FREE TRADE AGREEMENTS IN THE WORLD TRADE ORGANIZATION: THE EXPERIENCE OF EAST ASIA AND THE JAPAN-MEXICO ECONOMIC PARTNERSHIP AGREEMENT

Anna Turinov*

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* Law Clerk, Federal Court of Appeal, Ottawa, Canada. B.A. Hons (McGill), M.A. (University of British Columbia), LL.B. (University of British Columbia). I wish to thank Professors Ljiljana Biukovic and Pitman B. Potter for their guidance and support with this research.

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1. INTRODUCTION

In October 2002, Japan's Ministry of Foreign Affairs (MOFA) released a policy statement entitled Japan's Free Trade Agreement (FTA) Strategy. The policy statement signaled an important shift in Japan's trade relations with East Asia and the world. The statement called for maintaining and strengthening free trade systems amidst economic globalization and in addition to the multilateral trade system governed by the World Trade Organization (WTO) and the General Agreement on Tariffs and Trade (GATT).[1] Pointing to high tariff rates imposed on Japanese products by other world countries and trade blocs, MOFA stated that in promoting Free Trade Agreements (FTAs), attention should be paid to securing both political and economic stability within the larger regional context and eliminating trade obstacles to the Japanese economy. East Asia was highlighted as the region with the most promising partners for negotiations, in particular, the Republic of Korea and the Association of Southeast Asian Nations (ASEAN). "At the same time", the statement continued, "an FTA with *Mexico* [emphasis added in the text] should be concluded expeditiously where Japanese businesses have to pay relatively high tariffs, in comparison to those of NAFTA and the European Union that have already concluded FTAs with Mexico."[2] By the time this article was completed in late 2007, the Japan-Mexico EPA had been in force for almost three years, and Japan was on its way towards concluding its eighth preferential agreement.

Implicit in the MOFA statement is Japan's recognition of its relatively late entry into the FTA game and of multiple priorities that could be addressed by these preferential trade arrangements. In other parts of the world, FTAs, also known as Preferential Trade Agreements (PTAs) or Regional Trade Agreements

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1. GENERAL AGREEMENT ON TARIFFS AND TRADE, Oct. 30, 1947, 58 U.N.T.S. 187, 61 STAT. A-11, T.I.A.S. NO. 1700, *available at* http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm [hereinafter GATT].

2. Japan Ministry of Foreign Affairs, Japan's FTA Strategy (English Summary), Oct. 2002, *available at* http://www.mofa.go.jp/policy/economy/fta/strategy0210.html.

(RTAs) have been increasingly taking place alongside the multilateral trade system governed by the WTO and the GATT. In tandem with the global trend, East Asia, including Japan, is also seeing a rapid increase in FTAs. This proliferation of the past decade is a response to the new global and regional factors, which include the slow liberalization progress of the WTO Doha Round, the rise of China, marked expansion in the intra-industry trade between the economies of East Asia and the Association of Southeast Asian Nations (ASEAN), as well as competition between China and Japan to lead regional trade and economic integration.[3] Proposals for FTAs extend beyond the region to Australia, Canada, Chile, the Gulf Cooperation Council (GCC), India, Mexico, New Zealand, Switzerland, and the United States. The majority of the agreements under negotiation are bilateral, and are rarely plurilateral or regional.[4] These FTAs are formed among parties with various degrees of economic development and for a variety of motives. As such, there are concerns relating to the ability of current legal rules to accommodate this new reality of free trade.

This comment examines the extent to which the current legal regime is an effective framework to govern the proliferation of FTAs in East Asia, with particular focus on Japan and the Japan-Mexico EPA. This FTA provides a good study case because differences in economic development between the two countries, as well as the extra-regional aspects, raise issues of compliance and effectiveness of the multilateral rules that are mirrored in other FTAs concluded by Japan, by other East Asian economies, and in many preferential trade arrangements on the global level. The article argues that Article XXIV of the GATT is not always effective in ensuring that FTAs in East Asia and in Japan produce economic benefits, or that regional members forming preferential arrangements continue their institutional commitment to the WTO. However, at this time, there is no clear evidence that these FTAs are undermining either the non-discriminatory trade environment or the legitimacy and relevance of the WTO.

The article is divided as follows. Part 2 canvasses the key elements of Article XXIV of the GATT as well as the debates on its effectiveness as a framework for FTAs. Part 3 examines the

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3. T. J. Pempel & Shujiro Urata, *Japan: A New Move toward Bilateral Trade Agreements*, *in* BILATERAL TRADE AGREEMENTS: ORIGINS, EVOLUTION, AND IMPLICATIONS 78 (Vinod K. Aggarwal & Shujiro Urata eds., 2005) [hereinafter Pempel & Urata].

4. The plurilateral and regional agreements under negotiation are ASEAN + 3 (China, Japan and Korea), ASEAN-China, ASEAN-Japan, ASEAN-Korea, East Asian FTA (China, Japan and Korea), and Korea-Switzerland, Iceland, Lichtenstein, and Norway (EFTA).

extent to which the framework is helpful to govern the proliferation of FTAs in East Asia. Part 4 discusses the context in which Japan arrived into the free trade game, and examines how the challenges associated with Article XXIV are reflected in a specific instance of the Japan-Mexico Economic Partnership Agreement.[5] While Japan's free trade strategy raises the issues of compliance with the multilateral framework, this strategy will likely lead to greater liberalization of Japan's trade at both the bilateral and the multilateral levels.

2. ECONOMICS AND NON-ECONOMICS OF FTAS IN THE GATT AND THE WTO

2.1. Article XXIV: Canvassing the Terrain

FTAs represent an exception to the principle of Most Favoured Nation (MFN). MFN is one of the non-discrimination principles which underpin the multilateral regime, and can be found in Article I of the GATT. However, FTAs can be formed provided they comply with the requirements set out in Article XXIV of the GATT 1994. The key provisions that govern extension of trade preferences are found in Articles XXIV.5 and XXIV.8. Article XXIV.7 imposes on parties an obligation of full disclosure to the WTO members on the content of a future FTA. Once the parties notify the WTO, the FTA is reviewed by the WTO Committee on Regional Trade Agreements (CRTA). The CRTA may make recommendations to the parties seeking to form an FTA. The FTA cannot be put into force if the parties are not prepared to modify it according to these recommendations.[6]

Article XXIV distinguishes between three types of preferential agreements: a free trade area, a customs union, and an interim agreement. The focus of this comment is the free trade area, which is characterized by the abolition of internal trade barriers with each constituent party maintaining its respective external tariff regime. A customs union is characterized by the internal abolition of trade barriers among the constituent parties and the creation of one common external tariff regime with respect to third parties. An interim agreement is a transitional ar-

5. Agreement between Japan and the United Mexican States for the Strengthening of the Economic Partnership, Sept. 17, 2004 (entered into force Apr. 1, 2005), *available at* http://www.mofa.go.jp/region/latin/mexico/agreement/index.html [hereinafter Japan-Mexico EPA].

6. Mitsuo Matsushita, Thomas J. Schoenbaum & Petros C. Mavroidis, The World Trade Organization: Law, Practice, and Policy 560 (2006) [hereinafter Matsushita *et al.*].

rangement, which provides for the formation of a customs union or a free-trade area within a reasonable length of time.[7]

The formation of FTAs made possible by this framework is underpinned by two rationales. The economic or "welfare maximization" rationale is recognized in the wording of Article XXIV.4. "Welfare maximization" refers to increasing world trade at large through the elimination of trade barriers and the minimization of effects on third parties.[8] The non-economic rationale[9] is to ensure that regional exceptions to the non-discrimination principle of MFN do not result in unequal arrangements[10] or institutional diversion from multilateralism.

Yet Article XXIV does not always further these rationales, nor is Article XXIV always well-equipped to ensure that FTAs comply with other multilateral rules.[11] Given the rate at which FTAs proliferate today, as well as their considerable diversity, the existing rules do not always accommodate reality. The recent decade has seen an unprecedented proliferation of both full and partial preferential agreements concluded for a variety of motives. A total of 196 preferential agreements have been notified to the WTO, and 132 of these are currently in force.[12] As of March 2007, 116 FTAs were in force and notified specifically under Article XXIV.[13] While some of those agreements are formed for economic reasons, many others tend to primarily respond to political and social imperatives of the constituent parties. A number of FTAs may produce certain economic gains without complying with the relevant GATT provisions. Conversely, strict compliance with Article XXIV does not necessarily mean that the agreement will lead to trade creation.[14]

Further, notwithstanding economic benefits, FTAs are often viewed as diverting the parties' non-economic resources such as institutional commitment from the multilateral process. The rules do not look into the motives of countries entering FTAs,

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7. GATT, *supra* note 1, Art. XXIV, §§ 8(a), 8(b), & 5(c).

8. JAMES H. MATHIS, REGIONAL TRADE AGREEMENTS IN THE GATT/WTO: ARTICLE XXIV AND THE INTERNAL TRADE REQUIREMENT 101-4 (2002).

9. *Id.* at 117-19.

10. ROBERT E. HUDEC, DEVELOPING COUNTRIES IN THE GATT LEGAL SYSTEM 216-17 (1987).

11. JOHN H. JACKSON, THE JURISPRUDENCE OF GATT AND WTO: INSIGHTS ON TREATY LAW AND ECONOMIC RELATIONS 106 (2000).

12. Jo Ann Crawford & Roberto V. Fiorentino, *The Changing Landscape of Regional Trade Agreements* (WTO Discussion Paper No. 8, 2005), at 3, 19, *available at* http://www.wto.org/english/res_e/reser_e/discussion_papers_e.htm [hereinafter Crawford & Fiorentino].

13. WTO, Notifications to the GATT/WTO, Regional Trade Agreements: Facts and Figures (Mar. 1, 2007) [hereinafter WTO, Notification to the GATT/WTO], *available at* http://www.wto.org/english/tratop_e/region_e/regfac_e.htm.

14. MATHIS, *supra* note 8, at 103.

their welfare implications,[15] or their institutional impact. These concerns are reflected in two strands of critique related respectively to systemic and institutional issues.[16]

2.2. Systemic Issues in FTAs: Article XXIV.8(b) and XXIV.5(b)

Systemic issues involve interpretation and clarification of Article XXIV. They are contentious due primarily to the ambiguities contained in the internal and external requirements of Article XXIV, found in Articles XXIV.8(b) and XXIV.5(b), respectively. Article XXIV.8(b) states that "duties and other restrictive regulations of commerce. . .are eliminated with respect to substantially all the trade between the constituent territories."[17] The legal test of "substantially all" has a *quantitative* and a *qualitative* components,[18] which tend to produce different results in assessing compliance of an FTA with the multilateral rules.

The *quantitative* component measures elimination of trade barriers by a statistical benchmark that designates a percentage of trade between the constituent parties. The internal requirement can be undermined if elimination of barriers is below this often arbitrary benchmark. For example, the EU has traditionally employed the figure of 80 percent, while the figure more recently proposed by Australia is 95 percent.[19] The *qualitative* component assesses whether barriers have been eliminated in substantially all major sectors of trade. Thus, even where the *quantitative* component of the test is satisfied, the requirement

15. Matsushita *et al.*, supra note 6, at 553.

16. Transparency critique focuses on the requirements set out in article XXIV, § 7. The critique has focused on the absence of a required advance or later approval of a notified FTA by other WTO members. Once an FTA has been notified, unless other WTO parties agree on a set of recommendations, the language permits FTA parties to proceed with the agreement. The GATT and the WTO parties have never reached a decision by consensus that a notified agreement was inconsistent with the multilateral rules. Further, the timing of notification in article XXIV, § 7 is not explicit. It is reasonable to suppose that a prospective FTA requires an advance, not an *ex post* facto, notification. Nevertheless, most agreements have been notified *ex post* facto; and it would not be realistic to suppose that the WTO would recommend dissolution of an inconsistent agreement. *See id.* at 560-62. This is the least contentious provision of article XXIV and is not discussed here in detail. *See* Crawford & Fiorentino, *supra* note 12, at 19.

17. GATT, *supra* note 1, art. XXIV, § 8(b).

18. Matsushita *et al., supra* note 6, at 568.

19. *Id.* at 569-70.

can be undermined by the exclusion of a major sector such as agriculture from the agreement.[20]

For the economists, both legal tests can be misaligned with the welfare maximization rationale. Trade creation and trade diversion are economic concepts, which are not part of the legal test of Article XXIV.8(b).[21] Substantial elimination of trade barriers is not necessarily desirable in every context because it can result in greater trade diversion than partial extension of preferences. Conversely, partial elimination of barriers can result in less trade diversion than a complete extension of preferences.[22] Thus, even where an FTA is WTO-compliant within the meaning of Article XXIV.5(b), economic arguments for such an agreement may suggest otherwise.[23]

The external requirement found in Article XXIV.5(b) states that "the duties and other regulations of commerce . . . shall not on the whole be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation [of the Agreement]."[24] One issue associated with the external requirement is the absence of consensus at the WTO level as to whether the designation of "other regulations of commerce" captures rules of origin. Rules of origin in FTAs specify the minimum product content that qualifies for import or export within a free trade area, and are usually more restrictive than the multilateral rules of origin.[25]

For the economists, even where duties comply with Article XXIV.5(b), rules of origin can operate as *de facto* trade restrictions on third parties[26] and thus result in trade diversion and market discrimination. Rules of origin are often arbitrary, complex, and are accorded on a sector-by-sector basis. Multiple applicable tariff rates with respect to parties and non-parties to

20. Mitsuo Matsushita, *Legal Aspects of* FREE TRADE AGREEMENTS in the Context of Article XXIV of the GATT 1994, *in* WTO AND EAST ASIA: NEW PERSPECTIVES 504 (Mitsuo Matsushita & Ahn Dukgeun eds., 2004).

21. MATHIS, *supra* note 8, at 103-04, 113.

22. *Id.* at 103.

23. Jagdish Bhagwati, *Preferential Trade Agreements: The Wrong Road*, 27 LAW & POL'Y INT'L BUS. 865, 868 n. 5 (1996) [hereinafter Bhagwati].

24. GATT, *supra* note 1, art. XXIV, § 5(b).

25. *See* Agreement on Rules of Origin, Uruguay Round Agreement, Dec. 15, 1993, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1143 (1994), *available at* http://www.wto.org/english/docs_e/legal_e/22-roo_e.htm#ftnt1. Art. 1.1 defines rules of origin as "laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods." *Id.* Art. 1.2 states that the rules "shall include all rules of origin used in non-preferential commercial policy instruments", which entails coherent and equal application. *Id.*

26. MATSUSHITA *et al.*, *supra* note 6, at 563.

agreements lead to overlapping FTAs, known as the 'spaghetti bowl' phenomenon.[27] Further, due to the globalization of production, it may be increasingly arbitrary to assume that product content can be conclusively identified according to its country of origin.[28]

In addition, debates on the impact that FTAs have had on trade creation and trade diversion are inconclusive. Economic studies point out that trade expansion among parties to an FTA, upon formation of the agreement, tends to be greater than expansion of their trade with the rest of the world. Yet, it is not known to what extent this observed phenomenon reflects trade diversion and trade creation.[29] Overall, the proliferation of FTAs does not yet seem to have created a world trading system dominated by trade diversion.[30]

2.3. Institutional Issues in FTAs and the Multilateral Process

Even where FTAs are WTO-compliant and economically beneficial, Article XXIV does not always adequately address potentially adverse institutional effects of these FTAs. Such effects include conflict in jurisdiction, diversion of resources, and erosion of enthusiasm from the multilateral process.[31] Conflict or concurrency of jurisdiction occurs where one constituent party launches a complaint against the other party in respect of the same subject-matter simultaneously under the FTA dispute settlement provisions and the WTO Dispute Settlement Understanding (DSU).[32] This practice can result in a discrepancy between the jurisprudence of the WTO and the FTA panels on

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27. Jagdish Bhagwati, David Greenaway & Arvind Panagariya, *Trading Preferentially: Theory and Policy,* 108 Econ. J. 1128, 1139 (1998) [hereinafter Bhagwati *et al*]. Note that the author defines Preferential Trade Agreements (PTAs) as used in *id.*, as equivalent to FTAs.

28. Bhagwati, *supra* note 23, at 866.

29. Dean A. DeRosa & John P. Gilbert, *Predicting Trade Expansion under FTAs and Multilateral* Agreements, Peterson Institute for International Economics Working Paper Series No. 05-13, at 3 (Oct. 2005), *available at* http://peterson institute.org/publications/interstitial.cfm?ResearchID=572.

30. Viet D. Do & William Watson, *Economic Analysis of Regional Trade Agreements, in* Regional Trade Agreements and the WTO Legal System 17 (Lorand Bartels & Federico Ortino eds., 2006) [hereinafter Do & Watson].

31. Colin B. Picker, *Regional Trade Agreements v. The WTO: A Proposal for Reform of Article XXIV to Counter this Institutional Threat,* 26 U. Pa. J. Int'l Econ. L. 267 (2005).

32. Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing World Trade Organization, Annex 2, Legal Instruments – Results of the Uruguay Round Governing the Settlement of Disputes, 33 I.L.M. 112 (1994), *available at* http://www.wto.org/english/docs_e/legal_e/28-dsu_e.htm [hereinafter DSU Agreement].

the same issues and confusion within the trade community.[33] For example, some FTAs leave parties with a choice of only one forum, once procedures are initiated, to the exclusion of others. Examples of such agreements are the North American Free Trade Agreement[34] and the Olivos Protocol for the Settlement of Disputes of MERCOSUR.[35] Some FTAs, however, leave parties free to pursue remedies on the same issue in more than one forum.[36] One example of such agreement is the Japan-Singapore Economic Partnership Agreement (JSEPA)[37] discussed further below.

In addition to conflict, FTAs can divert institutional resources from multilateral trade liberalization. These resources include ministerial commitment, budget allocations to the multilateral negotiations, academic resources, as well as legislative expenditures associated with the ratification and implementation of FTAs into domestic law or the passing of secondary legislation.[38] Further, such agreements create vested interests, which impose significant costs domestically. Rules of origin, in turn, can make international trade for the country more costly and complex.[39]

Finally, FTAs can lead to the erosion of enthusiasm for the WTO process. States and the private sector may perceive it to be easier and more effective to negotiate FTAs to achieve specific goals quickly and directly, which has the potential to undermine the legitimacy and relevancy of the WTO. Loss of enthusiasm for substantive issues at the WTO level has also been attributed to the fact that these issues are being addressed by the FTAs, including competition policy, labour, investment, or environ-

33. Picker, *supra* note 31, at 294.

34. North American Free Trade Agreement between the Government of Canada, the Government of Mexico and the Government of the United States, Dec. 17, 1992, 32 I.L.M. 289 (pts. 1-3); 32 I.L.M. 605 (pts. 4-8), art. 2005.6 (entered into force Jan. 1, 1994), *available at* http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=78 [hereinafter NAFTA].

35. Olivos Protocol for the Settlement of Disputes of the Southern Common Market (MERCOSUR), Feb. 18, 2002, 42 I.L.M. 2, *available at* http://www.sice.oas.org/Trade/MRCSR/olivos/polivos_p.asp. MERCOSUR came into force by the Treaty Establishing a Common Market between the Argentine Republic, the Federal Republic of Brazil, the Republic of Paraguay and the Eastern Republic of Uruguay (Treaty of Asuncion), Mar. 26, 1991, 30 I.L.M. 1041, *available at* http://www.sice.oas.org/Mercosur/instmt_e.asp.

36. Locknie Hsu, *Dispute Settlement Systems in Recent Free Trade Agreements of Singapore: ANZSCEP, JSEPA and ESFTA*, 4:2 JOURNAL OF WORLD INVESTMENT 277, 281 (2003) [hereinafter Hsu, *Dispute Settlement in Recent Free Trade Agreements of Singapore*].

37. Japan Ministry of Foreign Affairs, Japan-Singapore Economic Partnership Agreement, Jan. 13, 2002, (entered into force Nov. 30, 2002), *available at* http://www.mofa.go.jp/region/asia-paci/singapore/jsepa.html [hereinafter JSEPA].

38. Picker, *supra* note 31, at 294.

39. Crawford & Fiorentino, *supra* note 12, at 16.

ment.[40] Thus, notwithstanding 'welfare maximization,' FTAs can cause adverse institutional effects at the multilateral level.

3. ANALYSIS: ARTICLE XXIV AND FTAS IN EAST ASIA

3.1. East Asia's Arrival into Free Trade

East Asia is a newcomer to both regional institutionalization of economic and political relations and to the FTA bandwagon. In other parts of the world, preferential trade arrangements have existed for some time. The first such arrangement notified under Article XXIV was the Treaty of Rome establishing the European Economic Community (EEC) in 1957.[41] With increasing integration of the international economy in the Western hemisphere, the customs union of MERCOSUR and NAFTA took effect respectively in 1991 and 1994. Other parts of Asia have also seen a rapid proliferation of free trade arrangements. In Southeast Asia, ASEAN members signed a Framework Agreement in 1992 with a view to establish an ASEAN Free Trade Area (AFTA) in 15 years.[42] In South Asia, the agreement to establish a SAARC Preferential Arrangement (SAPTA)[43] was signed in 1993. SAPTA was envisaged primarily as the first step towards the transition to a South Asian Free Trade Area (SAFTA)[44] leading subsequently towards a Customs Union, Common Market, and Economic Union. East Asia, however, has until recently remained largely outside of free trade. This reluctance to join the free trade game was due to the generally lower level of economic integration in the GATT era and the regional ideological and economic divisions. Further, the use of legal measures in regional cooperation, in the area of trade or elsewhere, has been traditionally unpopular among the governments of East Asia.[45]

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40. Picker, *supra* note 31, at 302-3.

41. Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 3, *available at* http://eur-lex.europa.eu/en/treaties/index.htm.

42. Framework Agreement on Enhancing ASEAN Economic Cooperation, Brunei-Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand, Jan. 28, 1992, 31 I.L.M. 507 (to enter into force upon signing), ASEAN, *available at* http://www.aseansec.org/12374.htm.

43. SAARC Preferential Trading Arrangement, Apr. 11, 1994 (entered into force on Dec. 7, 2995), *available at* http://www.saarc-sec.org/main.php?t=2.1.5 [hereinafter SAPTA].

44. SAARC, South Asian Free Trade Area, http://www.saarc-sec.org/main.php?t=2.1.6 [hereinafter SAFTA].

45. Takao Suami, Regional Economic Cooperation in East Asia and its Legalization. Paper presented at the International Symposium held by the Japanese Association of International Economic Law, Third Session: Regional Integration in East Asia – Some Developments of Regional Economic Cooperation in Asia, Nagoya, Japan (Nov. 2003) (unpublished manuscript, on file with author), at 4 [hereinafter Suami].

The recent FTA proliferation in East Asia is due to a number of factors. The pace of global economic integration has increased in the 1990s. At the same time, at the multilateral and regional levels, the WTO Doha Round and the APEC failed to produce the desired trade liberalization.[46] As these institutions were experiencing difficulties, the countries of East and Southeast Asia have managed to achieve an unprecedented level of regional economic integration in the 1990s. Intra-regional trade has grown exponentially in the last decade, largely driven by the expansion of intra-industry integration as well as by the rise of China.[47] In this context, the East Asian countries began to eye FTAs as a way to deepen such regional integration further.

Other factors behind the proliferation are not related to specific trade gains. Politically, FTAs with Southeast Asian countries represent a competition of China and Japan for regional leadership as well as for access to energy and natural resources. In addition, FTAs represent an important tool for trade diplomacy and provide new WTO members such as China with negotiating experience.[48] At the domestic level, FTAs can tackle socioeconomic problems. For example, in order to offset potential labour shortages in a number of sectors due to demographic changes,[49] Japan intends to facilitate the entry of foreign workers through FTAs with Indonesia, Philippines, Thailand, and Vietnam.

Further, FTAs represent a legal instrument to achieve domestic and international objectives. Traditionally, the use of legal measures in trade relations has not been popular among East Asian governments, which have preferred to rely on political means.[50] APEC exemplified such 'soft legalization' because it was not a treaty-based organization and therefore did not impose international law obligations on its members.[51] In addition to the strengthening of the multilateral system and China's accession to the WTO, the FTAs of East and Southeast Asia represent a marked progress from this traditional approach toward further legalization of trade relations. By 2007, the East Asian econo-

46. Gary Clyde Hufbauer & Yee Wong, *Prospects for Regional Free Trade in Asia*, Peterson Institute for International Economics Working Paper Series No. 05-12, at 3 (Oct. 2005), *available at* http://petersoninstitute.org/publications/interstitial.cfm?ResearchID=569 [hereinafter Hufbauer & Wong].

47. *Id.* at 4.

48. *Id.* at 3.

49. Japan Business Federation (Nippon Keidanren), Towards Broader and Deeper Economic Partnership Agreements, Policy Proposal (Oct. 17, 2006), *available at* http://www.keidanren.or.jp/english/policy/2006/072/proposal.html [hereinafter Nippon Keidanren].

50. Suami, *supra* note 45, at 4.

51. *Id.* at 4-5.

mies combined (excluding China and Taiwan) have ratified four bilateral and regional FTAs and have negotiated but not implemented another six. At that time, another 19 FTAs were at various stages of negotiations[52] or joint study with a view to launch FTA negotiations.

Given the variety of motives behind the recent proliferation of FTAs in East Asia and the differences in economic development among the countries, this part of the article explores the extent to which Article XXIV is an effective framework to govern free trade in the East Asian context.

3.2. Systemic Issues in East Asian FTAs

The internal requirement of Article XXIV is not uncontroversial in regional trade liberalization. Asia, including East Asia and Southeast Asia, is home to many developing countries[53] where disparities in economic development and trade patterns can be large. Upon application of the *quantitative* component of the legal test in Article XXIV.8(b), many regional FTAs do not appear problematic. However, upon application of the *qualitative* component to eliminate barriers in substantially all sectors of trade a number of East Asian economies may not be WTO-compliant.

For example, Japan and South Korea have highly protected agricultural and textile sectors, yet many of their regional economic partners in Southeast Asia and beyond are substantial exporters of agricultural products. In addition, a number of countries such as Singapore have textile sectors that may directly compete with those of Japan and South Korea. Like many other FTAs, FTAs that involve a constituent party from East Asia exclude these sectors, most notably agriculture, from preferential treatment. It is therefore likely that the pattern of exclusion will

52. Implemented: Korea-Chile, Japan-Singapore, Japan-Mexico, and Korea-Singapore. Negotiated, but not implemented: Korea-Switzerland, Iceland, Liechtenstein, and Norway (EFTA), Japan-Indonesia, Japan-Malaysia, Japan-Philippines, Japan-Thailand, Japan-Chile. Under negotiation: Hong Kong-New Zealand, Japan-ASEAN, Japan-Australia (First round to be held in April 2007), Japan-Brunei, Japan-Gulf Cooperation Council (GCC), Japan-India, Japan-Vietnam, Korea-ASEAN, ASEAN + 3 (China, Japan, Korea), East Asian FTA (China, Japan, Korea), Korea-Australia, Korea-Canada, Korea-India, Korea-Japan, Korea-MERCOSUR, Korea-Mexico, Korea-New Zealand, Korea-Thailand, Korea-United States. *See* MOFA, Free Trade Agreement (FTA) and Economic Partnership Agreement (EPA), *available at* http://www.mofa.go.jp/policy/economy/fta/index.html [hereinafter MOFA, Free Trade Agreement (FTA) and Economic Partnership Agreement (EPA)], and Hufbauer & Wong, *supra* note 46, at 19-21.

53. Won Mog Choi, *Regional Economic Integration in East Asia: Prospect and Jurisprudence*, 6:1 J. Int'l Econ. L. 49, 77 (2003) [hereinafter Choi, *Regional Economic Integration*].

be reproduced in future FTAs formed by the countries of East Asia within Asia and beyond.

Likewise, the external requirement in Article XXIV.5(b) poses interpretative problems in the East Asian context. The first unsettled issue for East Asia is the interpretation of the requirement that duties shall "not be higher or more restrictive than the corresponding duties" prior to the FTA formation in Article XXIV.5(b). The law of the GATT and the WTO remains unsettled as to whether the rate of duties should be assessed on the product-by-product basis or on the overall level of duties in each constituent territory.[54] This distinction is of particular significance for Japan and South Korea, which, despite eliminating certain barriers, may raise trade restrictions in some sensitive sectors such as agricultural products.[55] As a result, depending on the basis of assessment, compliance of the agreement with the multilateral disciplines in each respective case may be different.

Second, the overlap among the FTAs in East Asia and increased economic integration of East and Southeast Asia may pose problems with respect to rules of origin. A number of East Asian countries are parties to more than one FTA. Some countries are negotiating FTAs with a preferential trading bloc, while pursuing separate FTAs with its specific members. China has launched negotiations with ASEAN, while pursuing separate FTAs with the individual ASEAN members. It has a limited FTA with Thailand on agricultural products, and in 2006, held the first round of talks on an FTA with Singapore.[56] Similarly, Japan is simultaneously pursuing FTAs with ASEAN and with the individual members of ASEAN such as Thailand, Indonesia, Brunei, and Vietnam.[57] Japan has already formed agreements with three other ASEAN members: Singapore, Malaysia, and the Philippines. A number of countries are pursuing FTAs outside of the region. South Korea formed its first FTA with Chile. Japan has an FTA with Mexico, and is negotiating FTAs with Chile and the Gulf Cooperation Council (GCC). Taiwan has indicated interest in negotiating FTAs with the United States and New Zealand.[58]

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54. *Id.* at 57.

55. *Id.* at 63.

56. Singapore Ministry of Trade and Industry, News Release, *China and Singapore to Launch FTA Negotiations*, Aug. 26 2006, *availavle at* http://app.mti.gov.sg/default.asp?id=148&articleID=4421.

57. Japan Ministry of Economy Trade and Industry, Japan's Policy on FTAs/EPAs, Policy Paper (May 2006) at 6 [hereinafter METI] (unpublished manuscript, on file with author).

58. Choi, *Regional Economic Integration, supra* note 53, at 55.

If rules of origin were contemplated by XXIV.5(b), then there could be further interpretative problems. Including rules of origins into "other regulations of commerce" could mean that no rule of origin for any product could be higher or more restrictive under the FTA than before. This interpretation, however, can pose significant practical problems in evaluation of restrictiveness of each product prior and subsequent to the formation of the FTA.[59] The evaluation of product content is also arbitrary,[60] given a high level of integration among the industries of East and Southeast Asia as well as the presence of these industries in the global supply chains.

Even if rules of origin were not contemplated by "other regulations of commerce," they could still act as *de facto* trade barriers. Nevertheless, from an economic standpoint, it is unsettled whether such partial East Asian FTAs with major exemptions lead to greater trade creation or trade diversion than full FTAs. As indicated earlier, economic evidence on the global scale does not point to any substantial trade diversion effects subsequent to formation of the FTAs.[61]

3.3. Institutional Issues in East Asian FTAs

(i) Conflict Creation

From the above discussion, using legal rules to secure legal compliance and to settle trade-related disputes is a new practice for most East Asian economies. At this time, the dispute settlement provisions have not been used in any of the regional agreements concluded by the countries of East Asia. This absence of recourse to dispute settlement mechanisms, however, does not mean that room for conflict with the multilateral disciplines does not exist.

One area of conflict involves agreements that allow for launching complaints on the same-subject matter simultaneously under the FTA and the WTO. For example, the dispute settlement provisions of the Japan-Singapore Economic Partnership Agreement, set out in Chapter 21, allow the parties, in addition to the JSEPA procedures, to resort to any other dispute settlement procedure. Once a complaint is launched under Chapter 21 of the agreement or such other international agreement, Article 139.3 of Chapter 21 requires the selected procedure to apply to

59. *Id.* at 60.

60. Bhagwati, *supra* note 23, at 866.

61. Do & Watson, *supra* note 30, at 17.

the exclusion of any other forum.[62] The purpose of the provision is to prevent separate separate adjudication of the same dispute. However, this provision does not apply where the parties agree explicitly to allow more than one dispute settlement procedure per dispute.[63] Where multiple procedures on the same subject-matter are allowed, the clear potential for different decisions to be rendered concurrently in these forums arises, creating jurisdictional conflict. Further, if the complaint is launched under Chapter 21 and subsequently with the WTO, the WTO Panel, as the supreme forum, is likely to go ahead with its own complaint procedure.

Another potentially contentious area is the settlement procedure of non-violation complaints in East Asian FTAs. A non-violation complaint is defined by the WTO as a complaint by a government in respect of an action by another state, which, although not violating a specific provision of the GATT and the WTO agreements, deprives the government, directly or indirectly, of an expected trade benefit accruing under the relevant trade agreement.[64] Unlike the issue of conflict in jurisdiction, at issue here is not so much conflict with the WTO jurisprudence. Rather, the concern is that certain regional dispute settlement practices would conflict with the goal of comprehensive and integrated dispute settlement mechanisms that serve as the ultimate arbiters of complaints at both the FTA and the WTO levels.[65]

For example, the JSEPA provisions related to non-violation complaints have been interpreted by some as subject to a separate dispute settlement track from that of violation cases. Non-violation complaints are settled through the so-called 'general consultations' track, which is considered to be less judicial and instead more political in nature.[66] Some support this separate track. East Asian states are vulnerable to non-violation complaints because they have traditionally provided state-guided economic assistance; therefore, a quasi-political track may be more efficient for dealing with non-violations cases.[67] In addition, set-

62. *See* Japan-Singapore Economic Partnership Agreement, art. 139.3. *See also* Hsu, *Dispute Settlement in Recent Free Trade Agreements of Singapore, supra* note 36, 281.

63. *See* Japan-Singapore Economic Partnership Agreement, art. 139.4. *See also* Hsu, *Dispute Settlement in Recent Free Trade Agreements of Singapore, supra* note 36, 281.

64. DSU AGREEMENT, *supra* note 32, art. 26.

65. Won Mog Choi, *Making a Better Dispute Settlement Mechanism for Regional Trade Agreements, in* WTO AND EAST ASIA: NEW PERSPECTIVES 423 (Mitsuo Matsushita & Ahn Dukgeun eds., 2004) [hereinafter Choi, *Making a Better Dispute Settlement Mechanism*].

66. *Id.* at 425.

67. *Id.* at 426.

tlement through consultations is more desirable than proceeding to the dispute settlement panel.

On the other hand, some argue that all complaints should be subject to the same proceedings. When a dispute settlement mechanism of an FTA more comprehensively covers disputes, it becomes a more effective FTA. A determination of whether certain practices by the constituent parties deserve protection must proceed through no less judicial procedure than the violation claims. For this reason, the WTO establishes single and integrated proceedings for both types of complaints.[68] This practice is desirable for the FTA dispute settlement procedures to follow. Yet, given the significant level of state-assisted economic guidance by the East Asian governments and their historical preference for non-legal dispute resolution, the two-track mechanism will likely continue to be found in a number of future regional agreements.

However, in many other aspects, the relationship between East Asian FTAs and the WTO jurisprudence is far from conflict. Apart from the JSEPA, the majority of these FTAs do not allow for launching multiple proceedings in respect of the same complaint. For example, the dispute settlement provisions in the Korea-Chile[69] and Korea-Singapore[70] FTAs prescribe an exclusionary choice of forum and do not contain an exemption clause to such procedures comparable to Article 139.4 of the JSEPA.

In addition, conflict could be minimized. FTA dispute settlement procedures often imitate the WTO procedures, because FTA panels often find themselves dealing with issues similar to what a WTO panel has dealt with.[71] The WTO case law can inform both procedural and substantive practices of the FTA panels. The FTA panels such as that of the NAFTA are likely to seek guidance from WTO case law. Further, the WTO jurisprudence can help with interpretation of WTO-like terms in the FTAs as well as of the terms in the new areas.[72] The experience

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68. *Id.* at 427.

69. Free Trade Agreement between the Republic of Korea and the Republic of Chile, Feb. 15, 2003 (entered into force on Apr. 1, 2004), art. 19.16, *available at* http://www.sice.oas.org/Trade/Chi-SKorea_e/ChiKoreaind_e.asp [hereinafter Korea-Chile FTA].

70. Free Trade Agreement between the Republic of Korea and the Republic of Singapore, Aug. 4, 2005 (entered into force Mar. 2, 2006), art. 20.3 [hereinafter Korea-Singapore FTA].

71. Locknie Hsu, *Applicability of WTO Law in Regional Trade Agreements: Identifying the Links*, *in* REGIONAL TRADE AGREEMENTS AND THE WTO LEGAL SYSTEM 525, at 528 (Lorand Bartels & Federico Ortino eds., 2006) [hereinafter Hsu, *Applicability of WTO Law in Regional Trade Agreements*].

72. *Id.* at 550-51.

with dispute settlement in earlier agreements such as the NAFTA shows that decisions by the FTA panels are informed by the WTO. In two out of the three disputes involving states that have been brought to date under Chapter 20 of the NAFTA, the panel has referred on different occasions to the WTO and GATT decisions. In procedure, it referred to the WTO DSU in order to determine the requirement of "timely notice" for a complaint.[73] The panel's substantive interpretation of "like product" in Article 801[74] and "like circumstances" in Article 1202 of NAFTA[75] was guided by the WTO jurisprudence. The NAFTA panel has also referred to the language of exceptions in Article XX of the GATT in interpreting similar exceptions in NAFTA and to the long-established doctrine of the GATT and WTO.[76] Thus, where the FTA panels are guided by the WTO, the likelihood of conflict in both procedural and substantive issues can be reduced.

(ii) Resource Diversion and Erosion of Enthusiasm

A further concern relating to the proliferation of FTAs in East Asia is the diversion of resources and erosion of enthusiasm with respect to the multilateral process. East and Southeast Asia is home to the developing, developed, and newly industrialized economies (NIEs). Japan and Korea have protected agricultural sectors. Korea and Taiwan, both NIEs, have substantial state-guided assistance in the economy. In this context, formation of vested interests in the process of economic liberalization is inevitable, and vested interests bear economic costs.

In addition, East Asian governments and the private sector may find it easier to expedite bilateral agreements, which, unlike the WTO trade liberalization process, do not require absolute consensus.[77] While leaving major exemptions in the problematic areas such as agriculture - the case of protectionist Japan and Korea - East Asian FTAs cover areas which are yet to receive a

73. US Safeguard Action Taken on Broomcorn Brooms from Mexico (United States v. Mexico), USA-97-2008-01 (NAFTA Ch. 20 Panel, 1998) ¶ 53, *available at* http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=394. The Panel referred to the decision in Brazil - Measures Affecting Desiccated Coconut (Complaint by the Philippines), WTO Doc. WT/DS22/R (Panel Report 1996), upheld in WTO Doc. WT/DS22/AB/R (Appellate Body Report 1996). *See also* Hsu, *Applicability of WTO Law in Regional Trade Agreements*, *supra* note 71, at 546-47.

74. US Safeguard Action Taken on Broomcorn Brooms from Mexico, *supra* note 73, ¶ 64.

75. Cross-Border Trucking Services (United States v. Canada), USA-98-2008-01 (NAFTA Ch. 20 Panel, 2001) ¶¶ 249 & 251, http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=394. The Chapter 20 Panel referred to various Reports by the WTO Panel.

76. *Id.* ¶¶ 260 & 289.

77. Picker, *supra* note 31, at 302.

thorough consideration by the WTO. For example, Japan's negotiated FTAs with Indonesia, Philippines, Thailand and the agreement with Vietnam under negotiation contain chapters on the movement of natural persons,[78] otherwise known as labour mobility. The Japan-Thailand, Korea-Chile and Korea-Singapore FTAs contain chapters on competition and anti-competitive activities. Further, the majority of FTAs to which East Asian countries are parties contain investment chapters with their own dispute settlement procedures and complaint mechanisms open to private investors.[79]

In the long run, this practice may have the effect of undermining the legitimacy and relevancy of the WTO as the principal vehicle for mobilizing these contentious issues at the multilateral level. At this time, the GATT and WTO disciplines on free trade have no effective mechanism that can offset such potentially adverse institutional effects.

4. ARTICLE XXIV AND THE JAPAN - MEXICO ECONOMIC PARTNERSHIP AGREEMENT

4.1. Japan and the Proliferation of FTAs: Context

Like the rest of East Asia, Japan's experience with regulating its international trade relations through active recourse to legal rules is relatively new.[80] Japan's approach to multilateralism since its accession to the GATT and throughout most of the GATT era has remained largely informal and symbolic. Japan preferred to settle disputes by mutual agreement such as negotiations and consultations with other parties rather than via the formal GATT dispute settlement mechanism.[81] Although Japan began to use the GATT dispute settlement procedures in the 1980s, it preferred settling international trade disputes through consultations.[82] Japan's bilateral trade relations in the GATT era were also primarily characterized by reliance on negotiations and consultations at the political and diplomatic levels.

Like other East Asian countries, Japan's approach to international trade rules began to change in the early 1990s. Globalization has created competitive pressures, which have led the formation of new trade blocs, and thus, a need to move towards

78. MOFA, Free Trade Agreement (FTA) & Economic Partnership Agreement (EPA), *supra* note 52.

79. *Id.*

80. Suami, *supra* note 45, at 5.

81. Yuji Iwasawa, *WTO Dispute Settlement and Japan*, *in* New Directions in International Economic Law: Essays in Honour of John H. Jackson 473, 474 (M. Bronckers & R. Quick, eds., 2000).

82. *Id.* at 477.

harmonization of rules and policies among various members. Further, following the inception of the WTO in 1994, a more sound legal architecture for international trade has emerged. The new multilateral organization has significantly strengthened the legal process of handling trade-related matters and disputes, which was unavailable in the GATT era.[83] While these changes spoke to the willingness of all WTO members, and not just Japan, Japanese officials began to attach significant weight to the WTO institutions.[84] As a result, Japan's use of the WTO system has significantly expanded. In this new rule-based system, Japan's approach to regulation of its bilateral and plurilateral trade relations also began to undergo changes.

Japan's entry into the free trade game represents a response to a number of global, regional and domestic factors. First, like the trend among many other WTO members, Japan's move towards FTAs can be explained by the slow progress of multilateral trade liberalization during the Doha Round. Second, between 1999 and 2004, Japanese economic integration with ASEAN, China, Korea, Hong Kong, and Taiwan has deepened further with substantial growth in two-way trade and investment.[85] Third, FTAs provide a way for Japan to access global natural resources. Finally, Japan's economic malaise of the 1990s revealed the urgent need for structural reform of the domestic economy through liberalization, including reform in the agricultural sector and the acceptance of a foreign workforce to offset Japan's rapidly aging demographics.[86]

It is noteworthy that Japan chose not to use the conventional term "free trade area" or "free trade agreement" as found in the GATT and the WTO terminology. Instead, Japan's free trade agreements are known as the Economic Partnership Agreements (EPAs). According to the government of Japan, this more comprehensive term reflects better the new reality of international trade.[87] FTAs have traditionally focused on the trade in goods presupposed on the existence of national boundaries. EPAs, on the other hand, expand the scope of FTAs to include a broader

83. Saadia M. Pekkanen, *Sword and Shield: The WTO Dispute Settlement System and Japan, in* JAPAN'S MANAGED GLOBALIZATION: ADAPTING TO THE 21ST CENTURY 77, 79 (Ulrike Schaede and William Grimes eds., 2003). For further discussion on the evolution of Japan's approach to the multilateral dispute settlement system, *see* Ichiro Araki, *infra* note 114.

84. *Id.* at 79, 83.

85. METI, *supra* note 57, at 4.

86. Nippon Keidanren, *supra* note 49.

87. Japan Ministry of Foreign Affairs, *Japan's Foreign Policy in Major Diplomatic Fields, in* DIPLOMATIC BLUEBOOK 2006 (2006), ch. 3 *available at* http://www.mofa.go.jp/policy/other/bluebook/2006/index.html [hereinafter MOFA, DIPLOMATIC BLUEBOOK].

range of areas such as investment, trade in services, intellectual property, and the movement of natural persons.[88]

Japan concluded its first EPA with Singapore - JSEPA - in 2002. Since then, Japan has signed agreements with Indonesia, Malaysia, Mexico, Malaysia, Philippines, and Thailand. Japan is conducting negotiations with ASEAN, South Korea, India, Brunei, Vietnam, Chile, and the Gulf Cooperation Council (GCC). At the time this article was completed, the feasibility of EPAs with Australia and Switzerland were at various stages of joint study between the government of Japan and their respective governments.

The Japan-Mexico EPA was notified to the WTO under Article XXIV of the GATT on March 31, 2005, a day before its entry into force.[89] The agreement was concluded in response to some of the global factors discussed above, but has a number of its own unique characteristics. In the late 1990s, Japan became concerned with the gradual loss of trade and investment in North America. Following the advent of NAFTA in 1994, Japanese direct investment to North America has more than halved in 1999-2004.[90] Such diversionary effect on Japanese investment was due to restrictive rules of origin within NAFTA, on automobiles in particular, and to Mexico's elimination of the preferential treatment under the maquiladora program where Japanese investment concentrated.[91] Additionally, in 2000, Mexico entered into an FTA with the European Union 2000, which gave the European countries an advantage over Japan.

The Japan-Mexico EPA is a good case study because it exhibits the ambiguities and inadequacies with which the FTA-governing multilateral regime grapples. Many of the contentious issues found in this agreement can be found in other EPAs concluded by Japan, other East Asian economies, and globally. As with many other EPAs, this is an agreement formed between a developed and a developing country. While Mexico is a major exporter of agricultural products and textiles, Japan has a high level of domestic protectionism in both sectors. Japan's agriculture is protected through tariffs, import restrictions, and government price support schemes; financial support to this sector is among the highest in the Organization of Economic Cooperation

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88. *Id.* at 173.

89. WTO, Notification to the GATT/WTO, *supra* note 13. Note that to date, the WTO CRTA has not reported on any factual examination of the agreement.

90. METI *supra* note 57, at 4.

91. Mireya Solís, *Japan's New Regionalism: The Politics of Free Trade Talks with Mexico*, 3 JOURNAL OF EAST ASIAN STUDIES 377, 389-92 (2003).

and Development (OECD).[92] In addition, both Japan and Mexico are parties to other preferential arrangements, and are actively pursuing their respective free trade strategies, both regionally and globally.

4.2. Systemic Issues in the Japan-Mexico EPA

(i) *Article XXIV.8(b): the Internal Requirement in the Japan-Mexico EPA*

Closer examination of the Japan-Mexico EPA raises a question as to whether Article XXIV.8(b), which is not amenable to a single interpretation, can ensure that the EPA is both economically beneficial and WTO-compliant. Japan's Ministry of Economy, Trade and Industry (METI) currently employs a benchmark of 90 percent with respect to the internal requirement to eliminate "substantially all" trade barriers.[93] Where under the *quantitative* component of the test, the EPA may appear WTO-compliant, the *qualitative* component would suggest otherwise.

Japan's second EPA with Mexico stands in contrast to the JSEPA, which Japan concluded two years earlier. JSEPA, Japan's first EPA, was negotiated in less than a year. Singapore eliminated 100 percent of tariffs on Japan's exports, while Japan eliminated 94 percent of tariffs on imports from Singapore. Two-way trade between Japan and Singapore consists primarily of manufactured products, with imports consisting of electrical parts and semi-conductors. Singapore has no major agricultural sector with the exception of some marine products, which accounted for the 6 percent difference in elimination of tariffs.[94]

In the case of the Japan-Mexico EPA, the two countries decided to pursue an EPA in 1998. However, negotiations did not take place until late 2002 due to a deadlock on agricultural issues.[95] Mexico indicated that it was necessary for the agricultural area to be included in the final provisions of the agreement. Notwithstanding the existence of domestic opposition to the agricultural issues, Japan agreed to launch negotiations. By 2002, Japan already felt the effects of Mexico's preferential arrangements such as the NAFTA and an FTA with the European Union. While exports by the U.S. and European companies were subject to zero tariffs, Japanese products faced average tariffs of 16 per-

92. *Producer and Consumer Support Estimates*, OECD, Food Agriculture and Fisheries (within the Directorate for Trade and Agriculture), OECD Database (1986-2005).

93. METI, *supra* note 57, at 2.

94. Japan-Singapore Economic Partnership Agreement.

95. Solís, *supra* note 91, at 395.

cent due to the lack of a bilateral agreement[96] in the important Mexican market. While sensitive agricultural issues re-emerged on a number of occasions during the negotiations, recognition of Mexico's importance prompted Japan to offer limited agricultural concessions. Japan established a preferential tariff rate quota on two Mexican products — pork and orange juice — reducing the *ad valorem* rate of duties by half.[97] A substantial portion of remaining agricultural products included in the EPA became subject to a tariff rate quota.

On one hand, these major agricultural exemptions in the Japan-Mexico EPA appear problematic from the *qualitative* standpoint of Article XXIV.8(b). On the other hand, partial preferences on agriculture extended by Japan to Mexico can be seen as a progress in Japan's move toward substantial elimination of trade barriers in this major protected sector. Japan is beginning to recognize that in order to maintain economic viability and global competitiveness through a free trade strategy, agricultural concessions are inevitable.[98] In addition, Japan's reliance on high tariffs as one of the protectionist methods is increasingly at odds with international agricultural policy where tariffs are now significantly lower. Domestically, protectionism of the economically inefficient sector through tariffs imposes a heavy burden on consumers.[99] Japanese officials from METI and other trade bureaucrats have argued that a free trade strategy can bring fundamental reform in liberalization of Japanese agriculture. Since "substantially all" trade must be liberalized in order to be consistent with Article XXIV.8(b), protectionism is expected to lose ground to agricultural concessions that Japan will have to make in the process.[100] These agricultural concessions to Mexico are likely to be mirrored in Japan's future EPAs because most of these agreements will be formed with major agricultural exporters. This case shows that even partial elimination of barriers by Japan can represent a progress towards the elimination of barriers to "substantially all" the trade.

96. *Japan, Mexico to Launch FTA Negotiations in November*, KYODO NEWS INT'L, Oct. 27, 2002, *at* http://findarticles.com/p/articles/mi_m0WDP/is_2002_Nov_4/ai_94330385.

97. Japan-Mexico EPA, *supra* note 78, Annex 1 referred to in Chapter 3 - Schedules in Relation to Article 5.

98. KAZUHITO YAMASHITA, KOKUMIN TO SHOHISHA JUSHI NO NOSEI KAIKAKU - WTO/FTA JIDAI WO IKINUKU NOGYO SENRYAKU 262 [AGRICULTURAL POLICY REFORM FOR JAPAN AND ITS CONSUMERS: TO BETTER STEER WTO AND FTA NEGOTIATIONS] (2004).

99. *Id.* at 123.

100. Noboru Hatakeyama, Japan's New Regional Trade Policy - Which Country Comes Next After Singapore? Paper presented at the Second annual Whitman International Lecture, Washington, DC (Mar. 13, 2002), *available at* http://www.petersoninstitute.org/publications/print.cfm?doc=pub&ResearchID=453.

(ii) *Article XXIV.5(b): the External Requirement in the Japan-Mexico EPA*

Similarly, some provisions of the Japan-Mexico EPA raise the issue of compliance with the external requirement. The first issue is the assessment of the level of duties under Article XXIV.5(b) subsequent to the formation of the Japan-Mexico EPA. As suggested earlier, it is debatable whether the level of duties should be assessed on a product-by-product basis or on the overall level of duties.[101] If the level of duties is assessed on the former basis, it is reasonable to suppose that upon application of the tariff rate quota on Mexican agricultural exports largely exempt from preferences, the level of duties would turn out to be more restrictive than their corresponding level prior to the EPA formation. Such an outcome will fail to comply with the Article XXIV.5(b) requirement not to raise the duties upon formation of a free trade area.

The second issue in the Japan-Mexico EPA is the treatment of preferential rules of origin. Because rules of origin give a competitive edge to the industries in the EPA at the expense of extra-regional industries,[102] their imposition between Japan and Mexico may come to operate as a *de facto* trade barrier vis-à-vis third parties. Moreover, some of these complex rules of origin have potential for an overlap. Both Japan and Mexico are members of other free trade agreements. In addition to a number of bilateral FTAs, Mexico is a party to the major trading bloc of the NAFTA as well as to an FTA with the European Union. Further, Japan's major share of the Mexican market comes from Japan's exports in the automobile, general machinery, and electrical machinery industries,[103] where identification of the country of origin is increasingly arbitrary.

In theory, the trade creation effects in the Japan-Mexico free trade area could lead to the corresponding trade diversion effects elsewhere. At the same time, while trade gains of the agreement appear modest, empirical research and modeling analyses conducted on the Japan-Mexico EPA at this point indicate that the overall benefits from trade creation effects outweigh the drawbacks of any trade diversion effects.[104] As far as legal compliance of the EPA is concerned, since neither review by the CRTA nor substantial analysis of the preferential rules of origin in the

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101. Choi, *Regional Economic Integration*, *supra* note 53, at 57.

102. *Id.* at 60.

103. Japan Ministry of Foreign Affairs, Japan-Mexico Relations, http://www.mofa.go.jp/region/latin/mexico/index.html.

104. Kenichi Kawasaki, *Toward the Conclusion of a Japan-Mexico FTA* (Nov. 11, 2003) Research Institute of Economy, Trade and Industry (RIETI), http://www.rieti.go.jp/en/columns/a01_0105.html.

GATT context has taken place,[105] this aspect of the Japan-Mexico EPA will also lack the benefit of a thorough legal and economic analysis.

4.3. Institutional Issues in the Japan-Mexico EPA.

(i) Conflict Creation in the Dispute Settlement Provisions

The ability of the current multilateral framework, including Article XXIV of the GATT to prevent adverse institutional effects of the Japan-Mexico EPA remains inconclusive. The most apparent conflict may occur through respect of the dispute settlement provisions of the EPA. Like the NAFTA and the JSEPA,[106] the dispute settlement procedure under the Japan-Mexico EPA has elements of both the WTO and international arbitration. Article 153 found in Chapter 15 on Dispute Settlement of the agreement provides for establishment of the arbitral tribunal that hears complaints by the parties to agreement.[107] Once a dispute settlement procedure has been initiated in one forum, this procedure has to be used to the exclusion of any other.[108] In addition to the state-to-state disputes and Chapter 11 of the NAFTA, Article 76 found in Chapter 7 on Investment of the agreement gives standing to private investors to initiate complaints against the other constituent party.[109] The complaint is heard by the arbitral tribunal constituted under Article 82[110] under the agreed rules of arbitration.[111]

Unlike the JSEPA, Chapter 15 of the Japan-Mexico EPA does not contain an exemption clause that would allow the states, upon express agreement, to initiate multiple proceedings in respect of the same subject-matter. However, conflict in jurisdiction with the WTO disciplines can occur where a complaint on the same subject-matter is launched simultaneously by the constituent party under the WTO DSU and by a private investor of this party under Chapter 7 of the EPA. Further, where such complaint with the WTO is launched subsequent to the complaint under Chapter 7, the WTO is unlikely to defer to the proceedings initiated earlier in another forum. To date, the dispute settlement procedure of the Japan-Mexico EPA has not been tested. Also, Japan's EPAs do not have a developed body of jurisprudence comparable to that of the NAFTA, or extensive ex-

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105. Matsushita *et al.*, *supra* note 6, at 563-64.

106. Hsu, *Dispute Settlement in Recent Free Trade Agreements of Singapore*, *supra* note 36, at 290.

107. Japan-Mexico EPA, *supra* note 5, art. 153.

108. *Id.* art. 151.2.

109. *Id.* art. 76.

110. *Id.* art. 82.

111. *Id.* art. 79.

perience with the WTO of the European Commission, upon which the dispute settlement panels could draw in the event of conflict.

Dispute settlement of non-violation complaints can become another contentious issue in the Japan-Mexico EPA. Similarly to other East Asian governments, Japanese government has traditionally extended state-assisted economic guidance to a number of major industries, and this practice makes Japan prone to non-violation complaints.[112] Unlike the JSEPA, the Japan-Mexico EPA does not contain a separate consultations track for non-violations complaints. Yet, given Japan's traditional practices, it is still possible that some non-violation complaints launched against Japan under the agreement will be settled through political means, rather than through the existing formal procedures.

Such settlement of disputes, as shown, is not inconsistent with the WTO disciplines per se, where settlement through consultations is recommendable. The concern is that non-violation complaints will be routinely solved through the political track. Such practice may render the EPA procedures less relevant than they would otherwise be in settlement of bilateral disputes. The practice may also detract from the single integrated WTO dispute settlement procedures that were intended to deal with both the violation and non-violation complaints.[113]

(ii) Resource Diversion: Domestic Debates on Free Trade

It has been argued that the short-term impact of Japan's excessive enthusiasm toward EPAs is already visible among the resources at the disposal of Japan's trade bureaucracy.[114] For example, in the WTO group of the Trade Policy Bureau of METI, many officials who used to work exclusively for the group have been assigned additional task of negotiating preferential trade agreements or have been transferred to a division dealing with negotiations of such agreements.[115] The private sector is also likely to find the dispute-settlement mechanisms accessible to private parties and built into Japan's EPAs, including the Japan-Mexico EPA, more attractive than the WTO system. At this time, the government of Japan appears to be largely inaccessible to such private investors that have been disadvantaged by other WTO trading partners.

112. Choi, *Making a Better Dispute Settlement Mechanism, supra* note 65, at 426.
113. *Id.* at 427.
114. Ichiro Araki, *The Evolution of Japan's Aggressive Legalism,* 29:6 WORLD ECONOMY 783, 799 (2006).
115. *Id.* at 800.

Resource diversion can be further substantiated by the presence of domestic vested interests. The interests that favour free trade consist of Japan's Ministry of Foreign Affairs (MOFA), the Ministry of Economy, Trade, and Industry (METI), and the business community represented by national business organizations such as Japan's Business Federation (Nippon Keidanren). The constituency that resists free trade consists of the Ministry of Agriculture, Forestry and Fisheries (MAFF), the National Federation of Agricultural Co-operative Associations (Zennoh), which is Japan's most powerful agricultural interest group, as well as members of the ruling Liberal Democratic Party (LDP) with electorate in the predominantly agricultural constituencies. In addition to agriculture, the opponents of free trade include professional associations in other protected sectors.[116] It is therefore unsurprising that these opposed constituencies have been actively involved in Japan's EPA negotiations, including those with Mexico.[117] According to the institutional critique, the presence of such interests and their lobbying imposes additional economic costs upon the trade liberalization process.

Nevertheless, these battles can also bring long-term gains to the Japanese economy, domestically and internationally. Japan's concessions on selected agricultural imports from Mexico demonstrate that the EPA strategy has a potential to bring about a gradual opening of the protected agricultural sector. In addition to Mexico, the completed EPA negotiations with Thailand and the ongoing negotiations with Vietnam, both major agricultural exporters, show that unless Japan is prepared to address trade liberalization broadly, rather than selectively, it may be unable to secure the desired preferential trade arrangements.

(iii) Erosion of Enthusiasm: Japan in the WTO and the World

Like other FTAs, the Japan-Mexico EPA could contribute to the erosion of Japan's enthusiasm toward liberalization at the multilateral level. Japan's private sector and the government may prefer to focus on liberalizing a number of trade areas, which are controversial or unknown at the WTO level, on a preferential basis. In the short run, this process is easier and more expedient, compared to the slow progress of multilateral discussions on the same issues. For example, in addition to the chapter on investment, the Japan-Mexico EPA also contains a chapter on

116. Pempel & Urata, *supra* note 3, at 88. Unlike Japan's EPA negotiations with the Philippines, Thailand, and Vietnam, professional associations did not constitute a major opposition in the case of the Japan-Mexico EPA. From the above discussion, the main opposition in the case of Mexico came from the agricultural interests.

117. Solís, *supra* note 91, at 395-96.

competition and anti-competitive activities. As important WTO members such as Japan increasingly liberalize these areas on a preferential basis, there is a risk that the issues may not be comprehensively addressed at the WTO level. At the moment, the existing multilateral regime is not well-equipped to counter this adverse institutional effect.[118]

However, in other aspects, Japan's enthusiasm for the WTO as a principal vehicle for liberalization and regulation of trade relations remains strong. One area where such enthusiasm is now clearly visible is dispute settlement. In the GATT era, Japan has resorted to the multilateral dispute settlement mechanism infrequently, producing 9 decisions between its accession to the GATT in 1955 and the birth of the WTO in 1994.[119] In the 1990s, the WTO DSU significantly strengthened the legal process of handling trade disputes in the increasingly global economy. Japan, therefore, began to actively enlist the multilateral legal rules in order to settle disputes and to secure compliance with the WTO obligations. While not reaching the level of activity by the larger WTO members such as the United States and the EU, Japan's involvement in the dispute settlement system is more significant than in the past.[120]

To date, Japan has appeared as complainant in 12 cases, and as respondent in 15 cases brought before the WTO Panel.[121] It has been noted that unlike some WTO members who occasionally resort to the WTO complaints to induce a bilateral settlement, Japan appears to have been selective in launching complaints. The primary aim is to seek adjudication, rather than to extract bilateral concessions. Therefore, Japan tends to focus on those complaints that could be successfully pursued all the way to the end, often reaching the WTO Appellate Body.[122]

Overall, the government of Japan has, on numerous occasions, reiterated its commitment to the WTO. Japan holds the view that rule-making through the EPA strategy and diverse range of economic relations should be a means to complement the functions of the WTO framework for trade liberalization.[123] The economic reality has extended beyond the units such as states, and EPAs are one of the vehicles to enhance more direct

118. Picker, *supra* note 31 above.

119. WTO Dispute Settlement: GATT Reports List. ADOPTED PANEL REPORTS WITHIN THE FRAMEWORK OF GATT 1947, http://www.wto.org/english/tratop_e/dispu_e/gt47ds_e.htm.

120. Araki, *supra* note 114, at 784, 802.

121. WTO Dispute Settlement: The Disputes. Disputes by Country (2007), http://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm (last visited Apr. 6, 2007).

122. Araki, *supra* note 114, at 794.

123. MOFA, DIPLOMATIC BLUEBOOK, *supra* note 87, at 172.

and broad trade relations that increasingly involve private actors. Yet, EPAs are not seen by the government of Japan as a substitute for the multilateral process. Accordingly, this could mean that Japan's mobilization of support for contentious issues that are yet to receive thorough consideration at the WTO level would not weaken.

5. CONCLUSION

This article examined the effectiveness of the current multilateral framework, in particular Article XXIV of the GATT, to govern the proliferation of free trade in East Asia and Japan. The Japan-Mexico EPA that has been in force since 2005 is a good case study for this question. The negotiations and the final provisions of the agreement raise a number of controversies relating to the applicability of the GATT and the WTO framework to other EPAs concluded by Japan, East Asia, and globally. The Japan-Mexico EPA shows that the existing multilateral framework does not always adequately capture the motives, the welfare impact, and various institutional dimensions of FTA formation.

From the above discussion on systemic issues, due to the inherent ambiguities of Article XXIV, the legal requirements and the economic rationale of free trade are often misaligned. The Japan-Mexico EPA contains substantial agricultural exemptions, which do not appear to comply with the requirement to eliminate "substantially all" barriers to trade set out in Article XXIV.8(b). In addition, the treatment of preferential rules of origin in the agreement raises concerns with respect to trade diversion. Depending on the interpretation of Article XXIV.5(b), rules of origin can be problematic in both legal terms of compliance and from the economic standpoint as a *de facto* trade barrier with potential discriminatory effects upon third parties. Both Japan and Mexico are parties to other preferential agreements, and are actively pursuing FTAs in various regions. Thus, the complexity and overlap of rules of origin are inevitable.

Yet the case of Japan-Mexico EPA shows that the internal and the external requirements of Article XXIV can serve as a vehicle to greater trade liberalization. The elimination of "substantially all" barriers to trade and granting of preferential duties can lead to greater liberalization of Japan's largely inefficient and protected sectors such as agriculture. The EPA may not muster a strict *qualitative* interpretation of Article XXIV.8(b). Nonetheless, negotiations with Mexico have demonstrated that in the future, Japan would be increasingly compelled to liberalize trade in

agricultural products if it wants to benefit from the proliferation of free trade in East Asia and beyond.

Similarly, such two-sided arguments can be advanced with respect to the institutional dimension of FTAs within the WTO. The Japan-Mexico EPA shows that the multilateral rules may not always mitigate the adverse institutional effects of preferential trade arrangements. One such effect is a potential, although yet untested by Japan, concurrency in jurisdiction in the dispute settlement procedures. Another adverse institutional effect of the EPA proliferation is the growing polarization of Japan's vested interests, namely, the proponents and the opponents of free trade. There is also evidence that some resources in Japan's trade bureaucracy are being diverted from the multilateral issues toward free trade. Further, the practice of including investment and competition in the EPAs can undermine the relevance of the WTO as the main forum for mobilizing such issues at the multilateral level.

However, some institutional effects may be over-stated. The experience of other preferential arrangements such as the NAFTA shows that decisions of the FTA panels are often informed by the WTO jurisprudence, in both procedure and substance. Further, while domestic battles between vested interests bear economic and social costs, they will also likely bring about a gradual opening of Japan's protected sectors. Finally, Japan will probably retain most of its enthusiasm with respect to trade liberalization at the multilateral level. Japan's trade policy has undergone a number of progressive changes in the last decade and a half. Given Japan's evolution from the informal trade relations in the GATT era toward its active participation in the WTO and subsequently, toward the rule-based approach to bilateral and plurilateral trade relations, this trend is likely to continue.