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**Presentation**

### **Japan's Trade Strategy in the 21st Century and Economic Partnership with Latin American Countries Revisited**

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**Retreat of Globalization and How Japan deals with it**

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# Japan's Trade Strategy in the 21<sup>st</sup> Century and Economic Partnership with Latin American Countries Revisited

## 1. Prelude

In 2018, two major sources of uncertainty for international business arose; one was Brexit, and the other was the so-called "Trump shock" (Figure 1). Both, Brexit and Trump's trade policy based on his notion of protectionism, have been a nightmare for many Japanese companies. In particular, Brexit has become a focal point of Japanese trade policy.

**Figure 1.** Two sources of uncertainty

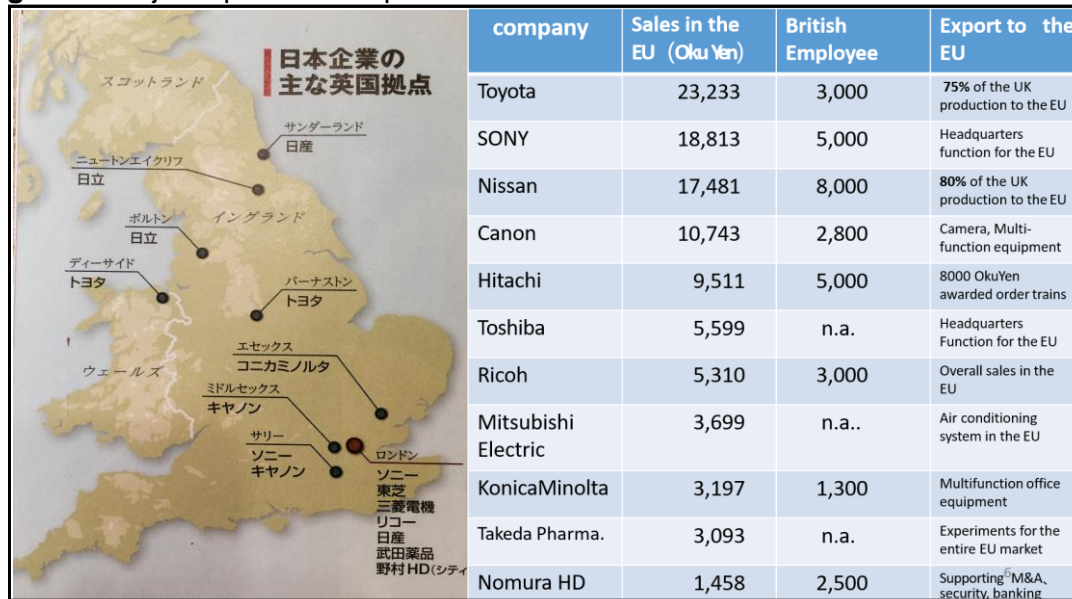


The UK had been part of the European Union (EU) since 1973, but after the referendum of June 2016, the country started to prepare for its exit. This will certainly cause some changes in EU–UK–Japan relations. In terms of trade, the UK has to establish its own national tariff schedule in order to assume full membership of the World Trade Organization (WTO), since the UK was covered by the common standard tariffs based on common external trade policies. In other words, once the UK leaves the EU, it must establish its own national tariff nomenclature, and do the same with trade in services under the General Agreement of Trade Services (GATS). Moreover, to establish its own entity list, the UK will have to negotiate its national commitment to government procurement under the WTO/GPA.

Figure 2 showcases famous Japanese companies in the UK as Toyota, Sony, Nissan, Canon, and Hitachi, many of which were established there during the second half of the 1980s at the invitation of Margaret Thatcher. There are two reasons why many Japanese companies went to the UK. One was to mitigate economic friction between Japan and the EU by investing in the UK and aiming to replace part of the massive exports from Japan with local production. The second was that since the UK was part of the EU, products made by Japanese companies in the UK could be subjected to a lower or zero duty treatment when entering the rest of Europe. For instance, in this way, Japanese

firms avoided EU charges of 10% on cars and 14% on electric appliances. As a result, Japan made enormous foreign direct investments in the UK.

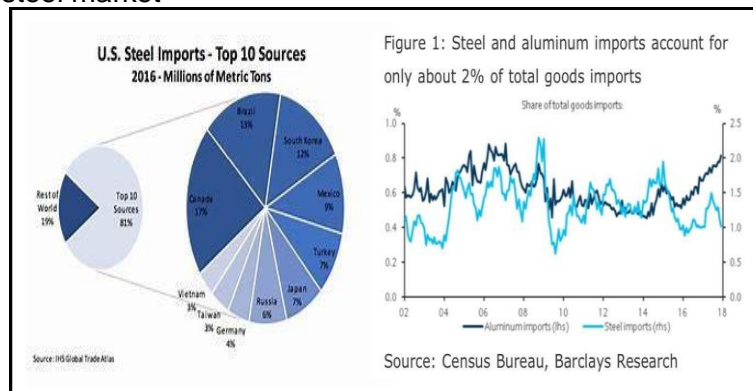
**Figure 2.** Major Japanese companies in the UK



In this framework, the important question was whether the products made in the UK would be subjected to a different duty scheme once the UK left the EU, and whether this would prompt companies to reconsider their continuation in the UK. Japanese-owned financial houses like Nomura Holdings were not perturbed since it was relatively straightforward for them to move from London to continental Europe, such as Frankfurt or Amsterdam. In contrast, Japanese companies actively engaged in local production could not move so easily.

As regards the trade war, this was initiated by Donald Trump’s decision to charge 25% tariffs on steel and 10% on aluminium. Figure 3 shows that steel and aluminium imports account for 2% of total imports of goods into the United States. Then, Mr. Trump proceeded to threaten Japan and other countries with an additional 25% tariff on the imports of cars, which would be quite detrimental to the Japanese and EU economies as well as to US consumers.

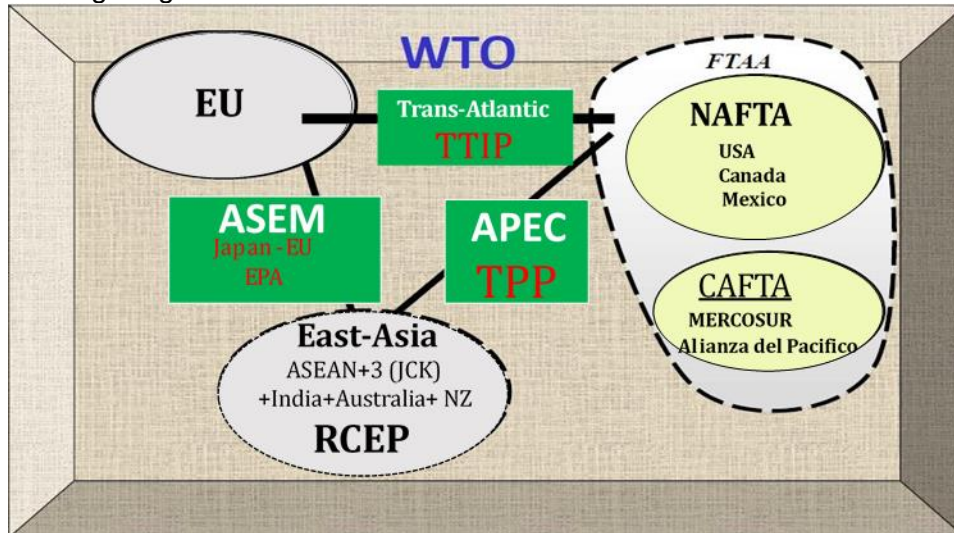
**Figure 3.** US steel market



**2. Introduction**

The world economy can be split into three mega regions: Europe (centered around the EU), the Americas, and East Asia (Figure 4). In each of these growth poles, there is a quite considerable degree of market integration. In the case of Europe there is the EU, for North America there is NAFTA, and for South America there are MERCOSUR and the Pacific Alliance. In the case of Asia, there is East Asia and several configurations like ASEAN+3, EAFTA, ASEAN+6, and RCEP.

**Figure 4.** Mega regions of the world

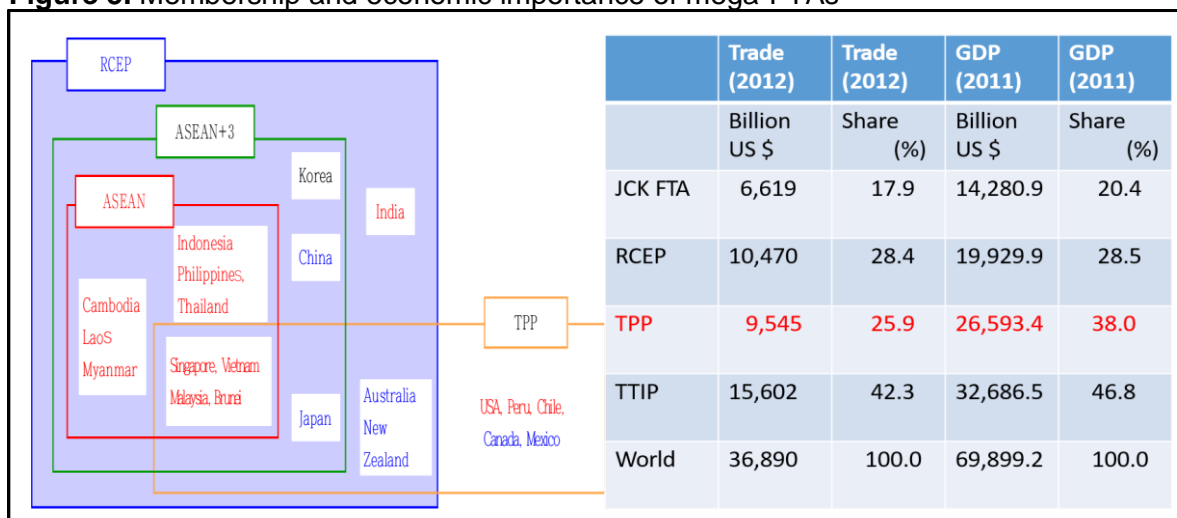


In addition, there are interregional cooperation frameworks that link the three mega regions. For instance, there is APEC, formed between Pacific Rim countries in East Asia and the Americas in 1999; ASEM, between the EU and Asia; and the North Atlantic Council, which binds the EU and North America. After 2010, cooperation frameworks have been upgraded to full-fledged legally binding FTAs. Based on the ASEM platform, the JAPAN-UE EPA, Korea-UE EPA, and Korea-EU FTA have emerged, while the TPP has come out of APEC. Between the EU and North America, the TTIP negotiations were in motion until Trump's election.

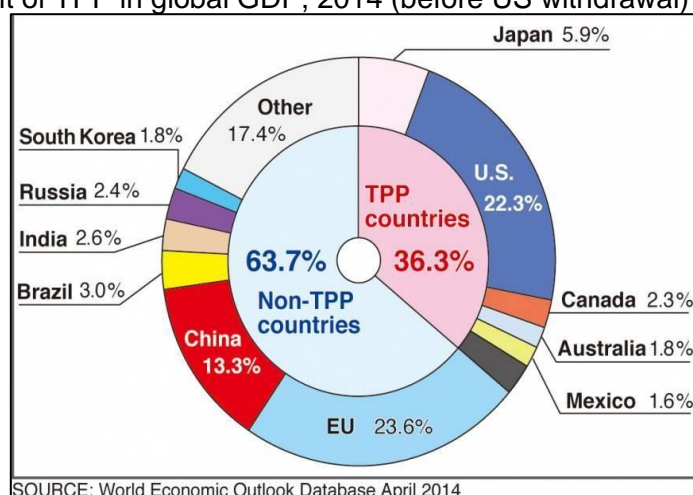
Beyond 2010, these mega FTAs attempted to make new rules on investment, intellectual property rights, competition policies, e-commerce, and more, since establishing new rules during the Doha Round of the WTO is always difficult. In this regard, after completing negotiations for mega FTAs such as the TTIP, the TPP, or Japan–EU, the results could be presented to the WTO to enhance or strengthen the system. Nonetheless, it should be recalled that, for instance, TPP rules are quite advanced, so it might be difficult for developing countries to follow them. Thus, the multilateralization of regional agreements or interregional agreements could be quite relevant for the future of the WTO. To complement this, Figure 5 exhibits the membership chart and economic importance of mega-FTAs, while Figure 6 reveals the weight of TPP countries in the world's GDP and trade.



**Figure 5. Membership and economic importance of mega-FTAs**



**Figure 6. Weight of TPP in global GDP, 2014 (before US withdrawal)**



**3. Japan’s FTA/EPA policy: from “de-facto business-driven Integration” to “de-jure EPA-driven integration”**

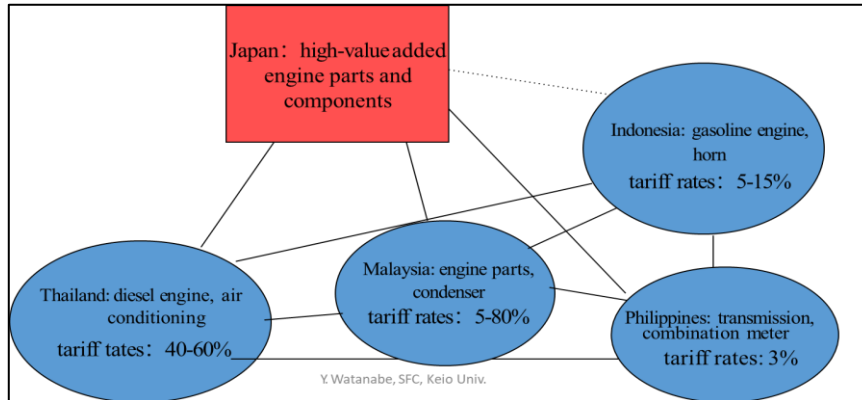
Integration in East Asia could be described as a kind of de-facto business-driven integration, because it started with foreign direct investment following the “Plaza Accord,” which was a G5 meeting of central bankers and financial ministers held at the Plaza hotel in New York back in September 1985. This marked a major exchange-rate realignment. Before the accord, USD 1 equaled ¥248, but this changed to ¥180 per dollar after it—a 25% appreciation in the yen. In order to mitigate the negative impact of the appreciation, Japanese manufacturers shifted their production sites from Japan to abroad. Before the Plaza Accord everything was made in Japan, but after and ever since parts and components have been manufactured overseas through production networks in Asia-Pacific.

Figure 7 shows the car industry scheme in which Japanese companies produce very sophisticated engine parts and components in Japan, and export them to Thailand, Indonesia, Malaysia, and the Philippines to be transformed into diesel engines, air conditioning, condensers, etc. These products are traded from one country to another within the ASEAN free trade area. Besides, if 40% of value added occurs in ASEAN, those products could be eligible for free entry to other ASEAN countries, thus taking advantage of value chains. Figure 8 provides more examples; the first is from a



Japanese car company based in Thailand that imports engines and transmissions from Japan, assembles them in Thailand, and exports to Australia. Another is the case of a Japanese elevator manufacturer that imports hoists from China, manufactures elevators in Thailand, and exports them to India.

**Figure 7.** Japanese car industry



**Figure 8.** Unification of supply chain networks in the East Asia region

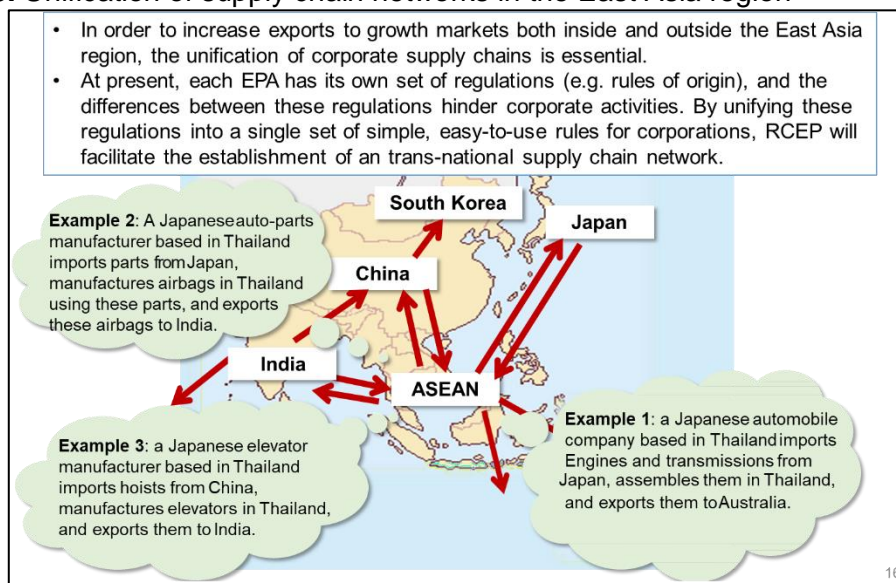
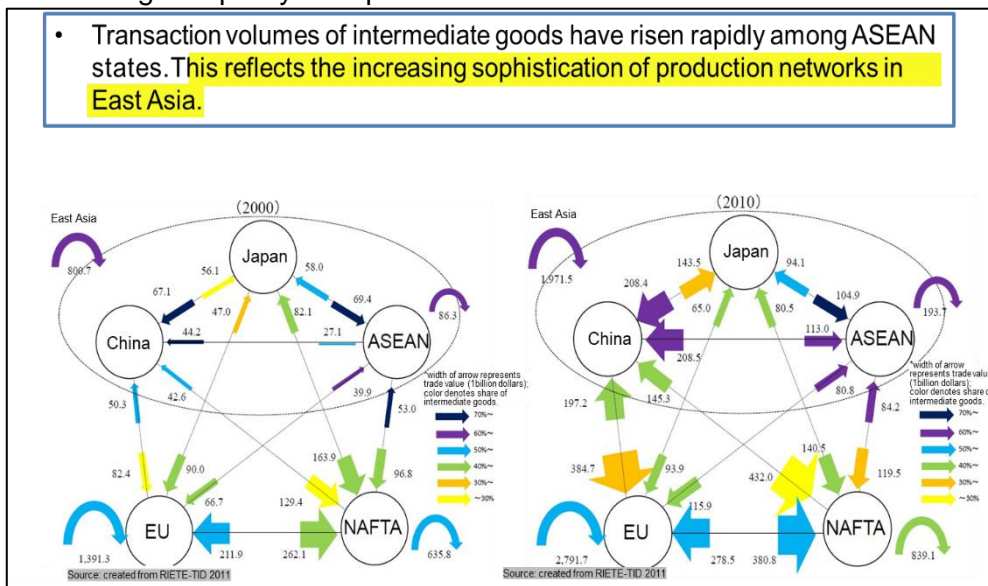


Figure 9 presents value chains where the purple arrows indicate that more than 70% of trade involves intermediate products like parts and components, while the yellow and amber colors represent trade involving more finished or semifinished products. From Japan and ASEAN to China there is a thick purple color arrow, which signifies that 60–70% of trade involves intermediate products that are then assembled in China to make semifinal or final products for subsequent exportation to the EU and NAFTA. This evidences how the global value chain has been created in East Asia and involves China, Japan, and ASEAN. Accordingly, Japan considers the FTA and EPA networks important instruments to consolidate its value chain or production network.

**Figure 9.** Change in quality of Japan–ASEAN–China trade



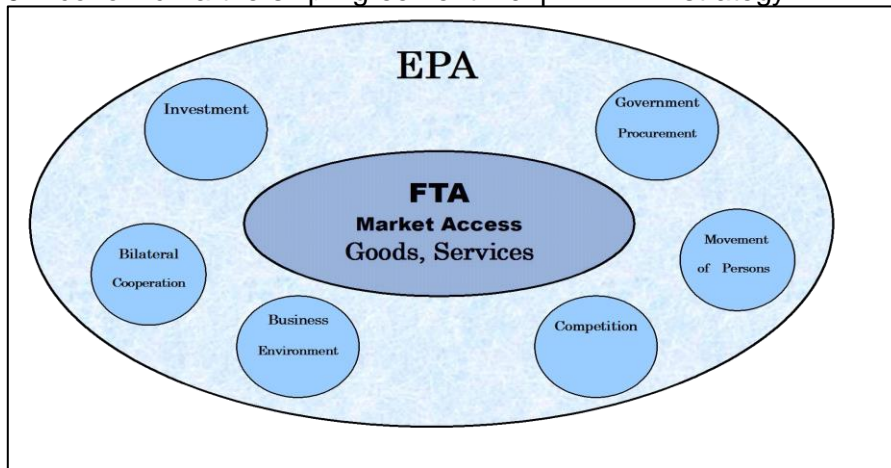
Hence, East Asia has focused on de facto business-driven integration rather than de jure integration present in the EU. East Asia started its integration through FDI, and Japan has been making active efforts to create an FTA/EPA to consolidate and improve the merits of this development and shift towards a de jure institution-driven integration where the institution part alludes to entering into economic partnership agreements. In this regard, Japan has achieved many bilateral FTA/EPAs that cover around 35% of Japanese external trade (Table 1).

**Table 1.** Japan’s FTA/EPA achievements

- Japan-Singapore EPA (in force since 2002.11)
- Japan-Mexico EPA (negotiations started in 2002.11, in force since 2005.4)
- Japan-Malaysia EPA (in force since 2006.7)
- Japan-Chile EPA (negotiations started in 2006.2, in force since 2007.9)
- Japan-Thailand EPA (agreement in substance 2005.9, in force 2007.11)
- Japan-Indonesia EPA (negotiations started in 2005.7, in force 2008.7)
- Japan-Brunei EPA (negotiations started in 2006.6, in force 2008.7)
- Japan-ASEAN EPA (negotiations started in 2005.4, in force 2008.12)
- Japan-Philippines EPA (agreement in substance 2004.11, in force 2008.12)
- Japan-Switzerland EPA (negotiations started in 2007.5, in force 2009.2)
- Japan-Vietnam EPA (negotiations started in 2007.1, in force 2009.10)
- Japan-India EPA (negotiations started in 2007.1, in force 2011.8)
- Japan-Peru EPA (negotiations started in 2009.5, in force 2012.3)
- Japan-Australia EPA (negotiations started in 2007.4, agreement in substance in 2014.04, in force 2015.01)
- Japan-Mongolia EPA (negotiation started in 2012.6, signed in 2015.02)
- Japan-EU EPA (negotiation started in 2013.03, agreement in principle reached in 2017.07 confirmed in 2017.12)
- Japan-Korea EPA (negotiations started in 2003.12, suspended in 2004.11)
- Japan-GCC EPA (negotiations started in 2006.9)
- Japan-Canada EPA (negotiation started in 2012.10)
- Japan-Colombia EPA (negotiation started in 2012.12)
- Japan-Turkey EPA (negotiation started in 2014.12)

The notion of Japan’s EPA is an FTA strategy that goes beyond traditional FTAs or market access improvements, trading rules, and services, but rather complements these with chapters on government procurement, movement of natural persons, competition policy, business environment improvements, bilateral cooperation, and, most importantly, investment that includes ISDS (Figure 10). Table 2 exhibits the extensive coverage of the bilateral EPAs that Japan has signed.

**Figure 10.** Economic Partnership Agreement – Japan’s FTA strategy



**Table 2.** Substance of Japan’s EPA

	Trade in goods		Trade in service				Investment				Dispute Settlement between state and investor	Government Procurement	Intellectual Property	Competition	Improvement Of Business Environment	Cooperation	Energy and Mineral Resources
	Market Access	Sps/TRT	Mutual Recognition	Market Access	National Treatment	MFN Treatment	Movement of Natural Person	National Treatment	MFN Treatment	Prohibition of performance restraints							
East Asia ASEAN	Vietnam	o	o	o	o	o	o	o	o	o	o	o	o	o	o	o	o
	Philippine	o	o	o	o	o	o	o	o	o	o	o	o	o	o	o	o
	ASEAN	o	o														
	Brunei	o			o	o	o	o	o	o	o	o	o	o	o	o	o
	Indonesia	o			o	o	o	o	o	o	o	o	o	o	o	o	o
	Thailand	o		o	o	o	o	o	o	o	o	o	o	o	o	o	o
	Malaysia	o	o		o	o	o	o	o	o	o	o	o	o	o	o	o
Singapore	o		o	o	o	o	o	o	o	o	o	o	o	o	o	o	
Latin America	Chile	o	o		o	o	o	o	o	o	o	o	o	o	o	o	o
	Mexico	o	o		o	o	o	o	o	o	o	o	o	o	o	o	o
Europe	Switzerland	o	o		o	o	o	o	o	o	o	o	o	o	o	o	o

Japan’s FTA/EPA strategy in East Asia is also moving from de-facto business-driven to de-jure integration, and from bilateral EPAs to wider regional FTA/EPAs like ASEAN+1, ASEAN+3, East Asia FTA, ASEAN+6, RCEP, and Japan-China–Korea FTA, as well as interregional FTAs like the TPP or the Japan–EU EPA.

The TPP, for its part, stipulates a very high percentage of tariff elimination—almost 100% for industrial products and 97% for agricultural ones. Among the new rules that have been proposed, the ones pertinent to state-owned enterprises (SOEs) are particularly important since many members in East Asia, even if China is not included, have large SOEs. Nonetheless, a hidden agenda of the TPP trade negotiations was always the inclusion of China. As a result, the TPP has SOE provisions in case China does decide to join.

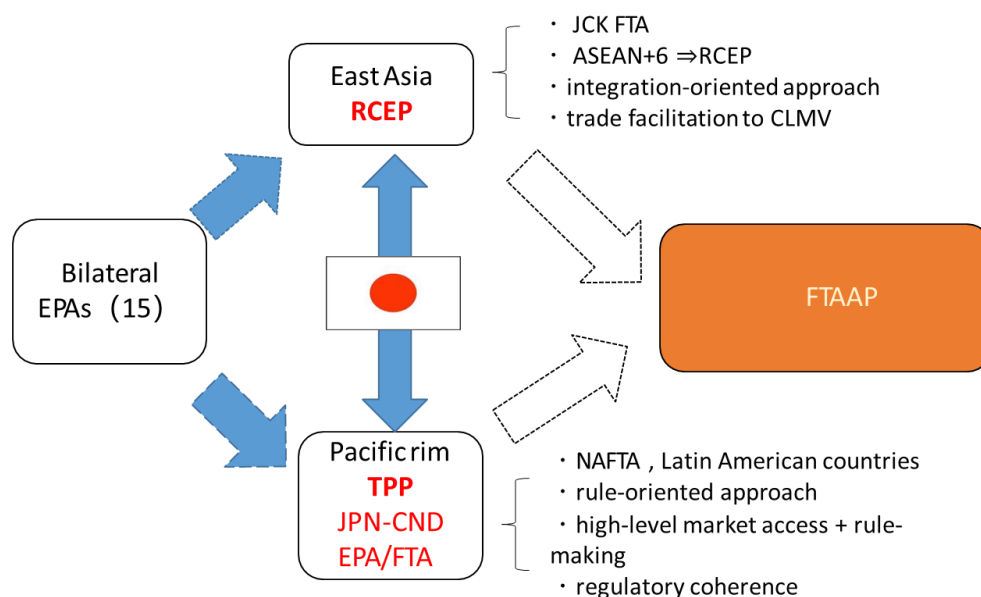
Rules of origin are also taken into account, and they adopt a generous accumulation principle that allows easy access to TPP markets, in comparison to the ASEAN CEPT scheme that has a threshold value of 40% to obtain duty free entry to other ASEAN countries. In the case of NAFTA, for cars the threshold is 62.5%, while the TPP proposes 55%. On top of that, the minimum threshold in NAFTA is 5% compared to the 7% of TPP;

this 2% difference is very important for bringing non-TPP countries' products into TPP countries to add value.

Japan has been conducting negotiations with countries and holding several ministerial meetings so that the TPP does not lose momentum. CPTPP, the new name for the TPP after Mr. Trump decided to withdraw the US, has suspended twenty provisions—mainly on intellectual property rights as a result of the US position during negotiations. This was the case of the biomedics provision, in which the US insisted on twelve years of data protection compared to the five years many approved. This ended up as eight years, but the provision was discarded after the US withdrawal. It is worth mentioning that there were no substantial changes to market access deals, all to facilitate the potential re-entry of the US.

Japan has signed fifteen bilateral EPAs across Asia–Pacific and one was being negotiated with the EU. Thus, the country has two branches of interregional agreements: the RCEP with East Asia and the TPP with the Pacific Rim, both of which could lead to an FTAAP in the APEC area during 2020–2025 (Figure 11). All the aforementioned constitutes the Asia-Pacific free-trade area.

**Figure 11.** Japan's FTA/EPA strategy



As regards the Japan–EU EPA, it was very difficult for Japan to bring the EU to the negotiation table because of discrepancies in tariff structure. Japan has much lower industrial tariffs (zero for cars and zero for all kinds of IT-related products) compared to the EU (10% for cars and 14% for plasma television sets). The EU was interested in the public procurement market and in bringing down non-tariff barriers. Nevertheless, thanks to Japan's entry to the TPP, the EU might become more responsive. This EPA has similar coverage to the TPP; it is an interesting instrument for the EU, since it wants to expand its agricultural products and processed food and drinks such as cheese or wine. The EU sought entry to the Japanese market, and Japan offered it immediate duty elimination on these products.

#### 4. Trump's trade shock

Protectionism has been a foremost characteristic of Trump’s time in office; this has been displayed in his decision to withdraw US from the TPP. John McCain stated that this was a mistake since it could create an opening for China to rewrite the economic rules at the expense of American workers, as well as sending a troubling signal of US disengagement from the Asia–Pacific region. Another signal of Trump’s protectionism is the bilateral trade tendencies. The US has asked Japan to engage in FTA negotiations, but Japan has constantly rejected this idea because of serious doubts.

When the US mentions bilateral deals, it is not necessarily referring to real FTAs. Bilateral deals seem to stand only to artificially balance the trade account by setting up numerical targets and, if these are not fulfilled, countries are subjected to unilaterally imposed sanctions. Table 3 shows the sanctions imposed by the US on different sections of US trade law.

**Table 3. Sanctions imposed by the US**

	Section 201 (SG)	Section 232 (national security)	Section 301(unfair trade practices)	Other Instruments (WTO DS etc.)
2017 April		Investigation initiated on steel & aluminum		
2017 May-June	Investigations initiated on solar panel and washing machine			
2017 August			Investigation on China’s IPR	
2017 Oct./Dec.	USITC recommendation			US-China Summit \$250 billion deal
2018 January		USDOC report on security concerns		
2018 February	<b>SG measures launched</b>			
2018 March		<b>25% tariff on steel, 10% on aluminum</b>	25% tariffs on \$50 billion China goods	WTO DS on IPR

The US withdrawal from trade and investment rulemaking across Asia–Pacific will be exploited by China imposing its own power-oriented trade policies such as aggressive use of anti-dumping measures or state subsidies on steel. Even more problematic is that the groups of progressive people within China who wanted the country to bet on more open trade, more competition, and SOE modernization have been pushed aside. In contrast, mainstream groups seem to have lost incentives to enhance FTAs in the absence of the TPP, thus jeopardizing further trade liberalization in East Asia.

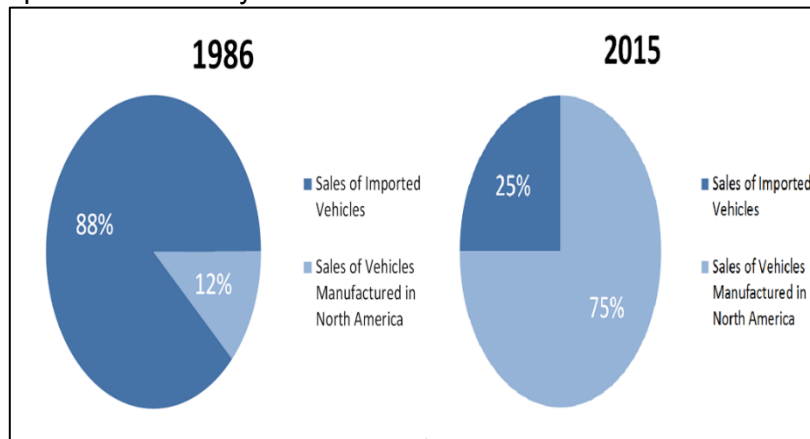
Instead, China has accelerated its Belt and Road Initiative by making full use of its financial arms such as the Asian Infrastructure Investment Bank (AIIB). This could cause market economic principles in the region to be pushed back or abandoned, which in turn would create a major crisis for free democracy, particularly in the Asia–Pacific region.

## **5. How Does Japan cope with this new situation?**

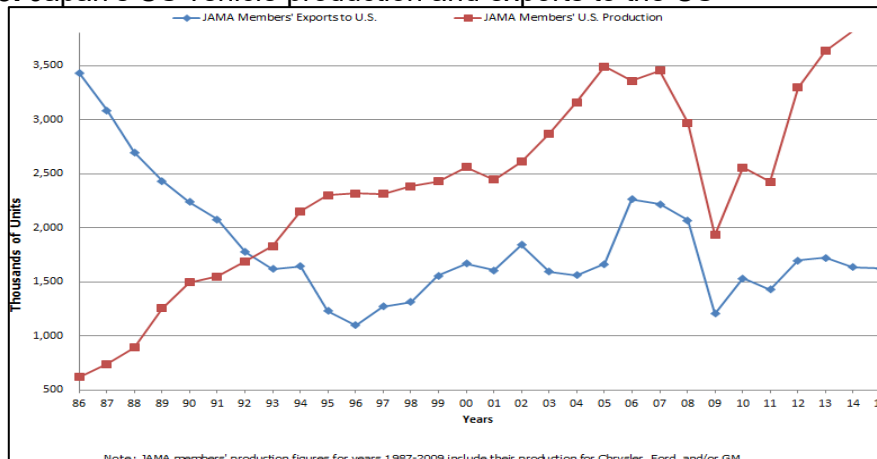
Japan has rejected the US proposal of a bilateral FTA, maintaining that the TPP is the best option for Japan–US economic relations. In the case of the car industry, which has undergone clear changes in the pattern of trade (Figure 12), this is a sensible focus for both countries. In 1986, 88% of Japanese cars in the US were directly exported from Japan to the US, whereas in 2015 only one quarter were exported directly from Japan.

Instead, 75% of cars were produced in the US. In Figure 13, the red line indicates local production of Japanese cars in the US while the blue one shows the decline of cars exported from Japan to the US.

**Figure 12.** Japan’s car industry



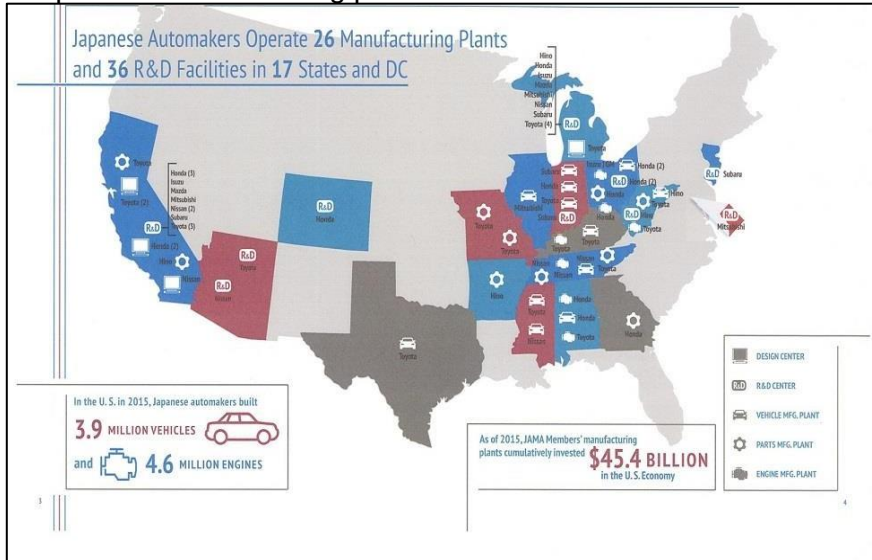
**Figure 13.** Japan’s US vehicle production and exports to the US



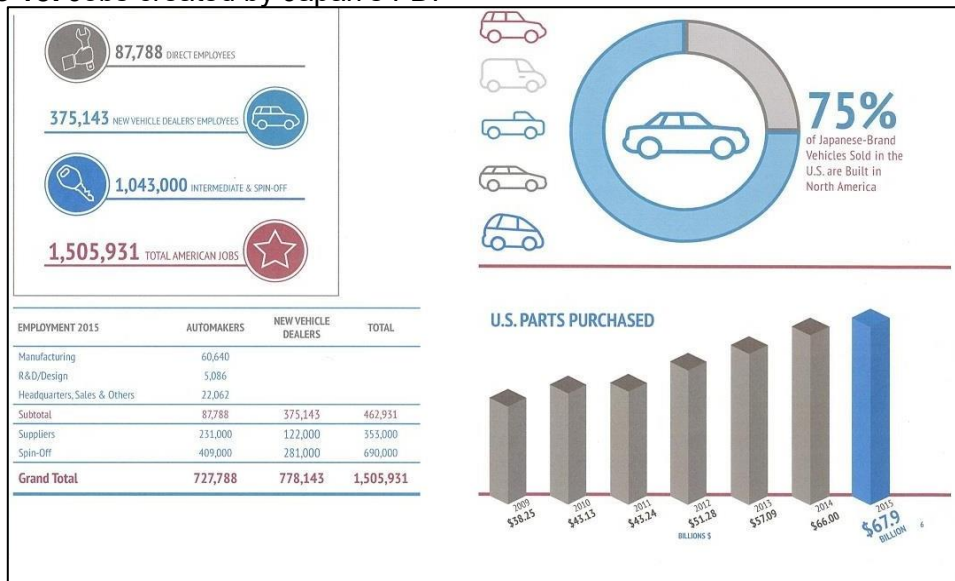
Japan’s FDI in the US is extensive; it has 36 research and development facilities and 26 manufacturing sites (Figure 14). This creates 87,000 direct and 1.5 million indirect jobs (Figure 15). Furthermore, 417,000 cars are produced in the US by Japanese companies and exported elsewhere (Figure 16).



**Figure 14. Japanese manufacturing plants and R&D facilities**



**Figure 15. Jobs created by Japan's FDI**



**Figure 16. Japanese cars produced in the US and exported elsewhere**





## **6. Strengthening the Economic Relations between Japan and the Latin American Countries**

One possibility for strengthening economic relations is the Japan–Mercosur EPA. Mercosur is a customs union that by definition it requires a single common commercial policy with third countries and a common external tariff regime, as the case of the Europe Union. However, Mercosur is far from a complete customs union, and its imperfect current status requires an interim arrangement when negotiating trade agreements with third countries like Japan.

Market access negotiations could be started bilaterally between Japan and members of Mercosur, while the final results of such negotiations would be all bundled together under the comprehensive framework of the possible Japan–Mercosur EPA. Similarly, the principle of “single undertaking” should be applied throughout the bilateral negotiations as well as in the plurilateral ones.

With regard to the Japan–Pacific Alliance, an interesting approach could be that forged with ASEAN, in which Japan first negotiated individual EPAs with the individual countries and then negotiated a comprehensive agreement with ASEAN as a whole. This could be replicated with Mercosur and the Pacific Alliance to foster further production networks, and eventually develop complementarity with the TPP11 together with EPAs. In this way, Japan could play a role as a linchpin to connect value chains in East Asia and the Pacific Alliance.

## **7. Conclusions**

Finally, the TPP could serve as a template for 21st century-type trade agreements and, while waiting for the US to return to the fold, it might be used to keep up the momentum for free trade. Similarly, the RCEP and the JCK play a role for updating the production network in East Asia.

As for Japan–EU, the EPA, concluded in 2017, provides great opportunities. Likewise, the Japan–Mercosur EPA should be promoted, while a comprehensive Japan–Pacific Alliance EPA should be further developed. All of this serves to keep trade multilateralism embodied in the WTO and to enhance predictability in international business.

## 8. Biography of the author



Professor Watanabe currently teaches International Political Economy at Keio University. He has ample experience in international trade policy. His distinguished career has featured significant engagement in all the major bilateral and multilateral trade negotiations in which Japan has been involved in the past two decades.

He was policy advisor to relevant government ministers and has had postings to Japan's diplomatic missions in Brussels and Geneva. In addition, he was Deputy Director-General of the Economic Affairs Bureau, Japanese Ministry of Foreign Affairs, from 2002–2004, and served as Chief Negotiator for the Japan–Mexico Economic Partnership Agreement (EPA) and the Working Party on Russia's Accession to the WTO. Likewise, he was Special Assistant to the Japanese Minister for Foreign Affairs in 2004.

Prof. Watanabe completed his BA and MA and was a PhD candidate at Sophia University, Tokyo. He also studied at the College of Europe in Bruges. He is the author of several publications on GATT/ WTO and trade and economic partnership agreements. His most recent book on the TPP was ranked one of the top-ten best-selling books on economics in December 2011 in Tokyo.