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— Policy research to shape the international development agenda

Japan and an Asian Economic Community

Masanori Kondo

RIS-DP # 106
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January 2006

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Abstract: Until recently, most Japanese considered the gaining momentum of Asian economic integration in the frame of ASEAN+3. With India maintaining a high economic growth rate and its population being predicted to overtake China as the most populous country in Asia is leading many to rethink the importance of India to Asian economic integration. In order to find a political and economic counterbalance to China, the Japanese government has also put effort in vitalizing the Japan-India relationship. India following its ‘Look East’ policy has been successful in improving its economic relations with Korea, China and Japan. However, with some exceptions, Japanese businesses are behind other countries (especially US, UK, and South Korea) towards investing in India. While there are indeed many unique difficulties involved in entering the Indian market, the massive consumer potential of the population combined with a skilled and numerous labour pool allows many South Korean and American firms to attain great success there. Japanese and Indian policymakers have great designs for the relationship between the two countries, but it is only when Japanese firms step up and make the needed large scale commitment in India that Indo-Japanese trade will start to grow.

1. Introduction
This paper examines the Japanese trade policy, focusing its recent development in Free Trade Agreement (FTA) and its relationship between India as well as China, and examines the role of Japan in building an Asian Economic Community.
Economic Community, which includes India. First, it reviews the status of Japanese FTAs with other countries. Already, Japanese FTAs have been effective with Singapore and Mexico, and some more negotiations are under progress with various Asian countries. This paper also compares the Japan-Korea-China economic bloc with other economic blocs. Lastly, the paper examines the future prospects for JACIK (Japan, ASEAN, China, India, and Korea), presenting some examples of such attempts, like the Japanese investment into India via Singapore, or Indian investment into China via Singapore to explore the Japanese market.

2. Japan’s Bilateral Trade Negotiations in Asia
Economic Partnership Agreements (EPAs) have become extremely important for Japanese policymakers in the past few years. Looking for greater progress beyond a mere FTA, the Japanese government has been actively negotiating EPAs with other countries. There are several reasons why they prefer an EPA over an FTA. As pointed out by Kinoshita (2005a), FTAs can help economic development but cannot solve income disparity problems. Proactive actions to correct such discrepancies are necessary for further economic integration. With this important recognition in mind, the Japanese government has proposed EPAs to its neighboring countries, rather than FTAs.

Few question the importance for Japan to successfully negotiate FTAs and EPAs among its Asian neighbours. Asia is not only the region that accounts for the greatest percentage of Japanese exports of goods and services, but it also has the highest tariff rates of any region in which Japanese companies do business. Therefore, it is very reasonable to conclude that successful Asian FTAs and EPAs have the greatest potential to boost Japanese exports and strengthen Japan’s overall economy.

In the past few years, quite a few EPAs have been under negotiation between Japan and other Asian countries. This reflects increased momentum for regional integration in Asia. So far, an EPA with Singapore is being implemented, and an EPA with Mexico has finished the negotiation stages. Besides, the negotiations for EPAs with Malaysia, Philippines and Thailand have been finished in principle. While there is some more way to go for Korea and ASEAN, the joint study groups have been set up for India, Indonesia and Australia. Following is an overview of Japanese EPAs with Asian nations.

(1) Singapore: Singapore and Japan’s close political and economic ties made them a near perfect match for an early FTA. Since the early 1970s, Japan has consistently been one of Singapore’s top three trade partners and number one investor country. Out of nearly 5000 multinational corporations with operations in Singapore, over 1700 are Japanese firms. Since 2000, the amount of Japanese investment has topped US $ 14 billion. As stated earlier, Singapore was the first country with which Japan signed an EPA. Because the two economies were already liberally open to trade in most products, the FTA concentrated mostly on investment and opening up of sectors, such as service, finance, information technology, and transportation. The fact is that Singapore does not export agricultural commodities, which allowed Japan to dodge its most sensitive trade issue and gain easy internal support for the agreement.

(2) Philippines: Japan reached agreement in principle on major elements of an EPA with the Philippines in November 2004. It mainly dealt with the areas of industry, agriculture and services. One of the major issues was on admittance of Philippine workers into Japan, which was the reason for several road blocs in the negotiation process. While the Philippine Government desired an increase in the admittance of lawyers, health workers, and nurses, Japan was extremely reluctant towards any kind of fast increase in foreign workers, especially, nurses and health care workers. It was agreed that Philippine nurses would have to pass Japanese language examination. While the numerical quota or goal for how many nurses were to be admitted was not initially identified, it would be included in ongoing negotiations. However, for the first year, one hundred nurses will be sent to Japan.

(3) Malaysia: The two governments confirmed the agreement in principle on major elements of the Japan-Malaysia EPA negotiations at the East Asian Summit held in Kuala Lumpur in December 2005. Though lowering of tariffs in regards to steel, automobiles, and plywood were the most difficult points in the negotiating process, an agreement has been reached that targeted a 10 year plan to gradual phase-out of Malaysian tariffs on Japanese exports in the steel and automobile sectors.

(4) Thailand: In principal, an agreement has been made between the two countries. Trade matters on agriculture were agreed first, and then
issues relating to steel, auto parts, services, and investments were discussed. After the progress made on the industrial goods in June 2005, general agreement was made in September 2005. Thailand’s extremely high automobile tariff of 80 per cent will be gradually lowered by 5 per cent each year for cars above 3000cc until it reaches 60 per cent in 2010. It has been agreed at that time that the Japanese and Thai governments will then renegotiate how the further liberalization of automobiles will proceed. The Japanese government has expressed a desire for the total elimination of automobile tariffs in 2010. Thailand will gain an elimination of tariffs for vegetables, fruits, cooked chicken, processed shrimp, stark, textiles, and jewelry exports to Japan.

(5) **Korea:** Japan is actively working for an FTA negotiation, but the Korean government has not been very keen to enhance the policy dialogue, at least in the eyes of the Japanese. Six meetings were already held, however, and it is expected to complete a major part of the negotiations by the end of this year. An FTA with Korea would be a great boon to Japanese exports, especially in regards to auto parts and industrial machinery sectors. However, the talks are threatened to be stalled by the South Korean Government’s strong request to exempt automobiles from the tariff cuts, which is currently at 8 per cent. South Korea fears an influx of Japanese cars would cause great damage to its domestic automobile industry.

(6) **Indonesia:** A joint group was set up to study the impacts of FTA/EPA, similar to the Joint Study Group between India and Japan. The first round of negotiations has started, and subsequent rounds are to continue every two months. Currently the framework for the negotiations is nearly complete, and both sides soon expect to be able to start substantive talks on various areas including market access, investment, trade in services, personnel transfer, energy, and bilateral economic cooperation. Japan is seen to be particularly interested in the development of energy resources in order to gain access to coveted Indonesian oil deposits. Both sides have expressed a strong desire to complete a deal within two years.

(7) **ASEAN:** The first meeting among all the countries was held in Tokyo in April 2005. There were several points of contention, especially in regards to how an FTA with ASEAN would be related to bilateral FTA negotiations and how the rules of origin would be defined. When the two sides met for a ministerial meeting in September 2005, there was no leeway on either side to overcome these issues. The representatives from ASEAN strongly lobbied in Japan to drop its plans to start concrete trade negotiations for a broad ASEAN agreement until all the individual bilateral FTAs have been concluded. The ASEAN ministers also expressed their disappointment at the slow pace and lack of progress in the meetings with Japan.

Meanwhile, Japan has started bilateral negotiations with Cambodia, Laos, Myanmar, Vietnam, and Brunei independently, and plans to eventually link them together into one larger ASEAN FTA. The two sides have agreed to full trade liberalization by 2012, which is behind the China-ASEAN agreement for 2010 and the South Korea-ASEAN agreement set for 2009.

(8) **India:** A joint study group to assess the prospects and impacts of EPA has been set up, and the first two meetings were successfully held in New Delhi and Tokyo in 2005. The group will submit a report to the two governments within a year. The two sides have spoken positively about the possibility for an FTA. It is important that India-Japan EPA will boost Japan’s direct investment in India. On the trade front, export of Indian mangoes has been one of the main issues. Also, India’s iron-ore export contract with Japan will end in 2006, which could prompt further efforts towards bilateral discussions at that time. The double-taxation issue for Indian software exports to Japan will be settled soon.

(9) **Australia:** A feasibility study on the impacts of FTA/EPA has been initiated, where Japan has finally agreed with the study that includes agriculture. Japan’s growing interest towards Australia for importing natural resources could help move the process along. However, Australia’s large agricultural sector and its desire to gain further entrance to Japan’s market will almost certainly prove to be a difficult sticking point in to overcome. Japanese agriculture industry also fears that countries like Canada may follow, if Japan imports more agricultural commodities from Australia under the free trade agreement.
separate economic entity, an FTA would have to take place apart from any negotiation with Beijing. However, the fact that Taiwan already has very low tariff on Japanese exports, there is seen to be little motivation to invest in an FTA between the two.

3. Sino-India-Japanese Relations

(1) Developments towards Change in the Sino-Japan Relationship
The compatible aspects of the Chinese and Japanese economies in regards to one another have resulted in an explosive growth of trade and investment between the two countries. Combining the factors of Japan excelling in high-level technology research and development and having the world’s second largest consumer market, and China being a geographically close haven of inexpensive labor as well as its possibility for becoming a desirable consumer market in the future, Sino-Japan trade and investment has continued to develop to the point where China has surpassed the United States in becoming Japan’s number one trading partner. In 2004, the amount of trade between Japan and China increased by 25.7 per cent to become almost US $ 167.9 billion. There are 9.2 million Chinese workers employed in Japanese factories within China, and taxes paid by Japanese companies comprise 9.1 per cent (5.9 billion dollars) of all of tax revenue from foreign firms operating in China. With both economies expected to grow at substantial rates in the upcoming years, this economic relationship is expected by many economic experts to only further develop and grow.

However, despite these close economic ties, recent political relations between the two countries has been deteriorating at a rapid pace. China is increasingly being viewed as becoming more aggressive in asserting its authority in East Asia, becoming a cause for concern among many Japanese and others by taking a more aggressive stance towards Taiwan with its recent “anti-secession law” that confirms China’s right to use “non-peaceful means” to reunite Taiwan with the mainland. In 2005, China participated in a joint military exercise with Russia, and one of the exercises involved using an amphibious assault in order to take island territory. Many consider this to be a warning towards Taiwan.

(10) China: China is the most important economic partner of Asia for Japan. According to a 2005 Mizuho Research Institute study, 37.5 per cent of the Japanese companies that were surveyed chose China as the most desirable FTA partner, which was the highest, followed by the United States (18.7 per cent). China also appears to show a great deal of interest for an FTA with Japan in order to boost its exports. The Japanese market is seen as having great potential for Chinese agricultural exports. However, pressure from Japanese agricultural as well as Chinese high-tech firms fearing competition makes progress towards an FTA politically very difficult. Questions concerning faithful compliance from the Chinese government in regards to intellectual property and service sector commitments are also an issue.

While the Japanese corporate climate, especially the manufacturing industry, for the most part appears eager for and ready for an FTA with China, there are still many forces at work preventing Japan from moving forward toward negotiations. The first of such factors is Japan’s desire not to even begin talks about an FTA with China until the tri-lateral investment treaty including South Korea are successfully concluded. This treaty is set to replace bilateral investing treaties that are currently operating between the three countries.

Another potential problem relates to Japanese resistance to a potential flood of Chinese agricultural products into its market. While many experts point out the fact that increasing demand for agricultural products within China and the advantage of high quality Japanese food products such as rice would offset much of the pain from liberalization, there still remains a great deal of fear in this area. The Japanese Government also must undertake more research into what possibilities a China FTA would entail. There is also a great deal of discussion of how to deal with China’s intellectual property problems and WTO commitments, and whether issues such as these should be tethered to bilateral free trade negotiations. Lastly, the recent icy political relationship between Japan and China has not helped to encourage a spirit of cooperation.

(11) Taiwan: The economic relationship between Japan and Taiwan is strong, especially in electronics industry. Because Taiwan is treated as a...
China has also been seen as using its new found political influence in East Asia to oppose Japan’s bid to become a permanent member of the United Nations Security Council. There have also been several territorial disputes between Japan and China, including the Senkaku Island Chain located south of Japan’s Okinawah as well as a disputed deep sea oil field, which lies in an overlapping area of Japan and China’s exclusive economic sea zones. Japan accuses China of being an unfaithful negotiating partner by not suspending exploration and development of the zone, while it continues to send military naval units into the disputed area. China has criticized Japan’s negotiation of development rights of the underwater oil field to several Japanese energy companies.

There is also the long standing Sino-Japanese dispute over history, specifically concerning Japan’s past military actions in Asia. China has decried the Tokyo Board of Education’s recent authorization of new textbooks which gloss over Japan’s wartime aggression over China (along with South Korea). China has also strongly protested Japanese Prime Minister Junichiro Koizumi’s repeated pilgrimages to Yasukuni Shrine, where several class A war criminals were buried. The most recent visit took place in October 2005, shortly after Koizumi’s party won a heavy victory in the September 2005 parliamentary election. Koizumi claims the visits are his personal and has made several statements in his trips to Asia stating condolences and regret over Japan’s past actions.

With the Japanese population observing a large amount of media coverage of recent anti-Japanese riots in China, more and more of the Japanese population is beginning to see China less positively and the number of those who consider China a trustworthy partner in international affairs have decreased rapidly, especially in the past years. The combination of these factors and others are prompting the Japanese leadership to seek new ways to deal with its growing rivalry with China. Quite a few Japanese argue that one of these is to seek a new economic and political partnership with India.

**2) Indo-Japanese Relations: New Possibilities and Challenges**

In April 2005, two weeks after Chinese Prime Minister Wen Jiabao took part in a historical China-India Summit in New Delhi, Japanese Prime Minister Junichiro Koizumi also made a visit to India and met many government officials, where he made the statement: “We are now in an era in which Asia is currently experiencing a process of transformation and India, too, is changing, thus elevating the importance even further of India and Japan cooperating as true global partners.” Japan and India are also currently cooperating towards United Nations Security Council reform, in which both Japan and India are attempting to gain permanent Security Council positions.

While there seems to be much promise in the political realm as Japan eagerly desires to counterbalance China’s growing influence and India seeks to grow in diplomatic influence as well, the economic relationship between the two countries is still very much underdeveloped. Indo-Japanese trade remained stagnant at around US $ 4-5 billion per annum for the past decade. Many Japanese companies also do not find India a very attractive investment location, as Japanese average annual direct investment into India has been only around US $ 200 million. Overall, both in terms of trade and investment, the volume of Japanese economic relationship with India is merely 3 per cent of that with China. Many reasons are seen by Japanese for the lack of investment in India, such as poor infrastructure, pro-labour laws, intellectual property problems, and cultural differences.

While Japanese business remains stagnant in India, Korean firms have been heavily investing in India, and companies like LG, Samsung and Hyundai have succeeded to capture a large market share in India. More recently, Sino-Indian trade and investment have been explosive. In 2004-2005, China has become India’s second largest trade partner and market for Indian products. China is a major importer of Indian iron ore, textiles, plastics, steel, and chemicals. For India, trade with China is seen as a vital catalyst for growth.

Koizumi and other Japanese officials have made statements that Indo-Japan trade can easily be increased to US $ 10 billion within 3 years, and more Japanese companies are taking a second look at investment opportunities in India. While there are some positive indicators, many remain skeptical that Japan can create an economic relationship with India that rivals China.
A big question mark remains whether Japanese political ambitions can prompt a cautious business community into strengthening its position in India.

(3) **JACIK (ASEAN+4)**
While many Japanese experts see the future of Asian economic integration as ASEAN+3 (ASEAN along with Japan, South Korea, and China), the growing economic presence of India cannot be ignored. For the past 15 years, India has continued to grow at an astonishing rate of 6 to 8 per cent per annum, and the extremely large population it possesses is predicted to increase its average consumption per capita by a multiple of 2.6 before 2020. The International Energy Agency (IEA) also predicts India to become the greatest consumer of energy in Asia by 2020.

India is also starting to look eastward in regards to forging new economic partners. As stated above, India has recently made great strides to increase trade and investment with China and Korea. Korean companies, like LG, Samsung and Hyundai have been extremely successful in India. India-ASEAN trade has also been booming. With India’s growing political and economic importance in Asia, it would be a grave mistake to attempt to exclude India from any plans for Asian economic integration. It should be only a matter of time before the idea of “ASEAN+4” is realized by all major players in the Asian economy.

4. **Japan’s Roles for Future Integration of JACIK**

(1) **JACIK as a New Asian Economic Community**
In the past decade, ASEAN has been struggling to compete with China in its export market, especially in regards to the US or Europe. Although the Chinese currency was devalued, it is still not enough to allow ASEAN to compete with China. Meanwhile, the trade between ASEAN and India has also surged, and Indian policymakers have been shifting their focus more towards East Asia. Under the circumstances, it is not surprising that India has been added to ASEAN+3.

Among ASEAN countries, Singapore seems to be particularly active toward working for JACIK, trying to balance between these two Asian superpowers. The importance of India for Singapore (and vice versa) can be confirmed by the recent agreement of CECA (Comprehensive Economic Cooperation Agreement). Under the agreement, Singapore intends to be a hub for a third party country, such as Japan, to invest in India. Already, several MNCs are considering investment in India via Singapore.

(2) **Motives and Strategies**
While Singapore is actively working for JACIK, the motivation to promote the JACIK for Japan is somehow more political and less economic than JCK. In Japan, many people want to include India in the East Asian Community as it can be a counter-balance to China. However, with the improvement of India-China economic relationship, this is less important for India. As we have seen in JCK, market forces will be more important than political considerations. Some people are afraid that with so many countries very little may be decided by JACIK.

Many Japanese consider ASEAN as an Asian partner for economic reasons, but India for political reasons. However, if Japan thinks India is more important in its business, this can be a strong driving force for JACIK, as Japan has already close ties with ASEAN+3. Japan can play a leading role to combine China, Korea, ASEAN and India, rather than considering only China, Korea and ASEAN as its economic partner.

Since it is an economic matter, the main driving force will be Japanese companies, rather than the government, as it has been the case in ASEAN. One good example is Toyota, which has decided to make its Indian plants as a global export base of transmission to its factories in other Asian countries. Another good example is Cannon, which invested in India not from Japan but from its subsidiary in Singapore. CECA between India and Singapore will bring more Japanese investment in India via Singapore, just like the Cannon example. The other example is the TCS, the leading Indian IT firm, which invested in China via Singapore, partly considering to work from China into the Japanese market. In its China office, a Korean engineer who speaks Japanese is employed, and this is a good example of JACIK cooperation. The other examples are Sony and Daikin, both exporting their products from Thailand to India.
5. Conclusions
The key role that Japan can play for an Asian economic integration is clear. It is to integrate ASEAN+3 and India by its trade and investment. Until recently, many Japanese companies have been only comfortable to manufacture in ASEAN and China to export back to Japan. Conversely, not many Japanese companies have made quite serious efforts to do business with India. Many Japanese still think Asian economic integration only as the relationship among ASEAN, Japan, China, and South Korea. However, as it is detailed in Kumar (2004) and Brooks et al. (2005), it is quite clear that if India is included in the Asian economic integration, Japan will receive a large economic benefit.

Further, an important factor that will increase the economic importance of India is its labour supply. In the near future starting with Japan, many of the countries in East Asia are anticipated to experience economic effects from declining birthrates and an aging society. Yet, much more important than the massive numbers of workers in India is the increase of skilled technicians and managers. American firms have done well to tap this resource, and as a result, the country has seen a large measure of success in fields such as IT. As other countries in Asia begin to face labour shortages, the labour pool India will become indispensable in supporting continuing economic growth in Asia.

Whether or not Japan can contribute to the momentum of economic integration among India and other East Asian countries is a deciding factor as to whether Japan can maintain its place as a world economic power. As shown above, Toyota, Canon and Sony understand this important trend. While India is often seen in Japan as a country where it is difficult to do business, the “East looking” India is seen very differently by other Asian countries. Whether Japan can make positive advancements towards the development of JACIK will be the key not only for its East Asian strategy, but also for its global strategy. The expectations for Japan’s economic contributions toward Asia remain very high.

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