

# Governance Reconsidered in Japan: Searching for New Paradigms in the Global Economic Downturn\*

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**Abstract:** This paper aims to answer following questions in the context of the global economic crisis: (1) What are the features and the causes of the socio-economic difficulties that Japan is facing now? (2) What efforts in public administration and governance are being made in Japan in order to overcome the crisis? (3) In the process of overcoming the crisis, will there be a paradigm shift in governance and will the new system be institutionalized? To answer these questions, this paper will stress the importance of East Asian integration by examining the domestic politics of the Japanese free trade agreement (FTA) policy. Asian regional integration is a way for the Japanese economy to undertake structural reform. Japan should advance two policy options in parallel: managing a domestic safety net and promoting an FTA with East Asia. In that sense, Japanese government accountability, in other words governance, is essential.

**Keywords:** global economic crisis, governance, Japanese FTA policy, East Asian integration

## INTRODUCTION

“Japan is at its most crucial crossroad in 100 years,” then Prime Minister Taro Aso said in an April 9, 2009 news conference. Referred to as an unprecedented and once-in-a-century event, the global financial and economic crisis that began in 2008 sent the

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world economy into a recession overnight and has had an extremely serious impact on Japan's economy and society. Japan is facing an employment crisis from the recession.

East Asian economies were relatively well insulated against the financial impacts of the global crisis, but their dependence on trade through regional production networks and export-led growth strategies made them vulnerable to the sharp contraction of demand from the North American and European economies. The International Monetary Fund has projected sharp real GDP declines in 2009, with Japan's economy expected to shrink by 6.2 percent, Taiwan's by 7.5 percent, South Korea's by 4 percent, and Singapore's by 10 percent. China is the outlier, with positive growth expected at 6.5 percent. Even so, China experienced a huge growth contraction (13 percent) in 2007. Japan was hardest hit by the contraction of export markets: its current account surplus is expected to shrink from 4.8 percent of GDP in 2007 to 1.5 percent in 2009. China's will shrink slightly, but Korea's and Taiwan's will expand.

In summary, Asian economies—including Japan, which appeared to be decoupling from the U.S. economy—are not immune to the deepening U.S. recession, and countries in the region are now forced to deal with weakening demands from abroad on top of their internal difficulties. Is it possible, despite these hardships, to hope that the present crisis might give the Asian countries that still have high growth potential an opportunity to strengthen their economic fundamentals as well as improve regional economic cooperation through a more solid framework?

This paper aims to answer the following questions about the global economic crisis triggered by the American financial crisis: (1) What are the features and the causes of the socioeconomic difficulties that Japan is facing now? (2) What efforts, in terms of public administration and governance,<sup>1</sup> are being made in Japan in order to overcome the crisis? (3) In the process of overcoming the crisis, is there likely to be a paradigm shift in governance, and will the new system be institutionalized?

This paper focuses on East Asian integration by examining the domestic politics of the Japanese free trade agreement (FTA) policy.<sup>2</sup> Balassa (1961, 1-5) proposed five categories for increasing degrees of economic integration: (1) free trade area, (2) cus-

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1. This paper uses the term *governance* to mean government accountability and fundamental principles and rules of regional cooperation.
  2. The terms FTA and EPA are used interchangeably in this paper. Technically, an EPA (economic partnership agreement) is defined as a bilateral or multilateral agreement among states to eliminate customs duties and other domestic import/export regulations, harmonize economic systems, and facilitate the free movement of people, goods, and capital within a region. An FTA (free trade agreement) is defined as an agreement, within a region or between states, to reduce or eliminate tariffs and other barriers on trade in goods and services. An FTA can be a major component of an EPA (METI 2005).

toms union, (3) common market, (4) economic and monetary union, and (5) complete economic union. FTAs<sup>3</sup> are a significant option for overcoming the global economic crisis. This paper argues that Japan should pursue the scenario “grow with Asia.” Before the current crisis broke out, regional economies already had strong economic fundamentals, strong financial reserves, good macroeconomic policies, and political stability. The economic downturn could possibly best be overcome by advancing Asian economic integration—establishing FTAs,<sup>4</sup> promoting regional infrastructure adjustment, enlarging consumption markets by diverting focus from the poor to the middle class, and focusing less on U.S. and European markets and more on Asian markets (Iguchi 2009, 4-5).

To protect domestic employment, there needs to be a strong push to divert economic policy towards the expansion of domestic demand. To stop the impact of the global economic crisis, there is no doubt that international cooperation between major developed countries and newly developing countries such as China and India is essential. However, when countries are highly dependent on each other through trade and investment as they are in East Asia, economic policies need to take into account not only recovery of domestic industries and employment, but also the economic recovery of neighboring countries. Furthermore, it is inevitable that countries like Japan, which have a low birthrate and a rapidly aging society and in which large growth in domestic consumption is highly unlikely, will become increasingly dependent upon market growth in the emerging countries (Iguchi 2009). Even though fiscal policies may be able to mitigate the influence of the economic downturn, prolonging these policies may result in further growth of the budget deficit (Iguchi 2009).

The key to revitalizing the Japanese economy after the global economic downturn is not only to have the safety net of a domestic economic stimulus package, but also to promote FTAs within the East Asian region—in other words, East Asian integration. Japan is advancing FTAs—focused not only on the removal of trade barriers but also on investment, movement of people, intellectual property rights, and certification standardization—mainly with East Asian developing countries. The main motive of these

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3. To establish a single East Asia-wide FTA will not be an easy task once FTAs have proliferated in the region. Each FTA may have different rules. One challenge is avoiding the “spaghetti bowl” effect by ensuring consistency across different trade arrangements. To make the task easier, each FTA or EPA should have transparent, simple rules with regard to external tariffs, exclusion lists, rules of origin, and harmonization of standards, procedures, and regulations. Convergence towards identical rules and common tariff rates, rules, and standards is highly desirable.
  4. For discussion of FTAs in East Asia, see for example, Aggarwal and Urata (2006), Urata (2002), Lincoln (2004), Soesastro (2006) and Kim (2010a).

agreements is to access the partner nation's market, advance domestic structural reform, and, most importantly, provide economic support for East Asian countries. The idea is that Japanese support for economic growth in East Asia will bring not only economic prosperity but also political and social stability within the region, and as a result, will benefit the Japanese economy and society as well (Urata 2007, 1-34).

This paper will discuss the socioeconomic difficulties brought on in Japan by the global economic crisis, the Japanese government's efforts to overcome these difficulties, the policy option of an East Asian FTA, and East Asia's experience with FTAs to date. After reviewing previous studies of factors promoting and hindering Japanese FTA policy, it will offer the Inner Adjustment Model as a theoretical framework. Using the successful Japan-Mexico FTA as a case study, it will explore changes in the way agriculture has been dealt with in Japan's domestic policy. Based on interviews with policy makers within the Japanese government (including officials from the Ministry of Foreign Affairs [MOFA], Ministry of Economy, Trade, and Industry [METI], and Ministry of Agriculture, Forestry, and Fisheries [MAFF]) and key interest groups (such as the Japan Business Federation [Keidanren], the Central Union of Agricultural Cooperatives [JA-Zenchu], and agriculture policy tribes [*zoku-giin*]), it demonstrates how the success of the Inner Adjustment Model has led the Japanese government to adopt the principle of promoting an East Asian FTA as well as the establishment of an East Asian Community. These two policy options can work in parallel to overcome the global crisis in Japan, combining a domestic safety net with effective governance in promoting an East Asian FTA.

## **JAPAN'S RESPONSE TO THE ECONOMIC CRISIS**

Starting with the so-called Lehman shock, the world around Japan was turned upside down in a few short months. Japan's economic fundamentals, in terms of international trade surpluses, unemployment rate, foreign assets, savings rate, and foreign currency reserves, are much better than those of its Western counterparts. But Japan had invested heavily in share markets in the United States and therefore suffered significant losses. Export industries also formed the core of the Japanese economy, with the United States as their most important market, and they suffered seriously from the downturn in the U.S. economy.

An explosive chain reaction of crisis, starting with the precipitous downturn in the fortunes of the export industries, the subsequent cutback in capital investment, the rapid rise in unemployment (the burden of which has been primarily borne by contingent workers), and the stagnation of consumption reflecting the deterioration in con-

sumer confidence have cast a thick pall of uncertainty and insecurity over the Japanese people.

The real GDP growth rate in the first quarter of 2009 declined 3.8 percent from the previous period (for a 14.2 percent annual decline), posting an even greater fall as a result of negative growth for five consecutive quarters.<sup>5</sup> The total unemployment ratio is continuously rising, and it was 5.2 percent in May 2009, with a total of 3.47 million people unemployed.

### **Aso Administration's Domestic Measures**

In order to respond to the rapid deterioration in the economy, the Liberal Democratic Party (LDP) submitted the Economic Stimulus Related Bills on December 3, 2008 (MHLW 2009). Its three stimulus packages are worth a total of 75 trillion yen (12 trillion yen in financial expenditures, and financial measures amounting to 63 trillion yen).<sup>6</sup>

In addition, it prepared the largest economic stimulus plan, Policy Package to Address the Economic Crisis, on April 9, 2009 (Nihon Keizai Shimbun, April 10, 2009).<sup>7</sup> This multiyear policy package will be supported by national government expenditures of approximately 15.4 trillion yen (total size approximately 56.8 trillion yen) in a supplementary budget, aimed at avoiding a negative spiral of the economy, participating in the international coordination of fiscal effort, and curbing an expected rise in the unemployment rate. As figure 1 indicates, this policy package is expected to boost real GDP growth rate by around 2 percentage points in 2009. The package is the largest ever for a single year, surpassing former Prime Minister Keizo Obuchi's 8.5 trillion yen stimulus during the Asian financial crisis in 1998.

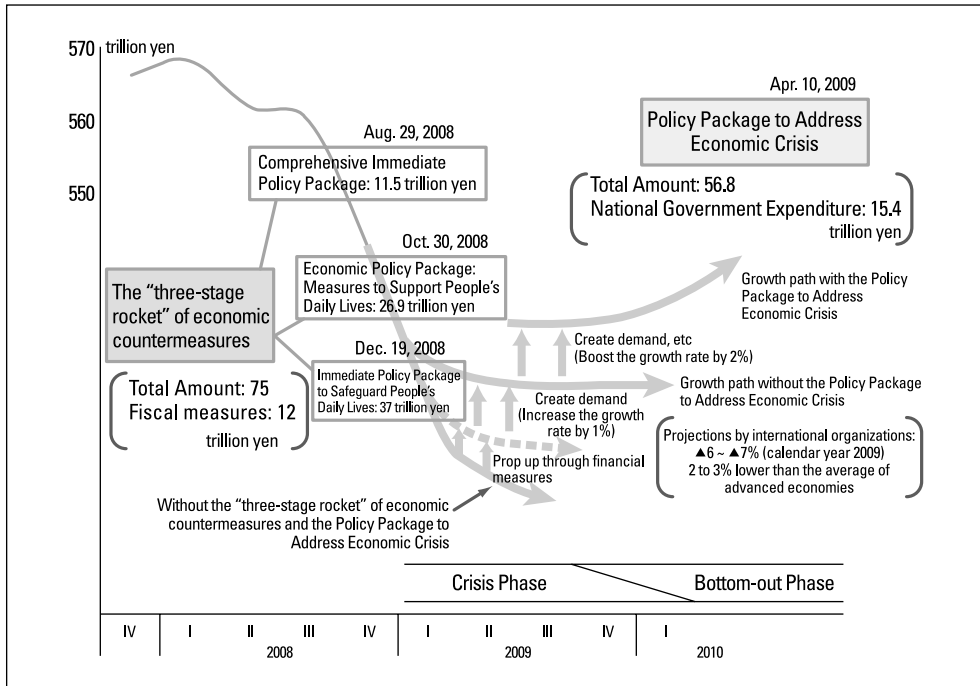
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5. Ministry of Health, Labor and Welfare, July 2009. Available at <http://www.mhlw.go.jp/english/policy/affairs/dl/04.pdf>. Access date: September 18, 2009.

6. In order to stimulate the domestic economy, Japan has reduced interest rates from 0.5 percent to 0.3 percent.

7. Additional employment measures after the financial crisis include the Comprehensive Immediate Policy Package to Ease Public Anxiety (formulated on August 29, 2008), Measures to Support People's Daily Lives (formulated on October 30, 2008), the Immediate Policy Package to Safeguard People's Daily Lives (formulated on December 19, 2008), and the Policy Package to Address the Economic Crisis (formulated on April 10, 2009). Available at <http://www.mhlw.go.jp/english/policy/affairs/dl/04.pdf>. Access date: September 18, 2009.

Figure 1. Real GDP Growth Path



Source: Reprinted from Cabinet Office 2009, 1.

The spending includes 1.9 trillion yen on employment measures, 3 trillion yen on financial initiatives, 1.6 trillion yen on low-carbon technology, and 2 trillion yen on health care and child care. A total of 370 billion yen will be spent on subsidies for consumers who trade their old cars for fuel-efficient ones. The section on “Growth Strategy—Investing for the Future” prioritizes three goals: “the low-carbon revolution,” “health, longevity, and child-rearing,” and “realization of the potential of the Japanese economy and development of infrastructure to deal with the challenges of the 21st century.”<sup>8</sup> Table 1 outlines future development strategies.

However, there is a high uncertainty over the stability of the global financial system and economic developments abroad. The process of selection and concentration has many additional requirements: clearly defined medium-term and long-term goals must be established; appropriate measures for the realization of these goals must be carefully selected; information on the effectiveness of individual measures must be

8. Prime Minister of Japan and His Cabinet, March 2009. Available at <http://www.kantei.go.jp/jp/asophoto/2009/04/090410kikitaisaku.pdf>. Access date: September 19, 2009.

**Table 1.** Future Development Strategies

Strategy	Contents
Low-Carbon Emissions Revolution	Ensure that by 2020, renewable energy consumption doubles and its share of total energy consumption increases to 20 percent. Create a new 50 trillion yen market and employment opportunities for 1.4 million people.
Healthy Long-Life Society	By 2020, create a new market of 35 trillion yen and employment for 2.1 million people. Create employment for 300,000 people in nursing care. Revitalize regional health care systems.
Promoting the Attractiveness of Japan	Make Japan a major tourist destination. Extend the soft power of Japan.

Source: Prime Minister 2009.

made available to the public; and arrangements must be made to facilitate verification of the progress and results of these measures.<sup>9</sup> The continuing economic difficulties and the negative effects of the liberalization policies of the previous LDP governments, which many believe to have brought hardships to people, contributed to the historic victory of the Democratic Party of Japan.

### **Hatoyama's East Asian Community Proposal**

Prime Minister Hatoyama recently proposed a European Union (EU)-style East Asian Community to China.<sup>10</sup> His proposal was published in the *New York Times* on August 27, 2009. In it, he, stressed the importance of an Asian regional economic block:

[The] national goal that emerged from the concept of fraternity is the creation of an East Asian Community. . . . I believe that the East Asian region, which is showing increasing vitality, must be recognized as Japan's basic sphere of being. So we must continue to build frameworks for stable economic cooperation and

9. Japan has been conducting financial reforms, together with political and social reforms, for the last 18 years—ever since the collapse of the bubble economy in April 1991. Japan's financial sector is therefore healthier than those of the United States and Europe and has been less affected by the crisis.

10. Available at <http://www.nytimes.com/2009/08/27/opinion/27iht-edhatoyama.html>. Access date: September 17, 2009.

security across the region. . . . ASEAN,<sup>11</sup> Japan, China, South Korea and Taiwan now account for one quarter of the world's gross domestic product. The economic power of the East Asian region and the interdependent relationships within the region have grown wider and deeper. So the structures required for the formation of a regional economic bloc are already in place (Hatoyama 2009).

Hatoyama's proposal was rooted in the Council on Economic and Fiscal Policy's Basic Policy (*honebuto housin*), which is discussed in more detail in the next section.

### **An East Asia-Centered FTA**

The Global Economic Strategy released by METI in April 2006 envisioned a Comprehensive Economic Partnership in East Asia in order to further economic integration. The strategy recognized that "the formation of East Asia Free Trade Areas is a current issue. Thus far, Japan has relied primarily on bilateral free trade agreements. Now, it is necessary to shift to a wide-area approach covering East Asia as a whole, once the negotiation of a Japan-ASEAN Economic Partnership Agreement is concluded."<sup>12</sup>

In July 2006, the Council on Economic and Fiscal Policy announced its Basic Policies for Economic and Fiscal Management and Structural Reform (*honebuto housin*).<sup>13</sup> In order to "enhance the growth potential by promoting the economic growth initiative," it stated:

The government will conduct further negotiations for economic partnership agreements (EPA) mainly with Asian countries in line with the EPA timetable attached to the Strategy for the Globalizing Economy. As a result, the value of trade with countries having concluded EPAs with Japan is expected to account for 25 percent or more of Japan's total trade value by the year 2010.<sup>14</sup>

The Basic Policy clearly demonstrated the Japanese FTA policy perspective on strengthening relationships within Asia. It showed the direction of Japanese future policy centered on Asia.

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11. ASEAN (Association of Southeast Asian Nations) member states are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

12. Available at <http://www.meti.go.jp/press/20060412001/g.senryaku-houkokusho-set.pdf>. Access date: September 19, 2009.

13. Available at <http://www.keizai-shimon.go.jp/cabinet/2006/decision060707.pdf>. Access date: September 19, 2009.

14. Available at <http://www.gichokai.gr.jp/newhp/11topics/2006nen/060707-02.pdf>. Page 9. Access date: September 20, 2009.



The above suggests that East Asian integration has become an important cornerstone of Japanese foreign policy. It would not be an exaggeration to say that the establishment of an East Asian Community built upon a single East Asian FTA is a policy goal for Japan.

### **Bilateral and Regional FTAs in East Asia**

Since the 1990s, the number of bilateral or regional FTAs has increased dramatically.<sup>15</sup> By the early 1990s in the Asia Pacific region, countries like the United States, Canada, Mexico, and Chile have included FTAs as one of the options in pursuing their trade policy objectives.

However, despite the diffusion of FTAs in the 1990s—the “third wave” of economic cooperation<sup>16</sup>—East Asia was characterized by a near absence of formal FTAs and regional institutions. Now, despite its being a latecomer to FTAs compared to the Americas and Europe, East Asia has seen an unprecedented increase in bilateral and plurilateral FTA activity since the late 1990s. While the ASEAN Free Trade Area has been in effect since the early 1990s, many more governments in East Asia have recently embarked on preferential trade arrangements. In this sense, East Asia as a whole has changed its long-standing policy of pursuing trade liberalization only in a multilateral framework based on the World Trade Organization (WTO) and Asia-Pacific Economic Cooperation (APEC). The region has shifted its trade policy to a three-track approach based on global (WTO-based), transregional (APEC-based), regional (ASEAN+3 or ASEAN+6),<sup>17</sup> and bilateral liberalization. The frameworks of the East Asia Summit and ASEAN+3, now moving forward with ASEAN as the driving force, provide significant opportunities that may lead to the realization of an East Asian community.

One notable characteristic of FTAs in East Asia is their comprehensiveness. As such, some are called Economic Partnership Agreements (for example, the Japan-Singapore EPA or JSEPA), or Closer Economic Partnership Agreements (for example, the China-

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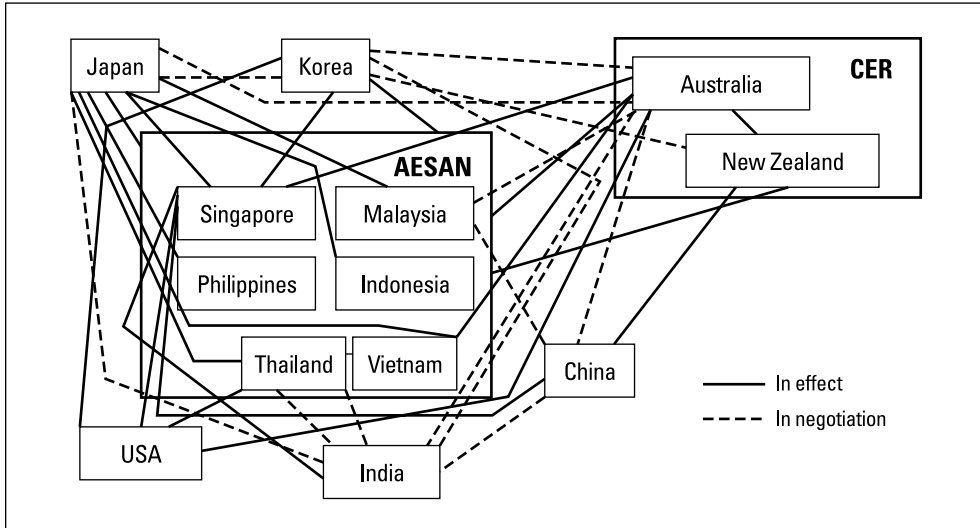
15. Many books and articles have been written on the regional economic institutions emerging in East Asia since the late 1990s, including those by Pempel (2005), Lincoln (2004), Oyane (2003), Aggarwal and Koo (2008), and Katzenstein and Shiraishi (2006).

16. The term “first wave” refers to the development in the 1950s and 1960s of the European Coal and Steel Community, the European Economic Community, and regional agreements in Africa and Latin America. The “second wave” emerged in the mid 1980s and included the 1989 U.S.-Canada Free Trade Agreement, the Single European Act of 1985, and the establishment of the Asia-Pacific Economic Cooperation (APEC) in 1989.

17. ASEAN+3 includes ASEAN member states plus China, Japan, and Korea; ASEAN+6 also includes Australia, India, and New Zealand.

Hong Kong CEPA). These new types of FTAs typically include facilitation of foreign trade, liberalization and facilitation of foreign direct investment, and economic and technical cooperation, in addition to trade liberalization, which is included in traditional FTAs. Figure 2 shows FTAs in Asia as of September 2009.

**Figure 2.** FTAs in Asia



The figure represents FTAs in Asia as of September 2009.

In parallel with the trend described above, the idea of an FTA covering East Asian countries has emerged. ASEAN+3 leaders meeting at a summit in 1998 established the East Asia Vision Group to study the options for long-term economic cooperation. The group has presented recommendations including the establishment of an East Asian FTA. Currently, the Expert Group, which was set up at the recommendation of ASEAN+3 economic ministers, is studying the possibility of an East Asian FTA, comprising 26 of ASEAN+3.

### **Basic Framework of the Japanese FTA Strategy**

Japan has pursued a single-track approach for close to fifty years, focusing its trade negotiating efforts exclusively on the multilateral forum and shunning regionalism as harmful to the GATT/WTO system.<sup>18</sup> However, the Japanese government today is

18. GATT (the General Agreement on Tariffs and Trade) was the predecessor to the WTO.

actively and strategically pursuing bilateral FTAs with Japan's trade partners, as table 2 shows.

**Table 2.** Japan's Bilateral FTA Initiatives

FTAs in effect (date signed)	FTAs in negotiation	FTA under study
Singapore (2002)	Australia (April 2007)	South Africa
Mexico (2005)	Korea (November 2004)	
Malaysia (2006)	Gulf Cooperation Council (September 2006)	
Chile (2007)	India (November 2007)	
Thailand (2007)	Peru (May 2009)	
Indonesia (2008)		
Brunei (2008)		
Philippines (2008)		
ASEAN (2008)		
Vietnam (2008)		
Switzerland (2009)		

The table reflects initiatives as of September 2009.

This history of trade negotiations leads to the question: What factors promote or hinder Japan's pursuit of its FTA policy? The next section reviews the literature and suggests a theoretical framework to help answer this question.

## **THEORETICAL FRAMEWORK**

Recent studies have focused mainly on the factors driving and hindering Japan's FTA initiatives. This paper argues that the Inner Adjustment Model offers the best explanation.

### **Research on Factors Driving and Hindering FTA Initiatives**

Scholars have argued that both international and domestic factors have influenced Japan's FTA policy.

#### **International Factors**

Krauss (2003) argued that with the rapid development of regional integration worldwide, led by the United States and the EU, the Japanese government changed its traditional policy orientation based on multilateralism, as it was worried that Japan might be left out of the worldwide trend of preferential market openings. Katada and

Solis (2006) argued that the Asian financial crisis pushed Japan to promote FTAs out of concern that a Japanese economic downturn could worsen the region's economy.

Kim (2001) suggested that the 1997 Asian financial crisis triggered Japan to actively implement FTAs and discriminative regionalism in Asia. A report by the Japanese government stated that APEC and ASEAN were powerless in dealing with the crisis. Lee (2000, 21-43) pointed out the growth of EU and NAFTA (the North American Free Trade Agreement) as an important factor behind the change in Japan's political measures. Along with the introduction of the EU and NAFTA, the trade diversion effect from regionalism was strengthened, which led to problems in exporting goods to the United States and Europe.

These arguments all focus on Japan's national interest in the face of external pressures. However, with the exception of the Asian financial crisis, these were all phenomena of the early 1990s. For instance, regionalism had already begun developing in the late 1980s, with the forming of an FTA between the United States and Canada in 1988 and of NAFTA, between those two countries and Mexico, in 1992. The Mercado Común del Cono Sur (MERCOSUR)<sup>19</sup> was formed in 1991. Even the implementation of the ASEAN Free Trade Area began in 1992. The above arguments do not explain why Japan only started changing its FTA policy in the latter half of the 1990s. Furthermore, while Krauss stated that the United States was a main factor affecting policy change in Japan, it can be argued that China and ASEAN had greater influence.

In summary, arguments based on international factors and external pressure to explain why Japan changed its policy orientation in the latter half of the 1990s are lacking in persuasive power.

### **Domestic Factors**

Other scholars have focused on domestic factors. Grossman and Helpman (1995, 667-90) and Baldwin (1995) argued that the economic elite has pushed bureaucrats to advance FTAs. Pekkanen (2005, 77-103), Yoshimatsu (2005, 258-278), Katada and Solis (2007, 279-301), Matsuishi (2005, 167-190), and Busch and Milner (1994, 259-75) emphasized the Keidanren's role. Urata (2002, 101-102) insisted that Japan's FTA policy shift was a move for Japanese economic structural reform, because that is hard to realize solely through domestic power in Japan.

Domestic political concerns remain relevant to how regional institutional architectures are set up. Grossman and Helpman (1995) attempted to explain this by arguing that whether a country chooses to enter a regional trade agreement is determined by

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19. Mercosur (Southern Common Market) is a regional trade agreement between Argentina, Brazil, Paraguay and Uruguay founded in 1991.

how much influence different interest groups exert and how much the government is concerned about voters' welfare.<sup>20</sup> They also argued that by excluding some sectors from an FTA, governments can increase domestic support for it, thus helping to explain why many FTAs do not cover politically sensitive industries. Although this research stressing the influence of interest groups on regionalism offers various useful insights, it also lacks empirical evidence indicating which domestic groups support FTAs, whose interests these agreements serve, and why particular groups prefer regional to multilateral liberalization.

Pekkanen, Solis, and Katada (2007) argued that heightened preferences for bilateral FTAs over multilateral trade forums emerge from domestic politics where, at the expense of the large trade gains of a multilateral forum, bilateral FTAs allow governments to control the agenda as well as partnership selection. As domestic politics of trade for the democratic government intensifies, the government increasingly turns to a bilateral forum with more controlled negotiation dynamics (Pekkanen, Solis, and Katada 2007, 945-970).

The above arguments largely focus on the influence of domestic economic interest groups and the role of officials responsible for promoting FTAs. The conclusions from previous research indicate that it is the cooperation between interest groups and officials promoting FTAs, as well as conflicts among these interest groups, that cause officials promoting FTAs to prioritize cooperation. However, previous studies questioned whether agriculture-related groups known as resisting actors (*teikou seiryoku*) changed their attitude toward FTAs because they were finally convinced by Keidanren or MOFA. Do all agriculture-related groups oppose FTAs? Should the various preferences inside agriculture-related groups be overlooked or taken into account? The conflicts and bargaining inside the agriculture-related groups, which are largely perceived as opponents of FTAs, need to be analyzed. By applying the key concept of "inner adjustment," it is possible to focus on the conflicts and bargaining among agriculture-related groups (MAFF, JA-Zenchu, and *zoku-giin*).

### **The Inner Adjustment Model**

This paper argues that "inner adjustment" among agriculture-related groups (MAFF, JA-Zenchu, and *zoku-giin*) is the main factor in driving Japan's trade policy shift, rather than inter-ministry conflict, as argued in the conventional literature.<sup>21</sup> This

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20. According to Mansfield and Milner (1999), even if influential domestic actors oppose commercial liberalization, institutional factors sometimes create opportunities for policy makers to sidestep such opposition by relying on regional or bilateral trade strategies.

analysis is based on interviews with FTA policymakers within the Japanese government (including officials from MOFA, MEFI, and MAFF) and key interest groups (such as Keidanren and JA-Zenchu).

Previous research on FTA policy has mainly focused on literature review and policy theory, relying too much on secondary sources such as newspapers. Interviews with key policy-making figures provide more accurate insight. Specifically, the current situation and characteristics of FTAs in East Asia and previous studies regarding the factors promoting and hindering Japanese FTA policy are key focus areas. The theoretical framework for this approach is the Inner Adjustment Model.

The Japan-Mexico FTA (JMFTA) is a clear example of how the agriculture problem has been dealt with in Japan's domestic policy, in particular the shift in patterns of policy development, seen through key actors' preferences. The Inner Adjustment Model can effectively explain the change in Japan's FTA policy and how such change consequently led the Japanese government to promote an East Asian FTA and further the establishment of an East Asian Community.

### **CASE STUDY: JAPANESE FTA POLICY ON AGRICULTURE**

The factors that shifted Japanese trade policy can be understood by analyzing the political process behind the conclusion of the FTA between Japan and Mexico, which was the first to deal with an issue that will also be crucial in future FTA discussions with Asian countries—namely, tariff reductions on agricultural commodities. In this context, the FTA between Japan and Mexico can be considered the first substantive negotiation.

Negotiations for the JMFTA were more complicated than those with Singapore, Japan's first FTA partner country. In the FTA with Singapore, agricultural products accounted for only 0.5 percent of all exports and were not a focal point of debate. In contrast, agricultural commodities became one of the main points of contention in FTA negotiations between Japan and Mexico, causing problems of domestic adjustment in Japan during the negotiation process. The incompatible agricultural structures of the two countries became the main concern for domestic agriculture interests in Japan. Differences in domestic political preferences, as well as conflict between governments, industries, and agricultural groups, had a clear impact on the negotiations and are significant in understanding and predicting the future direction of Japanese FTA policy.

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21. For detailed discussion of Inner Adjustment Model, see Kim (2008) and Kim (2010b).

What factors brought agricultural interest groups to overcome their opposition and agree to the JMFTA? By analyzing the negotiation process, several domestic factors can be identified involving domestic participants in the negotiations and policy making. Previous studies have largely focused on the conflicts between ministries, and persuasion by MOFA, METI, and Keidanren of the agriculture-related parties (MAFF, JA-Zenchu, and the pork industry). But inner adjustment among and within these agriculture-related groups explains the shift in Japan's trade policy more clearly than do the ministries' conflicts or persuasion. MAFF, as the main ministry directly responsible for Japan's agriculture and fisheries sector, had a key role in persuading other agriculture-related interest groups to support the FTA. Initially, MAFF strongly opposed the idea of including agriculture in the JMFTA negotiations. MAFF insisted on adhering to the decision of the LDP commission that tariffs on agriculture, forestry, and fisheries should be discussed at WTO negotiations, and that further tariff reductions should not be addressed in individual FTA negotiations.

MAFF changed its stance, however, departing from the precedent set in the FTA with Singapore, and made concessions in agriculture for the JMFTA. This about-face can be explained by two factors. First, pro-internationalist Diet members (*kokusai kyouchouha*) highlighted two concerns—increasing internationalization of trade, and framing the conclusion of the FTA as a national interest. MAFF was also pressured by the fear of being known as a force of resistance (*teikoseiryoku*). Second, the increasing need for and likelihood of FTAs with Asian countries made the inclusion of agriculture in FTA negotiations critical. Thus, MAFF and agriculture interest groups began to recognize the need for FTA promotion, particularly with Asia.

These common perceptions and realizations by agriculture interest groups were also helped by a coordinated political process that purposely included them, ensuring that the voices of all parties were heard and that the interest groups were aware of the reasons for and importance of any agricultural concessions in the JMFTA. Interviews with METI, MOFA, and MAFF officials<sup>22</sup> made it clear that Yoshio Yatsu, the former minister of MAFF, played a key role in persuading agriculture-related groups to come to a consensus on FTA. Yatsu was able to convince these groups that while protection of the domestic agriculture industry was important, East Asia is a growing market for Japan and it is in the national interest for the agriculture problem to be solved in order to promote future FTAs with Asian countries and to advance the idea of a future East Asian FTA.

Though Mexico is not an East Asian country, the FTA with Mexico was a mile-

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22. Anonymous interviews with Japanese METI, MOFA, and MAFF officials. October, November 2007. September 2008. June, July 2009. Kasumigaseki, Tokyo.

stone in Japanese FTA policy and a valuable accomplishment because it was the first FTA that dealt thoroughly with agriculture. Its significance was further evident when the MAFF announced the Green-Asia EPA Promoting Strategy (*midorino ajia EPA suisin senryaku*), which clearly declared Japan's intention to advance FTAs with Asian countries. This led to the inclusion of EPAs in the Japanese government's Basic Policy (*honebuto housin*), which declared the Japanese government principle of promoting an East Asian FTA and the East Asia Community.

### **CONCLUSION: IMPLICATIONS AND POLICY SUGGESTIONS**

This article has explored the roots of the Japanese government proposal for an East Asian Community focusing on the domestic politics of the FTA process. In order to establish an East Asian Community, some difficulties still need to be overcome. The following policy suggestions may help to achieve this goal.

To achieve the expansion of Asia's domestic demand through market liberalization, it is necessary for each country to first improve its governing capacities in general and its social security systems in particular and thereby expand the size of the consuming middle class. In addition, the middle class must be expanded by enhancing education. An East Asia-wide FTA cannot be established unless big countries, particularly China and Japan, agree to open up their markets. For this, not only economic factors but also political factors have to be dealt with. Accordingly, maintaining good political relationships is very important for the formation of a region-wide FTA. Needless to say, domestic reform and positive structural adjustment are also required to establish FTAs (Urata 2008).

There is a very important lesson to be gleaned from the current financial and economic crisis. This crisis occurred in an increasingly globalized economy and a society characterized by growing and deepening cooperation and partnership. The crisis is a clear warning of how completely inadequate the current system is in the prevention and resolution of such global challenges. We have entered a new age in which the foundations of global governance must be rebuilt into a system where a common awareness is shared not only by the developed countries but by all countries and regions of the world, including the newly industrializing and developing countries.

Domestically in Japan, there is strong opposition to FTAs from noncompetitive sectors, such as agriculture, that are expected to be adversely affected by them. There are various ways to overcome these obstacles—for instance, providing support in the form of temporary income compensation and improving technical abilities through education and training for people who lose their jobs (Shujiro Urata, professor at



Waseda University, personal communication, September 28, 2009). In order to advance Japan's FTA policy, so important for the country's future, it is essential to have both the leadership of politicians who understand its benefits and problems and the support of the Japanese people.

For Japan, the important thing is to make fundamental principles (that is, the governance system) penetrate through East Asian cooperation into highly valuable principles globally. The key for sustaining long-term economic growth in Asia is to strengthen Asia's own domestic and regional demand through strengthening of its social safety nets, broadening and strengthening financial markets, supporting Small and Medium-sized Enterprises (SMEs), and increasing exchange rate flexibility. While the short-term economic benefit is important, it is even more important to address the problem of institutionalization and governance—establishing the fundamental principles and rules of regional cooperation. Deep economic integration requires deep structural reform of the political system and economic structure (Kikuchi 2005, 42-55). Japan should pursue deep integration, which will lead other Asian countries to promote further efforts to build more transparent economic institutions and a more democratic political system.

As Japan is graying rapidly, it is irrational to expect an expansion of the domestic economy. Therefore, grasping the new opportunity to develop Asia is key to overcoming the socioeconomic difficulties resulting from the global crisis and to stabilizing the Japanese future. Asian regional integration is a way for the Japanese economy to undertake structural reform. Japan should advance two policy options in parallel: (1) managing a domestic safety net and (2) promoting an East Asian FTA. In that sense, Japanese government accountability—in other words, governance—is essential.

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