

FTA EXPERIMENTS

Japan's free trade leadership and China's economic liberalisation

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bringing different priorities to their China policies. For Japan, China is predominantly a geopolitical source of anxiety and a rising military power that challenges the regional balance of power. On the other hand, the United States—or at least Trump—sees China primarily as an economic foe, a 'currency manipulator' with a huge trade surplus.

This difference in perspectives has led to US policies that do not match Tokyo's priorities. Trump reversed his initial aggressive policy toward North Korea and met Kim Jong-un in person, while imposing high tariff rates on a wide range of imported goods from China. Although Tokyo shared US concerns with China's economic policies, economic engagement with China was also an opportunity for growth in the Japanese economy. There was recognition that trade regulations on China's exports could lead to a global economic recession. It is quite ironic that a tough China policy from the United States is now causing more anxiety than appreciation in Japan.

Foreign policy experts in Japan were aware of the gap in priorities between the United States and Japan and the possible chaos of Trump's unpredictable behaviour. But here the effect of *kantai gaiko* kicks in. The voices of the professionals have been silenced by the huge power accumulated in the Prime Minister's Office, leading to a series of policy failures such as Abe's visit to Iran, which had a negligible impact on Iran's aggressive policies. Abe may enjoy good relations with Trump, but any reward that may come from it is yet to be seen. **FAO**

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WHILE the threat of protectionism is looming thanks to the trade war between the United States and China, trade-dependent middle power Japan has stepped up as a free trade champion.

The 11-member Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), covering 13 per cent of the world's GDP and 500 million people, came into force on 30 December 2018. One month later, the Economic Partnership Agreement (EPA) between Japan and the European Union took effect, heralding the largest open trade zone in the world—accounting for nearly one-third of global GDP and 635 million people.

The Regional Comprehensive Economic Partnership (RCEP), a

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mega-regional trade pact among 16 nations—10 ASEAN members along with Japan, China, India, South Korea, Australia and New Zealand—may also be within sight. Fuelled by shared fears over the US–China trade war, China and Southeast Asian countries are now seeking to finalise the trade pact by the end of 2019. RCEP aims to cover areas such as trade in goods, trade in services, investment, rules of origin, intellectual property and electronic commerce. Japan has been pushing for high-standard rules during negotiations.

Japan's leadership in global trade has had an unexpected impact on China's free trade agreement strategy, as well as its domestic economic and financial reforms. China is pushing strongly for RCEP and initiating experimental measures in its domestic free trade zones with the aim of 'wide ranging and high standard' FTAs. The central government is speculating publicly about adopting rules from the CPTPP and the Japan–EU EPA in areas such as negative lists, investor–state dispute settlements, intellectual property, environmental protection and worker protection.

RCEP, along with other FTAs, has always been a top priority in China's foreign policy. At the 18th National Congress of the Chinese Communist Party (CCP) in 2012, the Chinese government set forth a policy of accelerating the establishment of FTAs. In 2015, the ambition 'to establish a global FTA network' along

the Belt and Road region was written into the 13th Five-Year Plan. Then US president Barack Obama declared that the United States would participate in the TPP, stating that 'we can't let countries like China write the rules of the global economy'. Leading scholars with close ties to top leaders in China asserted that RCEP without the United States could and would coexist with the TPP, RCEP and FTAs, in the eyes of China, were seen as the best platforms to blunt the TPP's negative impact.

While US President Donald Trump has taken the United States out of the TPP, the CPTPP and Japan–EU EPA are now in place. Given that the European Union is China's largest trading partner while Japan ranks fourth, China is still making efforts to propel RCEP negotiations forward. In order to keep India in RCEP, China has promised India that it would further liberalise its market in exchange for India's acceptance of tariff-elimination under RCEP. In the meantime, China has also proposed an 'ASEAN + 3 FTA' as the first step towards RCEP.

The CPTPP and Japan–EU economic partnership arrangements have also ignited China's enthusiasm for furthering long-overdue economic and financial reforms. The Xi Jinping administration sees that the rules set by the CPTPP and Japan–EU EPA demonstrate a vision for future global standards. These trade pacts entail rules and procedures of origin, reduce non-tariff measures and service trade barriers, and aim to improve mutual market access for government procurement. Still, China so far has been reluctant to compromise in some areas such as environmental standards, data flows and intellectual property protection.

Against this backdrop, the creation of 'comprehensive and high

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standard' FTAs has emerged as one of China's highest-priority policy goals. In the past five years, the Chinese government has established 12 pilot domestic free trade zones and announced the establishment of six more partly in response to the conclusion of the CPTPP and Japan–EU EPA. The Shanghai Free Trade Zone, the first test area, was approved in July 2013 and started formal operations in September that year.

Even when the prospects for the TPP were still unclear, policies had been crafted in the Shanghai Free Trade Zone to meet the standards of TPP. In this pilot free trade zone, most experimental policies are centred on the financial and trade sectors, since the goal is to turn Shanghai into an international financial centre and free port. The government has gradually introduced policies to liberalise interest rates and capital accounts, while it also founded the China (Shanghai) Pilot Free Trade Zone Court of Arbitration in 2013. If successful, the experimental policies and procedures adopted in the Shanghai Free Trade Zone are expected to be extended to other regions.

But economic liberalisation is not a foregone conclusion. The central

government's newly released *Report on the Development of China's Free Trade Pilot Zones* conceded that reforms in the financial sector have largely lagged behind those in the trade sector. Policies introduced in the Shanghai Free Trade Zone, which aim to hasten the process of internationalising the renminbi, are not consistent with existing policies outside the zone. This makes policy implementation extremely difficult. Financial liberalisation may also require political reforms aimed at ensuring an independent judiciary, while also building trust in the central bank and in government accountability—all of which are impossible missions for a government that has explicitly dismissed notions of Western-style polity reform.

Prime Minister Shinzo Abe's leadership on global trade has brought out unexpected yet promising changes in China. The CPTPP and Japan–EU EPA hold the possibility of provoking market reform of the Chinese economy, since the Chinese government is testing the water for further liberalisation in the pilot free trade zones by adopting the rules set by Japan and is considering possible changes in policies regarding environmental standards and data flows. But despite the promising effects of Japan's global leadership, China has reached the tipping point where no further real economic liberalisation is possible without substantial political reforms. Given that President Xi is prioritising the elimination of all political risks that may jeopardise the survival of the CCP, real reforms are unlikely in the near future. **ENQ**

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