



# New Phase of International Trade Policy I: Mega FTAs are Key Strategy

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## Key points

- Pressing need to restore rules-based international trading order
- Mega FTAs effective strategy in reducing policy risk
- Important to utilize and strengthen TPP11 and RCEP

Since the mid-1980s, international production networks have developed in East Asia. This international division of labor in terms of production processes and tasks has created “Factory Asia” in the manufacturing industry, particularly machinery industries. The production blocks responsible for processes and tasks in production networks are located across national borders, necessitating economic conditions and a policy environment that allows for close coordination between production blocks. A rules-based international trading order is therefore essential.

However, in the past four years the international trading order has been under assault. The international trading order has faced challenges on many fronts, including the Trump administration’s trade policy that shows a disregard for the rules, countermeasures by other countries, and the US-China trade war. While the inauguration of the Biden administration offers hope, for the present the trade policy of the Trump administration will continue. With the US-China standoff unresolved, decoupling is likely to become more acute.

East Asian production networks are overcoming the negative supply and demand shock caused by COVID-19. Digital technologies are further improving the efficiency of production networks and accelerating the development of new digital and related industries. The question is how to manage the uncertainty and further develop Factory Asia.

Japanese and Asian companies must continue to seek the best solutions to ensure efficiency and manage risk in their production networks. With global superpowers increasing uncertainty by themselves, it is difficult for the Japanese government to have complete control over the situation. One thing that can be done, however, is to further develop Japan’s Mega Free Trade Agreement (FTA) strategy.

Mega FTAs here refers to FTAs involving a large number of countries or FTAs among major world powers. In the past, the role of Mega FTAs was considered to be twofold: to liberalize trade and investment and to create new international rules. Mega FTAs were expected to respond to a new globalization in which the World Trade Organization (WTO) was seriously dysfunctional.



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In light of the weakening of the rules-based international trading order since 2017 and the intensifying conflict between the United States and China, Mega FTAs now have two additional roles. The first is to reduce the policy risk that trade policy will change according to the politics of the moment, and the second is to build a coalition of middle powers to support free trade.

The following examines Mega FTAs from the perspective of their four roles.

The table shows the FTAs in which Japan has participated in recent years. Negotiations for the Trans-Pacific Partnership (TPP), the Japan-EU EPA, and the Regional Comprehensive Economic Partnership (RCEP) began in 2013. The TPP was signed in February 2016, but the United States withdrew from it right after the Trump administration was inaugurated in January 2017.

The TPP11, led by Japan, survived the withdrawal of the United States and played a role in the formation of the Middle Power Coalition between the United States and China. The liberalization of trade and investment and the creation of international rules set new standards for East Asia to aim for. The rate of tariff elimination in Japan was 95%, reaching 99–100% in other countries.

| Japan's recent FTAs   |  |                                 |  |  |
|---|--|---------------------------------|--|--|
|   | Start of negotiation                             | Signed                          | In force   | Member countries and regions   |
| TPP   | July 2013<br>(Japan participated in negotiation) | February 2016                   | Not entered into force<br>(US withdrawal from TPP in January 2017) | Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, USA, Vietnam                                    |
| TPP11   | -  | March 2018                      | December 2018  | Mexico, Japan, Singapore, New Zealand, Canada, Australia, Vietnam, (entered into force), Brunei, Chile, Malaysia, Peru                   |
| Japan-EU EPA  | April 2013                                       | July 2018                       | February 2019  | Japan, EU 28 (27 countries after withdrawal of the UK in January 2020, the Agreement remains applicable to the UK until the end of 2020) |
| Japan-US Trade Agreement and Japan-US Digital Trade Agreement | April 2019                                       | October 2019                    | January 2020   | Japan, USA   |
| Japan-UK EPA  | June 2020  | October 2020                    | January 2021   | Japan, UK  |
| RCEP  | May 2013   | November 2020<br>(except India) | ?  | ASEAN 10, Australia, China, Japan, South Korea, New Zealand  |

In the case of services and investment, a negative list approach involving a high degree of liberalization was adopted, that is to say the sectors reserved for liberalization are specified. In terms of international rule-making, state-owned enterprise regulations as a means of leveling the playing field for state-owned enterprises are particularly important, as are electronic commerce regulations, which claims the free movement of data, the prohibition of data localization requirements forcing the installation of local servers, and the prohibition of forced source code disclosure.

The Japan-EU EPA also has a high degree of liberalization. The rate of tariff elimination is 94% for Japan and 99% for the EU. A negative list approach was adopted for services and investments. The international rules are also comprehensive, but do not include the free movement of data or the prohibition of data localization requirements in electronic commerce. The reduction of policy risk and the formation of Middle Power Coalitions have been a significant contributing factor.

The scope of the Japan-US Trade Agreement is restricted to trade in goods, although this does not extend to all goods and is subject to additional negotiations. Its significance for Japan lay in the reduction of policy risk, in particular the fact that it avoids the application to automobile imports of Section 232 of the Trade Expansion Act, which allows trade restrictions on security grounds. On the other hand, the Japan-US Digital Trade Agreement added a prohibition on the mandatory disclosure of algorithms to the Electronic Commerce Chapter (Chapter 12) of the TPP.

The RCEP, which was signed without India in November 2020, compares unfavorably with agreements such as TPP11 in terms of liberalization. However, the rate of tariff elimination is 91% for all participating countries, making its terms more beneficial than existing FTAs in East Asia. Further, despite irregularities such as the fact that tariff elimination arrangements will be set by each partner country, Japan and China, and Japan and ROK are for the first time linked in an FTA. Shared rules of origin apply within the region, facilitating trade more than existing FTAs and resulting in a certain trade creation effect. For services too, the ultimate goal is a negative list approach.

The RCEP is also wide-ranging in terms of international rule-making. It offers a starting point for negotiations on the participation of China and the Association of Southeast Asian Nations (ASEAN) in future international rule-making. Of particular interest is the Electronic Commerce Chapter, which includes broad exemptions but also claims the free movement of data and the prohibition of data localization requirements.

The ultimate goal of Mega FTAs is not to have them signed and come into effect. Their importance lies in the way they are utilized and the way their content is enhanced in the future.

The challenge for the TPP is to expand its membership. Although many are pessimistic about the return of the United States, objectively it would be a rational choice for the US. The world would welcome the return of the United States to the position of rule-follower. The potential return of the US has led countries such as the UK, Thailand and South Korea to express the desire to join. With Japan presiding over the Commission in 2021, this is a good opportunity to encourage new members.

China is also expressing interest in the TPP. The main obstacles are the liberalization of trade and investment, state-owned enterprises, and electronic commerce. If the reformist faction in China were to gain the upper hand, it could use TPP membership to promote radical structural reform.

However, China is aware that negotiations have a part to play. For example, Vietnam and Malaysia have obtained extensive exemptions with regard to state-owned enterprises. For electronic commerce, the overriding principles have been presented, but the extent to which domestic law reform will be required is not clear. It is also necessary to verify the compliance of the current member countries with the agreement so that China is not admitted into membership on lenient terms.

The RCEP must be brought into force as quickly as possible, and when the agreement is reviewed five years later, efforts must be made to conform as closely as possible to the standards of liberalization and international rule-making set by TPP11. It is also essential that India understands the nature of production networks and be encouraged to return to the RCEP, having withdrawn from the negotiations due to fears

of a sharp increase in imports from China.

The RCEP may function as a dialogue channel to reduce policy risks. Major powers tend to be lured into using trade policy as a political tool, depending on the political situation of the moment. At a time when the dispute settlement function of the WTO is declining, Mega FTAs can provide an opportunity for middle powers to cooperate and encourage major powers to regulate their policies. Japan should proactively use its position as a hub for multiple Mega FTAs.

Translated by The Japan Journal, Ltd. The article first appeared in the “*Keizai kyoshitsu*” column of *The Nikkei* newspaper on January 19, 2021 under the title, “*Shin-kyokumen no Tsusho-seisaku (I): Mega FTA senryaku no tenkai, kagi (New Phase of International Trade Policy I: Mega FTAs are Key Strategy)*.” *The Nikkei*, January 19, 2021. (Courtesy of the author).

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