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Japan's New Trade Policy: from GATT and the WTO to FTAs

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Introduction

Since the beginning of the 21st century, Japan has aggressively promoted Free Trade Agreement (FTA) negotiations, particularly with the countries of the Association of Southeast Asian Nations (ASEAN). Currently, Japan has put a total of 11 FTAs into effect, ten bilateral FTAs with countries such as Singapore, and one regional FTA with ASEAN, and is carrying out negotiations for five further FTAs with countries such as India and Australia. FTAs represent a policy of preferential trade agreements between specific countries aimed at eliminating tariff and non-tariff barriers and as such run contrary to the most favored nation treatment (equal treatment to WTO members) that is the basic principle of the World Trade Organization (WTO). From 1956, when it joined the General Agreement on Tariffs and Trade (GATT), which was the predecessor to the WTO, Japan implemented a trade policy as a member of GATT and the WTO with a focus on multilateral trade liberalization negotiations based on most favored nation treatment. With this in mind, Japan's proactive entry into FTAs in recent years can be interpreted as implying a significant switch in its trade policy.

In this paper, I examine Japan's FTA strategy from a variety of perspectives with the above situation in mind. In the next section, section 2, I give an overview of the trends and characteristics of Japan's FTAs. In section 3, I analyze the motivation behind Japan's FTA strategy, and in section 4, I highlight the obstacles to entry into FTAs. In section 5, I examine Japan's existing FTAs from both quantitative and qualitative perspectives and analyze the impact of FTAs on trade and direct investment. In the last section, section 6, I present the strategies that Japan should adopt in promoting an FTA strategy in the future.

2. Development and Characteristics of Japan's FTAs

Table 1 shows the status of Japan's FTAs already in effect and those for which negotiations on ongoing.¹ Japan's first FTA was with Singapore, coming into effect in November 2002. Later, FTA negotiations were carried out with a focus on ASEAN countries, and by August 2010 bilateral FTAs had come into effect with the ten countries of Singapore, Mexico, Malaysia, Chile, Thailand, Indonesia, Brunei, the Philippines, Switzerland and Vietnam (in the order the agreements came into effect), in addition to a regional FTA with ASEAN. The shortest period of time between launching negotiations and an agreement coming into effect was seen with the agreement with Chile at just one year and seven months, whereas the longest period of negotiations was four years and ten months in the case of the Philippines, caused by the long period required for ratification by the Congress of the Philippines after agreement was reached during negotiations. However, despite launching FTA negotiations with South Korea in December 2003, opposing opinions on the negotiating framework saw a breakdown in negotiations in November 2004, and negotiations have not been restarted since. Of Japan's 11 effective FTAs, ten have come into effect since 2005, six of which have come into effect since 2008, showing just how rapidly Japan's entry into FTA has increased in recent years. There are currently five FTAs under negotiation, including South Korea, with the other negotiating partners made up of the Gulf Cooperation Council (GCC), India, Australia and Peru.

There are a number of FTAs at the planning or investigative stage, such as FTAs between Japan

¹ For more on FTAs, see Urata, Ishikawa and Mizuno (2007) and Shiino and Mizuno (2010).

and the United States and Japan and the EU. However, in terms of FTAs at the stage of government-level investigations, there is the East Asia FTA (EAFTA) between ASEAN 10, Japan, China and South Korea, and the Comprehensive Economic Partnership in East Asia (CEPEA) between the members of the East Asia Summit, which includes the ASEAN 10 countries, Japan, China, South Korea, India, Australia and New Zealand. In terms of FTAs to which Japan is a candidate for membership, there is the proposed Free Trade Area of Asia Pacific (FTAAP) by member economies of the Asia-Pacific Economic Cooperation (APEC). The above concept was proposed in 2006 by the United States, where government-level investigations have since been carried out. In Japan, establishment of the FTAAP by 2020 has been promised as part of the Democratic Party's growth strategy. In May 2010, collaborative research between industry, government and academia was launched into an FTA between the three North-East Asian countries of Japan, China and South Korea.

A number of traits can be seen in relation to the countries with which Japan has concluded FTAs. The first is that its partners are mostly ASEAN countries. As has already been pointed out, bilateral FTAs have been concluded with seven ASEAN countries (the exceptions being Laos, Cambodia and Myanmar) in addition to an FTA with the ASEAN region as a whole. The second trait is that Mexico and Chile, which (among the countries of Central and South America) have aggressively promoted FTAs and formed an FTA hub in the Central and South American region, are also included in the list of countries with which Japan has concluded FTAs. The third trait is that there is a large number of FTAs with resource-supplying countries. If we include FTAs which are currently under negotiation it becomes clear that many of Japan's FTA partners are mineral resource supplying countries, with Indonesia and the GCC supplying the oil and natural gas which are crucial to Japan, Australia supplying coal and iron ore and Chile and Peru supplying copper ore and other minerals.

In addition to the thorough elimination of tariff and non-tariff barriers between signatory countries that is included in traditional FTAs, most of Japan's FTAs also incorporate economic cooperation in a variety of fields, such as the liberalization of direct investment, the facilitation of trade and direct investment, and the promotion of human resource training and small-to-medium enterprise. Because these agreements form such a comprehensive framework, the Japanese government refers to them as Economic Partnership Agreements (EPAs) rather than FTAs. Behind the construction of EPAs lies recognition of the fact that far-reaching and comprehensive arrangements are required to bring about major economic advantages in an international economic environment where people, money and information, as well as goods, now move across national borders freely and actively. There is also an awareness of the importance of supporting the economic growth of developing countries through economic cooperation. It goes without saying that, if these countries' economies grow, exports from Japan will increase and growth in the Japanese economy can be expected.

3. Japan's FTA Strategy

Japan's first FTA negotiations began in January 2001 with Singapore, but negotiations were carried out without a firm strategy until 2005, when negotiations with ASEAN were launched. During negotiations with many of Japan's FTA partners, such as Singapore, Mexico and Chile, rather than Japan

actively putting pressure on partner countries to carry out negotiations, the truth was that Japan's negotiations were launched in response to requests from partner countries. Despite these circumstances, Japan has been active in its promotion of FTAs with ASEAN, but behind these efforts lies the fact that China has also been rapidly promoting FTA negotiations with ASEAN. Strengthening relationships with ASEAN, which is in an important region both economically and politically in South-East Asia, is an extremely important way of expanding influence in the East Asia region as a whole.

In this chapter, we will examine the many motives behind Japan's promotion of FTAs. Firstly, we will examine the FTA strategy announced by the Japanese government, and then consider the motives behind Japan's FTAs based on a variety of information.

3.1 View of the Japanese Government

It was the Ministry of Foreign Affairs that was to publish the first document on the FTA strategy of the Japanese government, giving its opinion on FTAs in "Japan's FTA Strategy" (2002). According to the Ministry of Foreign Affairs (2002), promoting FTAs makes it possible to obtain economic, political and diplomatic benefits. In terms of economic benefits, the document cites an expansion in export markets, a switch to a more efficient industrial structure and improvements to competition terms, in addition to minimizing the politicization of economic issues and bringing the expansion and harmonization of systems. In terms of political and diplomatic benefits, increased World Trade Organization (WTO) negotiating power, an acceleration in WTO negotiations resulting from FTA negotiations, fostering political trust with FTA partner countries and an expansion in Japan's global diplomatic influence and advantages were all cited. The document cites comprehensiveness, flexibility and selectivity as the features Japan should seek in its FTAs. Specifically, in addition to trade liberalization Japan should seek comprehensive FTAs that incorporate investment liberalization, the facilitation of trade and investment and economic cooperation. The content of FTAs should be regarded flexibly and selectively depending upon the FTA partner. Furthermore, in terms of the criteria used for selecting FTA partner countries, the document argues for economic criteria, geographic criteria, political and diplomatic criteria, criteria on the possibility of implementation, and timescale criteria. When selecting FTA partners based on these criteria, the document argued that South Korea and the countries of South-East Asia, including ASEAN countries, were high priorities.

In March 2004, the Japanese government set up the Council of Ministers on the Promotion of Economic Partnership to look into a basic policy for FTA measures. In December of the same year, the Council announced its Basic Policy toward Further Promotion of Economic Partnerships. The content is similar to the Ministry of Foreign Affairs (2002) document, but more concise.² Specifically, the policy regards economic partnership agreements as something that can complement multilateral trade liberalization centered on the WTO at a time of increasing economic globalization, at the same time as contributing to the development of Japan's overseas economic relations and economic advantages and the promotion of structural reforms in both Japan and partner countries. Moreover, while prioritizing the East Asia region, the

² Prime Minister of Japan and His Cabinet,
<http://www.kantei.go.jp/jp/singi/keizairenkei/kettei/041221kettei.html>

policy argues for FTAs to include investment as well as trade.

In September 2009 the Liberal Democratic Party was replaced in government by the Democratic Party, which in its election manifesto argued for the aggressive promotion of EPAs and FTAs with various countries, including Asian countries, and for integrated initiatives aimed at reforming Japan's domestic systems, such as the liberalization and relaxation of the investment system. The party plans to announce a more detailed EPA/FTA strategy in the autumn of 2010.

3.2 Expanding Access to Overseas Markets

One of the motives behind Japan's FTA strategy is the expansion of Japanese companies' access to overseas markets. With the number of FTAs rapidly increasing globally, Japan was one of the few countries in the world that had not entered into an FTA at the beginning of the 21st century. As a result, Japanese companies were discriminated against in numerous world markets, and were beginning to lose their export markets. FTAs were chosen as a way of dealing with this disadvantageous situation. By removing trading barriers between the member countries, FTAs create numerous business opportunities for Japanese companies.

Expanding export markets for Japanese companies is something that could be achieved through multilateral trade liberalization under the WTO. However, multilateral trade negotiations under the WTO have stalled and experienced numerous delays. Under these circumstances, FTAs are an effective choice for expanding export markets. The motive of expanding access to overseas markets is applicable to all of Japan's FTAs. However, the clearest example of this can be seen in Japan's FTA with Mexico. The situation before Japan began FTA negotiations with Mexico saw American companies and European companies avoiding tariffs on exports to the Mexican market through the North American Free Trade Agreement (NAFTA) in the case of American companies and an FTA between Mexico and the European Union (EU) in the case of European companies. Meanwhile, Japanese companies' exports to Mexico were subject to tariffs. With an extremely high average Mexican tariff of 16.2% in 2001, Japanese companies were at a huge disadvantage in the Mexican market.³ There was also a problem with Japanese companies participating in the market for Mexican government procurements. Because Mexico is not a signatory to the WTO's Agreement on Government Procurement, it implements discriminatory measures whereby it opens up its government procurement market only to FTA partner countries. Japanese companies, for whom access to Mexico's government procurement market was closed because Japan had not entered into an FTA with Mexico, put a huge amount of pressure on the Japanese government to enter into an FTA.

Another characteristic of Japan's FTA strategy is the priority given to East Asia, where high levels of future growth are expected. The countries of East Asia have promoted trade liberalization in recent years, but there are still many markets protected by high tariffs (Table 2). Entering into FTAs with these countries promotes the exports of Japanese companies. Japan has entered into an FTA with the ASEAN region as a whole, but has also concluded seven bilateral FTAs with ASEAN countries. As a developed country, Japan is obliged to enter into FTAs with a high level of liberalization in a way that does not infringe upon Article 24 of

³ Taken from World Bank, World Development Indicators 2003 CD-ROM.

the GATT agreement, and in the light of the perceived difficulties of entering into such FTAs with later ASEAN members, such as Laos, Cambodia and Myanmar, Japan selected the path of entering into bilateral FTAs with the early ASEAN members, such as Singapore.⁴ After China and South Korea entered into FTAs with ASEAN, including the later ASEAN members, Japan renewed its FTA with ASEAN as a whole in order to fully utilize the advantages of the Cumulative Rules of Origin (explained below)⁵.

Allow me to explain the Cumulative Rules of Origin using the example of a Japanese automotive manufacturer with a production base in Thailand (which is a member of ASEAN). Let us assume that the Thai production base imports components from Japan in order to assemble vehicles, which it then exports to another ASEAN member, Indonesia. If Japan had not entered into an FTA with ASEAN as a whole the vehicles assembled in Thailand would not be regarded as Thai-made because the components used for manufacture would have been produced in Japan, meaning Indonesian import tariffs would be incurred when the vehicles were exported to Indonesia. However, with Japan entering into an FTA with ASEAN as a whole and the Cumulative Rules of Origin being applied, the Japanese-made components are regarded as ASEAN-made, and vehicles exported to Indonesia from Thailand become exempt from import tariffs. As the above example highlights, entering into an FTA with ASEAN as a whole brings the advantage of facilitating more efficient production for Japanese companies with production bases in ASEAN.⁶

Many Japanese companies operate overseas by setting up overseas subsidiaries through direct investment. These companies have expectations for the business environment to be improved as a result of FTAs. Developing countries, including those in East Asia, have strict regulations against direct investment, and in many cases the free activities of Japanese companies are hindered. For example, some regulations prohibit direct investment in certain fields and even where direct investment is permitted there are regulations governing investment ratios, for example by establishing a maximum percentage of overall capital that can be invested in an overseas subsidiary. In many cases, overseas subsidiaries are obliged to fulfill export requirements including technological transfer requirements. It is hoped that FTAs will be able to resolve similar situations in which the free activities of overseas companies are restricted.

3.3. Promotion of Structural Reform in Japan

Another reason why Japan has been promoting FTAs is to promote the structural reforms that are essential to revitalizing a Japanese economy that has been suffering from a long-term recession, with a falling birth-rate, ageing population and serious problems with the public finances. Since the bursting of the bubble

⁴ Under Article 24 of the GATT Agreement it is necessary to satisfy a number of conditions, such as effective liberalization of all products, when entering into an FTA. However, there is no need for developing countries to satisfy these conditions. See Urata, Japan Center for Economic Research ed. (2002) for the WTO's position regarding FTAs and related discussions.

⁵ Because FTAs are a preferential system of tax exemptions for products from FTA partner countries there is a need to clarify that the products in question originate from the partner country. There are numerous definitions of country of origin. See the Ministry of Economy, Trade and Industry's "Report on Unfair Trade Practices" for more details.

⁶ ASEAN put the ASEAN Free Trade Area (FTA) into effect in 1993, reducing trade barriers between the signature countries.

economy at the beginning of the 1990s, the Japanese economy has suffered from a long-term recession. This is why the 1990s have come to be referred to as the “lost decade”. There can be no denying that the economic system that arose in Japan after the Second World War (referred to as the 1955 System) made a huge contribution to the country’s rapid economic growth, but in recent years the system has experienced fatigue and lost its effectiveness. Many commentators believe that systematic reform is needed to implement a complete renewal of the system.

After the Second World War, Japan used international organizations, such as the General Agreement on Tariffs and Trade (GATT) and the Organization for Economic Cooperation and Development (OECD), as well as external pressure from countries such as the United States, to promote liberalization of trade and direct investment at the same time as implementing structural reforms within Japan. As a result, there was an extraordinary increase in domestic manufacturing and competitiveness. However, as described above, from the latter half of the 1990s onwards trade liberalization under the WTO became increasingly difficult.

In the past, the United States put a great deal of pressure on Japan to open its markets, but in recent years pressure on trade liberalization from the United States has weakened. The reason for this is that stronger methods have been used under the WTO for resolving trade disputes in recent years, rather than the bilateral methods used formerly. What’s more, the focus of America’s bilateral trade disputes has now switched from Japan to China.

Faced with the insufficiencies of WTO multilateral trade negotiations and a lack of external pressure from countries such as the United States, Japan began to show interest in FTAs as a method for promoting structural reforms. In fact, Japan decided that FTAs were a favorable policy after recognizing that the EU and NAFTA were successfully promoting structural reforms within the framework of FTAs.

3.4 Promotion of Economic Growth and Political and Social Stability in East Asia

For Japan, the importance of the East Asian economy has been expanding. The growth of the East Asian economy and social and political stability in East Asia have come to play a major role in the steady growth of the Japanese economy. However, despite the growing importance of the East Asian economy for Japan, a large number of issues still need to be overcome before further economic growth can be achieved, including an expansion in exports and investment, the training of human resources and infrastructure developments. FTAs with Japan are hugely significant in terms of overcoming these problems to bring about steady economic growth. Specifically, Japanese FTAs can be expected to bring about an expansion in both exports to Japan and investment from Japan. It goes without saying that expanding exports to Japan requires Japan to liberalize imports of agricultural products, and this will be discussed in greater detail in the following chapter. Japan decided to enter into FTAs actively with the countries of East Asia in recognition of the fact that supporting the growth of East Asian economies was possible through the above channels and that the resulting economic growth in East Asia would promote political and social stability in those countries and consequently have a favorable impact on the Japanese economy.

Awareness of the importance for Japan of steady economic development and growth by the

countries of East Asia was behind the CEPEA proposal. As described above, CEPEA is an FTA proposal involving the ASEAN+6 countries set up in 2006 in opposition to an ASEAN+3 East Asian FTA led by China. In 2008, Japan established the Economic Research Institute for ASEAN and East Asia (ERIA), with the ASEAN+6 countries as members, as an organization to provide intellectual support to the promotion of integration between the ASEAN+6 countries, or in other words CEPEA. The organization's head office is located at the ASEAN Headquarters. ERIA has been recognized as an international organization and is involved in a variety of activities, including research into the development of regional integration and related issues, the formulation of a comprehensive development plan for Asia and responses to energy and environmental issues.

3.5 Securing Resources and Regional Policies

For Japan, which relies on overseas supplies for a large number of natural resources, a steady supply of natural resources is essential to carrying out economic activities. In recent years, the rapid economic growth of newly emerging economies has led to a dramatic increase in demand for natural resources, leading to a situation of competition to secure resources. In order to provide a steady supply of resources from overseas, it is preferable to build up friendly and mutually dependent relationships with resource-exporting countries. One example of this would be Japan importing resources at the same time as exporting technology. FTAs are used as a method for creating these kinds of relationships. Examples of effective FTAs entered into by Japan with one aim being to secure natural resources include the FTAs entered into with Indonesia and Chile. The proposed FTAs with Australia, the GCC and Peru provide examples of similar FTAs currently under negotiation. Concerning the FTA with Indonesia, Japan was said to have requested that promises not to restrict the export of natural gas be included in the wording of the agreement with the aim of securing a steady supply of crude oil and natural gas. However, Indonesia did not agree to the request, instead promising to inform Japan promptly in the case that export restrictions became necessary.

In addition to economic motives, other motives for entering into FTAs include political motives and regional policy motives. Many of the United States' FTAs are entered into largely with the aim of pursuing economic benefits, such as NAFTA, but there are also many FTAs entered into in pursuit of stronger political relationships, rather than economic benefits, such as its FTAs with Jordan and Israel. Most of Japan's FTAs seek economic benefits, but there are some that also contain elements seeking to realize political objectives. For example, it is said that at the launch of negotiations for an FTA with Australia the Japanese side expressed gratitude for the surveillance provided by Iraq-based Australian armed forces to ensure the safety of Japanese Self Defense Forces dispatched to Iraq. As has already been described above, one of the motives for Japan in making the CEPEA proposal to include ASEAN+6 nations as member countries was the maintenance and expansion of political influence, as well as economic influence, in East Asia.

3.6 Economic Impact on Japan

In Chapter 3, our discussion has focused on the economic motives behind Japan's entry into FTAs. Here, we will use the results of a simulation analysis using economic models to analyze the economic impact

of FTAs.

Simulation methods utilizing Computable General Equilibrium (CGE) models are often used as a method for carrying out analyses of the economic impact of FTAs. CGE methods provide a model of the real economy focused on the behavior of market functions. During FTA analyses, CGE models are used to create economic conditions in the case that an FTA existed for comparison against the real economic conditions in which the FTA does not exist. In recent years, given the relative ease with which it has become possible to create CGE models for analysis, CGE models have come to be used to analyze FTA frameworks almost without exception. There is a wide variety of CGE model types, but the most popular is the GTAP model developed by Purdue University, Indiana, United States. In this chapter, we will examine analytical results produced by the GTAP model.

Kawasaki (2003) carried out an analysis into the economic impact on gross domestic product (GDP) of a variety of FTAs involving East Asian countries, using data from 1997.⁷ Table 3 shows the impact on the Japanese economy of Japan's bilateral FTAs with China, South Korea, Indonesia, Malaysia the Philippines and Thailand. According to the analytical results contained in Table 3, it is estimated that each bilateral FTA raised Japanese GDP by between 0.03% and 0.45%, respectively. These amounts may appear small, but in light of the fact that Japanese economic growth has been between 0% and 1% in recent years it becomes clear that the impact of FTAs has been substantial. This analysis gives figures higher than those produced by the results of many other analyses because it includes dynamic effects, such as capital accumulation and increased competition, in addition to the so-called static effects considered in normal analyses, such as efficiency improvements to the distribution of resources as a result of FTAs. However, given that FTAs are assumed to bring about an increase in direct investment and that direct investment is not included in this model, there is a strong possibility that the model underestimates the economic effects in this respect.

CEPEA carried out an analysis (2009) into the impact of FTAs on the ASEAN+3 and ASEAN+6 frameworks, rather than bilateral FTAs, using 2004 data. The results showed an improvement in Japanese GDP of 0.63% and 0.64% respectively. This suggests that multilateral FTAs have a larger economic impact than bilateral FTAs.

We have established that FTAs bring benefits to the GDP growth of the Japanese economy as a whole, but looking at individual industries it becomes clear that there is variation in the impact of FTAs, with some industries receiving the benefit of expanded production and others being forced into reduced production (Table 3). While the impact on Japanese industry varies from FTA partner to partner, generally speaking, primary industries such as crops suffer from reduced production whereas manufacturing, particularly the machinery industry, sees a rise in production. The differing impact of FTAs on production in the respective industries reflects the difference in competitiveness between these industries. Whereas the Japanese machinery industry is highly competitive, its primary industries are not. At the same time, the differences in the competitiveness of these industries reflect production factors and the existence of natural resources in the

⁷ A similar impact to GDP is estimated for economic welfare, which is used to analyze the impact on consumers.

Japanese economy. Whereas Japan possess abundant levels of the skilled workers and capital required for production in the machinery industry, it has poor levels of the natural resources required for production in primary industry.

4. Obstacles to the Promotion of FTAs

By promoting FTAs, Japan is able to obtain economic benefits. FTAs with East Asian countries promote the economic growth of those countries, facilitating a contribution to economic prosperity and political and social stability in the region. Economic prosperity and political and social stability in the countries of East Asia leads to growth in the Japanese economy through factors such as an expansion in Japanese exports and an increase in tourists to Japan. These are some of the beneficial effects that can be expected of FTAs, but a number of obstacles also lie in the path to concluding agreements. In this chapter, we will examine some of the economic and non-economic obstacles to entry into FTAs.

4.1 Economic Obstacles

As can be seen from the analytical results of the effect of FTAs on the Japanese economy from the previous chapter, it is Japan's primary industries that suffer damage as a result of FTAs. Of all primary industries, agriculture is expected to suffer particularly serious effects. Japan's agriculture sector has been protected for a long time in order to avoid this situation. According to an OECD estimate of the ratio of the various grants given to farmers against farmers' income between 2007 and 2009, the ratio was extremely high in Japan at 47% compared to an average 22% in OECD countries.

Average tariffs on agricultural products entering Japan are at a lower level than other importers of agricultural products. According to statistics for 2008 released by the WTO (2009), average customs tariffs on agricultural products entering Japan were 23.6%, lower than South Korea (49%), Norway (59%) and Switzerland (44%). However, Japan's protection of agricultural products is characterized by a variety of measures provided to give a high level of protection to certain agricultural products, including both tariffs and volume restrictions. For example, the ad valorem impact of these measures is as follows: rice (778%), wheat (252%), barley (256%), dairy products (218%), starch (583%), imported beans (excluding soya beans, peanuts and mung beans) (403%), peanuts (737%), konnyaku potato (1706%), raw silk (245%), sugar (379%), beef (50%) and pork (120%-380%).⁸ Of these agricultural products, the liberalization of rice is said to be the most difficult challenge, because rice is produced across wide areas of Japan and because rice production accounts for a high percentage of Japanese agriculture.

Agriculture represents a tiny proportion of the Japanese economy, accounting for just 1.5% of Japan's GDP (2006) and 4.2% of the workforce (2007), but its political power is extremely large. It is difficult to understand the political influence of Japanese agriculture from looking at the figures alone. In the background are the special interests of the agricultural machinery industry and construction industry, which have close ties to agricultural groups of farmers and farming cooperatives, politicians, the bureaucracy and the agriculture industry. Politicians become desperate to obtain the support of people related to these

⁸ Honma (2010)

organizations at elections and continue to protect agriculture in order to do so. For example, agricultural cooperatives use their monopoly in a variety of agriculture-related fields, such as the provision of animal feed, fertilizers and agricultural equipment, the sale of agricultural produce and the provision of loans, in order to raise their profits. They also seek protection so that this situation can continue. Politicians obtain the support of people associated with the agricultural cooperatives in return for providing this protection.

The arguments of the Ministry of Agriculture, Forestry and Fisheries for agricultural protection to achieve food security, protection of the natural environment and the handing down of village culture (the so-called multifaceted functions of agriculture) are supported to a certain extent by the Japanese population, but these arguments lack justification from an economic perspective. The best policy for achieving the multifaceted functions of agriculture is not agricultural protection. Rather, it would be better to apply the most effective policies for each of these individual functions. For example, the best policy for achieving the protection of the natural environment is not to restrict imports of agricultural products but to provide subsidies for projects such as tree-planting. The fact that a policy of protecting Japanese agriculture from imports has not been effective in bringing about food security (improvements in the ratio of food self-sufficiency) can be seen clearly in the fact that the food self-sufficiency ratio has plummeted under the policy of import restriction. It is possible that the continuation with the import restriction policy has even brought about a decline in the food self-sufficiency ratio.

The liberalization of agriculture has in fact been a major barrier to progress during FTA negotiations. Despite the fact that Japan imports almost no agricultural products from Singapore, Japan excluded the liberalization of agricultural products from the FTA between the two countries. During negotiations for the FTA between Japan and Mexico, the liberalization of imports on a variety of agricultural products, such as pork, became a major issue. Tough discussions were held about the liberalization of imports on agricultural products during FTA negotiations with a variety of other countries. Currently, the liberalization of agricultural products, fish in the case of Peru and dairy products and sugar in the case of Australia, is causing difficulties in FTA negotiations with those countries.

We need to understand that continuing with a protectionist policy that is extremely generous to agriculture not only impedes the promotion of FTAs for Japan, but by continuing with the inefficient use of production factors, such as labor and capital, also impedes a recovery and future growth in the Japanese economy.

4.2 Non-economic Obstacles

Let us discuss the non-economic obstacles to FTAs. In building FTAs with the countries of East Asia, there are a variety of political, security and historical obstacles for Japan. Japan and South Korea have built up cooperative security relationships with the United States, but China is not involved in this relationship. Specifically, there is a great deal of opposition over views on the Taiwan issue. As a result, some people believe it would be difficult for Japan and China to construct an FTA.

For Japan, there are also obstacles to establishing FTAs with China and South Korea because of historical issues. Developing FTAs with China and South Korea involves the historical problems of Japan's colonization of those two countries (partial colonization in the case of China) during the Second World War.

The image of Japan for people who still clearly remember their terrible experiences under colonization is far from positive, and this makes it difficult to build up cooperative relationships such as FTAs. However, in comparison to Sino-Japanese relations, a relatively positive relationship was built up with South Korea during the period when Keizo Obuchi was Prime Minister of Japan and Kim Dae-jung was President of South Korea. There were two reasons for this. The first was that reconciliation was reached between the respective political leaders on the historical issues. The second reason was that both countries began to understand the importance of close and cooperative economic and social relationships between the two countries. Reconciliation was reached after Prime Minister Obuchi made an apology for the actions of the Japanese towards Koreans during the war, and the strong political leadership of Kim Dae-jung facilitated acceptance of the apology. One important reason for increased recognition of the need for a closer economic and social partnership was that the realization of economic growth allowed people to change their view of the two countries' relationship from one that had been focused entirely on the past to one in which a future could be envisaged. This suggests the importance of political leadership and economic growth to the conclusion of FTAs. Later, despite a positive relationship continuing from a cultural perspective, political relations worsened during the period of Prime Minister Junichiro Koizumi and President Roh Moo-hyun, but improved after Lee Myung-bak took over as President of South Korea and Japan saw a change of government from the Liberal Democratic Party to the Democratic Party. Currently, political obstacles can be regarded as less significant.

5. Evaluation of Japan's FTAs

In this chapter I will be evaluating Japan's FTAs through comparisons with FTAs in other countries. First, I will carry out a quantitative evaluation. This will be followed by a qualitative evaluation. Later, I will examine the impact of Japan's FTAs on trade and direct investment.

5.1 Quantitative Evaluation

As pointed out above, Japan currently has 11 FTAs in effect (as of September 12, 2010). These break down into ten bilateral FTAs and one regional FTA with ASEAN. ASEAN has ten member countries, seven of which have entered into bilateral FTAs with Japan, meaning that there are 13 countries in total with which Japan has entered into some form of FTA relationship. The number of FTAs entered into by the major countries is as follows: United States (17), China (10), South Korea (9) and the EU (30). Despite having a lower number of FTAs than European countries, Japan is in a similar situation to the major countries of East Asia, all of which showed an interest in FTAs at a relatively late stage.⁹

The percentage (FTA coverage ratio) of Japan's trade (imports and exports) with FTA partner countries out of Japan's total trade was 16.5% in 2009 (15.9% in 2008)¹⁰. The FTA coverage ratio would expand greatly to 36.5% if countries with which FTA negotiations are currently ongoing were included, but even then would only cover a third of Japan's total trade. If FTAs could be concluded with Japan's major

⁹ WTO website: <http://rtais.wto.org/UI/PublicSearchByMember.aspx>

¹⁰ Shiino and Mizuno (2010), p.28

trading countries and regions, such as China, the United States and the EU, Japan's FTA coverage ratio would approach 90%. Looking at the FTA coverage ratio of the major countries as of 2008, most countries had a far higher ratio than Japan: United States (34.4%); European Union (72.7%), Mexico (82.3%), Indonesia (57.8%) and Thailand (54.2%). China (10.2%) and South Korea (13.9%) have lower ratios. However, in the case of South Korea this rises to 35.3% if the FTA signed with the United States and the FTA provisionally signed with the EU are also included.

5.2 Qualitative Evaluation

First, let us compare the comprehensiveness of the content of Japan's FTAs. Japan's FTAs generally have comprehensive content beyond trade liberalization, covering areas such as services, investment, intellectual property and competition, and are generally comparable to the FTAs of other developed countries. Given that most FTAs with developing countries rarely have comprehensive content from the outset (and have a strong tendency to begin with trade liberalization and then gradually expand to cover services, investments and other content) Japan's FTAs can be regarded as comprehensive. In terms of the comprehensiveness of liberalization and facilitation of trade in finance and services, Japan's FTAs are at the same level as other developing countries, and at a significantly higher level than FTAs in developing countries. One of the characteristics of Japan's FTAs is economic cooperation, covering a broad range of areas including the fostering of small-to-medium enterprises and the training of human resources. One of the reasons why economic cooperation plays a major role in Japan's FTAs is the fact that its FTA partners are developing countries in East Asia with a strong interest in economic cooperation.

Below, I shall carry out an evaluation into the quality of Japan's FTAs by examining decisions related to the fields of trade in goods, services and direct investment. This analysis is based on research results compiled during the "FTA Qualitative Analysis Project" carried out by the Research Institute of Economy, Trade and Industry (RIETI), for which this author acted as project manager. The project targeted the following FTAs: AFTA; the China-ASEAN FTA, the Australia-United States FTA, the Australia New Zealand Closer Economic Relations Trade Agreement, the Chile-South Korea FTA, EFTA, the EU-Mexico FTA, the Japan-Mexico FTA, the Japan-Singapore FTA, NAFTA and the United States-Singapore FTA.

According to Cheong and Cho (2010), Japan's FTAs have a lower level of liberalization (ratio of liberalization on imports as a percentage of overall imports) than other FTAs. The level of liberalization for agricultural products is particularly low. What's more, there are complicated rules of origin which have the effect of restricting imports from FTA partner countries. Table 4 shows the level of liberalization for the FTAs already put into effect by Japan, and in many cases the level of liberalization for Japan is lower than the level of liberalization in the respective partner countries. By providing economic cooperation, Japan has succeeded in keeping the market liberalization of its own economy at a low level. As a specific example, in the case of Japan's FTA with Malaysia, Malaysia was said initially to oppose the liberalization of its automotive market, but after Japan offered to provide technological support to contribute to improvements to the technological standards of the Malaysian automotive industry, Malaysia then agreed to the liberalization of its automotive market.

In this case, Japan succeeded in opening the market of an FTA partner country using a carrot-and-stick approach, resulting in an expansion in trade that can be seen as benefitting both countries. On the other hand, the Ministry of Agriculture, Forestry and Fisheries has used a similar carrot-and-stick approach to avoid opening the Japanese market. Specifically, the Ministry of Agriculture, Forestry and Fisheries is said to have obtained agreement on preventing demands for the opening of the Japanese market for agricultural products by providing technological support to contribute to improvements in plant and animal quarantine capacity. In fact, during FTA negotiations with Malaysia and Thailand, swift action by the Ministry of Agriculture, Forestry and Fisheries saw agreement reached on trade in agricultural products before agreement was reached on industrial products.

Ochiai et al. (2010) carried out an evaluation of the liberalization of trade in services under FTAs. They carried out an analysis of all 11 of Japan's FTAs and ranked the level of liberalization in trade in services for the Japan-Mexico FTA and Japan-Singapore FTA at 6th and 8th respectively. Japan's level of liberalization is lower than that found in the FTAs of other developed nations such as the United States and Australia, but higher than the level found in the FTAs of developing nations. There are four modes of trade in services, each with different levels of liberalization in the respective FTAs, but in terms of the average assessment of decisions implemented in relation to trade in services in Japan's FTAs overall, the figure was roughly average.

Urata and Sasuya (2010) carried out an analysis into decisions governing direct investment, and according to this analysis, Japan's FTAs with Singapore and Mexico ranked 3rd and 7th respectively among Japan's 11 FTAs. In terms of the overall ranking of Japan's 11 FTAs in comparison with the FTAs of other countries, Japan ranked 4th out of eight countries. From these results, it can be seen that Japan's FTAs have an average level of liberalization in direct investment and a similar level of liberalization for trade in services.

5.3 Effects of FTAs on Trade and Direct Investment

Next, let us look at the effects of Japan's FTAs on trade and direct investment. After analyzing the Japan-Singapore and Japan-Mexico FTAs, for which statistics are available, Ando (2010) makes it clear that FTAs have increased both trade and investment in comparison with past trends. Specifically, after falling between 2001 and 2002, total trade between Japan and Singapore rose significantly between 2002 and 2005 after the FTA between the two countries came into effect, rising from USD 14.1 billion to USD 18.5 billion. Before the FTA between Japan and Mexico came into effect, trade between the two countries rose by 13.5% annually between 1996 and 2004, but this rate of growth accelerated to 24.1% in 2005 after the FTA came into effect. A similar rise in direct investment was also confirmed. Direct investment in Singapore by Japan rose by 550% between 2002 and 2003, and direct investment in Mexico by Japan increased from USD 20 billion in 2004 to USD 69 billion in 2005.

Analyzing overall trends through comparisons before and after FTAs come into effect may be of benefit, but it does not allow close analysis of the effects of FTAs. In order to analysis FTAs' effects, it is necessary to examine changes in the trade of components for which tariffs have been abolished. As suggested by its reputation as a free trade port, Singapore imposes almost no tariffs on products. Accordingly, no tariffs

are imposed on Japan's exports to Singapore and there ought to be little impact on trade as a result of the FTA between the two countries. Let us look at one of the few items on which tariffs are imposed—beer. Singapore imposes a 4% tariff on beer, but tariffs on beer from Japan fell to 0% after the FTA between Japan and Singapore came into effect. Imports into Singapore of Japanese beer rose 20.3% between 2002 and 2004, and the FTA between the two countries can be regarded as one cause of this. Regarding the FTA between Japan and Mexico, the 50% tariff imposed on motor vehicles imported to Mexico was abolished after the FTA between the two countries came into effect and imports of motor vehicles from Japan to Mexico rose by 36.5% between 2004 and 2005.

From the results of statistical analysis using gravity models, it is clear that there was a statistically-significant rise in exports from Japan to Mexico after the FTA between the two countries came into effect, but a similar trend was not detected between Japan and Singapore. The above results of the statistical analysis are consistent with the expected impact given that Mexico had a very high rate of tariffs before the FTA came into effect and that Singapore's tariff rate was almost zero. In other words, the effect of FTAs on trade can only be recognized with there is a high level of tariffs before an FTA comes into effect. From a relatively imprecise analysis of the effects of FTAs on trade and direct investment, we have confirmed that FTAs contribute to a certain extent to an expansion in the market opportunities of Japanese companies in FTA partner countries. However, this effect can be regarded as smaller than the expected effect. The reason why FTAs do not have a bigger impact is because Japanese companies do not utilize FTAs to a great extent. According to Takahashi and Urata (2010), in a survey targeting 469 Japanese companies involved in trading, there were very low percentages of companies utilizing FTAs in the case of Japan's FTAs with Singapore, Mexico and Malaysia, at 6.4%, 12.6% and 5.5%, respectively. Reasons cited for why Japanese companies do not utilize FTAs are the lack of information on FTAs and the high costs of acquiring the certificates of origin required for the utilization of FTAs. In order to expand use of FTAs these issues needs to be addressed.

6. Conclusion: Towards the Promotion of FTAs

Many of the countries of East Asia, including Japan, are actively entering into FTAs with other countries within the region. Many of these countries have the stated aim of entering into an FTA for the East Asia region as a whole. If this were achieved, it would doubtless lead to a level of deep regional integration in economic terms comparable with the EU. Behind these expectations lies recognition of the likelihood of peace and prosperity resulting from economic wealth and political and social stability coming about as a result of regional integration. However, as has become clear in the above discussion, there are still many obstacles for Japan to overcome even when building bilateral FTAs, and if this is extended to the East Asia region as a whole the obstacles become not only more numerous but more complex. In this chapter, I will examine the measures that Japan needs to implement in promoting FTAs.

The most difficult problem from an economic perspective in terms of the conclusion of FTAs is the fact that the loss of workers' employment becomes unavoidable as a result of FTAs. There are at least two conceivable solutions to this problem. One potential solution is the payment of income benefits limited to the period of unemployment. Another is support for the acquisition of technical skills to encourage job transfers

to more productive occupations. For example, let us consider the likely issues of unemployment and career change for agricultural workers that would result in the entry into an FTA that included liberalization in the field of agriculture. In light of the fact that many agricultural workers are senior in age and consequently would have difficulty in switching career, income benefits are likely to be the most realistic measure.

One view is that in order to bring about liberalization under FTAs agriculture should be developed to the extent that it is capable of withstanding the competition of liberalization, and this is also related to the issue of agricultural workers. For example, regarding the largest issue, which is the rice issue, it is possible to conceive forward-looking agricultural policies in which income benefits are provided to any farmers who devote themselves to the large-scale production of rice, thereby strengthening competitiveness.¹¹ This policy would lead to the consolidation of farmland and improvements in farmers' productivity. As a result, it would be possible for the government to reduce the current level of costs related to maintaining prices. Consequently, markets would be opened up through liberalization reducing the burden on the consumer and removing barriers to FTAs.

When tackling trade liberalization of the agriculture sector, it is important not to forget the inappropriate measures implemented in the past. Specifically, this includes the rice import liberalization measures implemented during the Uruguay Round of multilateral trade negotiations. The Japanese government provided six trillion yen to agriculture as part of its measures to liberalize rice, but most of the money was spent digging for hot springs and paving national highways, not on strengthening the agriculture sector and improving the skills of agricultural workers. In promoting FTAs, it is necessary to consider the liberalization of agriculture under FTAs by examining the role of agriculture in building a competitive Japanese economy and implementing policies to bring about this type of agriculture.

Above, we have discussed the measures needed to overcome the economic obstacles to Japan's promotion of FTAs. In order to make these policies a reality, politicians with responsibility for policy proposals need to recognize the need for FTAs and work hard to bring them about. In order to do this, there is a need for Japan's citizens and politicians to possess a strong sense of crisis about Japan's future. Without this sense of crisis, we cannot expect to see the effective measures necessary for the promotion of FTAs. In promoting FTAs with East Asia in particular it is necessary to recognize that a closer relationship with East Asia brings economic prosperity and political and social stability to the region and that this is important for the prosperity of Japan.

In order for the Japanese people to recognize the importance of a close relationship with East Asia it is crucial that mutual understanding is strengthened with the people of East Asia. One effective way of achieving this would be to promote exchange between people at every conceivable level. Mutual exchange between businesspeople has made a great deal of progress as a result of deeper economic interdependence. Now there is a need to vitalize exchange between politicians and the citizens of the respective countries. Japan's politicians need to carry out meetings and exchange opinions with the people of East Asia through a variety of new meetings. In the past, Japan's politicians have prioritized the United States and Europe, but now there is a pressing need to build strong relationships with the countries of East Asia. Regarding the

¹¹ See Yamashita (2004) for more on this debate.

general population, it would be desirable for exchange to be promoted with a focus on the younger generation as far as possible. Specifically, promoting exchange between students and researchers through study exchange programs and joint projects would doubtless be effective. By invigorating exchange between these types of people it may be possible to overcome non-economic obstacles, such as politics and history.

Lastly, as the country with the highest level of economic development in East Asia, Japan needs to contribute in a variety of ways to the construction of an FTA that incorporates East Asia. Discussions have begun on an FTA with the countries of East Asia as signatories, and Japan needs to play a leading role in making an intellectual contribution to the debate on planning an East Asian FTA and the realization of that planning. Moreover, Japan needs to play a leading role in a variety of regional issues other than FTAs, including finance, energy and the environment. It goes without saying that in carrying out these roles it is essential that Japan should build and utilize cooperative relations with the countries of East Asia.

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Table 1: Japan's FTAs

	Partner Country/ Region	Start of Negotiations	Signed	Effective
In Effect	Singapore	January 2001	January 2002	November 2002
	Mexico	November 2002	September 2004	March 2005
	Malaysia	January 2004	December 2005	July 2006
	Chile	February 2006	March 2007	September 2007
	Thailand	February 2004	April 2007	November 2007
	Indonesia	July 2005	August 2007	July 2008
	Brunei	June 2006	June 2007	July 2008
	Philippines	February 2004	September 2006	December 2008
	ASEAN*	April 2005	April 2008	December 2008
	Switzerland	May 2007	February 2009	September 2009
	Vietnam	January 2007	December 2008	October 2009
	Under Negotiation	South Korea	December 2003*	
Gulf Cooperation Council (GCC)		September 2006		
India		January 2007		
Australia		April 2007		
Peru		May 2009		

Note: * FTA negotiations with South Korea were broken off in November 2004

Source: Ministry of Foreign Affairs document

Table 2: Development of Trade Liberalization in the Countries of East Asia

		Primary Products		Industrial Products		All Products	
		Simple average	Weighted average by weight of import amount	Simple average	Weighted average by weight of import amount	Simple average	Weighted average by weight of import amount
China	1992	35.1	14.1	40.6	35.6	40.4	32.1
	2007	9.0	3.0	8.9	6.3	8.9	5.1
Indonesia	1989	18.2	5.9	19.2	15.1	19.2	13.0
	2007	6.6	2.5	5.8	4.4	5.9	3.9
South Korea	1988	19.3	8.3	18.6	17.0	18.6	14.0
	2007	20.8	11.5	6.6	4.8	8.5	8.0
Malaysia	1988	10.9	4.6	14.9	10.8	14.5	9.7
	2007	2.8	2.3	6.5	3.4	5.9	3.1
Philippines	1988	29.9	18.5	27.9	23.4	28.3	22.4
	2007	6.0	5.2	4.8	2.7	5.0	3.6
Singapore	1989	0.2	2.5	0.4	0.6	0.4	1.1
	2007	0.2	0.0	0.0	0.0	0.0	0.0
Thailand	1989	30.0	24.3	39.0	35.0	38.5	33.0
	2006	13.6	2.1	10.4	5.8	10.8	4.6

Source: World Bank, World Development Indicators 2005 and 2009 and other published materials

Table 3: Impact of FTAs on the Japanese Economy (%)

	Bilateral FTA Partner Country					
	China	South Korea	Indonesia	Malaysia	Philippines	Thailand
Real GDP	0.45	0.12	0.06	0.08	0.03	0.24
Production volumes						
Grain	-2.50	-0.32	-0.94	-0.30	-0.16	-3.97
Meat	-3.05	-1.54	0.15	-0.08	0.03	-0.60
Other primary products	-1.34	-0.15	-0.15	-0.09	-0.35	-0.06
Minerals	-0.41	-0.15	0.26	-0.19	-0.01	-0.04
Food processing	-0.57	-0.22	-0.30	-0.06	-0.03	-0.37
Textile products	4.54	-0.20	-0.04	-0.14	0.03	0.06
Leather products	-9.95	-1.74	-1.24	-0.34	-0.09	-0.03
Chemical products	0.36	0.18	0.06	0.00	0.02	0.19
Metal products	0.30	0.30	0.17	0.09	0.04	0.28
Transportation machinery	0.38	-0.67	0.75	1.25	0.27	0.89
Other machinery	0.22	0.33	-0.05	-0.26	-0.02	-0.11
Other industrial products	0.07	-0.03	-0.09	-0.09	0.00	0.00
Construction	0.02	0.01	-0.01	0.02	0.00	0.00
Commercial and transportation services	-0.06	-0.02	0.00	-0.02	0.00	0.01
Other private sector services	-0.05	-0.01	-0.01	-0.01	0.00	0.00
Public services	-0.04	0.00	-0.01	0.01	0.00	0.00

Source: Kawasaki (2003)

Table 4: Level of Liberalization of Japan's FTAs

	Japan	Partner Country	Overall	Year of Trade Data
Singapore	94.7	100	Approx. 99	2005
Mexico	86.8	98.4	Approx. 96	2002
Malaysia	94.1	99.3	Approx. 97	2004 (Japan), 2003 (Malaysia)
Chile	90.5	99.8	Approx. 92	2005
Thailand	91.6	97.4	Approx. 95	2004 (Japan), 2003 (Thailand)
Philippines	91.6	96.6	Approx. 94	2003
Brunei	99.99	99.9	Approx. 99.9	2005
Indonesia	93.2	89.7	Approx. 92	May 2004 to April 2005
ASEAN	93.2	Approx. 91	-	2006 (Japan) 2005 or 2006 (ASEAN)
Switzerland	99.3	99.7	Approx. 99	2006
Vietnam	94.9	87.7	Approx. 92	2006

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