of Disputes are designed to solve trade frictions among WTO member countries through the interpretation of WTO agreements as international obligations. The Procedures embody higher levels of feasibility than other international procedures to settle disputes, as the Procedures encompass steps, not only to recommend measures to improve situations, but also to trigger countermeasures in case such recommendations are not carried out. Should a country breach any WTO agreements, it is important for Japan to urge such country to improve its relevant legislation and measures, for the sake of solving any possible disadvantage Japan could suffer from such noncompliance and ensuring the effectiveness of WTO agreements. Furthermore, to avoid turning trade frictions unnecessarily into political issues, it is necessary to reflect the rights and duties defined by WTO upon any proposals made and procedures taken by member countries. Under this policy, Japan resorts not only to bilateral negotiations but also to the WTO dispute settling procedures when it urges given countries to improve their policies and measures that breach WTO agreements. WTO received far more requests to apply for its dispute settlement procedures than GATT did before the launch of WTO, as a result of a significant reinforcement of such settlement procedures. This indicates an active use of the WTO trade rules by its member countries to settle their disputes (Column Figure 14-1). Since its foundation in 1995, WTO has had 361 cases to which it applied its dispute settlement procedures (as of the end of March, 2007). Japan participated in 11 of these cases and has also been involved in many other cases as a third country.

Below is a list of 11 individual cases that are deemed to have high priorities in the short term for Japan to forward its trade policies (prioritized commitments) (Column Figure 14- 2).⁹



⁹ METI Priorities On WTO Inconsistent Foreign Trade Policies Raised in The Report on the WTO Inconsistency of Trade Policies by Major Trading Partners (Ministry of Economy, Trade and Industry, Japan) (released on April 16, 2007).

Column Table 14-2 Priorities within WTO dispute settlement procedures

1) Issues that require prompt implementation of WTO recommendations
USA *Halt of distribution under the Byrd Amendment *Prompt implementation of WTO recommendations regarding zeroing *Prompt implementation of WTO recommendations regarding antidumping measures for hot-rolled steel *Complete implementation of WTO recommendations regarding 1916 antidumping law
2) Issues already brought before WTO dispute settlement proceedings to which Japan is a third country participant
China *Correcting tariffs levied on automobile parts *Operation/improvement of grant system that is both transparent and consistent with WTO agreements
3) Resolving issues through various future efforts (bilateral discussions, multilateral framework including the WTO)
China *Response to commercial fraud issues such as counterfeit and pirated goods *Improvement of inadequate operations of antidumping measures EU *Correcting tariffs levied on products that fall under the Information Technology Agreement *Ensuring precise and consistent regulations for chemical products and electrical equipment/devices Asian countries (ASEAN, Republic of Korea, Taiwan, Hong Kong, India) *Response to commercial fraud issues such as counterfeit and pirated goods

Source: *Action policy by Ministry of Economy, Trade and Industry in response to the report on unfair trade policy*
(Ministry of Economy, Trade and Industry)
(Published April 16, 2007)

2. Progress of EPA/FTAs

(1). Increase and expansion of EPA/FTAs

Since the 1990s, we have seen an increase of the numbers of economic partnership agreements (EPAs) and free trade agreements (FTAs)¹⁰ concluded, as regional integrations were speeded up by changes of the international economic environment and development strategies. Factors behind this include: both the United States and Europe accelerated their moves of tie ups with economically close neighboring countries through liberalization/facilitation of trade and investment activities, reflected in the North American Free Trade Agreement (NAFTA; formed in 1994) and the European Union (EU: established in 1993), respectively; amidst fast growth being achieved by countries of the new industrializing economies (NIEs) and the Association of Southeast Asian Nations (ASEAN) through their swift promotion of economic liberalization, emerging countries such as Chile and Mexico actively sought the advantage of EPA and FTA schemes as they shifted their economic policies to liberalizing trade and investment and introducing the market mechanism; and East Asian countries including Japan also shifted to active promotion of EPA and FTA schemes. As of March 2007, WTO had reported 141 regional trade agreements concluded.¹¹

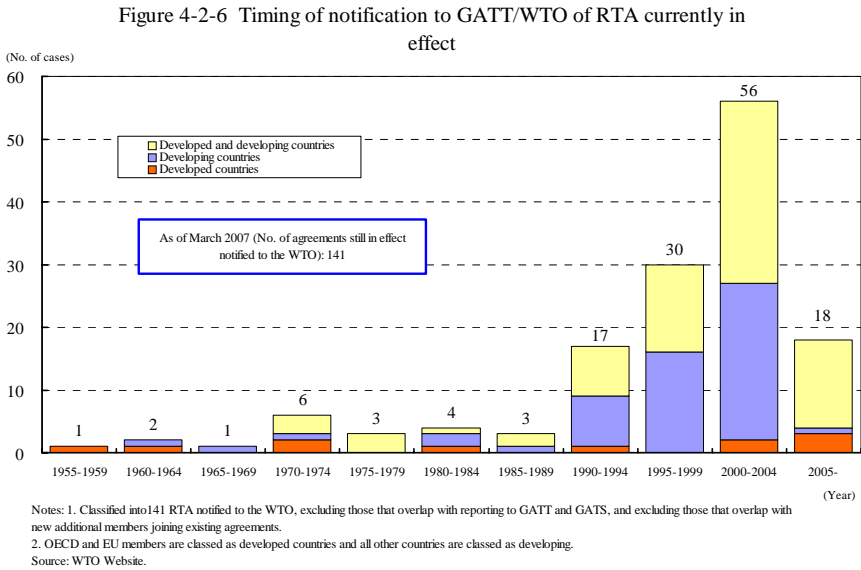
EPAs and FTAs have undergone not only numerical increases, but also significant changes of their substance. Until the middle of the 1970s, about 40% of economic partnerships were concluded between/among developed countries, while since 2000, more than 90% of such partnership pacts have

¹⁰ Free trade agreements (FTAs) are aimed at eliminating tariffs and other trade restrictions among party countries to the agreements. Economic trade agreements (ETAs) cover wider ranges: not only factors of FTAs but also measures to unify the market system and economic activities. In this section, discussions also include tariff alliances (based on agreements governing tariffs and other trade restrictions, to eliminate them among member countries and unify them to be imposed jointly by members on non-member countries). All these agreements are collectively referred to as regional trade agreements (RTAs).

¹¹ This number is based on the total 194 cases of RTAs reported to WTO, less any overlapping reports to

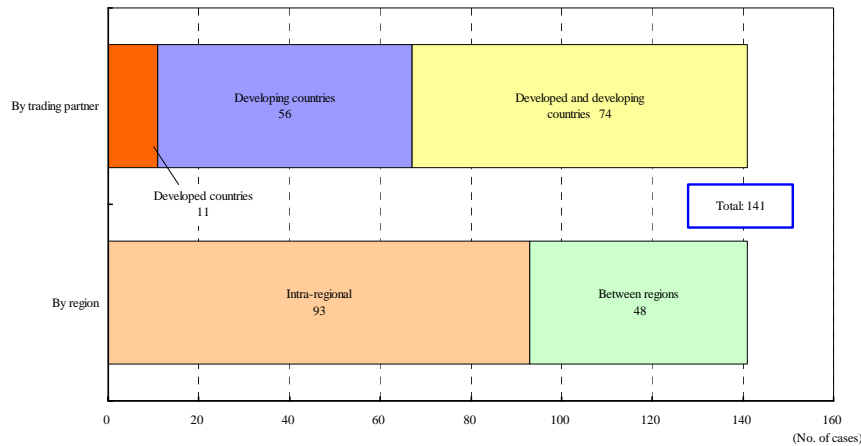
been concluded by developing countries as one or more parties to a pact (Figure 4-2-6 and Figure 4-2-7). Furthermore, in contrast to past EPAs and FTAs that were mostly concluded in single regions, over 40% of EPAs and FTAs concluded since 2000 span across regions (inter-regional). These suggest two types of EPA/FTAs expansions underway in parallel: one based on the inclusion of surrounding countries; and the other based on tie ups of geographically remote countries.

These are summarized as the changes of: 1) an increase of EPA/FTAs involving developing countries, and 2) the geographical distances among party countries to the agreements. In the background is an increase of the merits based on economic integration between developed and developing countries, as a result of globalization in progress, that has been expanding an international division of labor and thus activating trade between developing and developed economies. Asian countries achieved development led by industries prioritizing export under open economic policies. This has encouraged many developing countries to conclude EPA/FTAs, based on the recognition that trade and investment liberalization prompts technological transfers from developed countries and the enhancement of competitiveness. Countries also found it important to gain economic benefits by concluding EPA/FTAs with key trade/investment partners regardless of their geographical distances that allow them to promote trade under a privileged condition beyond the reach of third countries.



GATT and GATS and also less any reports of members added to existing agreements.

Figure 4-2-7 Breakdown by trading partner and by region (as of March 2007) of RTA



Notes: 1. Classified into 141 RTA notified to the WTO, excluding those that overlap with reporting to GATT and GATS, and excluding those that overlap with new additional members joining existing agreements.
 2. OECD and EU members are classed as developed countries and all other countries are classed as developing.
 3. The world is classified into six regions: Europe, Middle East, Africa, North America, Latin America, and Oceania. If countries with agreements conclude EPA/FTA purely within one of these regions they are classified as intra-regional, all others are classified as between regions.
 Source: WTO Website.

(2) Effects brought about by EPA/FTAs

Various final economic effects can be attributed to EPA/FTAs, that aim not only at eliminating/reducing tariffs, but also comprehensive areas of investment, services, intellectual property protection, competition, movement of people and cooperation. The paragraphs below categorize such effects into static ones achieved by lowered tariffs and dynamic ones achieved by capital accumulation and productivity enhancement.

(Static effects)

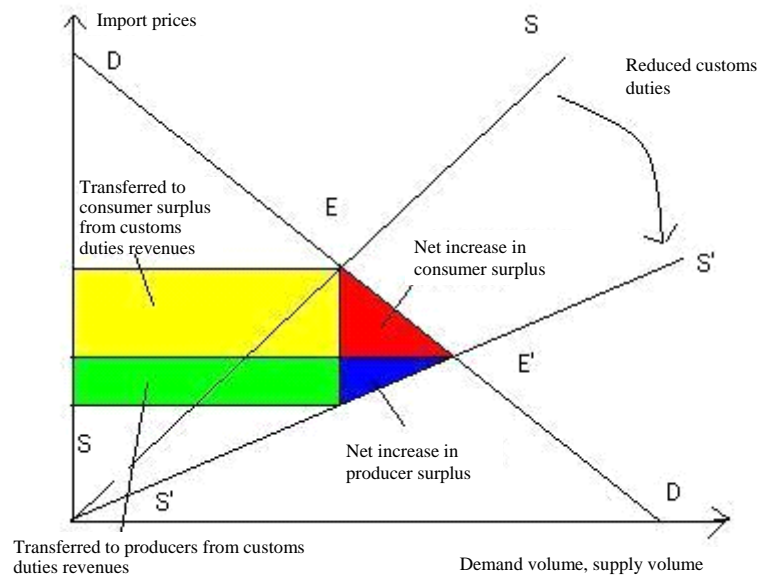
○ Trade creation effect

The conclusion of an EPA or FTA allows for the elimination or reduction of tariffs concerning trade among the signatory parties (intra-regional trade). This will result in changes in trade volumes both intra- and inter-regionally and the level of economic welfare within the region. Trade creating effect in this context refers to an increase of trade volumes within the region, based on the generation of new demand for intra-regional imports, replacing domestic products and imports from outside the region. This can expand the economic welfare of both importing and exporting countries in the region.

Figure 4-2-8 illustrates the demand curve (DD) and supply curve (SS) of item X imported to country A from other countries within the region. When country A abolishes the tariff on item X, the supply curve moves to the right side (S'S').¹² As a result, the market balance moves from E to E'. These shifts allow for the reduction of the price of X and increase of production in exporting countries. They also allow for an increase of both the producer surplus and consumer surplus, based on the distribution of the tariff income and the dissolution of dead load.

¹² This assumption employs the tariff based on the unit of the product. Therefore after the tariff elimination, the supply curve shifts clockwise centering on the original.

Figure 4-2-8 Trade creation effect



○ Trade diversion effect

While EPA/FTAs expand trade within the region established by the agreement, the resulting tariff reduction/elimination is valid only within that region. This could allow the **diversion** of imports from those foreign countries that are still subject to tariffs to those countries within the region where tariffs have been reduced/eliminated. This is called the “trade diversion effect”, illustrated in Figure 4.2.9. In this figure, both country B that belongs to the region and country C that doesn’t, produce item X. Country A imports item X at the price of P_b from country B and P_c from country C, respectively. Country C is superior to country B in terms of the technologies they use to produce item X, while P_c is lower than P_b . Before countries A and B concluded their bilateral EPA or FTA, country A imposed the same level of tariff on item X from both countries B and C, whereby $P_b < P_c + t$ was established. Before the conclusion of an EPA or FTA between countries A and B, consumers of country A bought item X imported from country C as it was cheaper than the equivalent imports from country B. Once the tariff was eliminated from item X imported from country B, the import price is P_b ($< P_c + t$). This induces the consumers to buy item X made in country B, thus the origin of the import is diverted to country B.¹³

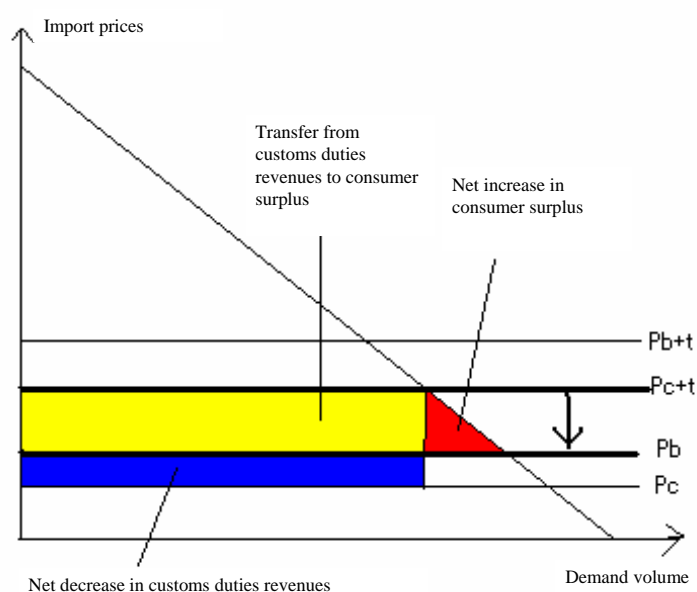
The reduction of the import price from $P_c + t$ to P_b allows in country A for the increase of a consumer surplus and diversion of the exporting country from higher-productive country C to lower-productive country B. This phenomenon does not occur, however, when a country liberalizes its trade comprehensively, instead of within a specific region. In this case, goods are supplied from

¹³ To simplify the story, it is presumed that: countries B and C produce item X with the same features and that the trade diversion from country C to country B is a complete diversion.

higher productive countries, thus the most efficient situation can be created. The worsening of efficiency, peculiar to EPA/FTAs, provides one of the bases for the opinion that multilateral trade agreements are better than regional ones. The degree of the worsening efficiency is represented by the difference between import prices P_c and P_b , which are applied when trade is totally liberalized.

When we look at the entire surplus including the tariff income, we need to take note that the increase/decrease of the surplus of country A is determined by the proportional scales of the net increase of the consumer surplus and net decrease of the tariff income.

Figure 4-2-9 Trade diversion effect



○ Term of trade effect

As discussed above, an EPA/FTA generally encourages the diversion of exporters from those outside the region ruled by the agreement to those inside the region. An EPA/FTA also weakens the regional demand for products from outside the region.¹⁴ As a result, import prices are lowered and thereby the trading condition with other countries is improved.¹⁵ This phenomenon is called the “term of trade effect”.

(Dynamic effect)

The effects of EPA/FTAs described above are called “static effects” that represent direct changes of trade volumes and other indicators due to the conclusion of EPA/FTAs. On the other hand, the conclusion of EPA/FTAs is believed to liberalize trade, investment and other activities and cause indirect influences to the production and investment activities of companies within the regions created

¹⁴ When the income level rises as a result of an EPA/FTA, it is also possible that consumption expands, pushing up the demand for goods from other countries.

¹⁵ Term of trade is an index defined by the export price/import price. This can also be interpreted to indicate how much a country can import against a unit of export goods, or its external purchasing power.

by the agreements, as EPA/FTAs prompts imports and exports of goods and services and entry of foreign companies into the regional market. These effects are called “dynamic effects”. Dynamic effects on economic activities are categorized into economic growth resulting from productivity enhancement and from capital accumulation.¹⁶

○ **Economic growth led by a rise of productivity**

The effects of productivity enhancement made possible by EPA/FTAs are categorized into four, as set forth below:¹⁷

(a) Effects caused by the expansion of markets

As EPA/FTAs reduce the barriers of trade, investment and other activities in the regions formed by the agreements increase, the regional market scales expand, putting the economies of scale in place and enhancing productivity.

(b) Effects caused by enhanced competition

Regional competition is enhanced by the influx of low-priced goods and services and entry of foreign companies. This pushes up productivity as a result.

(c) Effects caused by the proliferation of technologies

As an EPA/FTA activates regional economic activities, direct investment into the region expands thus creating the spillovers of technologies and management skills. As a result, investment recipient countries gain new know-how, which enhances their productivity.

(d) Effects caused by domestic institutional reform

The conclusion of an EPA/FTA encourages domestic deregulation in the signatory countries and thus helps them accumulate know-how of effective modalities of policies, regulation, etc. This will promote further deregulation (commitment effect) and enhance productivity.

○ **Economic growth caused by capital accumulation**

When the conclusion of an EPA/FTA leads to the above mentioned productivity enhancement, the resulting increase of the expected rate of return and decrease of uncertainty will lead to an increase of investment both domestically and directly from abroad. This is expected to realize the accumulation of domestic capital, which contributes to expanding productivity.

(3) EPA and WTO

(EPA/FTAs promote multilateral trade liberalization)

Under the WTO agreements, EPA/FTAs are regarded as exceptions to the principle of Most-Favored-Nation (MFN) treatment. WTO member countries, when fulfilling certain conditions

¹⁶ These dynamic effects are brought about not only by EPA/FTAs, but possibly also by WTO multilateral trade liberalization and other initiatives.

¹⁷ Urata, S. ed. (2002), *FREE TRADE AGREEMENT (FTA) GUIDEBOOK*, Japan External Trade Organization (JETRO).

under the WTO agreements, are able to conclude EPA/FTAs by flexibly and efficiently choosing partner countries, the region and applicable segments of trade, unlike the steps based on WTO multilateral trade liberalization. Member countries are also able to arrange an agreement to cover areas that are not prescribed by any WTO agreement. EPA/FTAs in this way are seen to have functions that can mutually supplement the multilateral free trade system.¹⁸ While the number of newly concluded EPA/FTAs is soaring, it is important to evaluate from a mid-to-long-term perspective how such EPA/FTAs can supplement and promote multilateral trade liberalization, in addition to evaluating effects on regional liberalization.

As an exception to WTO agreements, EPA/FTA signatory countries are allowed to maintain their tariff rates (tariff binding rates based on MFN), while enjoying market access made possible by the tariff elimination or reduction on goods traded within the region that has been shaped by the agreement. When EPA/FTAs achieve certain degrees of benefits of trade liberalization, member countries of such EPA/FTAs may see less appeal in further trade liberalization, given negotiation costs and the resulting loss of their superiority over non-member countries. This kind of mindset, some observers point out, could discourage efforts to cut tariffs imposed on imports from non member countries and possibly help divide the world economy into blocs.¹⁹

According to other opinions, EPA/FTAs are seen to help promote WTO-led efforts for multilateral trade liberalization. Once a country experiences economic merits through trade liberalization after its conclusion of an EPA/FTA, the country is seen to be more willing to advance further liberalization. When the country can enjoy effects of higher productivity due to the influx of lower-cost goods and services made possible by lower tariffs it now charges on imports, it may well be willing to seek the merits of further trade liberalization, by cutting tariffs not only on other EPA/FTA member countries but also non-member countries. For example, when a developing country, which has been unwilling to engage in multilateral trade liberalization, concludes an EPA/FTA with a developed country and then experiences a rise of productivity and progress of its domestic reform and liberalization made possible by direct investment from the developed country, the government of the developing country can possibly find more incentives to avoid abandonment of its liberalization policies or domestic reform and instead look to multilateral trade liberalization talks to further advance liberalization.

¹⁸ WTO recognizes that regional trade agreements promote trade liberalization and supplement WTO's multilateral trade system, which is stipulated in Article XXIV, Paragraph 4 of GATT which states: "The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories."

¹⁹ Jagdish N. Bhagwati (1993) coined the "Our market is large enough" syndrome, referring to EPA/FTA member countries having secured a large-scale market among themselves and losing motivation to further enlarge this regional market, fearing procedural costs needed to allow more members in. He also conceived the "These are our markets" syndrome, referring to a sentiment among interested groups in EPA/FTA member countries to avoid an increase of the membership that they see could intensify competition and reduce their vested interests.

Richard E. Baldwin, on the other hand, pointed out a “domino effect”,²⁰ in that non member countries to any given EPA/FTA see increasingly more demerits on their side, as member countries enjoy lessening of trading costs within their EPA/FTA region. This domino effect synergistically drives non member countries to signing up to the EPA/FTA. The expansion of the European Union (EU) is an example of such effect.

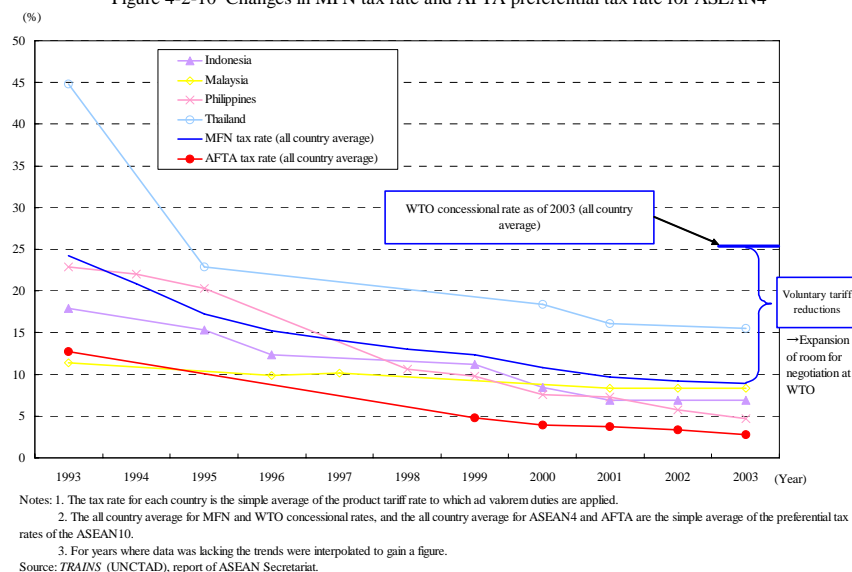
The above discussions, combined together, suggest that an EPA/FTA can be followed by either one of two motives concerning the tariff rates imposed on imports from outside the membership region : i) to maintain them; or ii) to cut them. In reality, however, we see more tendencies to cut the tariff rates (MFN tariff rates) on the exercise base on imports from outside the region. For example in the Association of Southeast Asian Nations (ASEAN), member countries are seen to lower their MFN tariff rates in proportion to the tariff rate cuts applicable to the ASEAN Free Trade Area (AFTA) (Figure 4-2-10).

WTO’s negotiations on tariffs look to reductions and reduction schedules of WTO tariff binding rates (the ceiling of tariff rates for member countries pledged to be observed on their tariff binding table submitted to WTO). When countries conclude an EPA/FTA and thereunder voluntarily establish their own MFN tariff rates below the levels of their WTO tariff binding rates, these countries thereby expand the room for their WTO negotiations, especially in the case of developing countries. Latin American countries have been lowering their MFN tariff rates in proportion to the gradual reductions of their FTA tariff rates.²¹ These demonstrative analysis shows that concluding EPA/FTAs affords developing countries in particular economical benefits realized by liberalization. It could also work as incentives for countries to seek further benefits of liberalization by lowering tariffs imposed on third countries of any relevant EPA/FTAs and work positively for the progress of multilateral trade liberalization by WTO.

²⁰ Baldwin, R. (1995) “The Domino Theory of Regionalism,” in Baldwin, R., Haapparanta, P., and Kiander, J. (eds.), *Expanding Membership of the EU*, Cambridge: Cambridge University Press.

²¹ Estevadeordal, A., and R. Robertson. (2004), “Do Preferential Trade Agreements Matter for Trade?” In A. Estevadeordal, D. Rodrik, A. M. Taylor, and A. Velasco (eds.), *Integrating the Americas: FTAA and Beyond*, Cambridge, MA: Harvard University Press.

Figure 4-2-10 Changes in MFN tax rate and AFTA preferential tax rate for ASEAN4



(A mutually supplemental set of trade liberalization by WTO and EPA/FTA)

As discussed above, the conclusion of EPA/FTAs can lead to advancement of multilateral trade liberalization. However when worldwide trade liberalization is sought merely through EPA/FTAs, a massive number of EPA/FTAs would be required, and that could make it difficult to maintain integrated trade order. Although recent years have seen a rapid increase in the number of newly concluded EPA/FTAs, among theoretical bilateral combinations that can be made by each country in the world, only about 15% are covered by any actually effective EPA/FTAs (Figure 4-2-11).

WTO rules are unparalleled as multilateral agreements governing basic principles and relevant procedures such as those on MFN and National Treatment, all indispensable for realizing free trade. For Japan to optimally receive the benefits of free trade, it must on the one hand promote flexible external economic policies, using bilateral and regional frameworks, in light of the reality that the use of strategic EPA/FTAs by other countries is expanding. On the other hand, Japan must also place WTO on the basis of its external economic policies, thereby seeking to enhance the reliability of WTO agreements and ensuring their implementation, in order to optimally endeavor to maintain and enhance multilateral trade order.

WTO agreements further refer to Regional Trade Agreements (RTAs) such as EPAs and FTAs by requiring their signatory countries: a) to abolish tariffs and other restrictive trade rules concerning substantially all the trade of products originating from the region established by such agreement; and b) not to make tariffs and other trade rules imposed on non-member countries of the agreement more restrictive. Any EPA or FTA which is short of these requirements can risk leaving too many areas as exceptions to tariff reductions and eliminations and hindering free trade by heightening the trade barrier against countries outside of the agreements. To avoid these events, any country concluding an EPA/FTA is required to ensure such agreement's conformity with WTO agreements.

Figure 4-2-11 No. of bilateral trade relations that have concluded a regional trade agreement (RTA)

	No. of combinations	Proportion
No. of trade relations among all countries (n countries)	$n \times (n-1) / 2$	-
192 UN member countries	$192 \times 191 / 2 = 18,336$	100.0%
150 WTO member countries	$150 \times 149 / 2 = 11,175$	60.9%
Current no. of bilateral trade relations covered by an RTA	2,686	14.6%

Notes: 1. From the 141 RTA notified to the WTO, excluding those that overlap with reporting to GATT and GATS, and excluding those that overlap with new additional members joining existing agreements, the no. of bilateral trade relations covered by RTA was calculated.

2. Combinations including non-UN members are excluded.

3. The no. of WTO and UN members are both as of January 2007.

4. The proportions are calculated as a percentage of the total no. of trade relations among all UN members.

Source: WTO Website.

(4) Analysis of effects fulfilled by exiting EPA/FTAs (Effects of Japan-Mexico EPA)

The Agreement between Japan and the United Mexican States for the Strengthening of the Economic Partnership (Japan-Mexico EPA) came into effect in April 2005, after the two countries agreed on the commencement of negotiations toward concluding the Agreement at their bilateral summit meeting in October 2002 and subsequently the heads of the two states signed the Agreement in September 2004. This Agreement is aimed at not only reducing and eliminating tariffs on the bilateral trade of the two countries, but also regulating the National Treatment in services, investment, government procurement and other areas. It further seeks economic coordination in a wide range of areas by means such as setting up a committee to establish the business environment. Mexico concluded the North American Free Trade Agreement (NAFTA) with the United States and Canada in 1994 and a FTA with EU in 2000. These agreements effectively shifted the barycenter of Mexico's trade toward North America and Europe, leaving Japan concerned about a significant loss of its weight in the Mexican market by the negative impact of effects caused by the FTAs. In light of this, Japan-Mexico EPA plays a crucial role of ensuring Japan of competitive conditions equal to the United States and EU, by expanding Japan's access to the Mexican market. As part of moves to free trade, Mexico has been eliminating or gradually lowering the tariffs averaging 16% that have been imposed on imports from Japan, in a schedule that will make virtually all items free of tariff within ten years after the EPA came into effect. The effects of such lowered tariffs are believed to already be manifest, evidenced by a surge of the volume of goods imported from Japan to Mexico, with transportation machinery playing a central role. By contrast, South Korea, which is yet to conclude an EPA/FTA with Mexico, is seeing a smaller surge of its export of transportation machinery to Mexico than Japan is, while South Korea's exports of general machinery is on a decline in terms of monetary amount (Figures 4.2.12 and 4-2-13).

Figure 4-2-12 Changes in trade value between Japan and Mexico

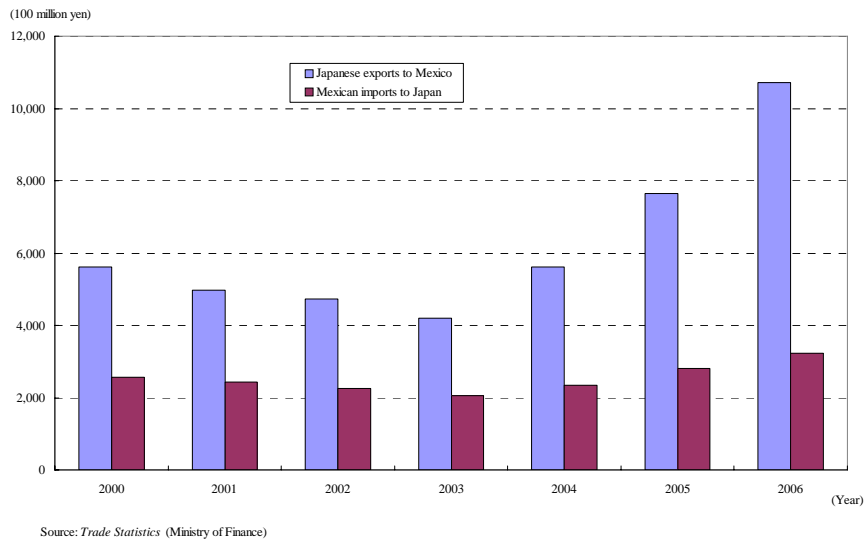
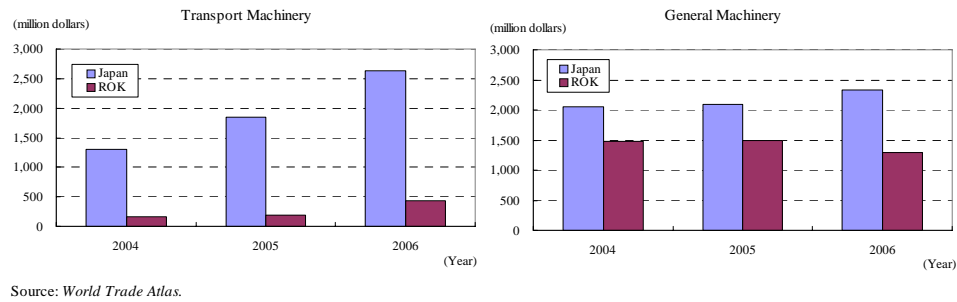


Figure 4-2-13 Changes in export value to Mexico from Japan and Republic of Korea before and after signing of Japan-Mexico EPA



The volume of bilateral trade is influenced not only by tariffs, but also exchange rates and the economies of scale of economy of both countries. Here, we employ the gravity model²² to verify how much the Japan-Mexico EPA has contributed to the increase of bilateral trade since 2005.

Figure 4-2-14 compares the amount of trade estimated by the gravity model and actually recorded. The table shows the balance of the actual figure less the estimated figure (the left column) and the ratio of such balance against the estimated figure (the right column). Looking at the export from Japan to Mexico, one observes an increase of about two times marked every year before the EPA was concluded in 2004, while in 2005 an increase by 2.63 times and in 2006 by 3.14 times occurred, proving a significant expansion. These are attributed to the tariff cuts based on Japan-Mexico EPA, which expanded exports from Japan to Mexico in particular and apparently contributed to the vitalization of the bilateral trade (trade creation effect).

²² The gravity model can describe the amount of trade between two countries based on the assumed tendency that the greater the economies of scale of the two countries are and the smaller the distance between them are, the greater the amount of their bilateral trade.

Table 4-2-14 Estimated Value of Japan-Mexico Trade by a Gravity Model

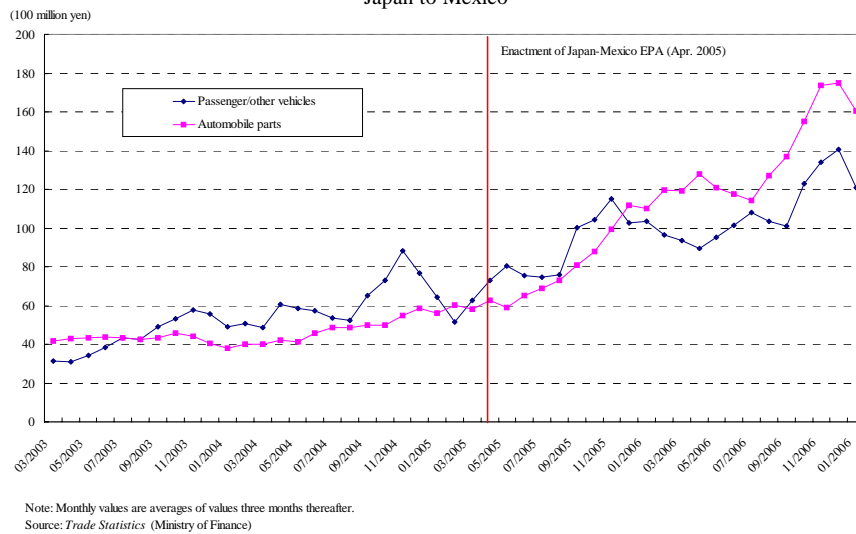
	Japan's Exports to Mexico		Japan's Imports from Mexico	
	actual – estimated (US\$millions)	(actual - estimated) / estimated	actual – estimated (US\$millions)	(actual - estimated) / estimated
2001	4,906	1.80	-473	-0.19
2002	6,256	2.29	-660	-0.27
2003	4,195	1.52	-788	-0.31
2004	6,332	2.24	-600	-0.23
2005	7,587	2.63	-496	-0.19
2006	9,283	3.14	-336	-0.12

Notes: Actual values of exports from Japan to Mexico are based on Mexico customs data, which also include exports passing through the U.S., so these values exceed Japan's trade statistics.

Source: Created from Mitsuyo, A. (2007), "Impact of Japanese FTAs/EPAs".

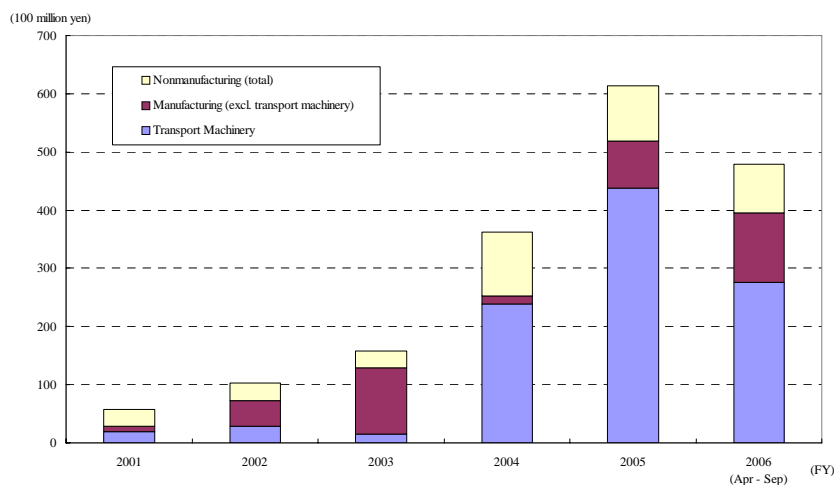
Here we focus on transportation machinery that clearly reflects the effects of Japan-Mexico EPA. In the past, Mexico employed a measure to promote its domestic automobile industry: when an auto maker produced finished automobiles in Mexico, the maker was entitled to a tariff exemption for automobiles it imported into Mexico, applicable to the number of units equivalent to 10% of the units the maker produced in Mexico. The general tariff on automobiles then was up to 50%. This made it possible only for those Japanese makers that had plants in Mexico to export automobiles to Mexico. Japan-Mexico EPA, however, has enabled the creation of a new tariff-free framework for automobiles, applied to 5% of the units a maker sold in Mexico in the previous year. The EPA also enabled the lowering of the EPA tariffs to 20-30% from the general tariff of 50%, save for certain types of automobiles. The EPA Most-Favored tariffs on automobiles are further scheduled to be abolished in 2011. These moves help the expansion into Mexico by those Japanese automobile makers that did not do so before (Figure 4-2-15).

Figure 4-2-15 Changes in export value of automobile related goods from Japan to Mexico



Furthermore, under Japan-Mexico EPA, direct investment by Japan into Mexico is subject to National Treatment as the investment from Europe and the United States is. This has pushed up the amount of direct investment from Japan to Mexico since 2005, particularly into the transportation machinery segment, suggesting an active entry into Mexico by Japanese companies eyeing their growth in North American markets (Figure 4-2-16). Also under Japan-Mexico EPA, the two countries have set up a Committee for the Improvement of the Business Environment, which has been holding a meeting annually in Mexico since it had its first session in April 2005 when the EPA came into effect. The Japanese side has thus far proposed an agenda including security improvement, intellectual property protection and improvement of transportation infrastructure. Mexican authorities responded to improve situations, which has helped fulfill achievements such as reinforced security at international airports in Mexico, reflected in a decrease of Japanese crime victims, among other improvements. The creation of these frameworks is seen to work positively on investors' sentiments and thereby contributing to an increase of foreign direct investment.

Figure 4-2-16 Changes in amount of direct investments from Japan to Mexico



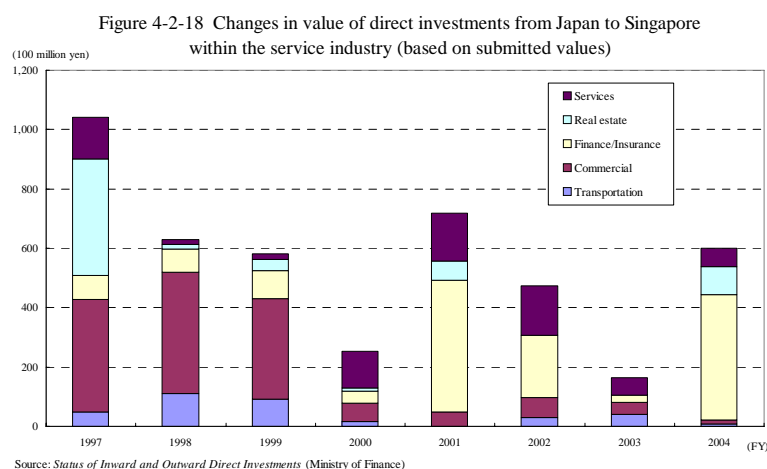
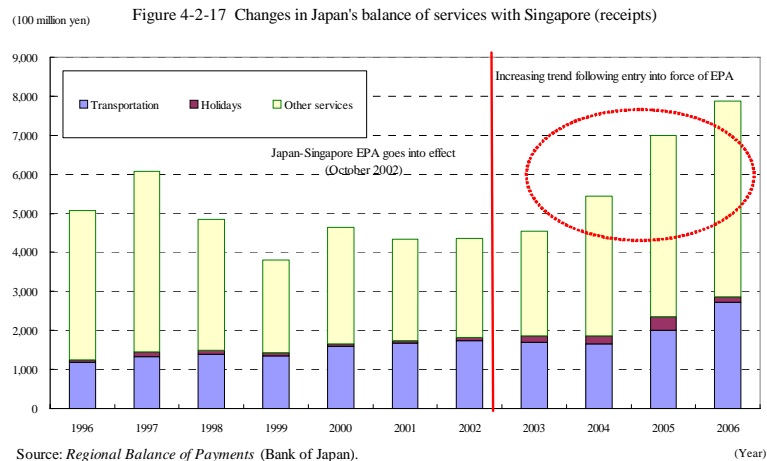
(Effects of Japan-Singapore EPA)

The Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership (the Japan-Singapore Economic Partnership Agreement (JSEPA)) came into effect on November 30, 2002 as Japan's first EPA. JSEPA is characterized by its comprehensiveness and high levels of its standards, as it governs not only the liberalization of trade and investment, but also a wide range including ways to smoothen trade and investment and to seek cooperation. To ensure the proper implementation and further strengthening of the Agreement, the EPA also set forth the establishment of: a) a Supervisory Committee consisting of ministers of the two countries; and b) a council to avoid any possible conflict that can be arise upon interpretation and application of the EPA and to seek amicable solutions.

As for trade liberalization, more than 98% of the bilateral trade on the monetary base has been freed of tariffs.²³ Already before the EPA, imports from Japan to Singapore had been tariff-free, save for beer and three other items. Therefore, the effects of the EPA are considered to be limited. As for trade in services, on the other hand, the EPA has expanded the scope of liberalization remarkably: among 155 areas designated under the General Agreement on Trade in Services (GATS), Japan has liberalized 32 new areas, while Singapore has liberalized 77, in addition to those areas both countries had already freed under GATS, respectively. Trade in services between Japan and Singapore is believed to have been expanded by these moves of expansive liberalization, as well as by investment liberalization (provision in principle of National Treatment; liberalization of money remittance; prohibition of performance requirements, etc.). As we saw in Chapter 3, GATS divides trade in services into four categories based on trading forms. Among them, Mode 1 (cross-border supply), Mode 2 (consumption abroad) and Mode 4 (move abroad by suppliers (natural persons)) are mostly appropriated to the balance of payments for services, while Mode 3 (the supply of services through commercial presence) is appropriated to the data of foreign direct investment. The following paragraphs provide a confirmation of the moves of Japan concerning the balance of payments for services and direct investment with Singapore.

When we look at Japan's balance of payments in services (receivables) with Singapore, we observe increases in the fields of other services (from ¥253.7 billion in 2002 to ¥502.5 billion in 2006) and transportation (from ¥174.7 billion in 2002 to ¥271.3 billion in 2006) (Figure 4-2-17). On the other hand, when we see changes of direct investment by Japan's service industries to Singapore by sector, we find, despite a lack of clear changes as a whole, a remarkable expansion in the financial and insurance field in FY2004. This could suggest that the liberalization of trade in services based on the EPA can contribute to the expansion of direct investment (Figure 4-2-18).

²³ The four items imported from Japan to Singapore, including beer, have been liberalized as tariff-free. From Singapore to Japan, the ratio of tariff-free items has been expanded from 84% to 94% on the monetary base.



In the foregoing paragraphs, we have seen the effects of the Japan-Singapore EPA centering around trade in services. We can further expect positive effects on manufacturing sectors brought about by the liberalization and ensured transparency of investment. As a hub in Southeast Asia, Singapore enjoys an active trade of goods, particularly processing trade, in which components are processed, composed and exported again. As such, Singapore houses a good number of manufacturing bases coming from overseas. This is reflected in the breakdown of exports from Japan to Singapore: 60% of which accounts for machinery and electronic devices. Many of these items are believed to be exported again within the East Asian region, thus making the EPA with Singapore highly important for Japan to capture the regional demand (Figure 4-2-19). In particular, Singapore ties up with India through their Comprehensive Economic Cooperation Agreement (CECA), under which products which have had 40% or more value added in Singapore are considered to be of Singapore origin and thus eligible for the preferential tariffs on exports for India. Therefore, to capture a rapidly growing Indian market, it is important to actively use the Japan-Singapore EPA in the future.

Japan and Singapore further agreed to launch negotiations on revising their EPA in April 2006 and signed the Protocol Amending the Japan-Singapore EPA in March 2007. The latest moves are expected to expand the scope of tariff eliminations among industrial products and agricultural, forestry and fishery items on the Japanese side, while widening the liberalization of financial services

in Singapore, such as relaxation of licensing restrictions imposed on the banking industry.

Figure 4-2-19 Composition of exported goods from Japan to Singapore (2005)

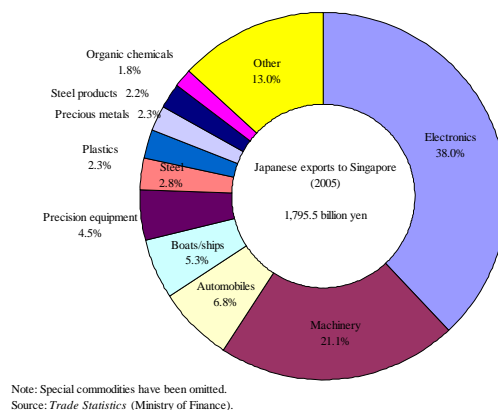
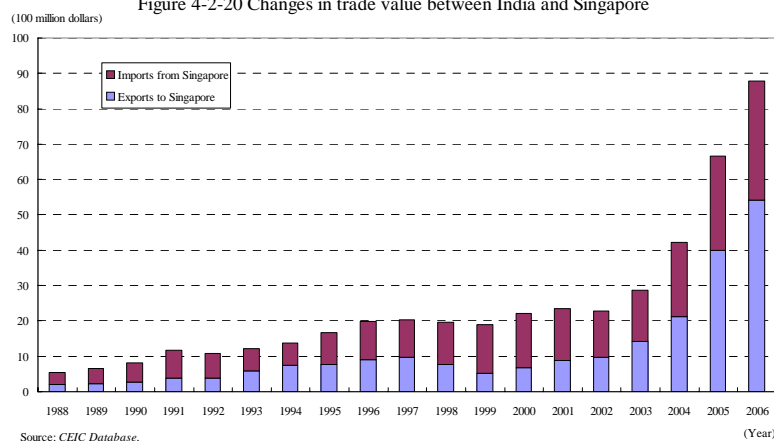


Figure 4-2-20 Changes in trade value between India and Singapore



(Effects of Japan-Malaysia EPA)

The Agreement between the Government of Japan and the Government of Malaysia for an economic partnership (Japan-Malaysia EPA) came into effect on July 13, 2006, as Japan's third EPA. Like the preceding EPAs with Singapore and Mexico, the one with Malaysia also governs a wide range of fields.

Under their EPA, Japan and Malaysia have pledged to eliminate 97% of the tariffs imposed on their bilateral trade based on the monetary value. A close look at the stipulations applied to Malaysia reveals that: among about 10,590 items in total (based on the nine-digit tariff classification codes), about 7,860 are to be immediately cleared of tariffs; 2,580 are to be on gradual elimination; and about 150 are subject to either tariff reductions or exceptions. A notable point for Japan is the tariff elimination applied to automobiles and their components. Since the launch of its national car program, Malaysia had long regarded the automobile sector as its core industry and thus maintained high levels of tariffs on relevant items (the MFN tariff rates were 50% on cars and 10-20% on components). The country, however, released the New National Automotive Policy (NNAP) in 2006, in an effort to strengthen its automobile sector's competitiveness amidst the liberalization of the international automobile market. Against these backdrops, Japan-Malaysia EPA carries significant substance,

including an immediate elimination of the tariffs on complete knock-down (CKD) components (Figure 4-2-21). The breakdown of exports from Japan to Malaysia shows that automobiles account for ¥168.6 billion (12% of the total), which suggests a significant benefit for Japan (Figure 4-2-22).

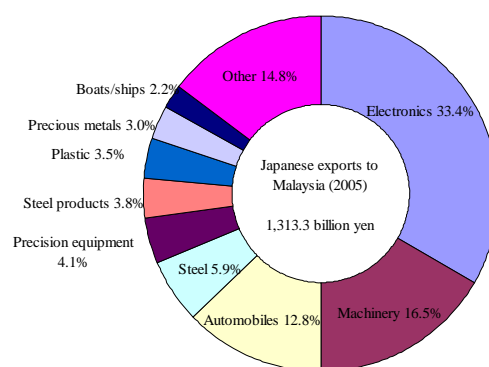
On the other hand, the Japanese side has eliminated virtually all the tariffs imposed on industrial goods from Malaysia. Japan further intends to promote cooperation projects with Malaysia's automobile sector, such as sending experts to the country. Malaysia has also eliminated the tariffs in its automobile sector under its EPA with Japan, as it advances its NNAP to strengthen its competitiveness to address liberalization.

Figure 4-2-21 Schedule of Malaysia's reductions & Elimination of Customs Duties for Japan (2005)

	2005	2006 (After issued)	2007	2008	2009	2010	2011	2012	2013	2014	2015
Passenger vehicles over 3000cc	50%	35%	20%	0.5%	0.5%	No duties					
Passenger vehicles from 2000cc to 3000cc	50%	40%	30%	20%	10%	No duties					
MPVs over 3000cc, Trucks over 20 tons, buses	50%	40%	30%	20%	10%	No duties					
All complete vehicles other than the above	50%	45%	40%	35%	30%	25%	20%	15%	10%	5%	No duties
CKD parts	10%	No duties									
Auto parts other than CKD	20%	20%	20%	0.5%	0.5%	No duties					

(Data) Made by Ministry of Economy, Trade and Industry

Figure 4-2-22 Composition of exported goods from Japan to Malaysia (2005)



Note: Special commodities have been omitted.
Source: Trade Statistics (Ministry of Finance).

Likewise with Japan-Mexico EPA, Japan-Malaysia EPA stipulates the establishment of a Sub-Committee on Improvement of Business Environment, which held its first meeting on March 19, 2007. It was highly significant that the two countries were able to meet at a timing that both agreed on, exchange opinions and give proposals to each other concerning issues they identified in relation improving the business environment. In the first meeting, the two countries discussed actively on subjects both raised in connection with improving the business environment, such as one proposed by Japan about the infrastructure (electricity and gas) yet to be enhanced in Malaysia. In their future meetings, the two countries are expected to follow up their issues and further improve their business environment.

(5) Current situations of Japan's EPA negotiations

Japan has been negotiating mainly with East Asian countries for bilateral and multilateral EPAs, since it executed its first EPA with Singapore in 2002. The negotiations are characterized by their scope, which do not only focus on trading of goods, but cover a broad agenda including: services; investment; government procurement; intellectual properties; competition; movement of people; business environment improvements; and cooperation.

Japan is now advancing its EPA/FTA initiatives in active and strategic ways pursuant to the Basic Policy towards further Promotion of EPAs, (approved by the Council of Ministers on the Promotion of Economic Partnership on December 31, 2004) and in line with the EPA work schedule, established in May 2006 and revised in May 2007. Separately, in the Global Strategy it approved on May 18, 2006, the Council on Economic and Fiscal Policy (CEFP) called for speeding up the conclusions of EPAs with East Asian countries, our major trade partners in which Japanese companies have established production networks. CEFP also stressed the importance for Japan to actively negotiate with resource producing countries which play key roles in its economic security, as well as with hugely populated countries which have sizable potential to expand trade with Japan.

We observe the following in an overview of Japan's efforts for bilateral agreements in the East Asian region: EPA with Malaysia, as discussed above, is already effective; EPA with the Philippines was also signed in September 2006, after bilateral negotiations began in 2004. Goals under the EPA with the Philippines include: tariff eliminations on virtually all items traded between the two countries; and the creation of a scheme for Japan to accept nurses and nursing care workers from the Philippines; EPA with Thailand was signed in April 2007, after bilateral negotiations began in 2004 and a basic agreement was reached in September 2005. EPA with Indonesia was basically agreed in November 2006, after negotiations began in 2005. This EPA strengthens Japan's ties with a country rich in underground resources such as natural gas and oil. As such, the EPA is the first one concluded by Japan to regulate the energy sector. Japan intends to arrange a close adjustment with Indonesia to promote further investment in the energy sector and contribute to stable procurement. EPA with Brunei was basically agreed in December 2006, after negotiations began earlier in the year. Similar to the one with Indonesia, EPA with Brunei is designed to strengthen ties in the energy sector.

Japan furthermore began EPA negotiations with Australia in April 2006, after the two countries agree to hold such negotiations in December 2006. Japan thereby intends to strengthen its "comprehensive strategic relationship" with Australia, which shares common basic values and strategic interests with Japan. Concluding EPA with Australia is expected to allow Japan to strengthen such relationship and gain other benefits such as the stable procurement of resources, energy and food. A joint study of the two governments suggests that Japan's gross domestic product (GDP) would rise either by 0.03% or 0.13% in an economic model calculation, when trade and investment between the two countries were completely liberalized. The same model calculation also suggests that a total contribution of about ¥2.3 trillion would be provided to Japan's GDP through the 20 years after such liberalization.

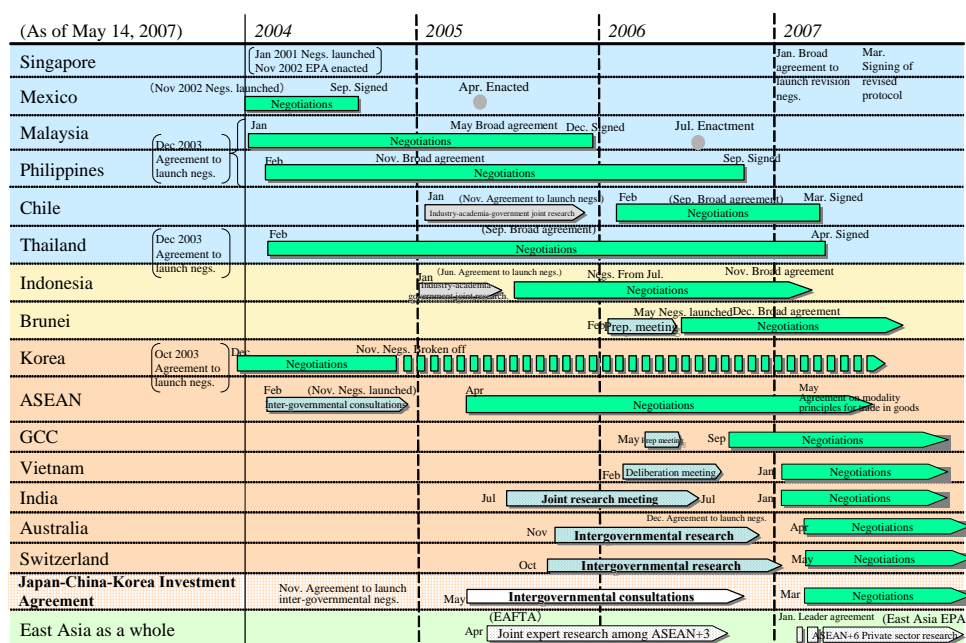
Negotiations on EPA with South Korea have been suspended since November 2004, after they began in December 2003. An early resumption of the talks is awaited, as Japan-South Korea EPA would be the first step to manifest the potential of the two countries' economic ties. A Japan-South

Korea joint FTA study group quotes an estimate that Japan's GDP would rise by about 0.04% to 0.12% when the two countries concluded an EPA. This would be between around ¥206.1 billion to ¥618.3 billion, when applied to Japan's nominal GDP of 1997.

In parallel with moves for bilateral EPAs, Japan is also promoting multilateral efforts in negotiations for ASEAN-Japan Comprehensive Economic Partnership (AJCEP). Specifically, negotiations began in April 2005, with a goal of completing talks by the end of 2007. An EPA concluded with the entire ASEAN would allow for the establishment of common rules within the region that accurately reflect the actual economic activities underway across Japan and ASEAN. It would thereby enrich the range of options for the regional business activities. For example, when value-added components manufactured in Japan are used in the ASEAN region to process a finished product, which is then exported within the region, there can arise cases which cannot be regulated by the ASEAN Free Trade Agreement (AFTA) or bilateral EPAs due to rules related to the country of origin. Efforts are underway to put these cases in order by setting up a common concept of the country of origin under an AJCEP agreement.

Outside East Asia, Japan signed an agreement with Chile in March 2007, while holding negotiations with the Gulf Cooperation Council (GCC) and Switzerland, respectively. As discussed in the section referring to the Global Strategy implemented by the Government of Japan, concluding EPAs with resource producing countries and others is significant as they contribute to improving the trade and investment environment for Japanese companies and strengthening the stable supply of mineral resources (Figure 4-2-23).

Figure 4-2-23 Schedule for Japan's efforts towards EPA

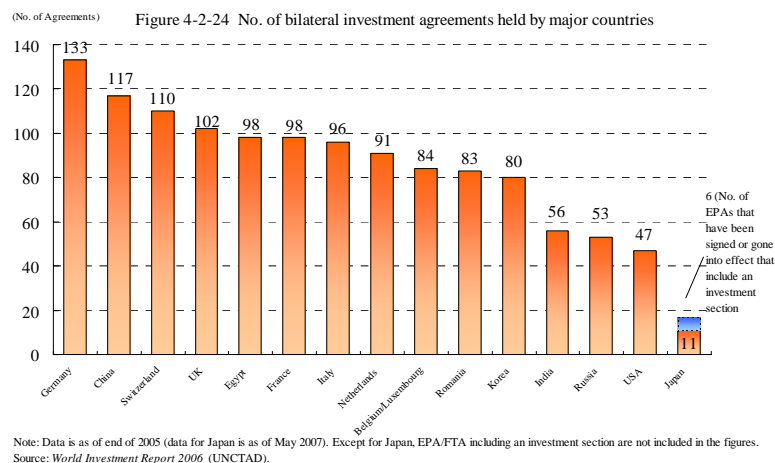


Source: METI.

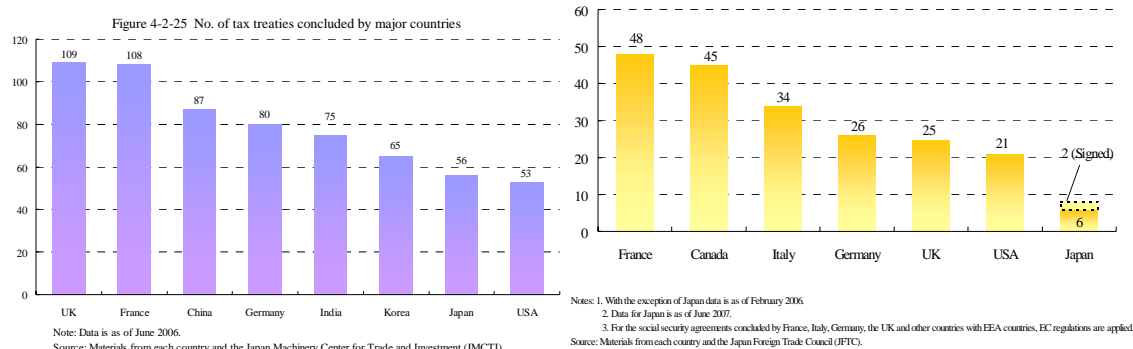
Japanese companies operating in the East Asian region are largely influenced by EPAs concluded by other countries in the region and also by the moves of the United States and EU in the region. To

assess Japan's EPA strategies, one needs to pay close attention to the moves by these countries concerning EPAs. China and South Korea have actively been promoting efforts for EPA/FTAs in recent years. China began with concluding the Closer Economic Partnership Arrangements (CEPAs) with Hong Kong in June 2003 and with Macau in October 2003. After that, it worked with ASEAN, enacting an agreement on trade in goods in 2005 and agreed on trade in services in 2007. Furthermore, China is either negotiating or preparing to do so with India, Australia and New Zealand. South Korea already maintains EPAs enacted with Singapore, Chile and the European Free Trade Association (EFTA).²⁴ South Korea is also negotiating with member countries of ASEAN for an overall EPA/FTA with the Association. It has signed agreements on trade in goods with the member countries save for Thailand. It further agreed on an FTA with the United States in April 2007. It is holding negotiations for FTAs with India, Mexico, Canada and other countries. In May 2007, South Korea also began negotiations with the EU.

Worldwide, negotiations for FTAs have been stepping up among countries and regions including major economic blocs. With regard to major markets and investment recipients including the United States and EU, Japan intends to consider agreements with them as future tasks, given moves by each country, their historical relations with Japan, and their economic scale, among other factors. Preparations will be made with any countries and regions with which necessary conditions are ready. In addition to EPA/FTAs, Japan also seeks to promptly increase the number of agreements on social security, investment and other conditions it concludes with other countries, in order to promote investment and activate human-to-human exchanges, taking into consideration specific needs arisen with each country (agreements on investment will be discussed later) (Figure 4-2-24 through Figure 4-2-26).



²⁴ FETA was established in 1958, when the European Economic Community (EEC) was launched. FETA members were seven European countries outside EEC, namely: the UK; Austria; Denmark; Norway; Portugal; Sweden; and Switzerland. Current member countries are: Switzerland; Norway; Iceland; and Liechtenstein.



3. Smoothing of external direct investment

The improvement of the investment and business environment in the overseas market is important, in terms of raising the predictability for business strategies as Japan advances its international development centering on a fast growing East Asia. Such improvement can benefit not only Japanese companies but also local companies of the areas hosting Japanese companies.

In particular, more than a few East Asian countries are still maintaining regulations that largely inhibit international corporate development, underdeveloped legal institutions and challenges to managing institutions.²⁵ In order to urge institutional improvements and adequate management of institutions in these countries to facilitate international corporate development, it is necessary for Japan to conclude high quality EPAs with them. Japan should also expand its framework of bilateral talks involving government and private sectors, which is being held with Vietnam and Indonesia, among others, into a scale of the entire East Asian region.²⁶

(Situations of bilateral investment agreements concluded worldwide)

The number of bilateral investment agreements has been rocketing worldwide recently, reaching about 2,500 as of 2005 (Figure 4-2-27). By country, about 100 of such agreements have been concluded each by Germany, China, UK, France and others. Japan largely lags behind, having reached 11 such agreements thus far (Figure 4-2-27 and Figure 4-2-28).²⁷

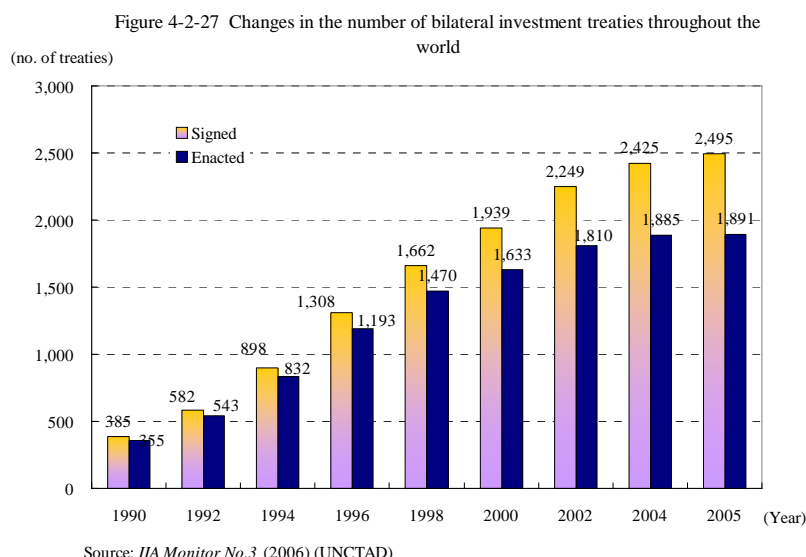
An increasing number of such investment agreements regulate cases of losses incurred by investors (companies) at their investment locations. Without such agreements that cover dispute settlement procedures, investors would find it hard to gain a legal ground to seek the removal of disinterest they incur at investment arbitration bodies. Data by the United Nations Conference on Trade and Development (UNCTAD) show the number of investment arbitration cases (the number of

²⁵ For example, strict remittance regulation, limitation of foreign capital ratio, and requirement of technological transfer.

²⁶ Japan's other efforts also include the proposal of an "ASEAN common investment environment," aimed at reflecting investors' views to improve the ASEAN region's investment environment.

²⁷ However, with some countries, Japan has reached economic partnership agreements (EPAs) that contain chapters for investment. When these are included, Japan has concluded 17 bilateral investment agreements (as of May 2007): Among such EPAs, those with Singapore, Mexico and Malaysia have come into effect, while those with the Philippines, Chile and Thailand have been signed.

cases submitted to relevant arbitration bodies) totaling 14 through 1998 from 1987²⁸ when the first such case was arbitrated.²⁹ The number began to surge from the late 1990s to reach a grand total of 255 as of November 2006.³⁰ Among Japanese firms, in contrast, only one arbitration request was filed by an overseas subsidiary of a securities firm as a case involving the investment arbitration system.³¹



²⁸ UNCTAD (2005), *INVESTOR-STATE DISPUTES ARISING FROM INVESTMENT TREATIES: A REVIEW*.

²⁹ A case between Asian Agricultural Products Limited and the Government of Sri Lanka (ICSID Case No.ARB/87/3).

³⁰ Interest in investment arbitration was heightened through an Ethyl Case filed with NAFTA in 1996 by a US firm, arguing that the Canadian government's environmental regulation can be deemed as "condemnation" under the NAFTA rules. The case was settled by a settlement package paid to the firm by the Canadian government.

³¹ In 1998, a Dutch-based subsidiary of a Japanese securities firm filed for an arbitration procedure against measures by the Government of the Czech Republic, pursuant to the bilateral investment agreement between the Czech Republic and the Netherlands.

Figure 4-2-28 Status of bilateral investment treaties signed with Japan

Signing country (including regions)	Signed	Enacted
Egypt	January 28, 1977	January 14, 1978
Sri Lanka	March 1, 1981	August 7, 1982
China	August 27, 1988	May 14, 1989
Turkey	February 12, 1992	March 12, 1993
Hong Kong	May 15, 1997	June 18, 1997
Pakistan	March 10, 1998	May 29, 2002
Bangladesh	November 10, 1998	August 25, 1999
Russia	November 13, 1998	May 27, 2000
Mongolia	February 15, 2001	March 24, 2002
Singapore (EPA)	January 13, 2002	November 30, 2002
Republic of Korea	March 22, 2002	January 1, 2003
Vietnam	November 14, 2003	December 19, 2004
Mexico (EPA)	September 17, 2004	April 1, 2005
Malaysia (EPA)	December 13, 2005	July 13, 2006
Philippines (EPA)	September 9, 2006	
Chili (EPA)	March 27, 2007	
Thailand (EPA)	April 3, 2007	

Source: Ministry of Foreign Affairs website

(Investment agreement as a tool to promote the liberalization of the investment recipients)

Bilateral investment agreements had traditionally been seen as “investment protection agreements,” designed to protect investors from possible expropriations of investment properties and other risks such as arbitrary operation of law by investment recipient countries, as the agreements stipulate the following as all or part of their main contents: National Treatment (NT) and Most-Favored-Nation (MFN) Treatment after investment is made; expropriations and compensation; freedom of remittance; resolution of conflicts between the signatory countries; resolution of conflicts between signatory countries and investors; and other aspects. In the 1990s, new types of investment agreements emerged, which, in addition to the ex post framework of investor protection as seen above, ensure all or part of the following: NT and MFN treatments applied as early as possible to the stage of applying for investment approval; the prohibition of performance requirements,³² requirement to maintain the current conditions or endeavor for gradual liberalization; prohibition of retreating from liberalization; and ensuring transparency (disclosure of laws and rules, obligation to respond to inquiries from the other parties to the agreement, etc.), among others. Typical examples of such agreements include NAFTA with its investment chapter in particular, as well as investment agreements Japan concluded with South Korea and Vietnam, respectively. As seen above, Japan largely lags behind in concluding investment agreements. As such, Japan needs to vigorously endeavor to conclude such agreements, even before it negotiates EPA/FTAs.

³² Certain requirements imposed as conditions for investment, for example, fulfilling local content ratios and export of a certain ratio of locally produced items, etc.