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Analysis

Japan's New Foreign Economic Policy: A More Strategic and Activist Model?

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Japan's foreign economic policy has embarked on new directions that just a decade ago would have seemed unthinkable. Long a critic of regionalism as harmful to the multilateral trading system that had anchored its export-led growth, Japan recently put aside its reservations on preferential trading to quickly develop an extensive network of free trade agreements (FTAs).

Japan has also come to promote regional trade agreements. Japan proposed the Comprehensive Economic Partnership in East Asia (CEPEA), which is an FTA covering ASEAN+6 (the plus six being Australia, China, Japan, India, Korea, and New Zealand) countries, at the ASEAN+3 (ASEAN, China, Japan, Korea) Economic Ministers' meeting last August. This proposal was considered to have been a counterproposal to the China-led East Asia Free Trade Agreement (EAFTA) covering ASEAN+3 countries, which has been discussed since the early 2000s. Japan has also been supportive of establishing a Free Trade Area of the Asia Pacific (FTAAP). For Japan, the economic benefits from regionally

based FTAs are likely to be much greater than those resulting from any bilateral FTAs currently in force, under negotiation or under study.

This recent departure in Japanese foreign economic policy reveals a new level of activism and policy experimentation. It also signals an attempt to develop a more strategic response to a number of challenges and perceived adverse trends at home and abroad.

Among the largest forces impacting the evolution of Japanese foreign economic policy is the rise of China and its increasingly assertive economic and security policies. On the FTA front, competition with China is evident in the sequencing of negotiations with ASEAN and in the contrasting proposals for a regional trade bloc that China and Japan have put forward in the context of the East Asian Summits.

Yet, Japan's ability to embark on a bold and strategic foreign economic policy is still very much undermined by its own domestic policy making dynamics. In both trade and economic assistance, new policy initiatives have to muddle through domestic politics, and in the process they lose their strategic focus and economic impact. The classic case in point is the success of the agricultural and labour lobbies in avoiding substantial liberalization commitments seriously compromising the quality of Japanese FTAs.

Paper of the Month

The paper of the month for May is **International Capital Flows and Business Cycles in the Asia Pacific Region** by A/Prof. Soyoung Kim et. al.

Latest News

The Japan Center for Economic Research (JCER) is the latest of the major regional research institutes to join EABER. JCER is one of Japan's premier economic research institutes. It produces discussion papers on Japanese and international economic policy, national and regional forecasts as well as publishing the journal *Asian Economic Policy Review*.

The first phase of the project on the Institutional Foundations of East Asian Economic Integration was completed with the final country conference in Seoul on 25 May. The next phase of this Project will start later this year and will review forms of regional cooperation that might assist East Asian and Pacific economies in enhancing policy making processes.

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The lack of capacity for strategic trade policy formation also limits the benefits of Japan's foreign policy agenda. For example, the countries with which Japan has established FTAs so far account for only a small portion of overall trade (7.1 per cent in 2005). This value increases to 33.8 per cent, if all the FTAs under negotiation or those about to start negotiation are successfully concluded but is still smaller than the value of trade covered in US agreements (36 per cent) or for the EU (60 per cent). If Japan is seriously considering FTAs as an important trade policy option, it should target its largest trading partners, China, the US and the EU.

In large part this is because Japan lacks the institutional structures, either formal or informal, to coordinate its foreign economic policies and establish a level of coherence in across its international engagement. Indeed, there is no high-level government body such as a council, where the full spectrum of foreign economic policy issues are discussed jointly.

Whilst an Overseas Economic Cooperation Council has been set up to discuss economic cooperation including ODA strategies, no such council has been established to assess trade strategies, including FTAs. A Council of Ministers on the Promotion of Economic Partnership Agreements (EPAs) has been created, but this

council is not active nor is it involved in discussions on EPA strategies. A working group on EPAs and agriculture has been set up inside the Council on Economic and Fiscal Policy but this working group is a temporary and special arrangement.

One way to formulate coherent and consistent foreign economic policies covering trade, ODA and other foreign economic issues such as FDI, might be to establish a Council on Foreign Economic Policy chaired by the Prime Minister, which could give special attention to the development of policy strategy. This would act as a counterpart to the Council on Economic and Fiscal Policy, which provides a focus for policy coordination on domestic economic reform issues in Japan.

This type of institutional reform will not provide a panacea for the coordination problems facing Japan's foreign policy agenda. Sustained political leadership will be required to overcome strong and persistent obstacles. However, it is clear that in the absence of some type of high-level coordination body, Japan will remain hampered in its attempts to develop a strategic approach to foreign economic policy and these problems will remain until there is an effective mechanism for policy coordination across the range of foreign economic policies, including trade policy.

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