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# The Role of Japan's Preferential Trade Agreements in Liberalising Agriculture

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## **ABSTRACT**

Where the 1990s was the era of multilateral trade liberalisation, the current agriculture-focused multilateral trade talks have dragged on with missed deadlines accompanied by a reluctance to act. In spite of this reluctance, there has been an emergence and proliferation of Free Trade Agreements in East Asia. These FTAs have provided briskly growing economies with the opportunity to develop discriminatory preferential trade agreements in an attempt to increase interactions through market and non-market channels, further accelerating their economic growth.

Through similar political desires, Australia and Japan have developed their capacity to form a FTA, the major obstacle being Japan's agricultural industry. Lying at the very nexus of trade liberalisation, Japan has one of the most heavily protected agriculture industries worldwide, the opponents to liberalisation being visible and vocal. In contrast, Australia has one of the most competitive agriculture industries with little if no government subsidy or protection.

By analysing the dynamics and stakeholders behind Japanese agricultural trade liberalisation, obstacles and challenges are identified. An understanding of the mechanics within the Japanese agricultural industry as well as the market and political pressures coming from outside, allow the prospects for economic reform and growth to be specified. How Australia and Japan could possibly succeed in implementing a proposed FTA is made clear with implications for how such bilateral agricultural liberalisation may also have multilateral ramifications.

*Keywords:*

FTA, Free Trade Agreement, Agriculture, Multilateral, Tariffs, Market Access, Trade Barrier, Liberalisation.

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## **List of Abbreviations**

ASEAN (10)	Association of South East Asian Nations (1967)
ASEAN 6	Indonesia, Malaysia, the Philippines, Thailand, Singapore and Brunei Darussalam.
ASEAN 4	Vietnam, Myanmar, Cambodia, Laos.
ASEAN + 3	ASEAN + China, South Korea and Japan
AFTA	ASEAN Free Trade Area
CGE Model	Computable General Equilibrium Model
East Asia FTA	ASEAN 5 (Indonesia, Malaysia, Philippines, Thailand, Vietnam), NIEs (Korea, HK, Singapore, Taiwan), China and Japan
EPA	Economic Partnership Agreement
FTA	Free Trade Agreement
GTAP Model	Global Trade Analysis Project Model
GTEM	Global Trade and Environment Model
GATT	General Agreement on Tariffs and Trade
NIE-4	Newly Industrialised Countries: Hong Kong, Korea, Singapore, Taiwan
TEF	Trade and Economic Framework
WTO	World Trade Organisation

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## **1. INTRODUCTION**

The 1990s have been the era of market led regionalisation where rapid economic growth was coupled with liberalisation of trade and FDI. When this liberalisation process slowed after the conclusion of the Uruguay GATT round in 1994, it became clear that the lack of progress stemmed from those countries that were unwilling to make concessions. As a result, high protection levels continue to prevail especially in agriculture where multilateral negotiations have all but ground to a halt.

Where multilateral negotiations have stalled, those countries willing to embrace reform have continued to pursue liberalisation by developing WTO approved FTAs; gaining preferential and hence largely tariff free trade opportunities for their goods. Whilst regional trade agreements such as the EU and NAFTA have been present for some years in more economically developed regions, countries in Asia have only recently entered the fray. Indeed, as countries across the world develop greater stability they are naturally pursuing trade liberalisation in an attempt to reallocate resources to industries that can be further improved. There has been an absolute proliferation of FTAs over the last decade with an increase from 50 FTAs notified to the WTO in 1995 to an anticipated approximately 300 which will have been concluded and notified to the WTO by the end of 2005 (Urata, 2004:3, JETRO, 2003:1).

The highest level of protection in this era of reform can be found in the agricultural industry where support policies are most prevalent in Japan. Japan maintains such high levels of support in an attempt to protect its farmers from competition from imported products whilst simultaneously trying to support aging agricultural farm populations. In effect, consumers pay for most of the domestic support through higher domestic prices, sometimes many multiples of world market prices. This means paying on average twice as much for goods than would be the case for the world market value of production (WTO, 1998). Whilst this has resulted in successful support for the relatively small agricultural industry, it has come as a huge cost to the Japanese economy. With agriculture contributing only 2% to the country's gross domestic product (Bull and Roberts, 2001:1), resources could be far more effectively used in other areas of the Japanese economy where the country poses a comparative advantage.

Such unrelenting protectionism has stalled multilateral trade rounds and has diminished the opportunity for developing countries to develop export markets for their agricultural products. With the 2005 WTO Ministerial meeting also poised to fail, there is even concern that the WTO may rapidly become obsolete. Where structural flaws inhibit the decrease of agricultural protectionism

through multilateral negotiations, a regime of bilateralism may offer developing countries previously unrealised export opportunities.

At the nexus of such a possibility is Japan and Australia. Japan having some of the highest agricultural support levels in the world, compared to Australia at the other extreme with some of the lowest levels of agricultural protection. Producers in Australia and other countries with low levels of agricultural protection are disadvantaged by the restrictive market access that comes with high levels of protection from Japan and other like minded countries. Access that is not likely to change through the disappointing progress of the WTO.

In the context of this rapidly advancing era involving the diminishing influence of multilateral agreements and the increasing propensity of preferential agreements, countries are becoming highly motivated to form FTAs. The risk of not participating is the risk of facing the adverse negative effects that comes with the trade diversion effect of being left out of such agreements and regional areas. In light of these developments, Japan and its other multilateral supporters such as Australia have rapidly been changing perspectives, away from their history of non-discrimination in international trade and economic dealings to a desire to form bilateral arrangements. Initially the formation of these agreements were fraught with political and economic problems but they have now advanced to the point where most see FTAs as being important and necessary precursors to closer Asian integration as a whole (Drysdale and Ishigaki, 2002:6).

With Japan and Australia being extremely important reciprocal trading partners, both countries have recently become highly motivated to develop closer trade ties. With complementary economic, industrial and labour ties, the one remaining obstacle is their disparate agricultural industries. One is the most highly protected in the world, the other possessing extremely low levels of protection. One possessing monsoonal small scale farming controlled by deeply entrenched, stringent cooperative management backed by an old school political elite, the other being a highly competitive large scale liberalised market.

How both countries work towards achieving the benefits that will come through a FTA agreement may subsequently impact agricultural reform on a global scale. Such a preferential agreement could simultaneously move the balance of production away from the high cost producing country of Japan, reorienting it initially towards Australia but also opening the door to further global liberalisation where agriculture is produced at lower cost with lower support. Where multilateral trade negotiations have stalled, preferential trade agreements open the possibility for the facilitation of movement of resources to industries where comparative advantage exists, opening

the door to previously protected agricultural industries for the benefit of agriculture producers worldwide.

## **1.1 Purpose of the Study**

In light of the decreasing success of WTO multilateral negotiations and the increased proliferation of preferential agreements, this thesis serves to provide an analysis of the possibility of a forthcoming Australia - Japan preferential trade agreement. Such an agreement lies at the very heart of the nexus between high and low levels of agriculture protection, the very issue that has so far failed to be negotiated through the current Doha WTO multilateral round of negotiations. Through an exploration of a variety of closely linked research questions, possibilities for such an agreement are evaluated.

### **1.1.1 Research Question**

The central research question upon which this thesis is based is:

- *What pressure does Japan face to liberalise its agricultural support levels, and how could such liberalisation be achieved through a FTA with Australia?*

The core issues contained within this question are explored through a number of other supplementary 'sub-questions,' these being:

- *How does trade theory and empirical modelling substantiate the benefits that come from agricultural liberalisation?*
- *What is the political motivation behind Japan's aspirations for trade liberalisation?*
- *Through what dynamics could a FTA agreement with Australia involving agriculture possibly occur?*
- *How could a Japan Australia FTA possibly benefit non-preferential trade partners?*

### **1.1.2 Scope and Limitations**

This thesis attempts to scrutinise the dynamics and factors by which a possible Australia Japan FTA agreement may be negotiated. An analytical perspective of the Japanese obstacles to such an agreement is presented. Reference is not made to any obstacles that Japan may have with reciprocally exporting goods or services to Australia.

The background of multilateral WTO trade negotiations involving agriculture is briefly described but only where it is needed to provide an insight into the development of bilateral preferential

agreements. The dynamics behind market barriers, whether they be tariffs, subsidies or any other internal market barrier are not discussed.

## **1.2 Methodology**

### **1.2.1 Selection**

It was ascertained that the most insightful and unique information would be attained from primary research; meeting directly with the policy makers concerned. As such, ministerial policy makers within the appropriate Japanese government departments were targeted. The Australian perspective was also gained through meeting with Australian agriculture representatives in Tokyo. This included beef industry representatives as well as the Australian minister-counsellor for agriculture. In person face-to-face interviews were conducted of a qualitative nature.

### **1.2.2 Reliability and Validity**

Through primary data collection involving detailed questioning of the policy makers concerned, a high level of accuracy was ensured. This primary research is supplemented by the use of secondary research involving journal articles, official government publications, books and articles from independent research institutes.

### **1.2.3 Criticism of Sources**

In some cases the Japanese government sources provided only a fundamental, well-rehearsed perspective of their policy positions. In such cases it became clear that the strong Japanese culture of governmental patriotism deterred the interviewee from steering away from the 'official' government policy perspective, thereby avoiding the possibility of any policy critique or personal reflection.

## **2 FREE TRADE AGREEMENTS**

### **2.1 Factors behind the growth of Free Trade Agreements**

As the number of WTO/GATT members has increased, the views and opinions on trade liberalisation have diverged. This inevitably led to the delays that influenced GATT members when they concluded the Uruguay round of negotiations in eight years in 1994, twice as long as expected (Urata, S. 2004:42). Moreover, this difficulty was further represented by the failure of WTO members to begin a new round of negotiations at the Seattle negotiations in 1999, a process that only became realised at the commencement of trade negotiations in Doha in November of 2001. More recently, the ambitious aims of the 2005 negotiations have again been reduced after a failure to reach consensus within the highly protected agriculture industries of Europe. The reduction in multilateral WTO agricultural protectionism has effectively come to a halt, increasing the importance for the possibility of preferential gains.

Those countries with trade liberalisation ideals that have been unable to proceed with liberalisation on a global multilateral scale have instead resorted to forming FTAs with other likeminded countries. Additionally, many WTO/GATT members have wanted to converge emerging economic activities such as foreign direct investment (FDI), services trade and mobility of labour into their agreements, something which the WTO/GATT rules do not adequately deal with (Urata, S. 2004:42). In the context of this situation, many countries have decided to use FTAs as a means to merge these rules, converging domestic systems in the area of competition policy.

This current political motivation is motivated by a number of other underlying factors that have been providing added pressure for some time. The Asian countries recognise the EU and NAFTA as being very successful examples of countries that use FTAs to promote economic growth, a tool that can also be used to promote deregulation and the implementation of structural reforms. Especially after the East Asian financial crisis of the late 1990s, countries have become more aware of the importance of forming economic partnerships to strengthen relationships through regional cooperation (Urata, S. 2004:44). Indeed, there has also been a desire within ASEAN to strengthen its already influential position in East Asia by forming FTAs before the establishment of an East-Asian wide FTA that will undoubtedly be dominated by China and Japan.

With political and economic motivation to develop such economic partnerships, the obstacles to such agreements are too often neglected until they become the major stumbling block upon which an agreement may be withheld. In the case of East Asian FTAs, obstacles come from many areas with the strongest opposition coming from non-competitive sectors such as

Agriculture. JA Zenchu, the Japanese agricultural cooperative believes very strongly that the monsoonal small-scale farms of the ASEAN region would be grossly threatened by the Australian large-scale industrial farms<sup>1</sup>. Indeed, the many different political systems and lacking political leadership has also prevented the early take-up and success of negotiations (Urata, S. 2004:45).

For FTAs in such diverse countries to become a success, academics and policy makers believe that it is important to tie conventional trade liberalisation with supplementary cooperation programs and economic assistance. Through FDI and the many other features of an FTA, the adjustment costs of trade liberalisation can be minimised and non-competitive industries can develop a greater chance of modifying production techniques or moving labour into other areas. In the case of Japan, small-scale farms would be able to merge, utilising modern technology to bring about greater efficiencies thereby restructuring to be able to compete without subsidy on the world market.

## **2.2 Trade Theory – Gains from Trade Liberalisation**

Arguments in favour of trade liberalisation focus on two very fundamental ideas in trade theory. The first belief is that the size of the global economy is maximised when each country focuses on producing and exporting the goods and services that they can produce and deliver most efficiently, importing the goods and services that are produced less efficiently domestically. The second belief is that a world trade system will deliver price and profit signals leading to a globally efficient pattern of production where governments do not intervene to distort markets. Effectively this means that when the sole basis of trade is comparative advantage, the economic wellbeing of all countries in the trading system cannot be improved by the allocation of resources (Caves and Jones, 1985).

However, the world economy is characterised by government intervention, which in most cases favours inefficient sectors where countries do not possess comparative advantage. In such countries, productive resources are moved away from their optimal uses which results in raised living costs, decreased incomes and subsequently lower growth. Moreover, once these distorting policies are in place they become an entrenched part of society and it is very difficult for them to be removed (Anderson 1998).

Simulated policy changes also suggest that countries can also benefit from unilaterally reducing their own trade barriers without waiting for others to open up their markets. The liberalisation occurring as market forces work to reallocate resources that are scarce into more profitable areas

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<sup>1</sup> Interview with Mr. Takuo Ichiya, JA Zenchu, 2<sup>nd</sup> August 2005.

bringing about greater competition, innovation and cost saving measures (Harrison, Rutherford and Tarr, 1995). The combination of these factors can then work to increase national income hence increasing economic performance of the economy as a whole.

When these circumstances take place, the removal of market distortions and trade liberalisation inevitably lead to higher economic performance than otherwise would be the case.

## **2.3 Empirical Research – Modelling Studies**

### **2.3.1 About the Modelling**

A number of quantitative studies have been performed to assess the possible economic benefits that may result from developing FTA arrangements in East Asia. These studies have provided quantitative evidence as to the success of this form of liberalisation. Economic modelling studies use general equilibrium models that simplify reality by relying on numerous assumptions about economic parameters, behaviour, relationships and the format of liberalisation (TEF Joint Study, 2003:165).

The model most widely used is derived from the GTAP model and is a multi-region multi-period general equilibrium model of the world economy, used in government and research studies (Bull, T. and Roberts, I, 2001:57). This model largely measures the static effects that include an analysis of the possible trade creation and diversion effects. Static effects are the terms of trade changes whereas dynamic effects are the scale and competition enhancing effects that come with the formation of a larger market as a result of a FTA (Urata, S. 2004:47).

An exception to this is the APG-Cubed model that is used to analyse the dynamic aspects of the economic impacts over time. Through this process, both financial and other real sectors are incorporated (TEF Joint Study, 2003:166). The difference in the models being that the APG-Cubed model is a fully dynamic model and subsequently, can report results for each year (as opposed to the GTAP model which is comparatively static without any time dimension). The studies that have been performed over recent years have covered a myriad of different scenarios, the most notable and applicable being the effect of a; (a) East Asian FTA, (b) Global Agricultural Trade Liberalisation, and (c) Japan-Australia FTA<sup>2</sup>.

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<sup>2</sup> A caveat should be made to simulations and models as some newly developed trading agreements are not taken into account. Moreover, changing assumptions, raising trade elasticities, the reform of services, changing investment flows and levels of productivity, and the reallocation of capital could have as important an effect as lowering trade barriers.

## 2.4 Macroeconomic Impacts

### 2.4.1 East Asia FTA

The idea behind the East Asian FTA came about at the Leaders' summit meeting of ASEAN+3 (China, Japan and Korea) in 1998 when the leaders decided to set up an East Asia Vision Group to study the long-term vision towards forming an economic cooperation (Urata, S. and Kiyota, K. 2003:4). As of yet, little concrete work has taken place on the concept, maybe in part due to pressure from opposition groups and strong differences of opinion on historical and other non-economic issues. It is increasingly looking more likely that ASEAN will want to keep its negotiating position by establishing three ASEAN+1 FTAs that could then move towards the establishment of an East Asia FTA<sup>3</sup>.

In 2003 a GTAP model designed to simulate the economic impacts of an East Asia FTA through the removal of trade barriers among East Asian economies was conducted. Trade barriers in this context meaning both tariff and non-tariff measures, calculated as the difference between domestic market prices and world market prices (Urata, S. and Kiyota, K 2003:10).

As seen in Figure 1, ASEAN

countries receive a large positive impact whereas non-member countries see a decline in GDP and EV. Negative impacts are attributed to the trade diversion effect of the East Asian FTA where the exports of non-member countries' to East Asia are substituted by those exports coming from within East Asia that are given preferential treatment. Clearly, the substantial negative impact reflected on Australia, New Zealand and other Asian economies reflects the importance of the region regarding export destinations

	GDP Changes %	Equivalent Variation \$US million	Changes divided by GDP in 1997
Australia/New Zealand	-0.23	-1,342	-0.29
China	1.27	5,485	0.64
Hong Kong	1.41	3,389	2.42
Japan	0.05	8,199	0.19
Korea	1.71	7,805	1.75
Taiwan	1.51	5,597	1.87
Indonesia	5.61	10,209	4.89
Malaysia	2.83	2,279	2.15
Philippines	2.02	602	0.77
Singapore	2.26	2,944	3.69
Thailand	15.9	19,790	12.54
Vietnam	8.42	1,446	6.61
Other Asia	-0.31	-1,803	-0.34
United States	-0.06	-7,059	-0.09
EU	-0.01	-1,807	-0.02

Figure 1: Estimated Effects of an East Asia FTA on Real GDP and Equivalent Variation for Selected Countries/Regions (Urata, S. and Kiyota, K. 2003).

It has been ascertained through these findings that the trade diversion effect is greater than the trade creation effect indicating that such an FTA would indeed promote regionalisation (Urata, S. and Kiyota, K, 2003). As a result, those sectors with a comparative advantage would increase

<sup>3</sup> Interview with Mr. Shinnosuke Irisawa, METI, 3<sup>rd</sup> August 2005.

output (in their respective sectors) and those with strong protection are more likely to increase their regional trade and export opportunities.

Further regional results can be extrapolated from the APG-Cubed model carried out in 2000 by David, McKibbin and Stoeckel (2000). The result of the study shows effects of an AFTA / CER free trade area bringing about efficiency and terms of trade effects as well as capital accumulation and endogenous productivity effects. The model used here allows for the identification of greater dynamic gains, the possible positive GDP effect in net present value being US\$48.1 billion, (a figure that Findlay notes as being three times that of previous studies (Findlay, 2002:27)). There appears to be no consensus though between authors as to the implication of these results. Findlay points out that the authors of the study suggest that APEC gains are attributable to this AFTA-CER connection, a connection which simultaneously would motivate greater liberalisation in the larger group as a whole (Findlay, 2002:27). On the other hand, other commentators still stand behind their belief that a set of preferential commitments would simply slow down a non-discriminatory program<sup>4</sup>.

#### **2.4.2 Global Agricultural Trade Liberalisation**

When conducting an analysis of Japanese trade barriers and protective macroeconomic sectors, Japan's agricultural industry stands out as being the most notorious bastion of protectionism with tariffs, price surcharges, and trade management by state agencies (Aksoy, M. A. and Beghin, J. C, 2005:9). Regarded as the most protected agricultural sector in the world, Japan has been the world's largest net importer of agricultural products since 1990-1991 whereas Australia has become the largest net exporter (Aksoy, M. A. and Beghin, J.C. 2005:26). Herein lies the nexus of global agricultural trade issues, the most fundamental form of trade protectionism in the form of import barriers from one of the worlds most developed country's, impairing the ability of those countries with competitive farming practises facing little if no agricultural protection.

A study produced by the Australian Bureau of Agriculture and Resource Economics in 2001 provided an analysis of just this issue; the estimated global impact of agriculture trade liberalisation as a result of a global reduction of 50% of all agricultural tariffs and subsidies. In this scenario, Japan experiences one of the greatest (agricultural) negative terms of trade effects as the country has a competitive advantage in non-agricultural sectors. However the economy as a whole benefits with US \$9 billion of the global US \$53 billion of global gains to gross domestic profit being made to Japan (Bull, T. and Roberts, I, 2001:62). The removal of such subsidies results in a contraction of the agricultural sector allowing inefficiently placed funds to move to

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<sup>4</sup> Opponents to the multilateral approach discuss their view in the context of bilateral agreements (FTAs) quickly spreading to create 'hub and spoke' type environments.

more efficient sectors. The overall effect being greater efficiency and higher economic growth (Bull, T. and Roberts, I, 2001:9).

Through reduced protection every Japanese person would benefit from relative price falls on agricultural products. Effectively Japan represents a market with widespread government intervention intermeshed with a distortion of production, consumption and trade in agricultural products. However to be fair, it should be noted that under agricultural liberalisation alone the greatest terms of trade benefits are likely to accrue to those countries that export agricultural products, most significantly Australia.

### 2.4.3 Japan-Australia FTA

The most recent modelling study was commissioned by the governments of Australia and Japan, conducted as part of the Trade and Economic Framework Joint Study. Completed in 2003, various parts of the study were authored in Australia and other parts were authored in Japan before coming together as a complete single document. The scenario that was modelled in this study was for full and complete bilateral trade and investment liberalisation with both static and dynamic effects covered through the use of APG-Cubed, GTAP and FTAP models (TEF Joint Study, 2003).

It is clear from the macroeconomic and welfare impacts that both Australia and Japan gain from full liberalisation. In the APG-Cubed study Australia's GDP increases 0.66% by 2020, 1.79% in the GTAP study. For Japan, GDP increases in the APG-Cubed study by 0.03% and 0.13% in the GTAP study. These figures are shown in figure 2.

Economic indicator	Australia		Japan	
	APG-Cubed % deviation	GTAP/FTAP % deviation	APG-Cubed % deviation	GTAP/FTAP % deviation
Gross domestic product	0.66	1.79	0.03	0.13
Investment	1.22	3.15	0.05	-0.01
Total exports	2.35	2.11	0.33	0.64
Total imports	1.96	4.95	0.27	0.46
Bilateral exports (to Japan)	21.30	53.79	Na	Na
Bilateral exports (to Australia)	Na	Na	17.98	23.87
Employment	0.11	Na	-0.00	Na
Wages	0.64	1.72	0.02	0.28

Sources: APG-Cubed, GTAP and FTAP modelling simulations.

Figure 2 – Macroeconomic Impacts-comparable results 2020 (Table 5.1.1. TEF Joint Study 2003).

The APG-Cubed analysis presents gains from liberalisation through a decomposition of three factors, these being; (a) removal of bilateral tariff and non-tariff barriers to merchandise trade, (b) removal of barriers to bilateral services trade; and (c) investment liberalisation by Australia (TEF Joint Study, 2003;186). The authors of the report speculate that the difference in results between GTAP/FTAP and APG-Cubed modelling are a result of the way that the models incorporate dynamic capital accumulation and productivity effects.

Welfare measure	Australia		Japan	
	APG-Cubed	GTAP/FTAP	APG-Cubed	GTAP/FTAP
Consumption (% deviation)	0.62	2.20	0.16	0.21
Equivalent variation (\$US million)	Na	13 642	Na	6 785
Gross national product (\$US million)	3 269	Na	3 043	Na

Source: APG-Cubed, GTAP and FTAP modelling simulations.

Figure 3 – Welfare Impacts, 2020 (Table 5.1.2, TEF Joint Study, 2003).

Other changes include the effects of the liberalisation on other countries. Should Australia and Japan form a bilateral FTA, it is anticipated that Australia would export slightly less to the rest of the world but more to Japan (in excess of the exports lost). Similarly Japan would export more to Australia but also more to other countries around the world (TEF Joint Study, 2003;177).

#### 2.4.4 Japan's Most Protected Industry – Agriculture

Through the introduction of a Japan – Australia FTA, Japan's agriculture sector undergoes perhaps the greatest change but not an overly dramatic one, with Australia's agriculture and food exports increasing by around 5%. This increase is actually quite modest due to the relatively large price rises seen within Australia (over 30% by 2020). Increasing Japanese demand for Australian agriculture and food exports sees these prices rise due to the dynamic impact of removing such a large trade barrier on a domestic sector. The expansion of exports and output clearly requires a far greater use of capital, and with the agriculture and food sector being so capital intensive, it takes time before this factor of production can change to impact greater output and hence greater export (TEF Joint Study, 2003;179).

Moreover, Japan's liberalisation of its agriculture and food sector results in greater import competition from Australian exporters resulting in productivity gains (within the Japanese sector) which has a further effect of reducing agricultural imports from Australia (TEF Joint Study, 2003;177). This increase in agricultural and food production productivity in Japan also leads to

increased food exports to Australia (over 350%), but it must be noted that this is from a very small base.

Nevertheless, due to the dynamic and productivity effects in both countries, the overall effect of the increase in Australian exports on the sector is rather small. In addition, a slight contraction of Japanese agricultural output is predicted by the findings as a result of the re-allocation of resources that is a result of the liberalisation (TEF Joint Study, 2003;181). Capital is moved from one sector to another where higher returns are more likely to be achieved. The capital in this case slowly depreciating away from the Japanese agricultural sector, the decline replenished by increased production from Australian and other parts of the world.

One last effect on the Japanese end is the change in employment which is forecast to move in line with output. As output decreases and dynamic productivity increases, real wages will increase and as a result, employment will fall. This is forecast to be in the order of 1.2% of the agricultural and food sector (TEF Joint Study, 2003;183). Both countries have efficient job markets and financial systems that allow for the movement of capital and labour allowing productivity and efficiency gains to be seen by both parties.

#### **2.4.5 Agriculture and the path towards Liberalisation**

##### *Multilateral negotiations historically*

Multilateral negotiations encouraging the minimisation of trading barriers between member states has been a goal of the General Agreement on Tariffs and Trade (GATT) since it originated in 1947. Since then, it has provided a framework for the regulation and reduction of tariffs on traded goods and a common mechanism for resolving trade disputes. The Uruguay round of GATT negotiations achieved significant milestones towards policy reform within the agriculture industry with agreement being reached in four key areas, these being: internal support, export subsidies, market access and special safeguard mechanisms (Hai, W. 2000:91). Other features of the agreements include the reduction of aggregate measures of support, (AMS) which are predominantly internal or domestic support measures as well as the reduction of export subsidies by 36% over six years for developed countries and 24% over ten years for developing countries (Hai, W. 2000:91). This reduction in tariffs would also be applied to non-tariff barriers that were to be converted into tariff barriers prior to applying the respective reduction.

For those countries concerned about a flood of imports due to the reduced tariff barriers, safeguard mechanisms would be available to protect domestic industries. The safeguard would apply if the quantity of imports was sufficiently large enough or if the imported goods were priced

below trigger levels (Hai, W. 2000:92)<sup>5</sup>. Perhaps the most significant aspect of the agreement though was simply the acceptance that no country could increase agricultural protection after that point.

Since this noteworthy agreement was signed in 1994, no further liberalisation progress has been made on a multilateral level, in part due to the reluctance with which Europe and Japan have signalled their intent to negotiate. Being the two largest countries with agricultural subsidies, these two have effectively been instrumental in stalling multilateral processes as a whole.

#### *Current multilateral intransigence on trade*

Again the current round of WTO talks under the 'Doha Development Agenda' have drawn to a gridlock with most observers believing the cause to be the fierce internal lobbying within the EU involving the French and their unwillingness to offer large cuts to farm tariffs. With the G20 proposing an average 54% reduction and the US proposing a 75% cut in farm tariffs, the EU appears to be bending to France's desires to protect its farmers by offering an average of only 39% in farm tariff cuts with many products designated as 'sensitive' with much lesser cuts<sup>6</sup>. Whilst France is being criticized for putting the interests of what is most likely a few thousand farmers above the large majority of the population of the world<sup>7</sup>, others are beginning to think that this impasse is a reflection of the obsolescence and deep structural flaws of the very idea of multilateral trade rounds.

This is in contrast to global institutions and academia who have unwaveringly emphasised the opportunity that multilateral negotiations provide to rationalise the proliferation of preferential agreements that allow markets to allocate access on a competitive basis, (Aksoy, M. A. and Beghin, J. C. 2005:9). In the case of the current WTO trade round, the real politics of the situation are shaping the greater impacts as the trade round is focused solely on farm goods. As such, there is little incentive for EU politicians to deliver as they are unable to gain any export advantage in their area of goods and services. This is despite the fact that business leaders throughout the continent are insisting that the Doha round succeeds so that goods and services markets can subsequently liberalise in later WTO negotiation rounds.

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<sup>5</sup> Japan invoked a quote tariff safeguard on Australian beef, see section 4.1.2.

<sup>6</sup> Celso Amorim, the Brazilian foreign minister quoted in the Financial Times, November 16<sup>th</sup>, 2005. 'Last round? Intransigence on trade calls into question the multilateral approach.'

<sup>7</sup> Ibid.

### *Political change in Japan*

The appointment of Junichiro Koizumi as prime minister in 2001 has seen the politics of Japan change dramatically. This was furthered by the introduction for the first time of a ruling majority within the Liberal Democratic Party, a result of the September 2005 federal election that saw the replacement of the old stalwart LDP. Throughout this process, Koizumi has shown assertiveness in a determined liberalisation plan to develop cooperation and partnership with related countries and regions. Such negotiations have also allowed Japan to insist on the inclusion of Australia and New Zealand in the first East Asia Summit, taking place in mid December 2005.

In light of these recent developments, Japan's deputy foreign minister has made statements to suggest that Japan will work hard to develop close relations that are very much of mutual benefit<sup>8</sup>. Mr. Yabunaka has stated that it is extremely important for Japan to continue developing and growing its trade relations with Australia and only made one reserved comment. Australia had to understand that there is a "...political and economic sensitivity of agriculture in Japan, where farming is heavily subsidised and considered part of the cultural heritage."<sup>9</sup> Japan is in this way like-minded to France in its attitude towards agriculture but at the same time, different in that it needs to define its political presence in Asia. In the midst of these conflicting motives, how Japan and Australia negotiate closer economic relations and the outcomes that will prevail will no doubt be closely watched by those multilateral intransigents that have thus far resisted change.

## **2.5 The Dire Need For Reform and The Role of FTAs**

With budgetary subsidies, subsidies from consumers and quantitative restrictions on domestic production in industrial countries two to four times higher than average manufacturing tariffs there is a real pressure for substantial reform (Aksoy, 2005:62). In the wake of the failed Cancun Ministerial Meetings of 2003, agricultural protectionism has become the most contentious issue in global trade negotiations with the lack of action by industrial countries being the clear area of blame.

In response to high levels of protectionism within industrial countries, middle-income and developing countries are beginning to respond by also increasing their protectionist dynamics. These countries are reducing their levels of taxation but are then reactively having to increase protection in response to the agricultural support provided by industrial countries. Whilst export subsidies and border barriers shrink, domestic support has continued to increase in the form of

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<sup>8</sup> Mitoji Yabunaka, Japan's deputy foreign minister for economic affairs, quoted in an interview with the Herald newspaper, September 14<sup>th</sup>, 2005.

<sup>9</sup> Ibid.

coupled or partially decoupled subsidies. As a result, averages represent a gross underestimation of the actual levels of protection (Aksoy, M.A. 2005:52).

These factors are further complicated by two further dynamics, anticyclical agricultural policies with protection increasing as world prices fall and sustained technological increases resulting in lowered production costs and hence prices (Aksoy, M.A. 2005:52). In the wake of such unrelentingly complex and persistent protection regimes it becomes resoundingly clear that a dynamic must change which is not only theoretically, but also politically viable.

Whilst the WTO, policy laureates and academics call for the conversion of non-ad valorem tariffs into ad valorem tariffs so that variances (including non-seasonal abnormalities) can be reduced, recent movements inspired both politically and by the market have been detrimental to this cause. One of the reasons behind the lack of progress in multilateral talks is the multitude of direct support programs that have so far failed to be decoupled from production in industrial and middle-income countries. A preferential trade commitment, by its very nature, removes these obstacles to the preferential trade partner.

Under agricultural trade preferences found within bilateral trade agreements the beneficiary developing countries gain all or part of the price premium normally accrued to the importing government as tariff-revenue (Brenton, P. and Ikezuki, T, 2005). Through trade preferences, premiums can be offered over the normal rate of return leading to investment and greater output. The development of common agricultural policies in the EC and NAFTA trade blocks have also provided a model for what East Asian policy makers hope to develop, an East Asian free trade area.

The Japanese Ministry of Economics Trade and Industry (METI) has a distinct strategy to form bilateral agreements with ASEAN countries, with the view to targeting areas for liberalisation and harmonisation<sup>10</sup>. Should Australia be included in a larger regional harmonisation of ASEAN, a certain level of agricultural preference regimes will become general and non-discriminatory, allowing developing countries (the main beneficiaries) to increase their market share as a group. The economic development and collective interests of all countries included will be improved bringing greater economic strength, stability and prosperity to the region as a whole.

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<sup>10</sup> Made clear through interviews with Mr. Hachiyama and Mr. Irisawa (METI).

### 3 JAPAN'S POSITION ON FTAs

#### 3.1 Japan's Political Situation

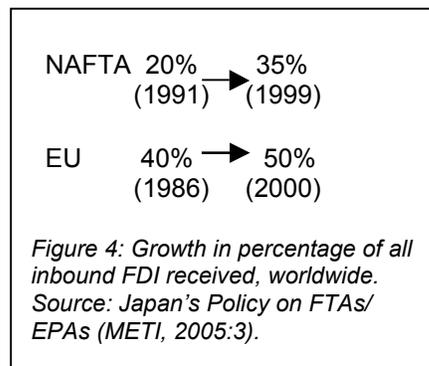
##### *The Critical Role of Japanese-Australian Agricultural harmonisation*

Having spent the 1990s largely in a state of recollect, Japan is currently involved in a vigorous effort to once again retain its reputable state of high economic productivity. Responding to recent developments in the world economy, Japan is attempting to lead a strong push in East Asia for institution led regionalisation. Against a background of shared common goals with other Asian economies, the most notorious challenge is coming from the high levels of resistance found within the agricultural sector. Should the distinctly diverse agricultural policies of Australia and Japan be harmonised, a precedent will be set for similar change within other regional trade blocks such as the EU.

##### 3.1.1 FTA/EPA Policy

Japan's policy is to promote EPAs<sup>11</sup> as much as possible in an attempt to energise its economy. Through this trade mechanism, the supply side of the economy recognises growth through a decrease in regulation on investment leading to a more inexpensive business environment and lower production costs due to eliminated duties on raw materials. This growth in FDI makes the environment generally speaking, a more attractive place as an investment destination (see figure 4).

Against the background of growing economic globalisation, the Japanese Council of Ministers has decided upon a basic policy upon which it can promote its Economic Partnership Agreement (EPA) interests. This basic policy is twofold, firstly to realise the promotion of economic partnerships with East Asia as its focus. Secondly, to identify other countries and regions based upon the importance of an EPA to the Japanese economy and society as a whole (MOFA, 2004).



Japan is Australia's largest trading partner and as portrayed in figure 5 below, Australia's exports are focused most heavily on four main products; iron ore, coal, aluminium and beef. Together these four products represent 52% of Australia's exports (TEF Joint Study, 2003:chapter 2). It is also important to note that 81.1% of the goods that Australia exports to Japan have no tariffs. The tariff area predominantly affecting Australian agricultural products that are largely 'sensitive' to Japan. In contrast, only 22.8% of the total goods exported to Australia by Japan have no tariffs.

<sup>11</sup> Economic Partnership Agreement (EPA) is the term used in Japan to refer to a FTA which goes beyond the conventional limitations of simply trade which are encompassed within a FTA.

Clearly with a large majority of Japanese goods (38.6% which are motor vehicles) facing large tariffs upon entry to Australia, there is motivation for Japan to form a FTA/EPA (METI, Aust/Jap FTA Breakdown Pie-Chart, 2005).

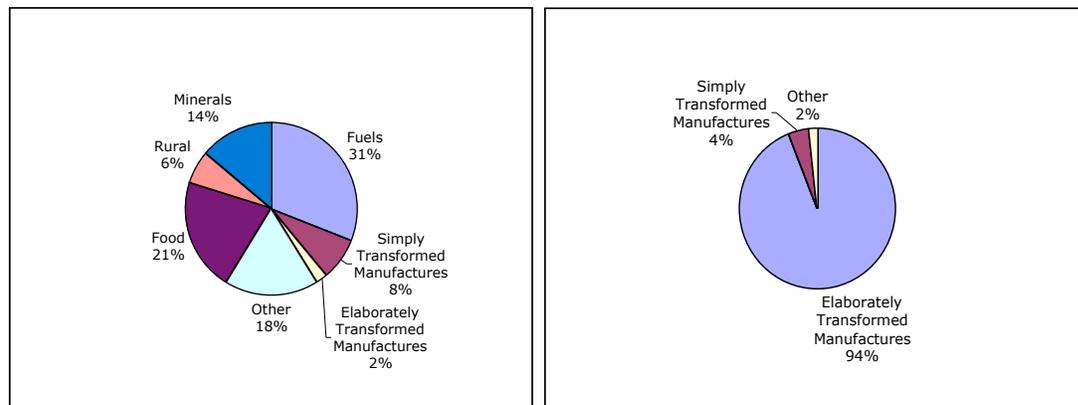


Figure 5: Japanese imports from Australia  
Non-tariff sectors 81.1% of imports

Japanese Exports to Australia  
Non-tariff sectors 22.8% of Japanese exports  
Source: TEF Joint Study, (2003) chapter 2.

When directly comparing tariff protection, it can be seen that tariffs in Australia are generally much higher than those posed by Japan as the majority of Australian goods exported to Japan, (over 80%) already face no tariff barriers. Moreover, of the remaining 20%, more than half face tariffs of less than 10%<sup>12</sup>. This is as opposed to the majority of Japanese goods, 77.2% of which face some form of financial tariff upon being exported to Australia. Clearly advantages can be gained to Japanese industry through a FTA with Australia, the only difficulty being the sensitivity of Australian goods facing Japanese tariff protection. These fall distinctly in the Japanese agriculture sector, the most heavily subsidised industry in the world.

### 3.1.2 Japan's Motivation for Trade Liberalisation - METI, MOFA, MOF and MAFF

Japan has developed an ambitious EPA schedule since its first undertaking with Singapore in 2001. Since then, it has rapidly accelerated its regionalisation commitments in a largely 'institution-driven' fashion. These agreements are largely led by the Ministry of Economy, Trade and Industry, (METI), but form a greater common plan to realise a policy to promote economic partnerships with East Asia as its focus (MOFA, 2004). An Australia Japanese EPA would be their most ambitious agreement yet, challenging core fundamental perspectives within the Japanese government due to the sensitive nature of the agriculture industry. Through a disaggregation of what seems to be disunity within the bureaucratic actors of Japanese government, the various tactical motivations of the different strands of the political scene can be presented. The ability for parties to develop their arguments is based around the level of political support and difference in preferences of the ministries concerned (Yoshimatsu, 2003:61).

<sup>12</sup> Mr. Bill Withers, Minister-Counsellor Agriculture, DFAT, Australian Embassy, Japan, 3<sup>rd</sup> August 2005.

- The Prime Minister, Junichiro Koizumi and the Diet have an underlying motivation to increase the presence of a more assertive Japanese foreign policy, in particular through building good relations with Korea, China and other Asia-Pacific countries. Japan expressed this positive motivation towards Australia by providing the dominant impetus for the inclusion of Australia in the first East Asian summit in the end of 2005. Japan wants to develop a Japan-ASEAN regional trade block and to do so must firstly form bilateral agreements with all prospective partners.
- The Ministry of Foreign Affairs has been seeking the initiative to offer a Japanese agenda, especially after the Asian financial crisis and US unilateralism undermined any remaining soft power that the Japanese may have had in the multilateral sphere. Hence, in the light of improved tactical public relations in presenting a government that is committed to integration, MOFA appears to be burying the past in motivating whatever deals it can as some form of progress.
- The Ministry of Economy, Trade and Industry has arisen out of what has been a back seat role for some years. It appears that a number of key METI people are now genuinely committed to the development of economic reform in Japan and it appears that it is their hope that bilateral trade and regional trade agreements will stimulate liberalisation, restructuring and opportunities in waning Japanese sectors<sup>13</sup>.
- The Ministry of Finance has a desire to stabilise Japan's fiscal situation by gaining greater control of the capital flows in and out of Japan. With a legitimate belief that Japan and Asia are under-represented in the United Nations, IMF and World Bank, the MOF seeks to avoid the prospect of conflicting with neighbouring markets over exchange rates by increasing Asian monetary integration. Moreover, should there be further Asian monetary integration, Japan is motivated to ensure that its integration regime places the yen in a position to serve as the anchor currency rather than that of China's renminbi.
- The Ministry of Agriculture, Forestry and Fishing have a chief concern of protecting the agricultural industry. This means safeguarding the production of sustainable agriculture in Japan to ensure food security whilst also preserving the multi-functionality of agriculture.

Within the context of competing ideological frameworks, two different perspectives can be observed. That of the export-orientated businesses in Japan who are chiefly concerned with

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<sup>13</sup> Mr. Shujiro Urata, Director of Policy, RIETI. 25<sup>th</sup> July, 2005.

moving production and investment abroad for both market access and efficiency reasons (Posen, 2002). And the other side of the spectrum: the non-trading and import-competing businesses that are the primary interest groups blocking domestic reform. Regrettably, export-orientated businesses are politically weak and as such require assistance in gaining the major domestic and international changes necessary for liberalisation. Groups such as those found within the agriculture industry are extremely politically powerful, their main concern being protectionism. Such groups undermine support for WTO-consistent trade agreements, weakening the support within the Diet for such initiatives (Posen, 2002).

### **3.1.3 Political Pressure for Change**

The Japanese political system is currently facing unprecedented pressure to adapt to a globalisation trend of liberalisation and reform. The voting population has also signalled its intent to change, voting away the traditional party system in Prime Minister Junichiro Koizumi's recently successful general elections. The importance of the recent change in political mentality cannot be stressed too lightly. Before the dissolution of the House of Representatives in July, members of the house only passed the Postal Services Privatisation bill by a margin of five votes on the 5<sup>th</sup> of July. After the September 2005 general election, the House of Representatives passed the privatisation bill by a wide margin of 200 votes, with 338 members voting for the bill and 138 members voting against it (Koizumi Cabinet, 13 October 2005). This symbolic statement represents the very changing nature of the will of the populace, resigned to liberalisation in an attempt to stimulate Japan's revival to ensure its place at the forefront of Asia.

### **3.1.4 Obstacles in the Political Decision Making Process**

Japan has historically had a very equalitarian negotiation process with four (4) key ministries involved in negotiating potential agreements with their opposite ministry in foreign governments. These ministry's are METI (Ministry of Economy, Trade and Industry), MOFA (Ministry of Foreign Affairs), Ministry of Finance (MOF) and MAFF (Ministry of Agriculture, Forestry and Fishing). JA Zenchu, the Central Union of Agricultural Cooperatives believes that this is one of the most specialised features of the Japanese decision making process – the fact that each sector is negotiated separately. Moreover, there is no trade off in negotiations between sectors<sup>14</sup>.

A practical example of this horizontal, decentralised decision making structure can be seen reflected in the recent Japanese/Mexican FTA where in the last moments of negotiation Mexico requested additional trade offs between the Industrial and Agricultural sector over oranges. In this

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<sup>14</sup> Mr. Ichiya, Takuo.. Assistant Manager, International Policy Division, Agricultural Policy Department, (JA ZENCHU), 2<sup>nd</sup> August 2005.

case negotiations broke off as no possibility existed for such a shift. Even though in theory, a chief negotiator is selected out of the four ministries, which is more often than not MOFA, JA ZENCHU believes that in reality, several co-chairs from different departments are recognised<sup>15</sup>.

The Australian minister counsellor for Agriculture, Mr. Bill Withers, theoretically agrees with this concept of departmentalised decision-making, but disregards it as being too unpractical. In Australia, Mr. Withers states that DFAT (the Department of Foreign Affairs and Trade) leads the Australian process and believes that a similar procedure takes place in Japan<sup>16</sup>.

The Japanese Ministry of Agriculture, Forestry and Fishing casts a different light on the situation stating that there are four (4) chairmen of the FTA negotiations each representing his or her own ministerial department. All four of the ministries must agree for FTA negotiations to proceed<sup>17</sup>. Mr. Kimura, one of the Directors within MAFF believes that some years ago it would have even been impossible for the prime minister to initiate a FTA feasibility agreement with Australia due to the huge political support and power held by JA Zenchu. More recently though, MOF, MOFA and METI have placed increasing pressure on MAFF to begin discussing the possibility of greater trade ties with Australia<sup>18</sup>. Due to this pressure and the diminishing power base held by JA Zenchu and MAFF, Japan ended up allowing and even encouraging Australian participation in the East Asian summit later in 2005.

### **3.1.5 Competitive Pressures from China**

Japan and Australia have had a long and prosperous trading relationship with Japan being Australia's largest export market for almost 40 years. Indeed, Australian Prime Minister John Howard affirmed this point after meeting with the Japanese Prime Minister on the 20<sup>th</sup> April, 2005 stating that "... Australia has no more loyal and valuable customer in the world than Japan."<sup>19</sup> The Prime Minister John Howard then spent the afternoon discussing Australia's trade and economic relationship with the Japanese Prime Minister, a meeting during which the joint feasibility study into a free trade agreement was initiated.

It comes as no surprise that this meeting came just 2 days after Australian Prime Minister, John Howard met the Chinese Premier, Wen Jiabao, on the 18<sup>th</sup> of April agreeing to commence negotiations on a FTA. This came after the completion of a joint FTA Feasibility Study, a

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<sup>15</sup> Mr. Ichiya, Takuo. Assistant Manager, International Policy Division, Agricultural Policy Department, (JA ZENCHU), 2<sup>nd</sup> August 2005.

<sup>16</sup> Mr. Bill Withers, Minister-Counsellor Agriculture, DFAT, Australian Embassy, Japan.

<sup>17</sup> Mr. Takayuki Kimura, Director, International Trade Policy Coordination Division, MAFF, Japan.

<sup>18</sup> Ibid.

<sup>19</sup> Australian Prime Minister John Howard at a Japanese Business luncheon, 20<sup>th</sup> April 2005, <http://www.pm.gov.au/news/speeches/speech1339.html> (14/10/2005).

document that was completed in March 2005<sup>20</sup>. Taking this into consideration, it comes as no surprise that Japan was under considerable political pressure to ensure that its trade relationship with Australia did not fall behind the developing Australia – Chinese relationship.

The developing rivalry between Japan and China to become a 'leader' in East Asia has also spurred the use of FTAs to strengthen trade relationships. This became evident when in November of 2002, Japan proposed an economic partnership framework with ASEAN 1 day after China had agreed to start FTA negotiations with ASEAN (Urata, 2004). It is reasonable to assume that China and Japan should become jointly responsible for leadership in East Asia, however as of yet, different political and economic sensitivities still exist. China has an authoritarian regime whereas Japan has a security alliance with the United States (Drysdale and Zhang, 2000). Hence, FTAs can be used as a method of developing closer economic and social ties in an attempt to break down obstacles with regard to pursuing greater East Asian cooperation.

## **3.2 Agriculture in Japan**

### **3.2.1 Agriculture Historically**

Japan has historically always been able to satisfy a large proportion of its agriculture needs through domestic production. In the 1980s, over 60 % of beef was produced domestically, with 67% self-sufficiency in all agricultural products in 1990. This figure dropped dramatically to 40% in 2003, the main reason cited by the government being a change in Japanese eating habits and constrained domestic production with limited national land no longer satisfying the demands of the populace (Statistics Bureau, 2004:67).

When measuring agriculture quantitatively, a number of different indexes and measurements can be used to determine the state of the industry. Perhaps the most commonly used measure; the overall agriculture production index, would show a decline in overall production by 4.9% since 2000 (Statistics Bureau, 2004:59). Alternatively, it can be seen that the number of farm households have declined since 1960, reduced to half the number in 2004. Similarly, the area of cultivated farmland has also declined, the 2004 figure reflecting a 20% decrease from the 1960 figure (Statistics Bureau, 2004:62). Whilst the cited reasons are farmers abandoning their land or allowing the land to be converted to alternate use (residential or industrial construction), this does not give an indication for the underlying motive behind the respective farmers choice.

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<sup>20</sup> DFAT, *Australia – China FTA Negotiations* <http://www.dfat.gov.au/geo/china/fta/> (14/10/2005).

Ever since the enactment of the Agricultural Basic Law of 1991, policymakers have been motivated to raise the price of rice and other agricultural foodstuffs in an attempt to boost farmers' incomes. This was followed by a Staple Food Control Law which upheld similar values and despite its removal in 1995, a cartel arrangement called 'production adjustment' replaced it resulting in continued high prices (Kazuhito, 2005). In such an environment, small-scale farmers have had a disincentive to give up farming, hindering the growth of competitive large-scale business orientated farmers. Accordingly, the average farm size in Japan has not grown much beyond 1.2 hectares compared to an average size of 4000 hectares in Australia<sup>21</sup>.

More recently, the government's primary economic research institute, RIETI (Research Institute for Economy Trade and Industry), which is closely associated with both METI and the university sector, has more accurately described some aspects of the present situation whilst other aspects seem largely contentious. Yamashita Kazuhito, a senior fellow of RIETI states that "Japan's overall protection of its agriculture sector is at roughly the same level as that of the U.S., and only around one-third that of the European Union," (Kazuhito, 2005). He bases this statement on the belief that Japan's protection is through high prices maintained by tariffs (which are incidentally the WTO encouraged preference), rather than direct subsidies which Kazuhito believes are being 'deceptively' used by the U.S. and E.U. Whichever the case, Japan is beginning to feel pressure abroad – criticised for its rigid opposition to tariff reductions, as well as at home – for damaging the nation's interest on multilateral WTO negotiations and free trade agreement talks.

### **3.2.2 Agricultural Interest Groups**

Japan has a rigid comprehensive agricultural organisation that has consistently opposed any structural reforms. Aimed originally at revamping wartime farmer control organisations, JA Zenchu became involved with the central agricultural policy of increasing the price of rice in response to demands from the majority of Japan's farmers who grew rice. Problems with the structure of JA Zenchu have stemmed from the organisations role in both controlling the prices of agricultural inputs (and profiting in the process) as well as selling farm produce, indeed financing the whole process (Kazuhito, 2005). With a one member, one vote system stipulated by law, part-time farmers are able to purchase a full set of inputs from JA Zenchu, selling their produce in total. As a result, such farmers are by far the majority and maintain far greater political clout than the smaller proportion of full-time farmers. As a result, these part-time farmers have consistently opposed any structural reforms aimed at expanding farming scale through introducing more business-oriented farmers.

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<sup>21</sup> Mr. Bill Withers, Minister-Counsellor Agriculture, DFAT, Australian Embassy, Japan.

In addition, the opportunity cost of part-time farmer labour is high and as such, a high percentage of Japanese farm household income comes from off-farm sources (MAFF, 1998). Farmers are motivated to rely on the heavy use of highly priced fertilisers, pesticides and other labour saving inputs (Hayami, 1998). This is in contrast to larger commercial farms that are able to conserve the fertility of their soil through the use of organic fertilisers. Therefore, if support for smaller farms is reduced, the number of profitable farmers would similarly likely decrease. This may affect the employment prospects and livelihood of hundreds of people but on the other hand, the entire population would gain through more competitively priced agriculture. Such is the trade off at stake.

An economic analysis of farming such as that provided by Kazuhito (2005) provides good reason for more productive and efficient farming on a larger scale, however the size of Japanese farms is symbolic of the size of farms across the entire monsoon region of South East Asia. Indeed, in Thailand, South Korea, Malaysia and the Philippines, average farm size is only around 1.5 hectares. Therefore, whilst the voting system or unfairly high priced agricultural inputs may be factors affecting the agricultural industry, they do not provide reason for the reduction on tariffs within sensitive products of the agriculture industry. JA Zenchu's arguments rather focus on the need for such tariffs to protect Japanese farmers so that Japan's (a) multifunctionality of agriculture, and (b) food security needs can be preserved.

### **3.2.3 Multifunctionality of Agriculture**

The Multifunctionality of Agriculture is claimed to be one of the most important aspects of Japan's agricultural industry. The OECD Secretariat believes that the benefits of multifunctionality extend to include environmental values, rural amenities, cultural values, rural development and employment (OECD Secretariat, 1998). JA Zenchu claims that the value of the multi-functions of agriculture in protecting the land and environment can be estimated to be worth approximately 7 million yen annually (JA Zenchu, 2005). The main examples of the spillover benefits are stated below (JA Zenchu, 2005), along with an associated critique.

- *Flood protection and soil erosion protected by paddy rice fields.* Forests could be replanted or alternatively, farmers could be paid by the degree of water buffering provided by their paddy, hence decoupling support measures from production and prices of rice.
- *Air purification and moderation of summer heat.* Paddy fields absorb air pollution and have the capacity to lower temperatures in the summer.
- *Rural Employment.* Agriculture does provide those in rural areas with employment however other economies do exist (including tourism), many rural areas are close to

urban areas and Japanese farming households are increasingly earning large proportions of their income from non-farm sources. It would also be less costly to provide rural employment programs advancing opportunities for non-agricultural employment.

### *Positive and Negative Spillovers*

Achieving the benefits that come with agriculture spillovers is a reasonable objective of any country. Indeed, Japan and the European Union have for some time advocated for the concept of multifunctionality as a rationalisation for continued agricultural protectionism. In contrast, there are two key reasons against the use of such policies. The first reason is that there are negative spillover benefits from agriculture as well as the positive ones. These include environmental damage such as water pollution, offensive odours and livestock wastes. The second reason is that agriculture subsidies result in higher production and input use than otherwise would be the case (Bull and Roberts, 2001:71). Unless there are a stringent set of criteria in place there are no strong arguments based on efficiency and effectiveness for pursuing broad agricultural protectionist policies.

As such, there are already a number of countries who use more effective means, using targeted policies to provide direct payments to conserve, maintain and restore a variety of landscape, wildlife and historical areas (MAFF UK). Through decoupling and isolating the positive multifunctional spillover benefits, support can be less market distorting than when it is linked to the variables involved in factors of agricultural production (Aksoy and Beghin, 2005). Where agricultural protection is used to obtain multifunctionality benefits, the true benefits of agriculture are also diminished as well as multifunctional benefits everywhere else.

### **3.2.4 Food Security**

Japan is the world's largest food-importing nation with the rate of food self-sufficiency being the lowest among major industrialised countries. Food security is defined as the ability of all people at all times to have physical and economic access to sufficient, safe and nutritious food to meet their dietary needs and food preferences for an active and healthy life<sup>22</sup>.

Within Japan, food security is seen as the main rationale for the high levels of agricultural support (Bull and Roberts, 2001:3). Where in other markets access to food is a result of incomes combined with the presence of efficient markets and the supporting infrastructure, in Japan food

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<sup>22</sup> As defined by the UN Food and Agriculture Organisation, [http://www.hsus.org/legislation\\_laws/international\\_policy/united\\_nations/united\\_nations\\_food\\_and\\_agriculture\\_organization.html](http://www.hsus.org/legislation_laws/international_policy/united_nations/united_nations_food_and_agriculture_organization.html) (17/10/2005).

security does not occur through the purchase of food from the cheapest sources. Japan attempts to achieve these goals through self-sufficiency.

This perspective has been supported by the introduction of a 'New Basic Law' on Food, Agriculture and Rural Areas, introduced in 1999 to provide a sustainable dynamic vision for Japanese agriculture. By establishing self-sufficiency targets, the Japanese government has established an agricultural support policy that effectively limits trade relative to production (Bull and Roberts, 2001:76). Restrictive trade policies ensure that the Japanese Food Agency purchases rice and other agricultural products from the domestic market, in the process paying higher prices and misallocating resources.

Japan's main rationale for its food security program comes as a result of an associated benefit of its 'multifunctionality' of agricultural production policy. To ensure food security Japan believes that self-sufficiency is required so that under abnormal circumstances such as a war or major coordinated export embargo, food imports are not threatened. Such protection would only be shortlived as much of Japan's agricultural production is based on imported imports. Feeds, chemicals, and fertilisers are all largely imported or manufactured from imported oils and hence production levels cannot be sustained should the country be in isolation (Bull and Roberts, 2001:73).

Other arguments against the Japanese rationale for food security include the obvious advantages that food trade with other countries could bring. Such trade could actually serve to reduce any potential impacts of conflicts or embargos by ensuring supply relationships with a number of major producing countries. Moreover, liberalising agricultural trade and increasing stockpile efforts would be more efficient as a policy instrument and far less costly than continuing with high domestic subsidies (Wailes, 2005:196). The extra cost of stockpiling rice would still be dramatically less than the costs of subsidising domestic production.

## **4. RECENT TRADE DEVELOPMENTS**

### **4.1 Recent Japanese Agricultural Issues**

A variety of recent cases have highlighted the increasing pressure facing the Japanese government to reform their policies. Due to the loose links between liberalisation and the subsequent gains which are normally widely dispersed and small, domestic consensus from those that gain from agricultural reform (which is most people) can be difficult to achieve. The problem of highlighting gains is made significantly harder by the potential losers who are normally visible and vocal due to their potential risk of losing financial support.

#### **4.1.1 Political Pressure – The Japanese Vegetable Case**

Due to increasing pressure from vegetable and other agriculture imports, the Central Union of Agricultural Co-operatives (JA Zenchu) began to see moves demanding the implementation of safeguards spread across the country. In the second half of 2000, 35 out of 47 local assembly prefectures and 1329 out of some 3200 municipal governments passed a resolution calling for the invocation of safeguards (Yoshimatsu, 2003:55).

Such local community pressure quickly changed to central political pressure in Tokyo through the national associations of agricultural groups. These groups made formal requests to the Ministers of MAFF, MOF and METI to introduce safeguards (quota tariff system) to take measures against rising imports of vegetables. Initially, MAFF was reluctant to push through the safeguard issues due to a bitter experience from 1996. In this year, the ministry had attempted to invoke safeguard measures against imports of garlic and ginger but during negotiations with MOF and METI, MAFF was blocked by METI's assertion that Japan as a country drawing benefits from free trade, could not adopt measures against free trade (Yoshimatsu, 2003:55).

Despite the fact that MAFF was reluctant to pursue the issue, LDP members who came from rural areas received adamant demands from their supporters to take measures against the rising imports and as such, demanded action from MAFF, METI, MOF and MOFA. This was seen as a move in response to a previous setback in the election of 1989 when the party experienced its first defeat ever due largely to the dissatisfaction of farmers with the liberalisation of oranges and beef. Responding to this pressure from the political supporters of agricultural groups and their myopic interests, MAFF paid little attention to the increasing changes in regional environments and in late April 2001 imposed emergency import quotas and tariffs (Yoshimatsu, 2003:58).

The Chinese government responded by taking retaliatory actions, tightening quarantine inspections to disrupt supply of machinery parts from China to Japan. Moreover, special customs duties were levied on Japanese motor vehicles, mobile phones and air conditioners – the most symbolic and internationally competitive items exported from Japan (Yoshimatsu, 2003:60).

The initial increase in imports throughout this period can be traced to two main factors; (a) a change in Chinese policy towards production of high-priced vegetables through the use of tax reductions and subsidies, and (b) the development of Japanese trading houses to encourage Chinese farmers to use Japanese seeds, spores and cultivation methods, as well as to improve

quality in the production and distribution process (Yoshimatsu, 2003:53). Since then, and combined with the WTO's Uruguay Round of Agricultural Agreements in 1994, Japan has vigorously reformed its support policies for major agricultural products including rice, wheat, soybeans, sweeteners and dairy products in an attempt to make them less trade distorting (JA Zenchu, 2005).

#### **4.1.2 The Australian Beef Case**

Japan has historically been a very protective agriculture market, for the first time removing beef quotas in 1991. Two years later, in 1993, Japan reduced its beef tariffs from 70% to 50% which resulted in a doubling of beef exports over the five years from 1990 to 1995 (Ag Exporter, 1994). Trade in beef continued to increase steadily past the Uruguay round of WTO negotiations in 1994 when again in 1996, Japan reduced its tariff rate on beef voluntarily to 38.5%. This went beyond the WTO commitment over the implementation period of the Uruguay round (TEF Joint Study, (2003:Chapter3:3).

As a part of the tariff reduction, Japan was permitted to increase, or 'snap back' the tariff to its 50% WTO bound rate as a safeguard measure if the cumulative quarterly imports of beef were to increase by more than 17% over a corresponding period in the previous year. Following the discovery of BSE in Japan in 2002, beef imports dropped off considerably and then when recovering, triggered the measure (TEF Joint Study, 2003:Chapter3:4). Whilst the instigation of this measure prompted heated responses from the Australian meat industry and government, MAFF defended its stance as being a fair play under WTO rules.<sup>23</sup> Fair in that the measure was designed to protect Japan's domestic industry from a sudden surge in beef imports, but not fair in that the surge came after an artificial reduction in imports due to a market scare<sup>24</sup>. Despite this, the Japanese beef industry remains one of the most highly protected with Japanese cattle receiving US \$7.50 per day compared to EU cows on \$2.50<sup>25</sup>.

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<sup>23</sup> Interview with Mr. Kimura, MAFF, 4<sup>th</sup> August 2005.

<sup>24</sup> The Australian government and MLA lobbied their Japanese counterparts heavily during this period as shown by documents and through interviews with MLA and DFAT, August, 2005.

<sup>25</sup> *Japan's farmers outstanding in their field* <http://www.atimes.com/atimes/japan/EI110Dh03.html> (12/09/2005)

Figures from METI state that Australian beef exports to Japan comprised 6.3% of total Australian exports in 2003 (METI, 2005b). This was Australian's largest single industry facing the highest tariff of 38.6%. JA Zenchu argue that further tariff decreases would lead to increased foreign sales, having a significant negative effect on the Japanese

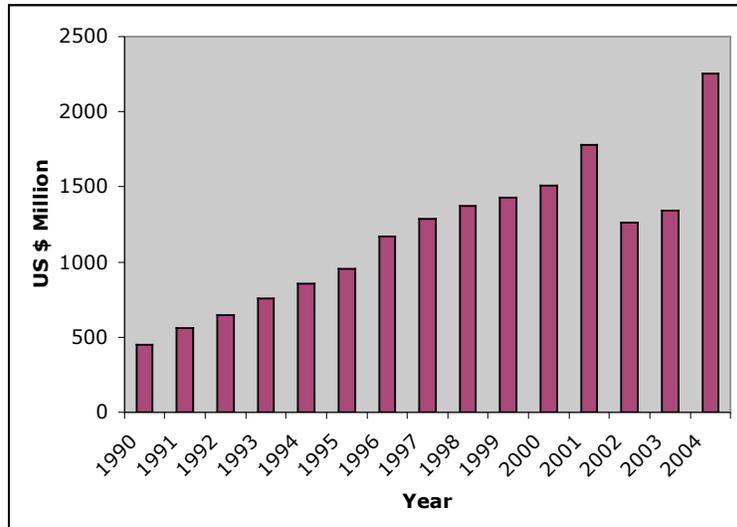


Figure: 6. Australian Beef Exports to Japan (Source: MLA)

industry<sup>26</sup>. The MAFF has a similar perspective, believing that liberalisation of beef would also lead to increased US competition<sup>27</sup>. MAFF believes such competition to be extremely detrimental to the Japanese beef industry, another factor reinforcing its opposition to a possible FTA.

Despite this, both the Australian Meat and Livestock Association (MLA) and the government agriculture department both believe otherwise. Data suggests that the populace prefer Japanese beef and that they would still buy Japanese beef even if Australian beef were cheaper<sup>28</sup>. Statistics from the last decade substantiate these claims as despite the increasing import of Australian beef due to diminishing tariffs, Japanese beef consumption has stayed relatively constant (MLA, 2005). Hence the Australian perspective is that beef liberalisation leads to increased beef consumption due to additional more inexpensive variety, rather than replacement of Japanese beef<sup>29</sup>. This is in line with the generally held world view on beef industry trade liberalisation which suggests that reform would lead to increased world prices, providing opportunities for exporters as well as gains (through price increases) of beef prices both at home as well as abroad.

## 4.2 Japan's Agricultural Cooperatives

### 4.2.1 A Potential Solution: More Business Oriented Farmers?

Kazuhito from RIETI makes a point of recognising the sea change occurring within Japanese agricultural cooperatives, as business-oriented farmers are having to go their own way due to

<sup>26</sup> Interview with Mr. Takuo Ichiya, JA Zenchu.

<sup>27</sup> Interview with Mr. Takayuki Kimura, MAFF.

<sup>28</sup> Interview with Mr. Rob Mann, MLA.

<sup>29</sup> Ibid, Interview with Mr. Bill Withers, DFAT.

unfair treatment. He comments on the case of one JA official who was so opposed to the high price of inputs (fertilisers) that he started his own cooperative and imported fertiliser from South Korea at two-thirds of the domestic price (Kazuhito, 2005). To this end, Kazuhito suggests that such unfairly treated business-oriented farmers should set up their own agricultural cooperatives and go one step further by forming economic and political alliances of pro-reform groups. This would complete the ingredients of what Kazuhito believes is necessary for successful structural reform: "strong political leadership; recognition by the public that reforms are necessary, important and urgent; and active pro-reform groups within the sector which is the target of reform," (Kazuhito, 2005).

## **5. POSSIBILITIES FOR THE FUTURE**

### **5.1 How a Japan – Australia FTA could possibly work**

The 2003 Trade and Economic Framework has set a precedent for higher political and economic collaboration between the Australian and Japanese stakeholders (TEF, 2003). As political determination continues to mount, it is only a matter of time before the remaining voices of those in opposition are overpowered. Whilst rumour suggests that a FTA could be achieved through the exclusion of Australian agriculture, the Australian Minister-Counsellor for Agriculture, Mr. Bill Withers has confirmed that this is not possible. The FTA would need to cover at least 90% of trade between countries (as stipulated by the WTO) and as such, a fair proportion of Australia's agriculture would need to be included<sup>30</sup>.

Whilst the JA Zenchu manager interviewed believes that this would be almost impossible to achieve<sup>31</sup>, Mr. Kimura of MAFF believes that a moderate (rather than a fully conclusive FTA) could be achieved through the use of a variety of different mechanisms<sup>32</sup>. Sensitive products could be included by establishing tariff rate quotas (TRQs) which provide reduced tariff rates on a specified volume of imports, (with higher tariffs for imports above these quotas)<sup>33</sup>. Other non-tariff barriers could be used such as phytosanitary standards and government import controls such as the issue of import licenses, quantity and quality restrictions and bureaucratic red tape (Mitchell and Mielke, 2005:202). Renegotiation clauses and transitional periods can also be used which would allow the associated goods to be included within the trade total for WTO classification purposes<sup>34</sup>.

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<sup>30</sup> Interview with Mr. Bill Withers, DFAT, 3<sup>rd</sup> August 2005.

<sup>31</sup> Interview with Mr. Ichiya, JA Zenchu, 2<sup>nd</sup> August 2005.

<sup>32</sup> Interview with Mr. Kimura, MAFF, 4<sup>th</sup> August, 2005.

<sup>33</sup> Ibid.

<sup>34</sup> Interview with Mr. Shujiro Urata, Waseda University/RIETI, 25<sup>th</sup> July 2005.

The use of these mechanisms would allow for the successful implementation of the agreement across some agricultural products whilst simultaneously leaving out those agricultural products most sensitive to the Japanese (such as sugar and rice). In this way, such a FTA would open the way for the preferential liberalisation of some of Japan's protected agricultural sectors.

## **5.2 Effects of a Australia- Japan FTA**

An FTA between the two countries would not only liberalise trade but also create many additional opportunities for value added activities. Australia would immediately benefit from preferential access through decreased tariffs and Japan would also see immediate benefits through cheaper agricultural products on shop shelves. The political decision also having reverberations by assisting in the development of more efficient farming practises and larger scale farms. Investment may also move into areas where Japan maintains higher levels of core competitiveness.

Whilst the benefits affecting the economy and consumers in general are great, some realignments within the agricultural sector may have negative consequences. Due to increased competitiveness, some farms will be closed as they join larger more efficient operations, in the process leaving some people unemployed. Whilst the government will most likely expand programs to re-skill and assist such unemployed, it is highly likely that some may not replace their lost agricultural work.

## **5.3 The Challenge for Trade Preferences in securing Multilateral Tariff Reductions**

### *Benefits for non-preferential trade partners?*

By bringing about an FTA with Australia, Japan will be forced to develop reforms that will simultaneously ready its agricultural industries for the prospect of increased competition. In the process of reform, it is important that Japan and Australia ensure that aspects of its preference scheme are complemented by reforms that developing countries are making. This means ensuring that all non-valorem tariffs are converted into ad valorem tariffs and direct support programs are decoupled from production (Aksoy, 2005:52). This will ensure that the return on export can be improved without at the same time stifling diversification and multilateral trade liberalisation.

With the reduction of market distorting subsidies, world market prices will rise in reflection of increased levels of market access due to increased world demand. The challenge here is that the

preferences within the FTA need to have a short half life to allow for the introduction of other markets, thereby extending coverage to a greater range of agricultural products (Aksoy, 2005).

Preference schemes can also become more transparent, offering greater opportunity for multilateral participants should a number of other factors be observed. Rules of origin should be simplified, compliance processes improved and there should be a general reduction in any sources of uncertainty concerning product and country coverage and duration of preference scheme. If developing countries simultaneously address their own internal barriers, factors such as lacking infrastructure and high transport costs, then they will also have the competitiveness to compete internationally through the opportunities opened up by reforms that preferential agreements initially bring about.

Rich nations have the bargaining power and capacity to instigate preferential agreements and should also have the capacity to simultaneously develop reforms that allow for greater transparency in markets. As a result of these reforms, smaller developing trading partners will have a greater chance at grasping opportunities than ever before.

## **6. CONCLUSION**

In seeking to provide an analysis of the pressures facing Japan to liberalise its agricultural support levels, a number of multifaceted arguments have been presented. The complexity of support mechanisms and the perspectives of the often vocal stakeholders have been detailed. In answering the research question posed within this thesis<sup>35</sup>, the main pressures facing Japan were identified as being either political or agricultural in nature. In addition, background information was provided through both a dissemination of trade theory and the results of modelling studies.

By providing an insight into quantitative modelling studies, it was ascertained early in section two that possible economic benefits could be made from liberalisation. In the current era of integration where countries are seeking to develop the competition enhancing effects that come with the formation of a larger market, these models provided an understanding of the motivation behind the changing political motivations. Motivations that inspired Japan to adopt an intensive FTA stance since its first foray with Singapore in 2001.

Since then, the pressures on countries to form FTAs have mounted, a point made especially clear through the current multilateral intransigence on trade. With more participants and a greater

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<sup>35</sup> The main thesis question presented in section 1.1.1 on page 3 states '*liberalise its agricultural support levels, and how could such liberalisation be achieved through a FTA with Australia?*'

number of agendas presented to the WTO, countries seeking rapid trade opportunities are making clear movements towards developing a preferential FTA agenda. Japan is leading the pace with strong political pressure amongst its Asian rivals to retain its place within East Asian trade.

This multilateral political pressure as well as bilateral pressures from individual trading partners has forced Japan to develop stronger trade ties with individual partners. Australia, having reached an agreement to research the possibility of a FTA with China, put Japan in a position where to stay competitive, it simply had to also research such a possibility. This has in turn led Japan one step closer to agricultural reforms.

External political pressures have also been accompanied by changes within the Japanese political landscape itself. The Prime Minister, Junichiro Koizumi has successfully implemented a program of liberalisation and reform, gaining approval from the parliament after the September 2005 general election. The removal of many of the older stalwart parliamentarians is also seen reflected in the pressure that Koizumi, MOFA, METI and MOF are placing on MAFF to instigate reforms within JA Zenchu. With business-orientated farmers beginning to develop their own agricultural co-operatives in response to unfair treatment, it is only a matter of time before pro-reform groups bring even greater structural reform.

Other changes to the agricultural landscape that have been discussed include Japan's reduced tariffs and support policies which come as a result of the Uruguay agreement in 1994. Despite the greatly increased competition, Japan is becoming increasingly resistant to the use of safeguards, predominantly due to international pressure and past instances of retaliatory action.

With increasing international pressure for the decoupling and isolation of positive multifunctional spillover benefits, this paper has also provided strong arguments for alternative means to gain the benefits from multifunctional agricultural production. It is argued that more effective policies could be used which would lead to greater benefits not only for the environment, but also for agriculture itself. Similar arguments are also raised concerning Japan's food security policy. With higher prices paid and resources misallocated, detailed analysis shows that policy instruments to increase stockpile efforts would prove more efficient than continuing with the current level of high domestic subsidies.

With pressure mounting from Australia, it appears that the change is coming through both political and market led mechanisms. With organic developments also occurring within the maturing agricultural cooperatives, greater competition may also come from various elements within the

industry itself. With the possibility of greater competition being the goal, it is only a matter of time before such change permeates through.

Australia will no doubt secure its goals with Japan, the key issues being the extent to which Japan's agriculture is liberalised. With an FTA only needing to cover 90% of trade, only half of Japan's tariffs need to be removed. Whilst unpleasant for some and difficult for most, a number of TRQs and non-tariff barriers will ensure that full agricultural liberalisation is gradual, taking place over at least a period of ten years.

With the simultaneous liberalisation of other agricultural barriers through similar FTAs, it is hoped that market access will be improved across the world. Momentum has become and liberalisation of agriculture is the focus. With the path already well trod, it is only a matter of time before obstacles are diminished and market access improved. If care is taken, benefits will accrue to all leading to previously unseen opportunities for low and middle-income countries to develop their industries through the export of their agricultural products.

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