

The Japan-Mexico FTA: A Cross-Regional Step in the Path towards Asian Regionalism

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Introuduction

To most observers, Japan and Mexico seem distant economic partners, with only a modest volume of bilateral trade and foreign direct investment and a large geographical and cultural gulf between them. By this account, the Japanese decision to negotiate with Mexico is puzzling if not downright nonsensical. Why would Japan invest so much political capital in the negotiation of a complex free trade agreement (FTA) with a nation accounting for such a minuscule share of its international economic exchange?¹

We challenge this interpretation of Japan's second FTA ever and demonstrate that far from irrational or insignificant, the stakes involved in the Japan-Mexico FTA were very high. This cross-regional initiative stands to exert powerful influence over the future evolution of Japan's turn towards economic regionalism.² For a number of Japanese industries (automobiles, electronics, and government procurement contractors), negotiating with Mexico was essential to level the playing field vis-à-vis their American and European rivals already with preferential access to the Mexican market based on their FTAs. For the Japanese trade bureaucrats, housed in the Ministry of Economy, Trade and Industry (METI), the stakes of the trade agreement with Mexico were also very high; not only would it enable Japan to use bilateral trade deals as an instrument to counter trade diversion abroad, but it would also be crucial in setting precedents on negotiation modalities regarding issues such as service liberalization or rules of origin (ROO). In addition, it would be all-important in helping the ministry tip the domestic balance in

¹ And contrary to other economically insignificant FTAs, there was no security rationale behind this inter-governmental agreement, either. Neither Japan nor Mexico stood to make geostrategic gains from proceeding with this negotiation.

² A clarification of terms is in order here. The official title of the free trade agreement is Japan-Mexico Economic Partnership Agreement (JMEPA). The Japanese government uses the term EPA because it includes an economic cooperation chapter. However, in keeping with the use of terms proposed in the analytical framework of this special issue, we use cross-regional trade agreement (CRTA) to refer to the Japan-Mexico free trade agreement (and will discuss the economic cooperation chapter as appropriate), unless we make specific reference to the official title of this bilateral trade agreement. The term FTA will be used to make reference to free trade agreements in general.

favour of an active FTA diplomacy despite the opposition from the agricultural lobby.³ The FTA negotiations with Mexico were in fact conceived from the beginning as an integral part of Japan's regional overtures in Asia in that they would constitute the litmus test both for the Japanese government and in the eyes of potential FTA partners in Asia on whether Japan could offer a satisfactory liberalization package to prospective FTA partners to make these negotiations worthwhile.

Mexican trade officials also assigned a high priority to a preferential trade agreement with Japan, both to achieve long-standing goals and to deal with pressing current issues. For a long time Mexico has attempted to diversify its economic relations in order to ameliorate its heavy reliance on the American market.⁴ As the North American Free Trade Agreement (NAFTA) intensified the concentration of economic exchange with the United States, the Mexican government embarked on the negotiation of multiple FTAs in order to expand Mexican exports in new markets.⁵ The trade agreement with Japan was deemed especially important in that it would constitute the first bridge into Asian markets and would address two pressing concerns: the need to promote foreign direct investment and to restore Mexico's competitiveness vis-à-vis other emerging economies, notably China.⁶

Despite the significance of bilateral trade talks for both countries, these negotiations did not proceed smoothly and were characterized instead by many false starts and major disagreements that at times looked almost irresolvable. Chronologically, the negotiations unfolded in three distinct phases. In late 1998 and 1999, Japan and Mexico seriously considered for the first time the possibility of negotiating an FTA and commissioned studies analyzing the feasibility of such an endeavour.⁷ This early interest, however, soon petered out due to a major disagreement over the Japanese proposal to exclude agriculture entirely from the negotiations. However, interest in going forward with a cross-regional FTA resurfaced in 2000 and 2001 for two main reasons: the negotiation of a bilateral investment treaty came to

³ Naoko Munakata, "How Trade Agreements Can Reform Japan," *The Globalist*, 10 July 2002. [Online, cited 17 May 2007]. Available at <<http://www.theglobalist.com>>.

⁴ Jorg Faust and Uwe Franke, "Attempts at Diversification: Mexico and Asia Pacific." *The Pacific Review*, vol. 15, no. 2 (2002), pp. 299-324.

⁵ Gerardo Bracho, "Mexico's Foreign Trade Strategy in Trouble: The impact of China." [Online, cited 29 September 2006]. Available at: <http://www.mexico.ox.ac.uk/working_papers_files/TheplightofMexico2.doc>.

⁶ Robert Donnelly, "Dealing with the Rising Sun. Mexico eyes a Japanese trade deal." *Mexico Connect*, 2002. [Online, cited 29 September 2006]. Available at: <<http://www.mexconnect.com/mex/travel/bzm/bzmjapan.html>>.

⁷ Japan External Trade Organization (JETRO), "Report of the Committee for Closer Economic Relations between Japan and Mexico." [Online, cited 12 February 2003] Available at <<http://www/jetro.org.mx/JetroMXJPFTAFullEng.doc>>. Mireya Solís, "Mexico and Japan: The Opportunities of Free Trade," Report commissioned by Mexico's Ministry of Trade and Industry, 1999," [Online, cited 12 February 2003]. Available at <http://www.economia-snci.gob.mx/sphp_pages/publicaciones/mexjapesp.pdf>.

naught after Mexico refused to extend national treatment to Japanese multinationals in the absence of a broader free trade agreement, and the enactment of the Mexico-European Union FTA (MEUFTA) sent the encouraging message that sensitive commodities could be excluded from an FTA which nevertheless claimed WTO consistency.⁸ The final stage (2002-2004) involved the actual negotiations which were not only time-consuming but also highly contentious. In fact, in October 2003 at the time of the heads of state summit scheduled to coincide with the original deadline to sign the agreement, an open rift brought a suspension in trade talks. After a major effort to patch up these differences, spurred by political intervention at the highest level, the agreement itself was reached in March and signed in September 2004. The Agreement between Japan and the United Mexican States for the Strengthening of the Economic Partnership entered into force in the spring of 2005.

This paper is organized as follows. Section two offers an overview of Japan's FTA diplomacy in order to place negotiations with Mexico in the broader context of Japan's preferential trading initiatives. Section three discusses the motivations of the Japanese business sector for demanding the negotiation of a cross-regional trade agreement (CRTA) with Mexico. In the fourth section, we discuss the position of key political and bureaucratic players in Japan regarding the pros and cons of moving forward with this free trade negotiation. Section five focuses on the most critical period in the CRTA negotiation process, as disagreements over agriculture and Japanese bureaucratic sectionalism threatened a successful outcome. Finally, we assess the significance and implications of the Japan-Mexico CRTA for the future of Japanese FTA policy.

This case study of Japan's CRTA with Mexico corroborates several of the hypotheses laid out in the analytical framework of this special issue. It shows the very real regional constraints that Japan has experienced in fleshing out its FTA diplomacy due to the rising frictions with China and the concern about a possible American backlash against a closed Asian trade bloc. Region-wide Japanese FTA initiatives have stalled partly for these reasons.

Moreover, this article also draws from the analytical framework to explain the specific Japanese motives in selecting Mexico as its first cross-regional partner. In essence, we trace Japan's willingness to invest significant political capital in order to achieve an FTA with Mexico to the desire of its business community to counter *trade diversion* and to the attempt of the Japanese trade bureaucracy to leverage this negotiation to promote Japan's regional FTA policy by building its trade *negotiation capacity* and *setting precedents* on liberalization modalities. As we show, negotiations with Mexico generated a

⁸ Mireya Solís, "Japan's New Regionalism: The Politics of Free Trade Talks with Mexico," *Journal of East Asian Studies*, vol. 3 (2003), pp. 377-404.

very heated domestic political process of accommodation between different bureaucracies and the interest groups under their jurisdiction precisely because it was widely understood that the credibility of Japan to engage in intra-regional FTA negotiations was also at stake.

The Birth of Japanese FTA Diplomacy

Japan's decision, in the late 1990s, to negotiate preferential trade agreements on a bilateral or minilateral basis represented a major departure in its foreign economic policy.⁹ For close to fifty years, Japan had pursued a single-track approach, focusing its trade negotiating efforts exclusively on the multilateral forum and had shunned regionalism as harmful to the GATT/WTO system. However, the 1997 Asian financial crisis, the proliferation of FTAs in the world economy and the difficulties experienced in launching a new round of multilateral trade negotiations persuaded policy makers and business executives in Japan of the need to develop a multi-track trade diplomacy through FTA negotiations.¹⁰ Through these preferential trade negotiations, the Japanese government is attempting to hedge against a breakdown in the WTO negotiation process,¹¹ to pursue deep liberalization issues that go beyond tariff elimination, such as liberalization of foreign direct investment¹² and to carve sectoral exclusions for sensitive sectors. In these ways, regionalism has not displaced WTO policy but rather has become an additional avenue through which the Japanese government can advance its trade interests.¹³

Preferential liberalization has, therefore, received a high priority in Japan's overall trade policy. Japan launched FTA talks with Singapore in January 2001 (concluded a year later), with Mexico in November 2002, and with Korea in December 2003 (still incomplete). In early 2004, FTA talks were initiated with Malaysia, Philippines, and Thailand. By the summer of 2005, Japan had reached a basic FTA agreement with all of these Southeast Asian countries, and the final FTA agreement was signed with Malaysia in December

⁹ We use the term minilateral to designate any agreement with more than two parties and less than the entire WTO membership.

¹⁰ T.J. Pempel and Shujiro Urata, "Japan: A New Move toward Bilateral Trade Agreement," in Vinod Aggarwal and Shujiro Urata, eds., *Bilateral Trade Agreements in the Asia-Pacific* (London: Routledge, 2005); Naoko Munakata, "Evolution of Japan's Policy toward Economic Integration," Working Paper, Center for Northeast Asian Policy Studies (Washington DC: The Brookings Institution, 2001); Shujiro Urata, "Towards an East Asia Free Trade Area," *Policy Insights*, no. 1 (Paris: OECD, 2004).

¹¹ Edward D. Mansfield and Eric Reinhardt, "Multilateral Determinants of Regionalism: The Effects of GATT/WTO on the Formation of Preferential Trading Arrangements." *International Organization*, vol. 57, no. 4 (2003), pp.829-62.

¹² Shujiro Urata, "Towards an East Asia Free Trade Area."

¹³ Saadia Pekkanen, Mireya Solís, and Saori Katada, "Trading Gains for Control: International Trade Forums and Japanese Economic Diplomacy." *International Studies Quarterly* (forthcoming).

2005, with the Philippines in September 2006, and with Thailand in April 2007. A Japan-Association of South East Asian Nations (ASEAN) FTA negotiation was launched in April 2005, and bilateral talks with Indonesia started in June 2005. A few months later, Japan agreed to start FTA talks with Chile, Vietnam and the nations from the Gulf Cooperation Council. In the fall of 2006, Japan reached basic agreements with Chile (September) and Indonesia (November). After more than two years of cautious examination, Japan also agreed in November 2006 to launch FTA negotiations with Australia by early 2007 but only after Australian officials signaled their “flexibility vis-à-vis sensitive products.”¹⁴ In 2007, talks were also started with India and Switzerland, and Canada is another possible future candidate.¹⁵ Broader regional initiatives, such as an FTA with Korea and China, one with ASEAN+3, and the formation of an East Asian Community, are still on the drawing board, with no substantive official action taken at the time of this writing.

Notably, Japan’s regional integration initiatives in Northeast Asia have proceeded very slowly, if at all. The current deadlock in FTA negotiations with Korea, the refusal so far to consider negotiations with China and therefore the impossibility of developing a Northeast Asian regional bloc (at least in the near future), are a reflection of many of the regional constraints identified in the analytical framework paper of this special issue. Historical (Yasukuni shrine and textbooks), territorial (Dokdo/Takeshima), and geopolitical factors (competition with a rising China) cloud the prospects of Northeast Asia regional integration.¹⁶ Moreover, Japan is still very hesitant to endorse any regional integration initiative that hints US exclusion.¹⁷ Although Japan eventually lost the argument to incorporate the United States as an observer in the first East Asian Summit that took place in December 2005, part of its acquiescence to go forward with the meeting has been the result of the muted reaction of the United States, especially compared to its resolute opposition to Mahatir’s 1990 East Asian Economic Caucus.¹⁸

¹⁴ Peter Alford. “All foods on the table in trade talks with Japan.” [Online, cited 28 November 2006]. Available at <http://www.bilaterals.org/article.php3?id_article=6467>.

¹⁵ Ministry of Economy, Trade, and Industry, “Japan’s Policy on FTAs/EPAs.” [Online, cited 11 November 2005]. Available at <http://www.meti.go.jp/english/policy/index_externaleconomicpolicy.html>.

¹⁶ Gilbert Rozman, *Northeast Asia’s Stunted Regionalism: Bilateral Distrust in the Shadow of Globalization* (Cambridge: Cambridge University Press, 2004), pp. 220, 234.

¹⁷ UPI, “Walker’s World: Battles around the New Asia Summit,” 4 April 2005. [Online, cited 10 November 2005]. Available at <<http://washingtontimes.com>>.

¹⁸ Lincoln (2005) believes the United States has not reacted strongly this time because, among other reasons, it heavily discounts the possibility of an East Asian bloc developing and is signing its own FTAs with Asian countries to avoid the possibility of discrimination from ongoing bilateral initiatives. Edward Lincoln, “The Bush Second Term and East Asian Economic Regionalism.” [Online cited 10 November 2005]. Available at <<http://www.jceer.or.jp/eng/rep/opinions/EJ.Lincoln0503.pdf>>.

While these political hurdles continue to complicate the task of building broad East Asian regional integration institutions, Japan has moved more swiftly with bilateral agreements in Southeast Asia and cross-regional partnerships. Significantly, in none of the CRTAs pursued (Mexico, Chile, India, or Switzerland) do historical, territorial, or geopolitical considerations impact the negotiation process. But in the particular case of Mexico (Japan's second FTA partner), the impetus to negotiate went much beyond the absence of such structural barriers to include the need to defend substantial interests of Japanese industries and to consolidate domestic support in Japan in favour of FTA diplomacy.

On the Demand for a CRTA with Mexico

Economic interests at stake

At first glance, it seems difficult to explain the Japanese interest to negotiate a free trade agreement with Mexico. Aggregate trade and investment flows between these two countries are very low and do not reveal a substantial intensification over time. Although the trade balance in Japan's favour increased markedly between 1990 and 2004 (mostly due to the reduction of Mexican oil exports to Japan), the overall position of the Mexican market in Japan's foreign economic relations is miniscule to say the least. Exports to Mexico have consistently represented between 0.8 and 1.1 percent of total Japanese exports. The same is true for foreign direct investment, where Mexico's share of total Japanese FDI has fluctuated below 1 percent with two exceptional years at 1.5 percent (1994) and 2.2 percent (1999).

However, these overall figures disguise the fact that for some specific Japanese industries the Mexican market is in fact very important. As can be seen in table 1, for the automobile industry, Mexico is a much more important export market than any of the Asian nations with which Japan has negotiated or is currently negotiating free trade agreements. In the case of electronics, exports to Singapore are much larger, but exports to Mexico are roughly equivalent to exports in the other selected Asian nations. In the case of steel, Mexico ranks third in importance as an export market in this nascent Japanese FTA network. Moreover, the Japanese business sector pressed harder to negotiate with Mexico because Japanese companies were actually reporting losses from NAFTA's trade and investment diversion effects.¹⁹ These industrial interests were not deterred by the well-understood challenge of negotiating with a large agricultural exporter. Indeed, table 1 also shows

¹⁹ Mark Manger, "Competition and Bilateralism in Trade Policy: The Case of Japan's Free Trade Agreements," *Review of International Political Economy*, vol. 12, no. 5 (December 2005), pp. 804-28. For the more general argument on the impact of trade diversion on FTA proliferation see Richard E. Baldwin, "The Causes of Regionalism," *The World Economy*, vol. 20, no. 7 (1997), pp. 865-88.

Table 1
Japanese industrial and agricultural interests in FTA counterpart nations
Unit: millions of US dollars, %

	Average exports (1999-2004)			Foodstuff imports as a share of bilateral imports*
	Automobile	Electronics	Metals	
Mexico	816.0	1,526.5	493.7	21.8%
Singapore	698.9	6,218.8	954.9	4.0%
Korea	252.5	1,290.9	241.4	8.5%
Malaysia**	294.6	1,506.0	281.7	1.1%
Philippines	343.7	1,757.0	328.6	10.6%
Thailand	400.9	2,049.9	383.4	20.2%
Indonesia**	467.8	2,391.5	447.3	5.6%

* These percentages were also estimated using average imports between 1999-2004.

** The shares for Malaysia and Indonesia are very small because the main primary products these nations export to Japan are lumber and oil, respectively.

Sources: JETRO: *Japanese Trade in 2004*; handout of Ministry of Finance trade statistics with Mexico received by authors, summer 2005.

that Mexico is the country with the highest share of foodstuff imports over bilateral Japanese imports among this group of Japanese FTA partners (21.8 percent).

Countering trade diversion

Mexico has one of the most extensive FTA networks in the world: 11 agreements with 32 countries at the dawn of the twenty-first century. Of these numerous FTAs, two in particular concerned Japan: NAFTA, which entered into force in 1994, and the Mexico-EU CRTA, which became effective in 2000. Japanese exporters and investors in Mexico felt at a disadvantage vis-à-vis their American and European rivals on several fronts. First, external tariffs in Mexico are relatively high: in the year 2001 the MFN average tariff stood at 16.5 percent, in sharp contrast to the 0.7 percent tariff applied to the United States. Within manufacturing, some of the highest applied tariffs were in footwear (31.8 percent), textiles (23.6 percent), prepared foods (26.5 percent), transport equipment (17.1 percent), and machinery (14.3 percent). Mexico's tariff policy, led the WTO to conclude that its "MFN protection is significant and has risen since 1997."²⁰

The advantages of FTA preferential treatment extended not only to the reduction or elimination of tariffs on goods and components but also to

²⁰ World Trade Organization, *Trade Policy Review: Mexico 2002*. [Online, cited 10 October 2005]. Available at <http://www.wto.org/English/tratop_e/tpr_e/tp190_e.htm>.

greater liberalization of services and foreign investment, the availability of a strong investment protection regime, and more transparency and certainty to business transactions as the Mexican government relinquished in many ways its ability to effect discretionary changes in policy. For example, Japan noted with concern that the Mexican decision in 1999 to raise tariffs by 3 to 10 percentage points on 10,000 items, but exclude from this provision its FTA counterparts, had damaged Japanese trade interests.²¹

Although the disadvantages of remaining outside Mexico's FTA network were numerous, specific Japanese industrial sectors with very large interests in the Mexican market felt those negative effects more keenly. These sectors constituted the bedrock of support for a Japan-Mexico CRTA: government procurement, automobiles, and electronics.

Government contracts

Since Mexico is not a signatory to the WTO's government procurement agreement, Japanese companies bidding for government contracts suffered many additional costs from operating outside a preferential trade framework in Mexico. For instance, Japanese firms complained that the tariffs applied to Japanese imported inputs inflated the costs of its plant exports and bids for government contracts, since their American and European rivals could import most components duty free.²² Moreover, the lack of national treatment for Japanese companies became more onerous as the Mexican government introduced in the year 2000 a 10 percent discount policy on the bids of Mexican suppliers when competing against foreign suppliers from non-FTA partners (in these situations foreign firms within the FTA network also qualified for the 10 percent discount on their bids).²³ It should, therefore, be no surprise that Japanese general trading companies were among the first to publicly voice the need for an FTA with Mexico.²⁴

Developments during the actual FTA negotiations in fact confirmed the worst fears of Japanese companies. Mexico's abrupt decision in May 2003 to restrict government procurement bids to firms headquartered in its FTA partners shocked Japan.²⁵ However, with the new provision, Japanese companies would effectively be shut out of this market. Japanese trade negotiators tried to persuade the Mexican government to return to the status quo ante arguing that since Japan was in the midst of FTA negotiations with

21 JETRO, Report of the Committee for Closer Economic Relations: 4.

22 JETRO, Report of the Committee for Closer Economic Relations: 4.

23 Takao Nakahata, "Nichiboku EPA to Nihon Kigyô [The Japan-Mexico EPA and Japanese firms]," In *JETRO, Shinkôkokuno taigai keizai senryaku (FTA nado) to nihon kigyô*, March 2005, p. 320.

24 Author's interview with JETRO official, Tokyo, summer 2005.

25 Until then and despite the restrictions mentioned above, Japanese firms had solid presence in supplying Mexican government procurement. For instance, until the year 2000, Japanese firms had captured more than 40 percent of electric power plant construction projects in Mexico ("Corporate influence looms behind Mexico trade talks," *Nikkei Net News*, 15 October 2003).

Mexico, this important market should not be closed to its enterprises.²⁶ Mexican officials were unmoved, however, probably realizing the important incentive this gave to the Japanese to speed up the FTA negotiations.

Automobiles

Japanese automobile companies strongly supported an FTA with Mexico in order to reverse some of the losses brought about by the move towards regional integration in North America. The first of these initiatives, the 1989 US-Canada free trade agreement, had meant the loss of preferential tariff treatment (as Canada had to phase out the duty remissions program it had implemented to attract Japanese automobile investment) and the added burden of complying with content rules in order to qualify for preferential treatment. In fact, Japanese compliance with these rules became a controversial issue as many US automobile firms complained that Japanese auto firms engaged in “roll-up” practices to inflate their regional content levels,²⁷ and Honda came under investigation by the US for improperly including overhead costs in its regional content estimates.²⁸

The Big Three auto companies regarded the NAFTA negotiations as a second chance to push for stricter ROO and more demanding monitoring systems to ensure compliance with these rules.²⁹ NAFTA not only raised the required regional content level to qualify for duty-free status (from 50 percent to 62.5 percent), but also adopted a much tougher tracing system whereby the possibilities of rollup were eliminated by tracing the value of third-country auto parts throughout the production chain. Japanese companies with less developed subcontracting networks in the region were, therefore, hard pressed to meet the stricter NAFTA rules.

Moreover, Mexico’s high tariffs on imported finished vehicles (20-30 percent) have seriously constrained Japanese exports. The size of Mexico’s overall import market for finished vehicles grew rapidly from 250,000 units in 1999 to 700,000 in 2004. However, most of these imports came from Mexico’s FTA partners (namely the United States and Europe) whose companies enjoyed duty-free access. For Japanese companies, the only possibility of gaining duty-free access to the Mexican market rested on local

²⁶ Interview with Mexico’s FTA negotiating team, Mexico City, July 2004.

²⁷ With rollup, a component’s origin is attributed to the country of majority content, so that a part with 51 percent US content is considered 100 percent American when it crosses the Canadian border. American companies accused Japanese car makers with plants on both sides of the US-Canada border of taking advantage of multiple cross-border shipments to artificially boost their content levels (Alain De Remes, Timothy Fitzpatrick and Antonio Ortiz, “NAFTA and the Automotive Industry,” in Van R. Whiting, Jr., ed., *Regionalization in the World Economy* (Delhi: Macmillan India, 1996), p. 125.

²⁸ Paul Magnusson and James B. Treece, “Honda: Is It an American Car?” *Business Week*, 18 November 1991.

²⁹ Mireya Solís, “Sharing the Spoils of Economic Integration? Japanese Direct Investment in North America,” in Whiting, Jr., *Regionalization in the World Economy*.

production, since the Mexican government allowed for duty-free imports of finished vehicles, equivalent to 10 percent of their local production, for foreign assemblers in Mexico.³⁰ Three Japanese auto manufacturers, Nissan, Honda, and Toyota, enjoyed such benefits. The size of their duty-free imports of finished vehicles was, however, rather modest: 35,000 units or 5 percent of total imports.³¹ The merits of an FTA with Mexico from the point of view of the Japanese automobile industry were indeed substantial: the elimination of tariffs and performance requirements to level the playing field vis-à-vis American and European rivals in the Mexican market.

Electronics

By the late 1980s, Japanese electronics companies were manufacturing mostly through the maquiladora program³² whose advantages included tariff exemptions, low-cost labour, proximity to the main market of destination in the United States and the operation of twin plants on both sides of the border. The rush of Japanese investment in the maquiladora sector had generated some friction with the United States as some voices were raised that Japan was using Mexico's maquila program as a back door into the US market. The ballooning US trade deficit vis-à-vis Japan made this charge a very sensitive one. For instance, in 1987 at a Congressional hearing in San Diego, two proposals were made that clearly reflected this negative sentiment towards Japanese maquiladoras: to restrict participation in the maquila sector to Western Hemisphere firms or to demand a 60 percent regional content level.³³ Although neither of these initiatives materialized then, the negotiation of NAFTA did bring about a major change to the rules of the game for the majority of Japanese electronic firms operating in Mexico.³⁴

NAFTA's provision to phase out the duty drawback benefits of the maquiladora program as of 2001 constituted a significant handicap for Japanese companies because this represented the loss of very important tariff benefits: the duty exemption on importation of machinery (since the

³⁰ NAFTA's stiff ROO also made it difficult for Japanese companies in the United States to export finished vehicles to Mexico that qualified for duty-free treatment.

³¹ Nakahata, "Nichiboku EPA to Nihon Kigyô," p. 307.

³² This program had in fact originated much earlier (in the mid-1960s) when Mexico and the United States devised a preferential tariff program to foster industrialization in border cities after the elimination of the US guest worker program. Through the maquiladora program, Mexico eliminated tariffs on inputs and machinery for production of goods to be exported to the United States. In turn, the United States exempted US components incorporated in such products from tariffs when they crossed the border. Although devised primarily as a bilateral cooperation program, it is important to note that the maquiladora program was open to the participation of enterprises from third countries.

³³ Solís, "Sharing the Spoils of Economic Integration?" p. 210.

³⁴ By the late 1990s, the Japanese Chamber of Commerce in Mexico (1998) in Mexico reported that 53 out of 59 Japanese electronic companies in Mexico were established in the maquila sector. (*Mekishiko Nikkei Kigyô Shinshutsu Ichiran* [A Glance at Japanese Companies in Mexico]. Mexico City: Japanese Chamber of Commerce in Mexico, p. ii).

agreement forbids import duty exemptions for equipment conditioned to an export requirement) and the zero tariff charged by Mexico on inputs to be assembled into an export good.³⁵ However, to moderate the negative impact of the NAFTA phase-out on third countries' maquilas (and concerned about possible disinvestments), the Mexican government adopted a special sectoral promotion program (PROSEC) to award duty-free treatment to machinery and inputs from selected industries. For the Japanese business community, however, the shift from maquila duty drawback to PROSEC has never been satisfactory. The largest concern is of course that PROSEC remains a unilateral liberalization measure by the Mexican government, subject to discretionary changes. The Japanese team in the joint study group on FTA negotiations noted for instance that in December 2000 the Mexican government had eliminated more than 2,500 electronic items from the PROSEC program and concluded that "even at present, prospects for continuation of the system as well as its revision, are unstable, causing serious restrictions to corporate activities."³⁶ For the Japanese electronic sector, the costs of remaining marginalized from Mexico's FTA network were therefore very tangible.

In sum, the impact of NAFTA and the MEUFTA on Japanese companies in Mexico became an issue of great concern to the private sector and government officials in Japan. METI estimates the costs of trade diversion to be in the order of 395.1 billion yen (approximately \$3.2 billion), arguing this represented a GDP decrease of 521 billion yen (approximately \$4.3 billion) and a loss of 31,824 jobs in Japan.³⁷ These losses derived from the declining market share of Japanese companies in the aftermath of NAFTA. For example, between 1987 and 1993, Japanese products had represented 6.2 percent of total Mexican imports, but their share of the Mexican market fell to 4.1 percent between 1994 and 1999. This was especially true for the automobile industry, whose exports to Mexico dropped from \$713.5 million in 1994 to \$415.1 million in 1996, and had not recovered by 1999 at \$485.9 million.³⁸ Japan also lost ground as a foreign investor in the Mexican market. During the 1980s, Japan's flows of direct investment to Mexico had represented 6.4 percent of total incoming FDI. In the years 1994-1999, Japan's share of total FDI into Mexico shrank to 4.8 percent.³⁹ Investments from the Japanese electronics industry in Mexico basically dried up due to concern

³⁵ Solís, "Mexico and Japan."

³⁶ Japan-Mexico Joint Study Group on the strengthening of bilateral economic relations. "Final Report." [Online, cited 16 February 2003]. Available at <http://www.economia.gob.mx/work/snici/negociaciones/japon/pdfs/japon_completo.pdf (2002)> p.15.

³⁷ Japan-Mexico Joint Study Group, "Final Report," p. 14. Yen figures converted to dollars by authors with the average exchange rate for 2001.

³⁸ Statistics from Japan's Ministry of Finance.

³⁹ Statistics from Mexico's Ministry of Economy.

over the future of the maquiladora industry with only \$8 million of fresh investments between 2000 and 2004.⁴⁰

Japanese manufacturing and commercial trade interests mobilized swiftly in the wake of dwindling export and investment opportunities in Mexico to negotiate a CRTA. For instance, the Japan Foreign Trade Council (representing the interests of the general trading companies) noted that “the non-existence of FTA with Mexico will bring about considerable disadvantages to Japan and majority of its industries.”⁴¹ Keidanren, the umbrella organization for Japanese industry, also flexed its political muscle.⁴² It argued poignantly that while the United States and the EU had actively pursued FTA negotiations, “Japan, however, has yet to undertake a single free trade agreement. As a result, Japanese companies are losing out on business opportunities in the international arena, and also finding themselves placed at a competitive disadvantage in doing business with countries that have already concluded FTAs elsewhere.”⁴³ METI rallied behind these efforts to use an FTA with Mexico to correct for ongoing trade and investment diversion.

On the Supply of a CRTA with Mexico

The pivotal role of METI

METI has undoubtedly played the catalytic role for Japan’s FTA initiatives and, early on, attached great importance to an FTA with Mexico. As the promoter of this CRTA initiative, METI launched a campaign to convince the political leaders and the Japanese public the importance of negotiating with Mexico. A first step in the campaign was to publicize the tangible losses (including potential job losses) incurred by Japanese industries if the country did not sign an FTA with Mexico. Because the concern for employment was high in the Japanese political agenda at that time, these concrete numbers (see above) struck a nerve among major political figures.⁴⁴ By emphasizing the negative impacts of not having the bilateral agreement, METI advocated

⁴⁰ As noted before, Mexican trade officials worried that the loss of duty drawback benefits and rising labour costs in the maquiladoras could produce an exodus of Japanese companies from Mexico to China. Restoring competitiveness vis-à-vis China in order to retain and promote Japanese direct investment became a major source of Mexican interest in a preferential trade agreement with Japan. See Robert Donnelly, “Dealing with the Rising Sun.”

⁴¹ Japan Foreign Trade Council. 2001. “Toward the Japan-Mexico Free Trade Agreement (An Appeal by Japan Foreign Trade Council).” [Online, cited 21 August 2002]. Available at <http://www.jftc.or.jp/english/news/2001_02/2001_02.htm>.

⁴² For a good analysis of Keidanren’s lobbying activities on behalf of free trade agreements see Hidetaka Yoshimatsu, “Japan’s Keidanren and Free Trade Agreements: Societal Interests and Trade Policy,” *Asian Survey*, vol. 45, no. 2 (2005), pp. 258-78.

⁴³ Keidanren, “Urgent Call for Active Promotion of Free Trade Agreements. Toward a New Dimension in Trade Policy.” [Online, cited 31 October 2001]. Available at <<http://www.keidanren.or.jp/english/policy/2000/033/proposal.html>>, p. 1.

⁴⁴ Indicated by a METI official author interview, Tokyo, July 2005.

the notion of “*mamori no* [defensive] FTA” in the case of Mexico.⁴⁵ For METI, the distance and weak political connections of the extra-regional partner were not central to its FTA initiatives. As long as Japanese economic and business interests spread across geographical regions, there were economic gains to be made by engaging in cross-regionalism.

METI also engaged in an advocacy campaign to garner strong support from the private sector across a broad range of industries. For instance, METI enticed Japanese businesses to increase their support for this negotiation by including a section on “Improvement in the Business Environment.” The purpose of this chapter in the Japan-Mexico EPA is to make sure that Mexico provides a hospitable environment, in terms of safety and orderliness, for Japanese businesses operating there. This was important to many Japanese businessmen living in Mexico who had been affected by the growing incidence of crimes or kidnappings over the past ten years.⁴⁶

METI’s strong commitment to the negotiation with Mexico derived from its estimation that this agreement was vital for the pro-FTA forces within the Japanese government to demonstrate Japan’s seriousness and ability to engage in FTAs with the rest of the world. Japan had first negotiated a FTA with Singapore, a country which is already quite liberalized with low or no tariffs on most manufactured goods, and with a very limited agricultural sector. Therefore, many saw the FTA with Mexico as the first “real” negotiation since it included a substantial agricultural component, essential to establish Japan’s credibility for future FTA negotiations.

Domestically, a successful negotiation with Mexico was expected to support a key priority for Prime Minister Koizumi: domestic economic reform, and in particular agricultural restructuring.⁴⁷ Although for most of the postwar period, the strong protectionist position of the agricultural lobby was supported by its visibly political presence among the Liberal Democratic Party (LDP) *norin zoku* (agricultural tribe) and rural-area based LDP politicians, some important domestic changes have begun to affect the clout of the agricultural lobby: a new electoral districting system (which requires

⁴⁵ The distinction between “defensive (*mamorino*) FTA” and “offensive (*semeno*) FTA” is often made by METI officials. *Asahi Shimbun*, April 19, 2004.

⁴⁶ In 1996, the President of Sanyo Video Components that operates maquiladora in Tijuana was kidnapped for \$2 million ransom. This was widely reported news that alerted the maquila-based businesses for the possible personal risk in operating business in Mexico. (*Financial Times*, 17 August, 1996, p. 3).

⁴⁷ The negotiation with Mexico was also deemed important to expose to international competition manufacturing sectors traditionally protected. A case in point is the concessions in leather and the rapid increase in shoe imports from Mexico. Mexican shoe manufacturers are planning to expand its 10,000 annual shoe sale in 2004 to 250,000 pairs in 2005 (Interview with a JETRO official, Tokyo, 14 July 2005). More generally, FTAs are expected to contribute to structural reform in Japan in a number of ways. For example, Japan’s protected service sector, including medical and education services, will have to be reformed in order to make the system compatible with Japan’s FTA partners if mutual recognition agreements are reached (Urata, “Towards an East Asia Free Trade Area,” pp. 394-95).

a winning politician to appeal to wider constituents and not just to appease special interest groups), generational changes with a dwindling farming population, and a more influential processed food industry willing to second foreign petitions for more open markets, enabling them to import cheap materials.⁴⁸ Moreover, having risen to power supported by an unprecedented popularity as a politician from the ruling LDP willing to oppose its own party's "old guard," Prime Minister Jun'ichiro Koizumi was not afraid to confront the LDP's agricultural interests. Yet the agricultural lobby continued to stubbornly resist market liberalization.⁴⁹

Champions of economic reform in Japan believed the agreement with Mexico would help circumscribe the influence of the agricultural lobby on trade policy since Japan would have to make its first-ever WTO-plus agricultural concessions for the CRTA to be in compliance with WTO rules regarding "substantial liberalization."⁵⁰ In short, Japan's pro-FTA forces represented by METI and supported by Koizumi aimed to gradually lock in Japan's agricultural reform through this FTA with Mexico to fend off future domestic opposition to other (mostly intra-regional) FTAs and to increase Japan's leverage and credibility.

Over coming yonsh ô taisei

The attainment of these important international and domestic goals in the FTA negotiation with Mexico rested, however, on the ability to reach a basic consensus, among political and bureaucratic actors in Japan, on the basic contours of the concession package offered to Mexico. This coordination process proved extremely difficult, giving credence to existing work on the importance of inter-bureaucratic politics in Japanese foreign economic policy making.⁵¹ It was quite evident from our interviews that the tug-of-war and coordination challenges among Japanese powerful ministries significantly shaped Japan's FTA policy towards Mexico. Officially, the Japanese government engages in FTA negotiations in the form of *yonshô taisei* (four-ministry structure) involving METI, the Ministry of Foreign Affairs (MOFA), the Ministry of Agriculture, Forestry, and Fisheries (MAFF) and the Ministry of Finance (MOF). Thus, it fell upon METI to bring on board

⁴⁸ Asahi Shimbun, ("Hogo" dakeja dame: "shoku no anzen" de jimin to, nosui zoku, henbo no toki) 31 March 2004, p.4).

⁴⁹ Christina Davis, *Food Fights Over Free Trade: How International Institutions Promote Agricultural Trade Liberalization* (Princeton NJ: Princeton University Press, 2003); Aurelia George, "The Politics of Interest Representation in the Japanese Diet: The Case of Agriculture," *Pacific Affairs*, vol. 64, no. 4 (1992), pp. 506-28.

⁵⁰ Munakata, "How Trade Agreements Can Reform Japan."

⁵¹ See, for example, on foreign aid, Alan Rix, *Japan's Economic Aid: Policy-making and Politics* (New York: St. Martin's Press, 1980); on trade liberalization Leonard J. Schoppa, *Bargaining with Japan: What American Pressure Can and Cannot Do* (New York: Columbia University Press, 1997); on capital outflow liberalization, Mireya Solís, *Banking on Multinationals: Public Credit and the Export of Japanese Sunset Industries* (Stanford: Stanford University Press, 2004).

other bureaucracies with different perspectives in order to collectively present a pro-FTA position vis-à-vis talks with Mexico and subsequent FTA initiatives.

Concessions on Japan's agricultural market access to Mexican products were critical to the success of FTA talks, so that the Fox Administration could score political points at home, and justify the opening of import markets to Japanese manufacturers. Obviously for Japan, too, agricultural liberalization held the key to future FTAs. Against this backdrop, the saliency of MAFF in the FTA process increased since it emerged as the bureaucratic player defining the upper limits on the liberalization package offered in this CRTA. MAFF defended its guarded position on FTAs and agricultural liberalization with the following three premises: First, exemptions on sensitive commodities must be made, while maintaining consistency with the WTO's Article 24; second, in tandem with liberalization through WTO and FTAs, the government must protect food security through sanitary and health requirements; third, the Japanese government must select appropriate FTA partners to avoid compromising Japan's food security and agricultural future.⁵²

As MAFF reluctantly came on board after the release of the joint study on a possible Japan-Mexico FTA in July 2002, it began to establish through its item-by-item negotiations with agricultural interests, a domestically and politically acceptable position regarding the level of agricultural liberalization *before* the Japanese government negotiated with the Mexican government. The purpose was, according to a MAFF official, to avoid political turmoil at the time of ratification as seen in the case of the South Korea-Chile FTA.⁵³ It became obvious, however, that the compromise MAFF and the Japanese agricultural sector were willing to make on the five most important items for Mexico—pork, beef, chicken, orange and orange juice—was not sufficient, and the disagreements over the volume of these tariff-rate quotas (TRQs) produced a breakdown in the negotiations in October 2003.⁵⁴

On the other hand, MOFA unenthusiastically played its role as official coordinator of the FTA with Mexico. MOFA's shift from its multilateral-only position to endorse FTA initiatives in the early 2000s was due in part to the expected payoff on Japan's regional diplomacy in Asia from engaging in economic agreements based on reciprocal cooperation.⁵⁵ Therefore, MOFA had insisted that "the first Japanese FTA ought to be concluded with an

⁵² Interview with MAFF official in charge of FTA negotiations for several years, Tokyo, July 2005. See also Masaki Sakai, "Wagakuni no Shokuryō Anzenhoshō to Jiyūbōeki kyōtei [Our country's Food Security and FTAs]," *Nōgyō to Keizai* (February, 2003), pp. 57-66.

⁵³ Interview with a MAFF official Tokyo, July 2005.

⁵⁴ Akio Fujiwara, "Nichiboku FTA Kōshō no Uchimaku [Inside story of Japan-Mexico FTA Negotiation]," *Gaikō Forum*, (May, 2004), p. 54-59.

⁵⁵ *Diplomatic Blue Book 2001* Tokyo: MOFA, 2001 [Online, cited 22 August 2005]. Available at <<http://www.mofa.go.jp/policy/other/bluebook/2001/chap1-e.html>>.

Asian neighbour.”⁵⁶ MOFA saw the agreement with Mexico more like an ordinary FTA with fewer benefits in terms of strategic or diplomatic gains of increasing regional cooperation. Therefore, the ministry was not so keen on this negotiation, particularly when it was seen as undermining Japan’s overall efforts to support trade and economic multilateralism under the WTO.⁵⁷ Nevertheless, MOFA came on board keenly aware that failure in talks with Mexico would have a negative impact on Japan’s intra-regional efforts.⁵⁸

Finally, MOF’s interest in pursuing FTA negotiations revolves around the issue of trade facilitation, particularly streamlining of customs procedures. MOF officials insist that inefficient or corrupt custom systems can be more onerous than trade barriers in hindering market access for foreign products. Although the goal of trade facilitation is also pursued in broader forums (the WTO and APEC), the advantage of bilateral FTAs for MOF officials is that they allow Japan to selectively target its technical cooperation on streamlining custom procedures.⁵⁹ Regarding FTA negotiations with Mexico, MOF’s main responsibilities revolved around overseeing the complex tariff-rate quota system on various agricultural goods, and hence the ministry was represented by its tariff bureau, not the international bureau. Another important issue that the ministry faced for the first time was the design of a manageable system of preferential ROO. For MOF, the ROO on steel became the point of tension with the Mexican negotiators when they insisted on applying its ROO to the original supplier of iron ore. This would have amounted to a de facto exclusion of Japanese steel (since there are no iron ore deposits in Japan), and eventually Mexico had to relinquish its proposed ROO.

The contrast among the promoter METI, the resister MAFF and the reluctant MOFA in FTA negotiations with Mexico could not be starker. As the failed Japan-Mexico negotiation of October 2003 demonstrates, the contrasting positions of responsible ministries could sometimes seem insurmountable. The incoherence among the four ministries was deemed the fundamental obstacle in reaching an agreement with Mexico by Japanese observers.⁶⁰ Interestingly, the fiasco of October led to institutional changes,

⁵⁶ Mark Manger, “Competition and Bilateralism in Trade Policy,” p. 815. Yoshimatsu (2005), p.269; Yoshimatsu also notes that MOFA officials questioned why Japan should conclude an FTA with an extra-regional partner like Mexico.

⁵⁷ This explains MOFA’s uneasiness when the Mexican government insisted (and later on secured) a negative list approach for service trade. This was not only incompatible with Japan’s FTA with Singapore (which adopted the positive list), but was also incompatible with the WTO. Interview with a MOFA official, Tokyo, July 2004.

⁵⁸ Moreover, MOFA was not impervious to the needs of Japanese industries. For example, Yanagihara notes that MOFA was also heavily influenced by the business community when it published its FTA strategy in 2002. Toru Yanagihara, “Nihon no ‘FTA senryaku’ to ‘kantei shudō gaikō’ [Japan’s FTA strategy and Prime Minister-led Diplomacy],” *Kaigai jijō* (April 2004), pp. 92-108.

⁵⁹ Interview with MOF official, Tokyo, June 2005.

⁶⁰ Nihon Keizai Shimbun, 11 October and 13 November 2003.

since three of the main ministries responded to the failed summit with Mexico by establishing their own “FTA headquarters” and began to allocate more personnel to the division.⁶¹ It was after the October showdown that a top-down intervention from Japan’s prime minister was necessary to break the bureaucratic logjam.

Showdown Time: The October 2003 CRTA Crisis

Slow progress on agriculture and failed October meeting

The clout of the agricultural lobby was felt at all stages of the negotiation process with Mexico. In fact, the agricultural lobby effectively chilled the FTA talks when they were first proposed in 1999. At that time, the Japanese delegation in charge of producing a report on prospects of negotiating with Mexico candidly admitted that a hard core group in Japan remained determined to exclude agriculture completely from negotiations with Mexico. Mexico found this unacceptable, and the FTA negotiation process stalled.⁶² Even after the FTA talks had been reactivated, the Japanese team in the joint study group questioned whether there were complementarities in agricultural trade between Mexico and Japan citing the substitution effect,⁶³ and it made reference to the LDP’s policy of not negotiating agricultural concessions bilaterally but only at the WTO.⁶⁴

The Mexican team, on the other hand, replied that while some flexibility could be offered in specific commodities, “agricultural products are indispensable in the final package of the bilateral agreement.”⁶⁵ These important differences in negotiating stands turned into an unbridgeable gulf at the time of exchanging the offer-request list for agricultural products in the fall of 2003. The Mexican FTA team, keenly aware that the opportunities to increase exports to Japan lay in the primary sector, pushed for the elimination of tariffs and quotas on agricultural commodities. Japan, however, was not prepared to entertain this possibility and offered instead concessions on a very limited amount of tariff lines and multiple exclusions of products of great interest to Mexico, such as pork, beef, bananas, etc.⁶⁶

As the date for the visit of Mexico’s president to Japan to sign a basic FTA accord approached in the fall of 2003, most of the agricultural negotiations focused on the tariff rate quotas of Mexican products sensitive for Japan:

61 Nihon Keizai Shimbun, November 13, 2003. MOFA had established the FTA office much earlier than the other two in November of 2002, but the number of staff was increased threefold from thirty in October 2002 to ninety in January 2003 (Nihon Keizai Shimbun, 29 November 2003).

62 Mireya Solís, “Japan’s New Regionalism,” p. 395.

63 The argument is that if the Japanese people consumed more tropical fruits they would decrease their consumption of fruits harvested in Japan.

64 Joint Study Group, “Final Report,” pp. 18, 22.

65 Joint Study Group, “Final Report,” p. 22.

66 Information provided to author by Consejo Nacional Agropecuario, May 2005.

pork, beef, chicken, oranges and orange juice (the so-called “five fingers”). The gaps to bridge with this controlled liberalization formula were nevertheless still substantial. Pork, for example, represents half of all Mexican exports of primary goods to Japan or 10 percent of total exports. The Japanese were offering a low-tariff quota of 80,000 tons (effectively doubling Mexico’s exports), while the Mexicans demanded a duty-free quota of 250,000 tons (which they believed more accurately reflected the industry’s export potential).

Bilateral agricultural negotiations, therefore, turned into a tense exercise of defining import quotas that both sides could sell domestically to their respective farming interests. As discussed below, Japanese negotiators were also concerned about the ratification process when many rural-based LDP politicians might try to sabotage this FTA. Although some progress had been made, substantial differences still remained at the time of President’s Fox trip to Japan. Despite four days of intense negotiations, the impasse over the five fingers could not be overcome. Deep divisions within the Mexican delegation were also responsible for this outcome. While some favoured the signing of an agreement despite the absence of significant agricultural concessions, others refused to do so arguing that such trade package could not gain domestic support in Mexico. In the end, Fox sided with the latter group.⁶⁷ The Mexican minister of the economy, Fernando Canales, hinted that the timing of the Fox-Koizumi meeting was all wrong by remarking that on the eve of Japanese national elections (scheduled for three weeks later) agriculture had inevitably become a political issue.⁶⁸ In Japan, the mirror argument was made by officials suggesting that the source of the negotiation breakdown could be found in President Fox’s domestic political interests.⁶⁹

Along with differences among four ministries involved, the agricultural resistance created a major impasse in Japan’s FTA negotiation with Mexico. It took a top-down intervention by the prime minister to engineer a breakthrough.

Koizumi’s Political Intervention

Koizumi had supported FTA negotiations with Mexico since taking office in May 2001 as he met with President Fox and agreed to reactivate the bilateral FTA negotiation which had been shelved earlier. Koizumi’s top-down governing style and his commitment to carry out economic reform in Japan, led his cabinet and the Cabinet Office to take a strong initiative in this FTA negotiation. As Japan’s FTA negotiation with Mexico began in earnest in fall

⁶⁷ Roberto Zamarripa, “Harakiri” *Reforma*, 21 October 2003. Author interviews with officials of Mexico’s Ministry of Economy, and with representatives of COECE and CAN, Mexico City, May 2005.

⁶⁸ Hussain Khan, “Mexico Free Trade Founders on Japan’s Farmers” *Asia Times*, 23 October 2003.

⁶⁹ Nihon Keizai Shimbun, 17 October 2003.

of 2002, Koizumi made several appointments to pave the way for FTA diplomacy. He appointed as METI minister a leading LDP reformer, Shoichi Nakagawa, who had a strong influence over the agricultural tribe. Koizumi also nominated Fukushima Nukaga, the head of LDP's FTA committee, as the chairman of the Policy Affairs Research Council (a key internal organ in drafting the party's policy positions). In this fashion, the Koizumi Cabinet tried to quell opposition to the FTAs, especially from the agricultural tribe within the LDP party.⁷⁰

With such support, the failure of October 2003 negotiation came as a major shock to the Koizumi cabinet. In order to amend the situation in the immediate aftermath, a mission representing the cabinet was sent to Mexico in November; and with the aim of increasing coordination among ministries, an FTA *Kankei Shôchô Renraku Kaigi* (meeting on FTA-related ministries and bureaus) was set up in December. The direct leadership taken by the Koizumi cabinet helped lower the barriers between the four ministries involved, and such political consensus made the MAFF take a more accommodative position toward agricultural liberalization than before.⁷¹ Some additional compromise on agriculture finally led to the agreement on the FTA between Japan and Mexico in March 2004. The Japanese government collectively took the conclusion of the FTA as a success on many levels, since it constitutes the first case where agricultural liberalization, though limited, was explicitly included and because MAFF and the agriculture lobby showed some flexibility. Both provided good precedents to increase Japan's leverage in future trade negotiations with Asian nations.

Nevertheless, table 3 summarizes the main features of the agricultural deal and offers a picture of only modest Japanese liberalization. Although the volume of trade covered seems impressive (99.6 percent of agricultural trade volume), in terms of tariff lines actually covered the results are not as impressive. More than 56.7 percent of the tariff lines were left aside as exclusions or items for future renegotiation (with no binding agreement to effectively renegotiate). For the five sensitive products mentioned above, the tariff quotas will remain in place, and in the case of chicken, beef and oranges, the preferential rate will not be decided until a few years after the implementation of the treaty.

To sum up, the Japanese agricultural lobby did make a substantial concession from its original position of negotiating exclusively at the multilateral level. But the agricultural sector was also able to tailor its agreement with Mexico to avoid substantial adjustment costs on sensitive

⁷⁰ Nihon Keizai Shimbun, October 17, 2003.

⁷¹ Interview from a METI official, Tokyo, July 2005; Pempel and Urata (2005, p. 88) note that METI had a difficult time exerting pressure on the MAFF toward agricultural liberalization in support of Japan's FTA efforts, for under METI itself there are many uncompetitive industries that resist liberalization.

Table 2
Modest agricultural liberalization in the Japan-Mexico FTA

Volume of trade covered	99.6%
Tariff lines covered	796 or 43% of total
Liberalization Schedule	
Immediate	511 tariff lines (27.8%)
Medium term (3-5 years)	113 tariff lines (6.1%)
Long Term (7-10 years)	92 tariff lines (5%)
Quota items	80 tariff lines (4.3%)
Five fingers	<p><i>Pork:</i> Initial quota of 38,000 to grow to 80,000 in 5 years with 2% tariff (half of 4.3%).</p> <p><i>Chicken:</i> 10-ton quota to grow to 8,500 in year five. Tariff rates to be discussed in first year of entry into force.</p> <p><i>Beef:</i> 10-ton quota to grow to 6,000 tons in year 5. Tariff rates to be discussed in the second year of entry into force.</p> <p><i>Oranges:</i> 10-ton quota to grow to 4,000 tons in year five. Tariff rates to be discussed in second year of entry.</p> <p><i>Orange juice:</i> 4,000-ton quota in first year to grow to 6,500 tons in 5 years with halved tariff.</p>
Exclusion or renegotiation	1,044 tariff lines (56.7%) Examples: rice, sugar apple, pineapple, wheat, nectarines, potatoes, sausages

Sources: Prepared by authors with data provided by Mexico's Consejo Nacional Agropecuario

items. For these reasons the Japanese agricultural lobby has become much more comfortable with Japan's ongoing intra-regional FTA initiatives. The CRTA with Mexico established a political compromise on agricultural issues whereby subsequent Japanese FTA negotiations with Asian nations will allow the agriculture sector to be included, but with some sensitive farm products clearly set as off-limits.

Conclusions: Significance and Implications of the Japan-Mexico CRTA

The CRTA with Mexico was a high-stakes negotiation not only because it was necessary to eliminate discriminatory treatment for Japanese companies operating in the Mexican market but also because it became a crucial battleground between industrial and agricultural lobbies on the direction of Japan's trade policy; because it helped the Japanese bureaucracy's FTA capacity-building efforts; and because it established significant precedents on negotiation modalities influencing Japan's subsequent negotiations with

many Asian nations. These findings, therefore, corroborate Solís and Katada's hypotheses laid out in the framework paper regarding the importance of economically defensive motives (trade diversion) and of leveraging cross-regional talks to score points in intra-regional negotiations (through capacity building and precedent setting).

As discussed before, some Japanese industries reported tangible losses from the trade and investment diversion effects of NAFTA and the Mexico-EU CRTA. These industrial interests (government procurement contractors, auto companies and electronic firms) demanded an FTA with Mexico in order to level the playing field, and for the most part their concerns were addressed in the final agreement. In the area of government procurement, Japanese companies are now eligible to participate in the bidding process and enjoy national treatment status. In the case of automobiles, there are some immediate gains (with a duty-free quota equivalent to 5 percent of the domestic market), but the big payoff will be realized in the medium term with the phase-out of all tariffs in a seven-year period. For Japanese electronic firms, the benefits of the agreement were twofold: to consolidate the tariff preferences that had previously been offered unilaterally (PROSEC); and to introduce the improvement of the business climate as an issue to be addressed bilaterally.

The CRTA with Mexico also helped many Japanese companies strengthen their export operations in North America. Japanese consumer electronics firms are likely to retain their position as key suppliers of televisions and other audiovisual products in the United States by consolidating the duty-free status of the multiple components imported for their maquiladora operations. And Japanese automobile companies in Mexico will be able to increase their regional integration levels (essential to clear NAFTA's ROO) to the extent that the investment protection chapter in the FTA encourages investment in Mexico from Japan's small and medium-sized auto part suppliers.

Although the benefits accrued to Japanese companies in Mexico from this bilateral trade agreement were clear, the domestic political battle in Japan between champions and detractors of its FTA policy yielded no clear winners. As noted before, METI bureaucrats considered the FTA with Mexico easier to sell at home given that Japanese industries were actually reporting losses from lack of preferential access. They hoped that an FTA with Mexico would help them lay the basis of political support for the unfolding Japanese FTA diplomacy and weaken the clout of the agricultural lobby over trade policy. However, the heated and protracted negotiations with Mexico show that far from being marginalized, the agricultural lobby has adapted well to the new trade diplomacy and has learned how to carve exclusions and deferments in sensitive sectors in this era of trade bilateralism. The negotiation of these liberalization opt-outs has in fact dominated Japan's FTA talks with Asian countries.

On the other hand, for Japan—a country trying to catch up with the worldwide FTA bandwagon—successfully engineering a free trade agreement with a consummate FTA negotiator was a major boost to its confidence and credibility. Obviously, the FTA with Singapore had had a similar effect in lifting the morale of Japanese officials,⁷² but Mexico represented a unique challenge and learning opportunity. With Singapore, agricultural trade was minimal, no preferential ROO were required given the duty-free status of most commodities, and WTO rules acted as the key benchmark on important issues such as service liberalization and dispute settlement procedures. None of this was true in the negotiation with Mexico, and this helped prepare Japan to negotiate with other Asian countries with large agricultural exports, high external tariffs and non-WTO commitments on important areas such as government procurement.

A very intense process of “on-the-negotiation training” is reported by Mexican and Japanese officials whereby Mexico transferred a fair amount of “FTA know-how” to Japan. Mexican officials noted that a main reason behind the lengthy negotiation process was the numerous queries from their Japanese counterparts on every detail of the agreement.⁷³ Perhaps the single most important piece of evidence regarding the training effect of this cross-regional initiative on Japan’s FTA diplomacy is that the Japanese government is using the FTA treaty with Mexico as the benchmark text with which it initiates negotiations with Asian countries.⁷⁴

Because the Japan-Mexico FTA is such a key reference point in Japan’s FTA diplomacy, this cross-regional initiative stands to exercise a large influence over Japan’s forthcoming free trade agreements with Asian partners. Japanese officials believe that the FTA with Mexico enhances Japan’s position on important issues. For instance, Japan now has under its belt an FTA with a positive list for service liberalization (Singapore), and one with a negative list (Mexico). The shift to the negative list came about because the Mexican government’s insistence to maintain NAFTA’s consistency. The Japanese government, nevertheless, saw it as an opportunity to introduce an effective tool to deal with Asia. Since the Japanese government can now “go either way” with the service agreement, it will be able to use this flexibility as the basis of negotiation.⁷⁵ Furthermore, the “business environment” clause is considered an innovation that Japanese business actively welcome as a part of the Japanese FTA negotiations with many of the developing countries in the region.⁷⁶

⁷² Naoko Munakata, “Whither East Asian Economic Integration?” CNAPS Working Paper Topic (Washington DC: Brookings Institution, June 2002), p.34.

⁷³ Interviews with officials from Mexico’s FTA team, Mexico City, May 2005, and with METI and MOF officials, Tokyo, June and July 2005.

⁷⁴ Interview with MOF official, Tokyo, June 2005.

⁷⁵ Interview with a METI official, Tokyo, July 2005.

⁷⁶ Interview with a METI official, Tokyo, July 2005.

The significance of the FTA with Mexico for Japan's Asia policy derived as well from a demonstration effect. Japan could not let negotiations with Mexico founder because, as noted above, this was the first FTA negotiation that actually included the agricultural sector, and failure to conclude this agreement would have sent a clear message to Asia that Japan was either not serious about FTAs or the agricultural opposition was so strong that the Japanese government would be unable to open the sector at all. Because many Asian nations are mostly interested in accessing Japan's agricultural market, the FTA with Mexico presented itself as a litmus test. The need to pass this test explains the visible intervention of Prime Minister Koizumi to rein in bureaucratic infighting and to hammer out an acceptable agreement for Mexico.

The cross-regional agreement between Japan and Mexico convincingly demonstrates that, rather than geographical proximity, those two countries were "dominoes" connected by specific Japanese industries with large interests in Mexico, and that in negotiating with Mexico the Japanese state never lost sight of the importance of going cross-regional in order to boost its regional integration efforts.

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