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The Concept of Trade Liberalisation in Japan and the Republic of Korea

Strategic Government Interventions in Agricultural Trade

Topic and Research Question

The thesis builds on the premise that East Asian countries tend to have protectionist trade regimes. Agriculture being the most “protected” sector, therefore most contended in trade, is subject to criticisms in the realm of trade liberalisation. Despite the low percentage of contribution it makes to the overall economy, agriculture remains vital to Japan and the Republic of Korea (hereafter referred to as South Korea). Rice farmers in Japan [and South Korea] can sustain production only with the help of protection (Udo 2008).

The research questions posed are: first, does the theory of Strategic Trade Policy explain the protectionist agricultural trade policies/government intervention in Japan and South Korea, controlling the effects of the agricultural trade in domestic market?; second, to what extent the agricultural sector and its trade have been compromised in the realm of trade liberalisation?; and third, how has international trade liberalisation impacted agricultural trade in East Asia?

The hypotheses of the thesis are that both economies’ agricultural trade policies tend to be protectionist on the basis of the theory of Strategic Trade Policy in order to give the domestic market a competitive edge over foreign markets especially in regard to the product of rice. Moreover, the concept of international trade liberalisation has entered the East Asian region however, has yet to regionalize agricultural trade in East Asia.

State of the Art

As New Trade Theory (NTT) can be explained in relation to the theory of Strategic Trade Policy which can demonstrate the interaction between government and domestic industries as well as firms in Japan and South Korea, literature on NTT were discussed to provide an insight to the theory of Strategic Trade Policy. Both theories attempt to explain why governments would rather use strategic measures to intervene than choose free trade. NTT is based on product differentiation, economies of scale and imperfect competition (Helpman & Krugman 1989). Governments, according to NTT, in the name of maximizing national welfare, “can tax (or subsidize) the output of domestic firms, tax (or subsidize) the exports of these firms, and tax (or subsidize) the imports from the foreign rivals of domestic firms” (Eaton & Grossman 1986).

Strategic Trade Policy is concerned with raising national welfare by supporting home companies in international

competition and stems from the view that interventionist policies by a government can reallocate excess returns from foreign to home enterprises (Krugman 1987).

Within the realm of international trade, free trade is still the norm, according to new trade theorists. Protectionism is said to block the free flow of trade, however, Strategic Trade Policy, aligned with new trade theory, competes with the notion of free trade. Practical implementation of strategic trade policies may disadvantage the economy as the strategic trade policies produce gains for a domestic firm often at the expense of a foreign competitor (“beggar-thy-neighbor policies”) (Krugman & Obstfeld 2000). However, there may also be positive analyses of the theory in practice in the international market. (Reimer & Stiegert 2006).

Rice holds a cultural and symbolic significance in Japan and South Korea. Despite the lack of natural preconditions, Japanese and South Koreans cultivated rice and take the pride in high quality of their rice. Over the course of industrialisation, primary industry declined in production and agriculture now employs only a fraction of what they used to “back in the day” however, to ordinary consumers, it is still important to distinguish between domestic and foreign rice.

Methodology and Approach

Dating back to Mercantilism, Adam Smith’s *invisible hand*, David Ricardo’s *comparative advantage* to Paul Krugman’s *new trade theory*, there is extensive literature discussing international trade. Theoretical framework chosen for the thesis is primarily built on New Trade Theory and the theory of Strategic Trade Policy. Analytical framework is based on a number of elements of Strategic Trade Policy. The comparative, analytical framework includes a list of government intervention tools in a single industry in order to “promote particular exports or discourage imports” (Krugman & Obstfeld 2000). Japan and South Korea hugely depend on imports for agriculture due to the lack of natural resources (Fader et al. 2013).

Previously, the theory of Strategic Trade Policy was explained in relation to Japan and South Korea’s heavy-chemical industry (i.e. steel and semi-conductors). Whereas the application of the theory to agricultural sector might not completely agree with the details, “agricultural trade research has for a long time recognized the importance of imperfect competition” (Lee 2002).

Brander and Spencer (1985) invented a duopoly model to find out “effects of a subsidy [given] to an industry or a firm”. The analysis shows that the government intervenes in the decision making of a firm or an industry by offering an incentive to the firm to do it no matter if the other firm from a competing country decides to do it or not. Brander and Spencer (1984) stated that a domestic subsidy lowers the world prices of a given product, which is beneficial for foreign consumers, but it also rises domestic and decreases foreign profit. Government intervention is neither bad nor illegal as “WTO rules allow for a variety of government interventions in international markets, and many of these – including export subsidies, state trading operations, subsidized R&D, products standards, and tax and investment policies – are potentially strategic in nature” (Reimer & Stiegert 2006).

The list of elements of government interventionist tools in agricultural trade include nontariff barriers, export subsidy, import tariff, R&D subsidy and state-trading enterprises.

Main Facts

Since the year 2000, East Asia has seen an explosion of trade agreements due to the massive proliferation of free trade agreements (FTAs) (Pomfret 2011). Brander and Spencer (1985) stated that most trade liberalisation has been multilateral because countries require reimbursement in the form of freer access to foreign markets for reducing their own tariffs or quotas because “protection can shift some of [excess] profits from foreign to domestic firms, and in addition, tariffs can transfer foreign rents to the domestic treasury in the form of tariff revenue. ... from a purely domestic point of view, protection is likely to be an attractive policy”.

Various restrictions are implemented in protecting domestic industry that is agriculture. Both Japan and South Korea subsidize the agriculture sector, especially rice and sugar. Japan has inclined to trade liberalisation by reducing the use of nontariff barriers and export subsidies but supported their domestic rice farmers through import tariffs, quota, state-trading enterprise as well as R&D and investment subsidy. South Korea has provided support for rice farmers through various nontariff barriers, high import tariffs, quota, state-trading enterprises as well as R&D and investment subsidy.

Even though there is no single entity like the European Union (EU) for monitoring and regulating trade among Northeast Asian countries, trade liberalisation has effectively taken place in the region, albeit not a regional one. There is, therefore, room for further development of

political and economic partnerships, engagement and interaction among Northeast Asian countries (i.e. Japan, South Korea and China).

Results

In essence, both Japan and South Korea exhibit a tendency to exercise most of the government interventionist tools listed in the above. Thus, it can be concluded that the theory of Strategic Trade Policy can explain Japan and South Korea’s agricultural trade policies are a product of protectionist/interventionist policies. Furthermore, the agricultural sector and its trade have suffered tremendously due to industrialisation. However, there remain political and civil factions that support the sector and rice farmers who are likely to embrace new advancements in order to sustain the agricultural sector. Lastly, international trade liberalisation surely impacted agricultural trade in East Asia to the extent that there has been an effort to involve Japan, South Korea and China in a trilateral trade agreement since 2012. The trade agreement may or may not bring about noticeably positive yields to the agriculture sector however, as shown in the recent South Korean rice exports to China, more avenues will be available for domestic rice producers.

References

All references can be found in the full version of the MA thesis available at <http://others.univie.ac.at>.

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