

## **Japan and China in the 21<sup>st</sup> Century: Trade Policy Agreements from the Liberal and Neo-Mercantilist Perspective**

### ***Introduction***

In the very late 90's and early 2000's trade policy all over East Asia began to make a dramatic shift. East Asia contains both the 2<sup>nd</sup> and 3<sup>rd</sup> largest economies in the world: China and Japan respectively. In the early 1990's, neither Japan nor China had many regional or bilateral trade agreements. Now the East Asian Region is often referred to as the "noodle bowl" because of the massive amount of bilateral trade agreements that exist between East Asian nations.

Japan did not even consider making bilateral agreements until 1999 due to their confidence in informal relations and a reliance on multilateral agreements. After WWII, Japan relied primarily on a mercantilist approach to create domestic growth, but has begun liberalizing their markets more recently. China was a latecomer to the global market, but was able to progress rapidly due to the size of its market and, later, increasing liberalization of its trade policy.

In this paper, I will examine the move toward bilateralism and regionalism in both Japan and China through both the liberal and neo-mercantilist perspective. This will include a discussion on how their trade policies have changed and what has cause China and Japan to change their regional trade strategies.

### ***Definitions and Theories***

For the purposes of this paper, I will be defining liberalism as the belief that by removing trade barriers and promoting open markets amongst nations in trade will

provide the greatest benefit. In turn, this will maximize overall efficiency as described by Robert Gilpin<sup>1</sup>. Basically, this view espouses that the less barriers there are to trade, the better off all actors will be. One liberal model of regime change that will help explain this move is the Economic Process Model, which basically claims that regimes change when technology or the way actors interact with each other, undergoes a change. Regimes have to keep up with the current level of progress. The Nested Institutions model will also be used. It explains new regimes as being “nested” or created within the constraints of older institutions. When a new regime or institution is created, it must reconcile its authority within the existing framework already established for the regime.

Neo-mercantilism will be understood as the idea that though, total wealth in the world can indeed grow, a nation’s wealth is still relative. Though everyone may get richer in total, some countries will still be relatively better off; one nation’s relative gain is another nation’s relative loss. In the neo-mercantilist view, the state enacts policy to control imports and exports; this includes tariffs, quotas, and non-tariff barriers. The Nested Systems Model will help to understand some changes as it explains how some higher nested systems, such as security, can affect a lower nested system, like the economy.

Another important definition is the Free Trade Agreement (FTA) this is defined in Article XXIV of the General Agreements on Tariffs and Trade (GATT). Basically it creates an area where restrictive regulations on substantially all trade are eliminated. Christopher Dent makes a distinction between FTAs and Preferential Trade Agreements (PTAs) in that PTAs exclude non-signatory parties and exclude some important trade

---

<sup>1</sup> Gilpin, 26

sectors<sup>2</sup>. For the purposes of this paper, I will not make a distinction between the two categories, but will acknowledge that some FTAs would be more appropriately described by the term PTA since they do not always cover “substantially all trade.”

### ***Japan: Background***

Japan did not sign its first FTA until 2001. The first agreement Japan made was with Singapore, which was called the Japan-Singapore Economic Partnership Agreement (JSEPA)<sup>3</sup>. In 1998 Japan’s Ministry of International Trade and Industry (MITI) published its *White Paper on International Trade* in which they claimed that FTAs were detrimental to free trade because they allowed for discrimination. By the end of 1998, this attitude was already changing. The 1999 *White Papers on International Trade* endorsed the idea that, indeed, FTAs could be beneficial to the multilateral system of trade. Japan chose to focus first on Singapore because of Singapore’s lack of a large agricultural market<sup>4</sup>. From a liberal perspective, it seems that Japan finally realized the importance of trying to open up free trade. By creating a FTA with Singapore they created a freer exchange that would benefit both countries. It also served as a model for future FTAs that Japan would construct which further liberalized trade. This deal also retains elements of neo-mercantilism as well. Japan has a very protected agricultural industry and was very hesitant to open up its agricultural markets because foreign prices on commodities, such as rice, were so much lower than the Japanese prices. By choosing a country like Singapore for a FTA agreement, Japan was still acting like a gatekeeper because it was able to protect its agricultural markets.

---

<sup>2</sup> Dent 2005, 289

<sup>3</sup> Dent 2005, 293

<sup>4</sup> Hamanka 2008, 75

The JSEPA was important to Japan not necessarily because of the trade it facilitated with Singapore, but rather the fact that it opened Japan's attitude toward FTAs<sup>5</sup>. After this first Agreement, Japanese policy makers went on to start discussions on creating a number of FTAs. In 2004 Japan and Mexico signed an FTA and Japan and Malaysia signed another in 2005<sup>6</sup>. This would seem to indicate an expansion of the liberal idea of trade. Because Japan has continued to pursue FTA agreements in the East Asian region and outside of the East Asian region, it would seem like Japan is trying to follow the liberal ideal and open trade up more and more. By expanding the number of free trade partners that Japan has, they can expect to grow more efficiently. At the same time, Japan faces domestic difficulties when liberalizing. Domestic pressures, such as agriculture, forestry and fisheries fight against the trend toward liberalization<sup>7</sup>. These industries have typically enjoyed greater protectionism in Japan because they were important domestic constituencies for the Liberal Democratic Party (LDP), which has dominated Japanese politics since the 1950's. Actors from protected sectors of the Japanese economy have argued for more neo-mercantilist policies that would exclude those actor's favored sectors from liberalization under FTAs. This exemplifies the issue structure model of regime change. For example, agriculture is one of the main supporters of the LDP, which has relied on rural and agricultural votes to stay in power. Though agriculture is only one part of trade, it is a very important sector and can retain more protection, especially in Japan, than other sectors can.

---

<sup>5</sup> Pekkanen 2005, 93

<sup>6</sup> Yoshimatsu 2006, 484

<sup>7</sup> Yoshimatsu 2006, 483

Perhaps the most important negotiation Japan conducted with regard to trade was the ASEAN-Japan Comprehensive Economic Partnership. ASEAN, or the Association of South East Asian Nations, consists of ten countries and has a combined population of almost 600 million people, which is a huge market for Japan. In 2002 Japan and ASEAN agreed to complete an FTA by 2012<sup>8</sup>. This is important to Japan, not just because it opens up ASEAN market, but it also helps secure Japan's access to raw materials and energy<sup>9</sup>. As the rest of Asia began to liberalize, it was important for Japan to keep up with the trend. If they did not liberalize through bilateral agreements, then they would likely be left behind and cut out of important markets, such as ASEAN.

### *Japan: Analysis*

One event that led Japan to create FTAs and engage in regionalism was the Asian Financial Crisis. Though the Asian Monetary Fund was never created, the crisis still influenced an idea that Asian countries should increase their links to each other. Before 1997, there was only one FTA being discussed among East Asian nations. After, there was a veritable explosion of FTA talks<sup>10</sup>. At 2000's ASEAN plus three Finance Ministers Meeting held in Chiang Mai, Thailand the members agreed to the Chiang Mai Initiative (CMI). This agreement was a series of bilateral agreements that dealt with currency swaps as well as economic oversight provisions<sup>11</sup>. According to the Nested Institutions Model, new institutions must reconcile with the established order; the CMI was no exception. The International Monetary Fund (IMF) was the larger institution the CMI was nested within. Because of IMF rules, most CMI transactions would have to be

---

<sup>8</sup> Corning 2009, 649

<sup>9</sup> Corning 2009, 648

<sup>10</sup> Dent, Christopher M, 287-294

<sup>11</sup> Hamanka 2008, 71

approved by the IMF. Japan wanted to delink the CMI from the IMF, which caused tensions with the U.S<sup>12</sup>. Japan was the major financial backer of the CMI, so it is natural that they would want more control of the organization. If Japan were able to dominate the CMI instead of the IMF having control, it would support the notion that Japan was the East Asian regional hegemon.

As shown above, there has been a move in Japan to rely more on bilateral FTAs, than to utilize multilateral agreements. This has occurred for a number of reasons. One is the stalled Doha round negotiations of the WTO. In the past, Japan has relied heavily on multilateral agreements in order to liberalize markets, but since the Doha round has made no progress, policy makers have turned to smaller bilateral agreements<sup>13</sup>. Smaller agreements seem like a good alternative for modern liberalization because they can be negotiated quicker. This is due to fewer actors being involved. Bilateral agreements might also be seen as a form of protectionism from a neo-mercantilist view. By making agreements bilaterally, actors may be unwilling to later make broader multilateral agreements because they already have what they want. At the same time, bilateral FTAs can easily exclude some sectors so they do not have to liberalize immediately.

Agriculture is an example in Japan. By turning to bilateral agreements, Japan could be seen as still pursuing protectionism.

Competition with China is another reason that explains Japan's move toward bilateralism and regionalism. Japan is now the 3<sup>rd</sup> largest economy in the world and both China and Japan are competing to be the dominant force in the East Asia region. Japan did not create bilateral trade agreement in the 1990's because it relied on its informal

---

<sup>12</sup> Hamanka 2008, 73-74

<sup>13</sup> Corning 2009, 648

power network. China's rise and the growth of FTAs in the region have forced Japan to change its strategy<sup>14</sup>. In an effort to secure and maintain regional hegemony, Japan has turned to focus on bilateral trade agreements.

The Economic process model also explains Japan's behavior. There was a shift in the trade regime and Japan had to shift as well to stay current. With the growth of liberalization in East Asia and the proliferation of FTAs, it was necessary for Japan to join the trend. FTAs have also been used to regulate newer topics, such as online business and investment,<sup>15</sup> when similar negotiations on a multilateral scale would take a much longer time. The very nature of trade in the region was shifting, and Japan could not longer rely on its informal networks or on its close ties with the U.S. to maintain its position in the region; it also had to shift with trends in the trade regime.

### ***China: Background***

China began its discussion of FTAs before it even became a member of the WTO in 2001 with the bid for the ASEAN-China Free Trade Area (ACFTA). The initial groundwork for ACTFA was proposed in 2000 by the Thai Trade Minister Supachai Panitchpakdi at the ASEAN plus three (APT)<sup>16</sup> meeting. This could potentially create an economic region with about 1.7 billion people and would encompass 1.23 trillion US dollars worth of trade<sup>17</sup>. Obviously, China had a good economic reason to want to participate in such an agreement, but this is not the only benefit China sought to gain from entering into cooperation with ASEAN. In November 2002, China and ASEAN

---

<sup>14</sup> Corning 2009, 641-642

<sup>15</sup> Dent 2005, 288-289

<sup>16</sup> Dent 2005, 308

<sup>17</sup> Chow 2006, 251

signed a framework agreement to later establish ACFTA. The cooperation progressed quickly with the Agreement on Trade and Goods as well as the Agreement of Dispute Settlement Mechanics being concluded in 2004 and the Agreement on Services was concluded in 2007<sup>18</sup>.

The cooperation with ASEAN was important to China for many reasons. From the neo-mercantilist power perspective, this deal was very important with regard to regional influence. It both relived ASEAN country's worries that China becoming a member of the WTO would harm their own prosperity and it gave China more power regionally by forging closer diplomatic ties with ASEAN. Overall this enhanced China's ability to influence regional and global trade<sup>19</sup>. China had to make some trade concessions, which might seem like it would be harmful, but officials felt it was more important to gain influence diplomatically over the ASEAN nations. This also enhanced China's position as the regional leader. The agreement also would lead to a liberalization of trade.

Since China join the WTO in 2001, it has pursued many other bilateral FTAs. China's officials were in talks with 27 countries/economic regions in 2007 with the intent of creating nine new FTAs. By that point, China had already established FTAs with Chile and ASEAN<sup>20</sup>. While this can be seen as the liberalization of China's trade regime, that it not always the main reason Chinese officials seeks out such agreements. There are often other reasons, such as diplomacy and power, which benefit China more.

---

<sup>18</sup> Ravenhill and Yang Jiang 2009, 38

<sup>19</sup> Ravenhill and Yang Jiang 2009, 38-39

<sup>20</sup> Hoadley and Yang Jian, 328

The Closer Economic Partnership Agreement (CEPA) with Hong Kong shows how trade agreements have been used by China as a political and diplomatic tool. It was not referred to as a FTA because Hong Kong was not an independent nation, but the ideas governing the arrangement are the same. Mainland China did not gain many benefits from CEPA; it was mainly designed to help Hong Kong recover from economic depression. Instead, China hoped the agreement would show Hong Kong and other territories, such as Taiwan, that the “one country, two systems” agreements were good ideas<sup>21</sup>. Hong Kong became a special administrative region of Mainland China in 1997 under the Sino-British Joint Declaration, so China felt obligated to assist Hong Kong through CEPA.

China also hoped to influence Taiwan into becoming a Special Administrative region, an offer that had been proposed in 1981 by Deng Xiaoping. The Nested Systems Model explains why this was the case. Security is typically a more important issue than trade. China is often in fear of being encircled by hostile powers. In this way, CEPA can be explained by China’s desire for security overriding their economic motivations. For example, China has often been afraid that a hostile power, like Japan or the U.S, would use Taiwan as an unsinkable aircraft carrier. Since CEPA was a way to encourage Taiwan to become a special administrative zone, it can be seen as move to increase Chinese security. If CEPA would had enticed Taiwan to join the Mainland Chinese government, it would have increase China’s security position and lessened China’s constant fear of encirclement.

---

<sup>21</sup> Ravenhill and Yang Jiang 2009, 36

China was also an important actor within the Chiang Mai Initiative (CMI). By 2002, China had made agreements with Thailand and Japan concerning currency swaps. Unlike Japan, China did not want to delink the CMI from the IMF. China's support of the IMF can be attributed to a number of reasons. One good explanation is that without the IMF, Japan would dominate the CMI<sup>22</sup>. By balancing Japan and the U.S. against each other, China is able to stop Japan from gaining power in the region.

### *China: Analysis*

Like Japan, China has chosen to focus more on bilateral trade agreements, rather than a multilateral approach. China started even later than most countries in negotiating deals because China saw global trade as more important and it did not need FTAs until recently to achieve its goals concerning trade. China was able to rely on its large markets for favorable trading conditions for some time, but as countries erected trade barriers, it became important for China to make bilateral agreements. This is especially true because of the stalled Doha Round of the WTO<sup>23</sup>. As other East Asian nations began to create more bilateral trade agreements, it became necessary for China to create its own FTAs in order to stay competitive. China practices many neo-mercantilist policies, such as tight fiscal policy, but some liberal concessions on trade are necessary to stay competitive and to achieve regional leadership.

According to Ravenhill and Jiang, Chinese officials have four main motivations for pursuing FTAs. These are to facilitate production networks, create agreements with neighboring economies, to secure access to raw materials, and to accept agreements with

---

<sup>22</sup> Hamanka 2008, 74

<sup>23</sup> Hoadley and Yang Jian, 327-330

rich industrialized nations<sup>24</sup>. The Economic Process Model explains why China would seek FTAs to facilitate production networks. As technology changes, the way that goods are produced also changes. Production chains are spread around the global and often concentrated in Asia. To maximize efficiency and profit, it would make sense for China to reduce trade barriers when dealing with these productions chains. Establishing FTAs with rich industrialized economies is also explained well by the Economic Process Model since these countries have already adapted to the new technology and methods of trade. Many of these countries, like the U.S. and those in the E.U, have already created their own FTAs and China should join them to stay current. The Nested Systems Model explains China establishing agreements with its neighboring economies. Economic agreements can improve Chinese security as describe in the above section on CERA. Securing access to raw materials would be important under the neo-mercantilist view. China is reliant on other nations for raw material, such as oil. Without oil, China could face a serious security threat, so securing reliable access to it ensures China maintains power and security.

### ***Conclusion***

Overall, there seems to be a trend toward liberalization through smaller FTAs in both Japan and China. This can be attributed to a variety of reasons. Both China and Japan have moved away from multilateral agreements on trade. One reason that explains both countries' actions is the failure of the WTO. The Doha round of WTO negotiations began in 2002. Though rounds were supposed to be concluded no later than 2005; this has not been the case. Talks have broken down in a number of areas including, but not

---

<sup>24</sup>Ravenhill and Yang Jiang 2009, 30

limited to, agriculture and industrial tariffs. Negotiations are still ongoing in 2013, so it is not surprising that many countries have turned to creating bilateral and regional agreements in order to promote their own trade agendas.

In general, this marks an overall change for both Japan and China toward liberalism and away from neo-mercantilism. Prior to the 2000's, Japan was heavily reliant on the multilateral system of trade negotiations; however, the Doha stall has forced them to adapt. In order to liberalize Japan has turned to smaller bilateral FTAs. This has also allowed them to retain some of their neo-mercantilist policies, such as protectionism within the agricultural sector. Shujiro Urata theorizes that if Japan does not relent on its protectionist agriculture policies it will likely be left out of future FTAs<sup>25</sup>. The stall of the Doha round has also made China more reliant on bilateral agreements as a way to lower trade barriers in the region.

Bilateral agreements were also influenced by the Asian Financial crisis. Japan, China, and the rest of the East Asian region recognized that they had few regional agreements linking them economically. This realization has helped create the vast proliferation of trade agreements that Christopher Dent refers to as "lattice regionalism<sup>26</sup>." This expansion of FTAs forced both Japan and China to consider bilateral regional agreements much more thoroughly.

Japan seems to be liberalizing, while still retaining elements of neo-mercantilism. By negotiating FTAs, Japan has been able to liberalize some economic sectors and protect others. The Economic Process Model explains why Japan had to change its trade

---

<sup>25</sup> Urata 2002, 31

<sup>26</sup> Dent 2005, 294

regime to keep up with technological changes. FTAs also provide a way for Japan to gain regional power, something that it has only recently had to compete with China over.

China has begun to liberalize its trade policy. Since it could not just rely on its market size and the Doha round of the WTO was not progressing, it turned to bilateral FTAs like the rest of East Asia. China has used these FTAs not only to enhance its economic position, but also to secure regional power and security. CERA is a good example of China using a trade agreement diplomatically. The Nested Systems Model explains why China would accept some economic losses if it put them in a better strategic security position.

Through the late 1990's and early to mid 2000's both Japan and China liberalized their trade policies with the use of FTAs. The use of FTAs also allowed both countries to retain some elements of neo-mercantilism. It remains to be seen if FTAs like the ones created by Japan and China will harm multilateral trade efforts like those of the WTO. It might be the case that smaller bilateral FTAs are the most efficient form of liberalization in the ever-changing world.

Word Count: 3801

### ***Bibliography***

Chow, Michael Ewing. "ASEAN-China F.T.A.: Trade or Tribute?" *Singapore Year Book Of International Law* 10 (2006): 251-267.

Corning, Gregory P. "Between bilateralism and regionalism in East Asia: the ASEAN Japan Comprehensive Economic Partnership." *Pacific Review* 22, no. 5 (December 2009): 639-665.

Dent, Christopher M. "Bilateral Free Trade Agreements: Boon or Bane for Regionalism in East Asia and the Asia-Pacific?" *European Journal Of East Asian Studies* 4, no. 2 (September 2005): 287-314.

Gilpin, Robert. "U.S. Power and the Multinational Corporation." In *PS 126 International Political Economy Reader*, edited by Vinod Aggarwal. Berkeley, CA: Copy Central, 2013.

Hamanaka, Shintaro. "Comparing summirty, financial and trade regionailsm in East Asia: from the Japanese Perspective." In *China, Japan and Regional Leadership in East Asia*, edited by Christopher M. Dent. Cheltenham: Edward Elgar Publishing Limited, 2008.

Hoadley, Stephen, and Yang Jian. "China's Cross-Regional FTA Initiatives: Towards Comprehensive National Power." *Pacific Affairs* 80, no. 2 (2007).

Pekkanen, Saadia M. "'Bilateralism, Multilateralism, or Regionalism? Japan's Trade Forum Choices.'" *Journal Of East Asian Studies* 5, no. 1 (2005): 77-103.

Ravenhill, John and Yang Jiang. "China's Move to Preferential Trading: a new direction in China's diplomacy." *Journal Of Contemporary China* 18, no. 58 (January 2009): 27-46.

Urata, Shujiro. "Globalization and the Growth in Free Trade Agreements." *Asia-Pacific Review* 9, no. 1 (May 2002): 20-32.

Yoshimatsu, Hidetaka. "The Politics of Japan's Free Trade Agreement." *Journal Of Contemporary Asia* 36, no. 4 (November 2006): 479-499.