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## The Impact of Japan's Rivalry with China on Its Willingness to Pursue Free Trade Agreements \*

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This study explores the main causes that have led Japan to conclude an FTA with ASEAN. This paper appraises Japan-ASEAN relations and shows that closer relations between Japan and ASEAN have provided momentum for the launch of Japan's FTAs with ASEAN. Consequently, this paper explores the origins and progress of Japan-ASEAN FTA, as well as the strategies and initiatives embraced by Japan in its FTA negotiations with ASEAN. By examining the domestic, regional, and global factors that led to the launch of the Japan-ASEAN FTA, this paper concludes that the strategies adopted were primarily aimed at its main rival, China. The rivalry has resulted in both positive and negative consequences for East Asian Regional economic environment. The negative consequences include the creation of a “spaghetti bowl”, which increases costs for Japanese firms operating abroad, and “slows down the progress of the creation of an effective single regional institution”.

Keywords: Political Rivalry, Free Trade Agreements (FTAs), Impacts, Negotiations, Strategies, East Asia, AJCEPA

JEL Classification: F50, F55, F59

### I. Introduction

Several studies have offered a wide array of insights regarding the recent regionalism-taking place within East Asian political and economic integration (Aggarwal and Koo, 2005; Bergsten, 2000; Breslin, 2007, Buszynski, 1999, Harris, 2002, Higgott 1998; Hurrell, 1995; Katzenstein, 2002; Solis and Katada, 2008; Yoshimatsu, 2011). A second group of studies has discussed the specific dynamics that have persuaded some individual East Asian economies to jump into the FTAs trend after the end of the Cold War (Aggarwal and Koo, 2005;

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Baldwin, 2008; Capie, 2004; Kim, 2013; Kawai, 2005; Kawai and Wignaraja, 2008; Leenabanchong, 2006; Scollay, 2003; Urata, 2005; Urata, 2008). Last but not least, many authors examined the common dynamics that have pushed the states in East Asia towards regionalism (Cheong, 2004; Collard-Welex, 2006; Mansfield and Busch, 2000; Milner, 1998; Tay, 2013; Snidal, 1991; Urata, 2005).

However, those studies have not significantly discussed the political drives behind the individual East Asian economies, which motivated the decision to introduce FTAs, or more specifically, the political drives behind the Japanese economic policy decision to create the ASEAN-Japan Comprehensive Economic Partnership Agreement (AJCEPA)<sup>1</sup>. In this context, the author will explore the political motivations behind Japan's creation of AJCEPA. On the other hand, some scholars have focused on political rivalries, in particular, the Japanese political rivalry with China (Solis and Katada, 2008; Yoshimatsu, 2011). The impact of the rivalry on the East Asian region is still unknown, but both positive and negative outcomes for the region resulting from the rivalry can be made evident.

This research will attempt to answer three research questions in order to fill the gap discovered in the literature. First, what kind of strategies has Japan implemented in order to support AJCEPA? Second, what are the main factors that stimulated Japan to commit itself to AJCEPA? Third, how has the political rivalry influenced the region?

The research hypothesis specifies that the main considerations that have stimulated Japan to commit itself to AJCEPA are:

- Local Factors – The preferences of societal and political actors in Japan played an important part in the creation AJCEPA with ASEAN.
- Regional Factors – Japan pursued the AJCEPA with ASEAN in order to advance its regional leadership credentials in competition with China by reaching out to ASEAN members.
- Global Factors – Japan realizes that its AJCEPA with ASEAN is a response to challenges made by protectionism and competitive regionalism in the world economy.

After the Cold War ended, the East Asian region emerged as a new strategic,

<sup>1</sup> Although Ministry of International Trade and Industry (MITI) officials recognize that there is little difference between an Economic Partnership Agreement (EPA) and a Free Trade Agreement (FTA), Japan prefers to refer to its preferential trade agreement as EPAs rather than FTAs. One possible reason behind Japan's preference to EPAs is that the term is "less apt to provoke domestic political opposition" to trade liberalization (Yoshimatsu, 2008).

political and economic center, which has played a significant role in the world economy. Since the late 1990s the number of Free Trade Agreements (FTAs) in East Asia has grown rapidly. Currently global FTA activity occurs in East Asia more than any other region (ADB, 2013)<sup>2</sup>. Consequently, given that Japan holds the key to regional integration in East Asia, a study on Japan's strategy toward FTAs is significant in gaining an understanding of regionalism in East Asia and the future prospects for integration in the region. In this context, in order to contribute new insight into understanding the East Asian economies raising interest in FTAs, this paper examines the factors and motivations behind AJCEPA. This paper will also analyze approaches and initiatives embraced by Japan in its FTAs with ASEAN. Last but not least, as those approaches and initiatives were aimed mainly at rivaling China, the paper will analyze the various impacts of this rivalry on the East Asian region.

The paper uses a qualitative methodological approach in order to better understand the dynamics that compelled Japan to embrace the regional FTA trend and the drives behind its initiatives towards the creation of FTAs with ASEAN member states. The research draws on observation and documentation derived from both primary and secondary data, such as books, E-books, journals articles, official reports, conference papers, newspapers, magazines, and electronic databases related to FTAs in East Asia and AJCEPA in particular.

## II. The Background of AJCEPA

In the late 1990s, Japan transformed its trade policy stance from using only one track trade liberalization system under the World Trade Organization (WTO) framework to a multilateral track trade liberalization system. Japan began to engage in bilateral and regional FTAs. The motivations for transforming its trade policy stance were the slow progress in trade liberalization negotiations under the WTO, and the desire to comply with a strong trend of increasing FTAs around the world. In connection with the transformation of its trade policy, Japan successfully concluded a FTA with Singapore in 2002. Interestingly, immediately after signing the agreement, Japanese Prime Minister (PM) Junichiro Koizumi

<sup>2</sup> The parties to Asia's 101st FTA, the Republic of Korea and the United States (US), have a total of 47 FTAs, 23 of which are in force. This FTA came just 2 weeks after the 100th FTA was ratified between Japan and Peru. Even Laos, a relatively poor landlocked nation of only six million people, is involved in 13 FTAs, 8 of which are currently in effect, despite having struggled for more than a decade to meet the requirements for accession to the World Trade Organization.

proposed the creation of a FTA with ASEAN. However, no clearly detailed aims of the agreement were given at that time. The proposal was obviously a rushed response to the ASEAN-China Free Trade Agreement (ACFTA) proposal put forth by Chinese PM Zhu Rongji in 2001.

In 2002, the two sides created a Japan-ASEAN Expert Group on Economic Partnership. This organization was tasked with studying the creation of the Japan and ASEAN FTA. The Group joined the ninth Consultation Summit Meeting in 2002 in Brunei in an effort to present its report. In fact, the positive report recommended that the two sides needed immediate and tangible action in order to create a framework for AJCEPA, which would contain components of a possible FTA. Remarkably, the Ministry of Foreign Affairs of Japan (MoFA) issued a report stressing the fact that ASEAN was one of the most influential FTA partners on the global scene.

Following this, in 2002 Japan and ASEAN issued a Joint Declaration on the Comprehensive Economic Cooperation Agreement (CECA) in which they agreed to implement measures for the subsequent inauguration of an AJCEPA within 10 years. In 2003, the two sides signed the Framework Agreement (FA) on AJCEPA. This agreement offered measures for immediate implementation of Technical Assistance (TA) for ASEAN, trade and investment, promotion and policy dialogues, and the exchange of customs tariffs and bilateral trade statistics. The time frame for the implementation of the AJCEPA FA was planned for completion in 2012. However, due to economic development gaps and the presence of sensitive sectors within each of the ASEAN member states, the FA was to be completed by 2017 between Japan and Cambodia, Laos, Myanmar and Vietnam (CLMV).

The official opening discussions on AJCEPA began in 2003 and the basic principles of cumulative Rules of Origin<sup>3</sup> and Customs Classification of AJCEPA were discussed in 2004. A year later, formal negotiations began and the two sides agreed on concluding negotiations within two years. However, it took almost five years and 11 rounds of talks before the two sides officially reached the conclusion of negotiations for AJCEPA in 2007. The agreement, which had a principal framework including trade in goods, trade in services, investment, and economic cooperation, was later signed by ASEAN and Japan. As part

<sup>3</sup> The Rules of Origin are used to determine the country of origin of a product for purposes of international trade. There are two common types of rules of origin depending upon application, the preferential and non-preferential rules of origin. The exact rules vary from nation to nation, from agreement to agreement.

of the built-in agenda of the AJCEPA's FA, the services and investment chapters were to be negotiated later. The negotiations for both chapters commenced two years later in 2009. However, as of the present moment there has not been much progress.

A comparison with ACFTA shows that Japan adopted a different approach. Under AJCEPA, there was no provision that liberalized "Trade in Services" between the two sides. The agreement basically pointed out that Japan and ASEAN would continue to hold discussions to discover measures toward further liberalization and facilitation of "Trade in Services". There was also no provision on "Trade in Investments". What was indicated in the agreement was that there would be a provision to continue negotiations on investments, specifically with a view to strengthening the efficiency and competitiveness of the investment environment of the two sides via a progressive liberalization policy.

### III. Japan's Techniques in the AJCEPA Negotiations

First, Japan sought to retake the lead from China after the end of the Cold War by utilizing five strategies. Having already signed a bilateral FTA with Singapore, in the negotiations for the creation of AJCEPA, Japan used a "Two-Track" strategy that was different from the Chinese strategy which adopted a FTA with ASEAN by choosing "negotiations with the group". Japan's strategy was WTO-plus bilateral FTAs with individual states of ASEAN-6 first. This provided the flexibility to include only countries that were ready to liberalize their trade and investment. This approach also allows the partners to design FTAs outfitted to specific circumstances. Later, Japan will squeeze these bilateral agreements into a single AJCEPA. After signing a bilateral FTA with Singapore, PM Koizumi declared the adoption of this Two-Track strategy. He then suggested an initiative for AJCEPA in 2003. Since 2004, Japan has hastened bilateral negotiations with ASEAN member states by starting formal negotiations individually (Yoshimatsu, 2012).

Second, Japan's two-track strategy can also be explained by its economic status under the WTO. As a developed country listed by the WTO, Japan has to abide by Article 24 of the GATT. This meant that Japan had to comply with the mutual removal of tariffs on 90% or more of all trade within a ten-year period (Munakata, 2006). Similarly, there were differences within the two bureaucracies (MoFA and METI) on how to pursue AJCEPA, which account for Japan's two-track strategy. While the MoFA strongly pushed bilateral FTAs

followed by a merging of these agreements into a single AJCEPA, the METI pushed for directly creating a single AJCEPA.

In order to overcome these issues and differences, Japan decided to emphasize a “Single-undertaking Negotiation” strategy for the liberalization of trade in goods, services, investments and economic cooperation, with all of these being encompassed by a single agreement. This strategy was new to ASEAN and resulted in slowing the growth of AJCEPA. In fact, the negotiations ceased about eight months later. Japan’s strategy related to AJCEPA contrasts with those pursued by other East Asian “super economic countries”, namely Korea and China, in their respective FTA talks with ASEAN. Korea and China pursued the ASEAN Free Trade Area (AFTA)<sup>4</sup> format encompassing a step-by-step strategy for negotiating liberalization on “trade in goods”, “trade in services”, followed by “trade in investments”.

Third, other obstacles slowed down the progress of the AJCEPA negotiation, including: the unwillingness of Japan to reduce and remove agricultural tariffs; an unwillingness by Japan to liberalize its labor market; and Japan’s demand that 1 percent of the total goods (over 500 items) imported from ASEAN be completely excepted from liberalization (Corning, 2009). In order to deal with this deadlock and in particular to compensate for the exclusion of agriculture in the AJCEPA negotiations, Japan adopted an “Economic and Technical Cooperation” strategy. Thus, Japan utilized economic and technical cooperation as bargaining power, effectively linking trade to aid and investment. Japan’s FTA partners have so far accepted the uneven terms [of an FTA with Japan] because of Tokyo’s strong bargaining power and the expectation that [such] agreements could lead to increased economic cooperation and investments from Japan (Terada, 2010). In this context, Japan seems to be committed to utilizing economic and technical cooperation as bargaining leverage. For example, this approach was demonstrated when Japan offered Thailand agricultural cooperation on food hygiene standards, bolstered cooperation with other agricultural cooperatives and allowed Thai nurses to work in Japan.

Fourth, with the creation of a “Comprehensive” FTA strategy, Japan created an Economic Partnership Agreement (EPA)<sup>5</sup>—not a conventional FTA—with

<sup>4</sup> The ASEAN Free Trade Area (AFTA) is a trade bloc agreement by the Association of Southeast Asian Nations supporting domestic manufacturing in all ASEAN member countries.

<sup>5</sup> Although Ministry of International Trade and Industry (MITI) officials recognize that there is little difference between an Economic Partnership Agreement and a Free Trade Agreement, Japan prefers to refer to its preferential trade agreement as EPAs rather than FTAs. One possible reason behind

ASEAN. Japan's EPA strategy was derived from a strong belief that EPAs are superior to conventional FTAs as they serve to promote the overall reform of economic structures by targeting broad areas from investment and intellectual property rules, competition policy and economic cooperation (Yoshimatsu, 2012). Importantly, Japan's EPAs differentiated between AJCEPA and ACFTA. Japan's strategy over an ASEAN FTA was in stark contrast to China's strategy for ASEAN (Yoshimatsu, 2012).

Finally, Japan was delayed in concluding a FTA with ASEAN because of its demands for protection for domestic agriculture products. To sustain its presence in the formation of a FTA with ASEAN and also to counter China's FTA initiative with ASEAN, Japan implemented a "Hamburger" strategy, which appeared in the Comprehensive Economic Partnership for East Asia (CEPEA)<sup>6</sup>. Japan pursued this strategy to forge virtual FTA networks in East Asia through a bilateral FTA with each of the ASEAN members and a broader ASEAN+6<sup>7</sup> FTA. Similar to a "Two-Track" Strategy, Japan would squeeze these bilateral agreements into a single CEPEA. CEPEA aimed to reduce the relative significance of a China-created ASEAN+3<sup>8</sup>. China will take the lead in +3 negotiations and so Japan should promote +6 negotiations ahead of the curve (Yoshimatsu, 2012).

#### IV. Why Japan's Commitments Deepened on AJCEPA

Prior to its proposal for the creation of a FTA between Japan and ASEAN, Japan was described as a passive participant. However, after China concluded the ACFTA in 2002 with ASEAN in order to compete against Japan-Singapore Economic Cooperation Agreement (JSEPA) between Japan and Singapore (Terada, 2010), Japan changed its role in the FTA race from a passive participant to an active participant. A year later, Japan concluded a FTA with the group of ASEAN, known as the AJCEPA, in order to have an equal position with

Japan's preference to EPAs is that the term is "less apt to provoke domestic political opposition" to trade liberalization (Yoshimatsu, 2008).

<sup>6</sup> The Comprehensive Economic Partnership for East Asia is a Japanese-led proposal for trade cooperation and free trade agreement among the 16 present member states of the East Asia Summit.

<sup>7</sup> ASEAN+6 refers to the 10 members of ASEAN plus Australia, China, India, Japan, the Republic of Korea, and New Zealand.

<sup>8</sup> ASEAN+3 refers to the 10 country members of ASEAN plus China, Japan, and the Republic of Korea.



China. Since then, Japan concluded additional FTAs with many other countries in the world such as India, Australia, Costa Rica, Korea, etc. The next section will shed light on the motivational factors that pushed Japan to propose the formation of the AJCEPA. The paper will first discuss the domestic factors.

### *1. Domestic Political Factors*

#### 1) Stimulus for Domestic Economic Recovery

The collapse of the Japanese post-war economic miracle, due to alterations in the domestic dynamics which were necessary for the Japanese economy to sustain growth, has brought about decline and stagnate. The first of the dynamics necessary for sustaining economic development that collapsed was local savings and investment. As noted by Foroohar (2009), local investment and savings had significantly declined. He also points out that wages had stagnated since the early 2000s, resulting in discouraging Japanese consumers from spending. As a result, domestic consumption became stagnant. Second, the collapse was partly due to the decreasing population in Japan and of youths in particular. Based on Yamaguchi (2011), the Japanese population dropped notably by 23% between 1980 and 2009. At the same time the number of elderly, those aged 65 years and older, was estimated to rise. Based on the Central Intelligence Agency (2011) Japan's fertility rate as of 2011 remains at 1.21, which is 219<sup>th</sup> among 223 assessed nations and entities. The harmful effect of the drop in the number of youth and the increase in the elderly population has not only lessened the size of the labor force in the country, but has decreased domestic consumption (Central Intelligence Agency, 2011). Foroohar (2009) forecasts that the ratio of working age citizens to seniors will drop severely from 8:1 in 1975 to 1:3 by 2055. This means that the Japanese labor force will drop by 8 million before 2020. As a result, this has put a heavy burden on young Japanese workers as far as social security and medical taxes are needed to care for the growing number of elderly people in the country (METI, 2010).

There were reductions in domestic consumption affecting profits for Japanese firms. In this context, Nanba (2007) demonstrated the fact that the declining population (as a whole), coupled with a growing elderly population in the society, has been a serious cause of reductions in the savings rate in Japan. Theoretically, savings are crucial for the economy. As the author is not an economist, this issue will be not examined in detail. Thus, Japan's three decades long "Economic Miracle" can no longer be sustained by domestic dynamics

alone. Hasegawa (2010) pointed out that now the foreign contribution to Japan's economic growth is higher than the domestic contribution. The foreign contribution has grown remarkably during the 21<sup>st</sup> century.

The Japanese government must take advantage of business, investment and consumption in markets abroad in order to sustain its economy. ASEAN member states are some of the most important economies and markets in the world. By fostering trade through FTA linkages in the Southeast Asian region, Japanese firms can utilize markets outside of Japan. In this context, the Prime Ministers of Japan have been strongly determined to help the Japanese business sectors seek profits via trade with the ASEAN market (Yamamoto, 2012). Many scholars pointed out that making profits abroad is needed for economic progress (Yamamoto, 2012). Itoh (2010) explained that it is fundamental for Japan to enrich East Asian markets (in particular ASEAN) for its own economic growth. Japanese firms must adapt to Asian markets through FTAs because these markets are quickly becoming the foundation of its economic growth.

As domestic dynamics are no longer solely supporting the Japanese Economic Miracle, in particular due to inactive consumption, Foroohar, who is a Professor at the Institute for international Policy Studies in Tokyo, announced:

“In fact, there is no viable model for rising domestic consumption. What the Japanese government needs to do in order to increase the domestic consumption is that the government needs to create a new model, which is very much based on more regional integration. Ideally, the integration will provide Japanese firms to open new and expanding Southeast Asian markets” (Foroohar, 2009).

## 2) Disunified Government Bureaucracies

In addition to revitalizing and strengthening its long stagnant economy and regaining competitiveness as pointed out earlier, Japan turned to FTAs as a policy option to promote structural reform (Yoshimatsu, 2008; Yamamoto, 2012). In principal, as a unified state, Japan employed FTAs in order to counter the international rise of China. Japan's trade processes of negotiating for domestic economic and political purposes are usually commenced by an inter-ministerial special team, established by representatives of four Ministries. They are the MoFA, the METI, the Ministry of Agriculture, Forestry, and Fisheries (MAFF) and the Ministry of Finance (MoF). In the case of the FTAs between ASEAN and Japan, inter-ministerial special teams were put together beginning in March

2003 and continue at present. However, inter-ministerial special teams “split”, and “sectionalism” exists among ministries, as each ministry tends to cling to its own model of Japan’s national interests. For example, the MAFF has been unenthusiastic about reducing tariffs on agricultural goods, whereas the METI has reduced tariffs on all goods in order to enlarge free trade with other states, in particular South East Asian states (Yamamoto, 2012). This process demands much more time to build FTA diplomacy compared to other countries, especially competitive countries, which assign one team or ministry within their government to introduce FTAs (Hatasa, 2011).

The above mentioned fact has been combined with a conflict of interests of Japan’s two most important and biggest interest groups - the Japanese Federation of Economic Organizations, called “Nippon Keidanren,” and the Japanese Central Union of Agricultural Cooperatives, called “Zenchu”. In addition, the self-interest of politicians from the dominant party in Japan, the Liberal Democratic Party (LDP), which have intimate connections to both of these special interest groups, have made it difficult for Japan to go to the trade negotiation table with a unified policy and strategy (Yoshimatsu, 2007; Yamamoto, 2012). As a result, the decision makers of Japan have to make policy based on the differing interests of these two influential groups. As already noted in Japan’s strategy of launching FTAs with ASEAN member states, Japan concluded a FTA first with Singapore and then with other members and the group of ASEAN. This is because Singapore, as a non-agricultural country, is not a threat to Japan’s agricultural groups.

Japan’s agricultural products, such as rice, beef, and etc., have been relatively expensive compared to those of other countries in the world and much more expensive than those of ASEAN member countries. That is why Japan has set tariffs on non-agricultural goods at 2.5% when negotiating FTAs with others. Its tariffs on agricultural goods are set at 12% to 21% in order for Japan to preserve its domestic agricultural sector (Hatasa, 2011). Agricultural liberalization is a weakness or a vulnerable point for Japan in its pursuit of AJCEPA. Based on Heng (2007), agriculture in Japan accounts for almost 15% of the combined GDP of the Philippines and Indonesia, and more than 45% of the combined GDP of Cambodia, Laos, and Myanmar (CLM). In spite of the fact that, based on the WTO estimates, the agricultural products account for only 1.2% of Japan’s GDP and 4.6 percent of its total employment<sup>9</sup>, the agricultural sector has had

<sup>9</sup>‘WTO Critique Of Japanese Agriculture’. Available at <<http://www.forbes.com/sites/stephenharner/2011/02/17/wto-critique-of-japanese-agriculture/>>. (accessed Jan. 20, 2013).

a substantial influence on the Japanese government with respect to Japan's trade policy.

In this context, MAFF agencies along with the Japanese Central Union of Agricultural Cooperatives and members of the ruling LDP have declared themselves as an "Agricultural Tribe" named "Norin Zoku"<sup>10</sup> and have designed the "Agricultural Policy Triangle" for Japan's trade policy. The policy has long been an obstacle to agricultural trade liberalization with the result that agricultural goods imported into Japan are given a tariff rate between 12% and 21% (Hatasa, 2011). In point of fact, the Japanese government has had no choice but to bow to domestic agricultural protectionist demands. As a result, Japan has been required to exclude "sensitive products," namely rice, beef, wheat, sugar, pork, and dairy products from the FTA between Japan and ASEAN (Urata, 2007; Hatasa, 2011).

In spite of the above barriers raised by the agricultural interest groups, in particular the agricultural tribe, both important ministries (METI and MoFA) who lead trade liberalization and structural reforms have resisted these domestic pressures in order to enable Japan to climb onto the FTA bandwagon. The METI produced an article to show the nature of this challenge in their White Paper in 2001. Based on the paper, they named the article as "Domestic Structural Reform Catalyst." The article mainly pointed out that "FTAs will be significant in setting the seal on early Japanese domestic structural reform" (METI, 2001). Similarly, MoFA produced a report in 2002 expressing a view along the same lines as the METI. The report acknowledged the fact that "Japan cannot secure the benefits of FTAs without getting some difficulty as a result of the full opening of its markets" and that unless Japan links "FTAs to economic reforms, it will not succeed in making FTAs a means of advancing the global competitiveness of Japan as a whole". MoFA proclaimed that ASEAN is one of the "most likely" FTA partners for Japan (MoFA, 2002).

Japan's business interest groups are led by four key interest groups—the Federation of Economic Organizations named "Nippon Keidanren", the Japanese Chamber of Commerce and Industry, the Japanese Association of Corporate Executives named "Keizai Doyukai", and the Japan Foreign Trade Council, Inc.

<sup>10</sup> The Liberal Democratic Party (LDP) has ruled Japan since 1955 except between 1993 and 1994 and more recently following its defeat in the general election held in August 30, 2009. Norin-zoku (agricultural tribe) refers to influential members of the LDP who depend on the farm electorate for votes, monetary contributions and other forms of political support, and in return have long vetoed any reforms in the agricultural sector.

In order to challenge and contest domestic agricultural protectionist groups, the business interest groups systematized an intensive program with a “policy statement” published in December 2005. The policy statement outlined the necessity for a conclusion the AJCEPA to not be left in a gradually unfavorable position compared with rivals such as Korea and China in the Southeast Asian region (Corning, 2009). By emphasizing the essential role of FTAs as positive mechanisms to promote domestic structural reforms, the revitalization of the Japanese economy and its long-term competitiveness with China and South Korea in particular, Japanese leaders have dynamically pushed for the conclusion of AJCEPA. This is particularly true for PM Koizumi who declared that he would not to budge “an inch from [his] posture of ceaselessly carrying out structural reforms without sanctuaries.”<sup>11</sup>

## *2. Regional Political Factors*

### 1) Maintaining its Influence and Leadership Role in Southeast Asia

Historical issues between Japan and China, and in particular the recent disputes between Japan and China over the Senkakus islands, have demonstrated that a strong division exists between the two countries. In this context, many scholars have adopted a state-centric or neorealist approach to explain Japan-China relations. For example, based on neorealist Kenneth Waltz, “as unit actors in the anarchic world principally believe their survival and seek power capabilities, Japan and China are single-mindedly pursuing power in order to achieve a stronger influence over others in East Asia and specifically the world at large” (Yang, 2007). Distinctively, Japan and China are economically powerful countries in East Asia. Both countries use FTAs and many other economic programs or projects as non-military or “soft” power in exerting their influence over East Asian nations as well as the international community. Yoshimatsu (2008) pointed out that Japan is largely motivated to “balance China’s influence” by supporting and promoting FTAs with ASEAN member countries. The realist logic of Japan’s rivalry with China over a regional leadership through FTAs will be discussed below.

Japan and ASEAN relations started in late 1970s. On the other hand, the relationship between China and ASEAN began mostly after the end of the Cold

<sup>11</sup> ‘General Policy Speech by Prime Minister Junichiro Koizumi to the 155th Session of the Diet’ <[http://www.kantei.go.jp/foreign/koizumispeech/2002/10/18sisei\\_e.html](http://www.kantei.go.jp/foreign/koizumispeech/2002/10/18sisei_e.html)> (accessed Dec. 01, 2013).

War. Also, Japan's efforts toward FTAs predates China's FTA initiative by at least three years. Despite this, by strengthening its relationship with ASEAN through a FTA, China has taken the lead over Japan in free trade with ASEAN. In fact, before China sought the creation of FTAs with the group, Japan had been adamantly unenthusiastic and unwilling to form a FTA with them. Based on Oba (2001), Japan turned down ASEAN's suggestion for a joint-study on a possible AJCEPA in October 2000.

However, any initiative taken by either Japan or China is habitually met by responses from the other, as the two countries compete for influence and leadership in the region (Terada, 2010). As a consequence, according to this rationale, China's FTA initiative towards ASEAN has left Japan "faced with an urgent necessity to enrich its traditional, good-old relations with the group geo-politically and geo-strategically, as well as to expand economic interdependence economically with each other" (Terada, 2006). As a METI former senior official clearly stated, "the prospect of an ACFTA shocked and surprised Japan, as Japan was anxious about China that the country would utilize its FTA with the group to expel Japan from the East Asian political, strategic, and economic spheres." (Terada, 2009).

Many scholars hold that the Japan-China contest in launching FTAs was not only to oppose the trade distortion and discrimination which a FTA without themselves would establish, but also to race for an influential leadership role in the region (Rathus, 2010; Terada, 2010; Lai, 2008 and Yamamoto, 2012). Japan was shocked and surprised by the Chinese government's proposal for the creation of the ACFTA and was anxious about China's increasing influence in Southeast Asia, fearing that it would replace Japan's long-term traditional economic, strategic, and political leadership position and role in the region. The Japanese government immediately reacted with its own request for the creation of the AJCEPA in January 2002.

The timing reveals that rather than a sign of the Japanese government having a strong and honest interest in creating a FTA with the group of ASEAN, it was more an act of frustration reacting to the Chinese government's FTA proposal with the group. Thus in this context, many scholars acknowledge the fact that Japan not only interprets the AJCEPA as a tool to bolster its economic strategy, and political linkages with the ten ASEAN member states, but also views it as a method to counterbalance China's rising influence in Southeast Asia (Yoshimatsu, 2007).

As for China, the country has embarked on projects for assisting the huge

economic developmental gap that exists between ASEAN-6 and ASEAN-4. One of the important projects in addressing this gap is the China-Mekong Sub-regional Development project subsumed under the Asia Development Bank (ADB)'s Greater Mekong Sub-region (GMS) project. The first China-Mekong Summit was launched in 2002 in Phnom Penh. In order to compete with this important project, Japan made linkages with ASEAN its top priority and also started to address the huge economic development gap between the two sides. As a result, five years later, Japan proposed the Japan-Mekong Sub-regional Development project which was also under the ADB's GMS umbrella, and launched its first Japan-Mekong summit meeting in 2009. This competition was described by Masaki (2007) as a Japan-China "tug-of-war" for influence in Southeast Asia and it "opened a new front in the Mekong River basin, and moves [by both] Japan and China to support the improvement of the Mekong sub-regional countries have intensified in recent years".

Japan has been an important Official Development Assistance (ODA) donor, especially with respect to loans to Mekong countries compared to China (see Table 1). Despite this, China's recent and latest economic development initiatives towards the GMS countries began to intensely weaken Japan's influence not only in the Mekong sub-region, but also in the entire region. On top of that, the Japanese government is also worried about the close relations between Chinese and Myanmar military rulers which could permit Chinese access to advantageous shipping lanes in the Indian Ocean and most seriously to "a squeeze position within ASEAN" (Green, 2003). As a result, Japan would have less influence on the entire region. Accordingly, Japan has to increase its own initiatives (including ODA) towards the Mekong countries and has to court Myanmar in order to remain a prominent player and to reduce China's growing influence in the Mekong sub-region. It is equally vital to note that China's growing influence in the sub-region will spread to the whole Southeast Asian region.

For Japan's increasing competitiveness and initiatives against China, Japan has commenced two important flagship projects under the GMS program. The two flagship projects are: "East-West Economic Corridor (EWEC)" and "Second East-West Corridor (2<sup>nd</sup> EWC)." EWEC is a project that connects Vietnam, Laos, Thailand, and Myanmar, and the 2<sup>nd</sup> EWC is the enlargement of a transport roadway from Vietnam to Thailand through Cambodia, which is also classified as a major route in the Asian Highway network. In fact, these two flagship projects stemmed from the Japanese government's geopolitical rivalry and aimed

Table 1. Japanese and Chinese ODA in CLMV from 2001-2010

CLMV	Japanese ODA			Chinese ODA		
	2001	2006	2010	2001	2006	2010
Cambodia	120.21	106.25	147.46	No data	No data	No data
Laos	75.47	64.05	121.45	93.7 (Year-2000)	No data	No data
Myanmar	69.86	30.84	46.83	186.7 (Year-2000)	289.8 (Year-2005)	No data
Vietnam	459.53	562.73	807.81	87.5 (Year-2000)	289.8 (Year-2005)	No data

Source: compiled from various sources by the author.

Figures of Japan's ODA to CLMV (2006, 2010) in million US\$, compiled from Japan' MoFA Online data (2011).

Figures of Japan's ODA to CLMV (2001) in million US\$, compiled from Japan's ODA, White Paper 2002, Ministry of Foreign Affairs.

Figures from Chinese ODA to Cambodia are not available; for others, figures are for 2000 and 2005. Compiled from Kobayshi (2008).

at countering the influence of the Chinese government which significantly supports the development of transport infrastructure in the Mekong sub-region. The geopolitical nature of the rivalry was evident in the GMS's flagship projects created by the Chinese government that focused on "vertical transport corridors". These are the North-South Economic Corridor (NSEC) linking Kunming in China, and Bangkok in Thailand, and the second North-South Economic Corridor (2<sup>nd</sup> NSEC) connecting Kunming and Haiphong in Vietnam (Sonya, 2010).

Following their intention to have a leadership role in decreasing the economic development gap, Japan has provided approximately 4 million dollars to 24 projects related to Human Resources Development (HRD). Also, Japan provided \$1.5 billion dollars between 2003-2006, under the Japan-ASEAN Plan of Action, to numerous improvement projects in the Mekong sub-region. Likewise, Japan promised to increase its ODA to each of the ASEAN 4 countries (CLMV) and to all of the ASEAN member states until the end of 2009, under the Japan-Mekong Sub-region Partnership Program approved in early 2004. To further foster the Japan-ASEAN economic partnership, Japan offered 52 million dollars to the ASEAN Secretariat, of which 40 million dollars were allocated to the ASEAN-4. Twenty million dollars of this amount were assigned to be used in the Cambodia, Laos, and Vietnam (CLV) Development Triangle project (Sudo, 2009). By the same token, Japan offered a 330 million Yen grant-type aid to



Cambodia in order to reduce poverty and also another 1.39 billion Yen to advance health and hospital facilities in late 2008. A year later, Japan granted a 1.5 billion Yen loan and a 54.9 billion Yen ODA loan to Laos and Vietnam, respectively, to assist social and economic development programs intended at lessening poverty in these two underprivileged nations (MoFA, 2009).

Japan's recent initiatives towards the ASEAN-4 also included bilateral investment agreements between Laos and Cambodia. The Japan-Mekong Region Ministerial Meeting, created in 2008, and the Japan-Mekong Summit Meeting created in 2009, offered information technology support and other means of assistance to the Ministries of Foreign Affairs of the ASEAN-4 (Sudo, 2002). As a follow-up to those projects, particularly the Japan-Mekong Region Ministerial Meeting and the Japan-Mekong Summit Meeting, the Japanese government and Mekong countries have held the Mekong-Japan Foreign Ministers' Summit Meeting which has occurred annually since 2008 and the Mekong-Japan Summit Meeting which has been held annually from 2009<sup>12</sup>. At the 4<sup>th</sup> Japan-Mekong Summit Meeting held in April of 2012, the Japanese government and the leaders of the Mekong countries agreed to adopt the "Tokyo Strategy 2012" in order to put forward a new vision for Japan-Mekong collaboration until the end of 2015. Based on Japan's ODA White Paper (2012), the aims of this new vision are "Enhancing Mekong Connectivity" (Support for Intra-Connectivity), "Developing Together" (Facilitation of Investment and Trade), and "Ensuring Human Security and Environmental Sustainability" (Support for Disaster Risk Reduction, Maternal and Child Health, etc.<sup>13</sup>).

In order to achieve these aims, Japan pledged about 600 billion Yen in ODA for a three-year period after fiscal year 2013 and showed a list of 57 flagship infrastructure projects for each CLMV country such as: a) the upgrading of National Road No. 9 under the East-West Economic Corridor of the Mekong Sub-region Project; b) the Southern Region Power Systems Development Project in Laos; c) the Project for constructing the Neak Loeung Bridge in Cambodia (South Economic Corridor of the Mekong Sub-region); d) a Project for developing the Thilawa Special Economic Zone (SEZ) in Myanmar. Japan's ODA White Paper (2012) pointed out that the total cost of these projects was estimated at approximately 2.3 trillion Yen<sup>14</sup>.

<sup>12</sup> 'Mekong-Japan Foreign Ministers' Meeting'. Available at <<http://www.mofa.go.jp/region/asia-paci/mekong/index.html>> (accessed Jan. 18, 2013).

<sup>13</sup> 'ODA by Region East Asia'. Available at <[http://www.mofa.go.jp/policy/oda/white/2012/pdfs/0102\\_4.pdf](http://www.mofa.go.jp/policy/oda/white/2012/pdfs/0102_4.pdf)> (accessed Feb. 21, 2013).

As for building a relationship with Myanmar, Japan could not improve its relationship between itself and the said country because of international economic sanctions. The Myanmar military government, which controlled the country for decades, amended its political system by establishing democratic procedures. Myanmar's current President has improved its democratic credentials by offering greater press freedom and releasing many political prisoners. Since then Japan has pursued closer ties with the country as demonstrated by its declaration that it would forgive 3.7 billion US Dollars of Myanmar's debt and resume aid as a way of supporting democratic and economic reforms<sup>15</sup>. To follow up, Japanese Prime Minister Abe visited Myanmar on May 27, 2013. He brought investors seeking business opportunities there and offered 91 billion Yen for financial cooperation<sup>16</sup>. On December 15, 2013, during the Japan-Myanmar Summit Meeting between PM Abe and Myanmar President Thein Sein (under the ASEAN-Japan Commemorative Summit Meeting), PM Abe reiterated the intention of Japan to continue to work with its partner towards opening the Thilawa SEZ in 2015. PM Abe offered a total of 63.2 billion Yen in ODA loans for 4-projects focused on improvement of railways, water supply, and irrigation<sup>17</sup>.

## 2) Secure Southeast Asian International Shipping Lanes

Japan is an island country located in the East Asia region with extremely few natural resources, and is deeply dependent on shipping lanes for imports of natural resources, feedstock, raw materials, and trade (in particular exports). Based on Table 2, seaborne trade from/to Japan accounted for 99.7% and 99.9% of their total trade from 1985 and 2011, respectively. Based on Chart 1, the volume of seaborne trade from/to Japan by region shows that Asia has a high volume of seaborne trade from/to Japan, which accounted for 31% of the total as compared with other parts of the world. In this context, Southeast Asian

<sup>14</sup> 'ODA by Region East Asia'. Available at <[http://www.mofa.go.jp/policy/oda/white/2012/pdfs/0102\\_4.pdf](http://www.mofa.go.jp/policy/oda/white/2012/pdfs/0102_4.pdf)> (accessed Feb. 27, 2013).

<sup>15</sup> 'Japan Pledges \$7.4 Billion in Aid to Mekong Region'. Available at <<http://www.voanews.com/content/japan-pledges-74-billion-in-aid-to-mekong-region-148373895/180890.html>> (accessed Dec. 15, 2013).

<sup>16</sup> 'Visit to Myanmar by Prime Minister Abe'. Available at <[http://www.mofa.go.jp/region/page3e\\_000061.html](http://www.mofa.go.jp/region/page3e_000061.html)> (accessed Jun. 23, 2014).

<sup>17</sup> 'Visit to Myanmar by Prime Minister Abe'. Available at <[http://www.mofa.go.jp/region/page3e\\_000061.html](http://www.mofa.go.jp/region/page3e_000061.html)> (accessed Jun. 20, 2014).

region is geo-strategically significant to Japan not only for feedstock resources, natural resources, and markets, but also for their geographical position along shipping lanes, given that seaborne trade is the lifeblood of the Japanese economy. For example, sixty percent of Japan's Liquefied Natural Gas and more than 98% of its crude oil have been imported through Southeast Asian International Waters (SAIW), predominantly the Straits of Malacca including the territorial waters of Indonesia, Malaysia, Singapore, and Thailand, as well as the South China Sea (Umaña, 2012).

The SAIW (especially the Straits of Malacca and Lombok in Indonesian water) are under relentless and severe threat of piracy attacks. For example, "piracy doubled during the 1990s, to 200 attacks per year as of 1999, with the bulk taking place in Asian waters"<sup>18</sup>. This means almost 3/4 of global piracy attacks took place in Asia. Based on Valencia (2005), Southeast Asian waters accounted for more than 40% of the world piracy attacks in 2003. The total of piracy attacks in the Malacca Straits in 2003 was 121 making it the world's most piracy prone zone (Valencia, 2005). A year later, in Lombok, the largest number of piracy attacks occurred accounting for 93 of a global total of 329. By the same token, there were 96 vessels linked to Japan that were attacked by pirates between 1999 and 2004. Many scholars hold that those attacks are enormous headaches to Japan, because it costs Japan between 10 and 15 million dollars per year and poses a threat to its energy security and economic lifeblood (Chaikin, 2005; Percival, 2006).

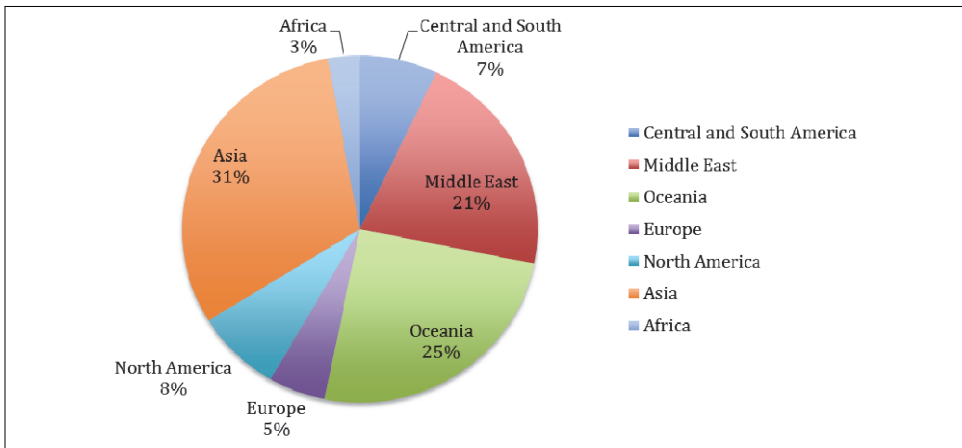
Table 2. Seaborne Trade from/to Japan

Year	Export		Import		Total	
	Volume	By sea (%)	Volume	By sea (%)	Volume	By sea (%)
1985	94	94 (99.5)	604	603 (99.9)	698	697 (99.9)
1990	85	84 (99.1)	712	712 (99.9)	798	796 (99.8)
1995	117	116 (99.3)	772	771 (99.8)	889	886 (99.8)
2000	131	130 (99.0)	808	807 (99.8)	940	937 (99.7)
2005	136	134 (98.8)	817	816 (99.8)	953	950 (99.6)
2009	145	144 (99.2)	690	689 (99.8)	835	835 (99.7)
2010	158	156 (99.0)	761	759 (99.7)	919	915 (99.6)
2011	151	150 (99.1)	7534	753 (99.8)	906	903 (99.7)

Source: The Japanese Ship-owners' Association (Key figures of Japanese Shipping 2013-2014. p1). Available at <<http://www.jpmac.or.jp/img/relation/pdf/epdf-p01-p05.pdf>> (accessed Jan. 09, 2014).

<sup>18</sup> The Economist, 2000.

Chart 1. Volume of Seaborne Trade From/To Japan by Region (2012)



Source: Ministry of Land, Infrastructure, Transport and Tourism (Key figures of Japanese Shipping 2013-2014. P5). Available at <<http://www.jpma.or.jp/img/relation/pdf/epdf-p01-p05.pdf>> (accessed Jan. 09, 2014).

The South China Sea dispute between some ASEAN member states and China threatens Japan's energy security and economy. Akimoto's (2001) paper pointed out the fact that the South China Sea or the Malacca's Straits water is prone to piracy, terrorist attacks, and military clashes. Japan has to pay an extra cost of approximately \$300 thousand per tanker and incur losses of approximately \$300 million when petroleum tankers cross from the Middle East water to Japan through other routes apart from the South China Sea or Malacca Straits. Additionally, based on the Japanese government-owned Japan Oil, Gas and Metals National Corporation (JOGMEC, 2006), Japan's emergency stockpiles of crude oil and oil products stored in Japanese public and private facilities will run out within 168 days following a disruption of its oil imports<sup>19</sup>. In this sense, if there is any trouble at checkpoints, it could endanger Japanese economy. Undoubtedly, in this context, Japan has taken a dynamic role in the Southeast Asian region, especially Southeast Asian international waters. Japan has one of the most sophisticated military forces on the earth; yet, the country cannot really guarantee prevention of the above-mentioned threats. This is mainly because of its constitutional law, as Chapter II Renunciation of War in its Constitution, which was promulgated on November 3, 1946, states:

<sup>19</sup> 'Overview of Petroleum and LPG Stockpiling'. Available at <[http://www.jogmec.go.jp/english/stockpiling/stockpiling\\_003.html?recommend=1:>](http://www.jogmec.go.jp/english/stockpiling/stockpiling_003.html?recommend=1:>) (accessed Feb. 15, 2014).

Article 9. Aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as means of settling international disputes<sup>20</sup>.

In order to accomplish the aim of the preceding paragraph, land, sea, and air forces, as well as other war potential, will never be maintained. The right of belligerency of the state will not be recognized”, (The Constitution of Japan, came into effect on May 3, 1947)<sup>21</sup>.

Apart from its constitutional constraints, the international community will put pressure on Japan if it unilaterally deploys its military forces beyond its territorial waters. Additionally, pertaining to the four nations—Thailand, Indonesia, Malaysia, and Singapore – along with their jurisdiction over the Malacca Straits, only Singapore is in some way receptive about the presence of foreign military personnel in the Malacca Straits to fight piracy (Storey, 2008). As a result, it is hard for Japan to send its Maritime Self-Defense Force to the Malacca Straits and to the other international waters beyond its territory in order to fight piracy and terrorism.

In order to overcome political restraints of domestic legislation, international communities, and affiliates of Malacca Straits, Japan has had to adopt a new approach in order to fight against piracy and terrorism. Japan has addressed the predicament by designating sea-lane security concern “as a matter of civilian law enforcement and assigned this role to its Coast Guard<sup>22</sup> rather than to the constitutionally-constrained Maritime Self-Defense Force” (Christoffersen, 2009). In doing so, Japan commenced a series of joint training exercises bilaterally between its Coast Guard and maritime self-defense forces of Indonesia, Vietnam, Singapore, Malaysia, and Thailand. In late 2001, at the ASEAN Summit Meeting, PM Koizumi urged the creation of an intergovernmental working group to conduct special research on the construction of a multilateral agreement on regional cooperation

<sup>20</sup>‘The Constitution of Japan’, Available at <[http://www.kantei.go.jp/foreign/constitution\\_and\\_government\\_of\\_japan/constitution\\_e.html](http://www.kantei.go.jp/foreign/constitution_and_government_of_japan/constitution_e.html)> (accessed Jan. 09, 2014).

<sup>21</sup>‘The Constitution of Japan’, Available at <[http://www.kantei.go.jp/foreign/constitution\\_and\\_government\\_of\\_japan/constitution\\_e.html](http://www.kantei.go.jp/foreign/constitution_and_government_of_japan/constitution_e.html)> (accessed Jan. 10, 2014).

<sup>22</sup> Unlike other countries namely the U.S and India where the Coast Guard is a branch of the military, in Japan, the Coast Guard is a civilian force under the jurisdiction of the Ministry of Land, Infrastructure, Transport and Tourism.

for addressing armed robbery and anti-piracy measures. Correspondingly, the Regional Cooperation Agreement on Combating Piracy and Armed Robbery against Ships (RECAAP or ReCAAP) in Asia was drafted in November 2004. The multilateral agreement under the RECAAP was supported by 16 countries in Asia and has currently 19 signatories including China, Australia, South Korea, and India (Panda, 2013). The agreement also included the RECAAP Information Sharing Center set up in Singapore which came into effect in September 2006. RECAAP Information Sharing Center is an initiative for facilitating the dissemination of piracy and armed robbery-related information, supporting capacity-building efforts of contracting parties, and establishing cooperative arrangements<sup>23</sup>.

### *3. International Political Factors*

#### *1) Reinforcing its Position in the East Asian Region*

Apart from facilitating the trade operations of Japanese multinational corporations running throughout Southeast Asia and counterbalancing the Chinese government's increasing influence in region, Yoshimatsu (2007) acknowledged the fact that geostrategic and geopolitical motivations also influenced the Japanese government's decision to form an AJCEPA. From the post WWII period until the new millennium, Japan considered itself a separate country from the rest of Asia and engaged with Southeast Asian states by means of a network of bilateral relations rather than with the group as a whole. On top of that, given the legacy of its Greater East Asian Co-Prosperty Sphere proposal, Munakata (2006) argues that Japan avoided taking any initiative in inventing regional frameworks and had become a regime taker.

Starting from early 2000s, Japan changed its stance and turned to support the FTA movement, and the AJCEPA in particular. Japan's aim was not only to display initiative in regional affairs and to have a voice in the region's economic development and socio-political stability, but also to reinforce and reintroduce its own political clout in East Asia and the world at large (Urata, 2007). In fact, the key dynamic that drove Japan to support the AJCEPA movement was the realization of the potential negative scenarios emanating from first "China growing, Japan decaying", second the establishment of an East Asian economic block without Japan, and third the prospect of "Japan Passing". The two formers points were already explained. The last point is based on the Asian

<sup>23</sup> 'Welcome to ReCAAP ISC'. Available at <<http://www.recaap.org/>> (accessed Jan. 15, 2014).

Times, using the term “Japan Passing” to reflect anxieties that the country was being passed by in a fast-changing world, and that the country could no longer be taken seriously. The notion of “Japan Passing” was symbolized by former President Bill Clinton’s nine-day trip to China in 1998, a visit to East Asia, during which he did not come to Japan<sup>24</sup>.

As Urata (2007) noted, Japan exploits FTAs specifically to bolster its foothold in international and regional affairs. Additionally, as Japan takes political and diplomatic issues into consideration, the country has chosen the Southeast Asian region as the most likely FTA partner. As a result, it can be argued that an AJCEPA would empower Japan to influence all ASEAN member states. Heng (2007) stated that the AJCEPA would give the country a geostrategic and geopolitical foothold in Asia as well as strengthen positive views of a Japanese constructive commitment in the region.

During PM Koizumi’s visit to the Philippines, Malaysia, Thailand, Indonesia, and Singapore in January 2002, he delivered an interesting speech regarding the policy he initiated. The speech was entitled “Japan and ASEAN in East Asia: A Sincere and Open Partnership,” and it outlined Japan’s strategy for East Asian countries as follows: “Our goal should be the establishment of a regional community that acts together and advances together”<sup>25</sup>. Apart from his speech, he called for expansion of the AJCEPA into an “Expanded East Asian Community” or a “CEPEA”, bringing together all the ASEAN member states as well as Japan, Korea, China, India, Australia, and New Zealand (Urata, 2009). Most of PM Koizumi’s successors have followed the aforementioned policy.

## 2) Trade Facilitation<sup>26</sup> and Third Market

Trade is not just about cheap labor and natural resources. The region of 600 million people also provides a rising source of demand for Japanese cars,

<sup>24</sup> *Asia Times Online*, 26 November, 2008. Available at <<http://www.atimes.com/atimes/Japan/JK26Dh01.html>> (accessed Dec. 21, 2013).

<sup>25</sup> ‘Speech by Prime Minister of Japan Junichiro Koizumi, “Japan and ASEAN in East Asia: A Sincere and Open Partnership (January 14, 2002)’. Available at <<http://www.mofa.go.jp/region/asia-paci/pmv0201/speech.html>> (accessed Jan. 17, 2014).

<sup>26</sup> Trade facilitation is a concept directed towards reducing the complexity and cost of the trade transaction process and ensuring that all these activities take place in an efficient, transparent and predictable manner. Trade facilitation comprises the whole trade chain from exporter to importer, including transportation and payment, with emphasis on the border-crossing and the agencies involved there.

electronics and services as robust growth expands the middle class. In this context, ASEAN has been one of the key destinations for Foreign Direct Investment (FDI)<sup>27</sup> from Japan (Table 3). With the export-oriented industrialization strategy of ASEAN, Thorbeke and Salike (2011) pointed out that the extremely high-cost of wages in Japan and the reinforcement of the Japanese currency (Yen) encourage investment in ASEAN countries. In order to continue to be globally competitive, many Japanese industrialists and manufacturers relocated their production bases to the Southeast Asian region. From 2002 to the first quarter of 2010, Japan's FDI into ASEAN, China, H.K (China), and India were 3662, 3580, 883, and 1196 billion Yen, respectively (Table 3). As a result, from 2005 to the first quarter of 2010, the ASEAN countries were the recipients of more of Japanese FDI than other key East Asian economies. Based on the Direct Investment Data from the Bank of Japan, Japan's FDI to ASEAN was less than FDI to the U.S, the E.U, and South America at the end of 2011 (Chart 2).

Numerous Japanese companies have moved their labor-intensive production

Table 3. Japan's FDI into the East Asian Major Countries (billion yen) from 2002-2010

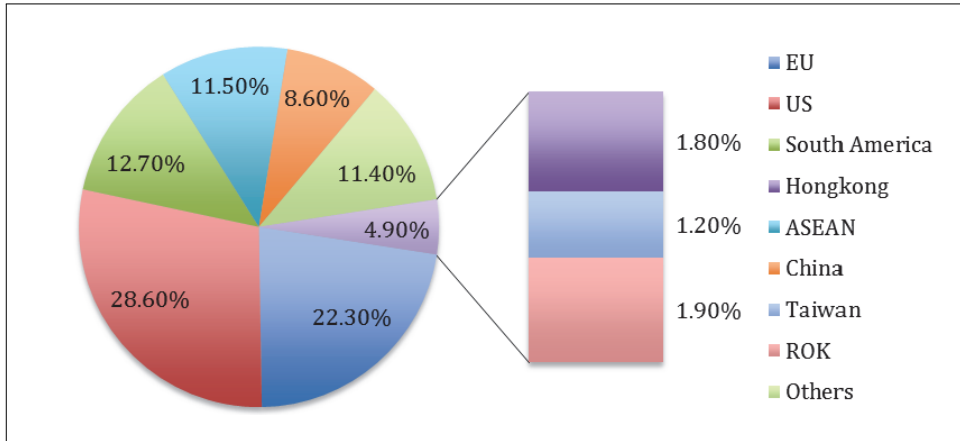
Countries & Organization		2005	2006	2007	2008	2009	2010/Q1	Total:
ASEAN	Manufacturing	432	755	563	400	385	31	3662
	Non-Manufacturing	126	54	354	252	273	36	
	Sub-Total	558	809	917	652	659	67	
China	Manufacturing	563	567	493	502	462	62	3580
	Non-manufacturing	163	150	238	168	188	25	
	Sub-Total	726	717	731	670	649	87	
HK, China	Manufacturing	75	85	41	65	25	17	883
	Non-manufacturing	122	90	92	69	127	10	
	Sub-Total	196	176	133	134	152	27	
India	Manufacturing	39	47	141	512	73	19	1196
	Non-Manufacturing	-9	12	38	31	271	22	
	Sub-Total	30	60	178	543	344	41	

Source: The Bank of Japan, Direct Investment Data and made by author.

<sup>27</sup> Foreign direct investment is direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or by expanding operations of an existing business in that country.



Chart 2. Japan's Foreign Direct Investment: Regional Breakdown  
(end of 2011:JPY 74828 billion)



Source: the Bank of Japan, Direct Investment Data.

to the Southeast Asian region. Japanese medium and advanced high-tech, and high value-added components, specifically high-tech automobile parts and Liquid Crystal Displays for flat panel televisions, are still being manufactured in Japan. As a result, once finished products containing components imported from Japan are exported from any member of ASEAN to a third country within the region<sup>28</sup>, they are subject to high-tariffs. Hiratsuka et al. (2009) pointed out that these products are subject to high-tariffs because many components are not meeting the requirements of the Rules of Origin under the AFTA which requires that local contents must comprise at least 40 percent of the product. For example, once a Japanese Liquid Crystal Display television manufacturer assembled television sets in an ASEAN associated country by using high value added components imported from the Japanese territory and exports the finished good to a third state within Southeast Asia, these exports had been imposed tariffs of up to 40%.

These high tariffs levied on Japanese Liquid Crystal Display television manufacturers not only add to their transaction costs, but also made it difficult

<sup>28</sup> Initially, most Japanese companies moving to Southeast Asia used the region as a base for finishing and exporting their products back to Japan and to third markets outside the region. However, as the purchasing power in ASEAN member states began to increase, Japanese firms started to show interest in supplying ASEAN domestic markets as well.

to compete with their Korean counterparts. Korea proposed ASEAN-Korea Free Trade Agreement (AKFTA) a year later than Japan and concluded its FTA with ASEAN years ahead of Japan, for it did not have the same issues as Japan had concerning the agricultural protectionism. As a consequence, Korea does not confront such trade obstacles because they are covered and protected under the umbrella of the AKFTA which grants preferential tariffs to Korean Liquid Crystal Display television exports to any of the ASEAN member countries. As for using Thailand as a production base, Japanese companies were outmaneuvered by the U.S. This was because of the U.S-Thailand Treaty of Commerce and Navigation that allowed U.S firms a favorable investment environment.

In order to eliminate taxes and to equalize the playing field for Japanese firms in Southeast Asia, Japan launched the creation of an EPA with the group of ASEAN providing that “the Japan-ASEAN Cumulative Rules of Origin would authorize firms situated in the Japan-ASEAN territory to do trade with “ZERO” tariffs”. The Japan-ASEAN Cumulative Rules of Origin under the AJCEPA allowed Japan trade rules equal to the AKFTA and U.S-Thailand Treaty of Commerce and Navigation, and other free trade agreements created with ASEAN. As a consequence, based on Morihiro (2008), under the AJCEPA “tariffs on flat panel televisions were abolished in seven of the ASEAN member states”. He further added that this would advance Japanese firms’ business in flat panel televisions within the entire region.

Japanese appliance industrialists, Panasonic and Sony firms in particular, were able to import machinery for Liquid Crystal Display Televisions from their country and assemble them in their respective factories located in Thailand. As a consequence of the benefit from the AJCEPA, those finished products are free of tariffs. Similarly, apart from this kind of business, Japanese firms producing as auto parts, automobiles, textiles, and garments also benefit from the agreement (Corning, 2009). The research concerning auto parts and automobiles is by Prasirtsuk and Suzuki (2004) and Hiratsuka et al. (2009). The agreement authorized Toyota Motors Company to produce gasoline engine blocks, power steering gears, transmission parts, and diesel engine parts and auto body stamping in Indonesia, Malaysia, the Philippines, and Thailand, respectively, to assemble in Vietnam, and then to export the final products to the ASEAN member countries without any trade barrier.

It is equally important to note that, apart from trade facilitation, Japan’s FTA proposal to ASEAN was also “for the purposes of safeguarding its approach to third markets outside the Southeast Asian region” (Corning 2009). Japanese

firms, under the AJCEPA, with production networks in ASEAN, can export their products to U.S and E.U markets with no tariffs (Cheewatrakoolpong et al., 2013).

## V. The Influences of the Japanese Rivalry with China on the Region

### *1. Rivalry Policies and Strategies*

So far, the author has found that there are many Japanese competitive policies and strategies aimed to counter China's initiative for a FTA with ASEAN. Before the Chinese government proposed a FTA to ASEAN, the Japanese government had been unenthusiastic and unwilling to form a FTA with the group. Indeed, the Japanese government turned down ASEAN's suggestion for a joint study on a possible AJCEPA in October 2000. But, as soon as China became a member of the WTO in November 2001, the country proposed a FTA with ASEAN. China then sped up its FTA's discussion with the group of ASEAN and the two sides successfully concluded the FTA in 2002.

In order to compete with China, and to prevent China from taking the lead over Japan in terms of influence and leadership in the region, Japan adopted a Two-Track Strategy and then signed the JSEPA in Singapore in January 2002. Immediately after signing the JSEPA, Tokyo proposed an economic partnership, "AJCEPA", which equals the ACFTA. There were no specific policies and/or agenda that were given when PM Koizumi proposed AJCEPA and, at that time, the proposal was seen as a rushed response to the ACFTA proposal which was announced by Chinese Premier Zhu Rongji in November 2001. In September 2002, at a meeting of economy ministers, an ASEAN-Japan Closer Economic Partnership Expert Group was founded, and it submitted a report recommending urgent steps to recognize a framework for the AJCEPA, including fundamentals of a potential FTA.

Japan made use of its joint statement on combating international terrorism in 2004 and in 2005 PM Koizumi pledged 100 million dollars towards the prevention of infectious diseases in Southeast Asia<sup>29</sup>. In this way, Japan would not fall too far behind China in terms of China-ASEAN security relations. Japan's EPA strategy emanated from the belief that EPAs are superior to

<sup>29</sup> The Treaty of Amity and Cooperation in Southeast Asia is a peace treaty among Southeast Asian countries, established by the founding members of the Association of Southeast Asian Nations (ASEAN), a geo-political and economic organization of 10 countries located in Southeast Asia.

conventional FTAs, as they would serve to promote the overall reform of economic structures by targeting broad areas of investment and intellectual property rules, competition policy, and economic cooperation. Notably, Japan's EPAs seek to differentiate AJCEPA from China's FTAs with ASEAN (MoFA, 2009).

At the Japan-ASEAN Summit held in Indonesia, Japan and ASEAN signed the Framework Agreement on Comprehensive Economic Partnership, which outlined objectives, fundamental principles, measures for comprehensive economic partnership, liberalization and most favored nation (MFN)<sup>30</sup> status. The agreement implementation timeframe was set for 2012 for Japan and the more advanced ASEAN-6, with an extra five-year period given to the ASEAN-4 (Yoshimatsu, 2008). It was obvious that this agreement aimed to compete with China's Early Harvest Program (EHP) which was proposed in 2002. EHP is a free trade arrangement under the framework of ACFTA and is designed to accelerate the implementation of the China-ASEAN Economic Cooperation Framework Agreement. By lessening the tariffs on agricultural products such as livestock, meat, fish, dairy products, live plants, vegetables, fruits and nuts, the ASEAN member states can attain early access to China's massive domestic market prior to the creation of the FTA<sup>31</sup>.

Japan's CEPEA formal proposal in the METI report on Global Economic Strategy published in April 2006 aimed to initiate an EPA among the ASEAN+6. After the EPA negotiations between ASEAN and Japan in 2007, Japan requested the initiation of negotiations on the CEPEA in 2008 (METI, 2006). At the 2<sup>nd</sup> EAS meeting in January 2007, the heads of governments of the ASEAN+6 approved an agreement to commence private level activities to develop support for CEPEA policy proposals. It was obvious that the motivation behind this was to decrease the relative prominence of the China-initiated ASEAN+3 FTA. Japan's thinking seemed to be, "China will take the lead in +3 negotiations. We should promote +6 negotiations ahead of the curve," a Japanese senior METI official said, as quoted by Yoshimatsu (2012)<sup>32</sup>. In this context, Yoshimatsu (2012) added that Japan's CEPEA proposal was an attempt to balance China's

<sup>30</sup> Most favored nation status is a level of treatment accorded by one state to another in international trade. The term means the country, which is the recipient of this treatment, must receive equal trade advantages as the "most favored nation" of the country granting such treatment.

<sup>31</sup> For further information, see <<http://ph.china-embassy.org/eng/sgdt/t171568.htm>> (accessed Jan. 07, 2014).

<sup>32</sup> *Asahi Shimbun*, 27 August 2006.

rising influence and leadership in East Asia.

Last but not least, as part of the Greater Mekong Sub-region programs, Japan has created two flagship projects “EWEC” and “2<sup>nd</sup> EWC” which concentrated on vertical transportation corridors in the Mekong countries. The EWEC and 2<sup>nd</sup> EWC concern the enlargement of a transport road from Vietnam to Thailand via Cambodia. The geopolitical competition can be seen in these flagship projects as they respond to the horizontal transportation corridors initiated by China. These are the NSEC linking Kunming in China and Bangkok in Thailand and 2<sup>nd</sup> NSEC connecting Kunming and Haiphong in Vietnam. The EWEC and 2<sup>nd</sup> EWC were aimed at countering China’s heavy influence on the development of transport infrastructure in the Mekong countries.

## *2. The Influences of the Japanese Rivalries with China on the Region*

The first positive impact is that East Asia will have various FTAs such as bilateral FTAs between each member of ASEAN with Japan and AJCEPA, and CEPEA because of the “Two-Track” and “Hamburger” strategies. Because of its concern with Chinese domination through the ASEAN+3 Summit and ACFTA, Japan proposed the creation of AJCEPA apart from its bilateral agreements with members of ASEAN and CEPEA. The second positive result is that CEPEA will provide more mutual benefits for the three latest members of ASEAN+3 because of the large size of their respective GDPs and populations.

The third positive result is speeding up the conclusion of various bilateral FTAs in East Asia, which increases the possibility of CEPEA being concluded. It is impossible to conclude CEPEA without concluding bilateral agreements first. In theory, small group discussions and negotiations on bilateral FTAs are much easier and faster than large group discussion and negotiations on multilateral or East Asian Regional Agreements as these types of agreements have a high potential to become deadlocked. This is because of less interest and a myriad of other reasons. East Asian countries have a lot of historical issues, and every member has its own domestic issues that are obstacles to achieving the conclusion of negotiations on CEPEA (i.e. agricultural products for Japan).

The fourth positive result is that because of most MFN status, in order to compete under the EHP, ASEAN states (in particular the Mekong countries) have enjoyed exporting some manufactured products and agricultural products not only to China’s massive domestic market with zero tariffs, but also Japan’s massive domestic market until 2012 for ASEAN-6 and 2017 for CLMV. This

will reduce the economic development gap between ASEAN-6 and CLMV, within the context of Japan's competition with China.

Last but not least, at the Mekong level, in order to assist CLMV states to bridge their economic development gap with ASEAN-6, the seventh positive result is Japan's creation of EWEC and 2<sup>nd</sup> EWC, aimed at rivaling the NSEC and 2<sup>nd</sup> NSEC created by China. As a result, the Mekong countries were endowed not only with the horizontal transportation corridors, but also with the vertical transportation corridors, which linked the entire Southeast Asian region and the world at large.

There are negative outcomes as well. Because of the uncooperative and divergent business policies of China and Japan, FTAs create the "Asian Noodle Bowl" or the "Spaghetti Bowl" effect, which entangles diverse administrative procedures in the region that may increase costs for Japanese or other large-scale firms in operating trade abroad (Kawai and Wignaraja, 2011). Kawai and Wignaraja added that "this wave of FTAs will undermine the multilateral liberalization process," which is at odds with the expected role of FTAs to drive East Asian regionalism. In connection, the JETRO (2012) survey shows that most Japanese firms have been reluctant and hesitant to apply for FTAs, partly because of the "Asian noodle bowl" effect. These assessments conclude that although Japan uses FTAs as politically motivated policies in order to respond to its rivalry with China, there is also some of its relative negative impact on East Asia from concluding more FTAs with the Southeast Asian countries.

The second negative outcome is that a single solid regional institutionalization for the EAC will not be realized. The rivalries will slow down the movement towards a single community like the EU for decades. Therefore, what East Asia has right now is "multiple institutional systems". East Asian countries face the complexing of a host of multiple institutional meeting for regional economic and security cooperation. Moreover, in view of the tremendous political and economic uncertainties prevalent in the region, the path to deeper and wider economic and security integration in East Asia is likely to be difficult.

## VI. Conclusion

The author was able to find five strategies used by Japan in order to conclude its FTA with ASEAN such as: Two-Track, Single-undertaking Negotiation, Economic and Technical Cooperation, Comprehensive, and Hamburger strategies. At the international level, Japan repaired its previous relations with ASEAN

via the FTA, which aimed to bolster its influence in East Asia and to prove Japan's constructive engagement in the region by erasing its legacy from WWII. Increasingly, Japan has viewed itself as a separate state from the rest of East Asia and even worse, the "Japan passing" phenomenon demands that Japan assume bolder international relations actions. This new policy direction is also for the benefit of trade facilitation for Japanese global firms operating in Southeast Asia. AJCEPA is designed to eliminate the trade barriers encountered by Japanese firms in ASEAN and to enable Japanese firms to stand on equal ground with their Chinese rivals.

At the regional level, this willingness to create trade agreements is seen as Japan's influence increasing in Southeast Asia in comparison with China. It is evident in the Mekong sub-region where Japan, seeking to bolster its relations with ASEAN, instigated numerous initiatives oriented towards playing a leadership role in decreasing the huge economic gap between ASEAN-6 and ASEAN-4. Moreover, Japan has been assisting ASEAN in the Southeast Asian choke points to prevent piracy attacks and to eliminate terrorism, which also supports its own economic interests. At the domestic level, Japan has turned to FTAs because the country needs to unify the government's bureaucracies in order to regenerate its economy and recover international competitiveness. Given that domestic dynamics are no longer sustainable, Japanese firms have to find new and expanding markets around the world, and in particular Southeast Asia.

The author discovered that the impact of Japan's "rivalry policies" and strategies in the region are both positive and negative. The former includes proofs. First, it turned ASEAN+1 to CEPEA. Secondly, because of their large GDP, it is good to have India, New Zealand, and Australia join CEPEA. Third, CEPEA will never have a chance to be concluded if the Two-Track Strategy or Hamburger Strategies are adopted because bilateral agreements are easier and faster to conclude. Fourth, ASEAN has received a lot of incentive as Japan woos ASEAN away from China. In connection with this, the CLMV states received MFN from Japan until 2017. Finally, the sixth result is that Mekong countries received both horizontal and vertical transportation corridors in their region.

There are also two negative results. First, the FTA's rules created the "spaghetti bowl" effect. This effect may increase costs for Japanese firms operating abroad because of diverse administrative procedures. The second negative result is that, due to lack of cooperation, progress towards the creation of an effective single regional institution has slowed.

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