

The East Asian Economies after the Global Economic Crisis and the Course Japan Should Take: Focusing on GMS (Greater Mekong Sub-Region) Development Plan

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Abstract

The purpose of this paper is to discuss the future course that Japan should take regarding regional cooperation in light of the changes to the schemes addressed so far. Firstly, I examine the motives of the U.S. in favoring schemes such as the TPP and FTAAP in relation to how it intends to correct global imbalances that currently affect it (large deficits in its balance of payments). This naturally necessitates a discussion of efforts by China to address global imbalances affecting it (large surpluses in its balance of payments), as in this respect it is mirror image of the U.S. Secondly, I present an analysis of Japan's economy in the wake of the global financial crisis, noting that the conventional model of East Asian economic development (often called "triangular trade") has reached its limits as regards to corrections to the trade imbalance between the U.S. and China. As such, initiatives to exploit demand within Asia and to develop the Mekong region have grown in importance. Thirdly, I note that the TPP debate is arguably more of a political, diplomatic, and security issue than an economic one. I conclude by addressing how the TPP relates to the new National Defense Program Guidelines and by discussing the path that Japan should take.

Keywords:

TPP (Trans-Pacific Partnership), FTAAP (Free Trade Area of Asia-Pacific), global imbalances, triangular trade, the Mekong region.

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I. INTRODUCTION

In October 2010, a series of three important and now generally annual meetings on regional cooperation in East Asia were held in Hanoi, Vietnam; the 17th ASEAN Summit (October 28), the 13th ASEAN Plus Three Summit (October 29), and the 5th East Asia Summit (October 30).

As the title of the Chairman's Statement "Towards the ASEAN Community: From Vision to Action" suggests, the main agenda of the 17th ASEAN Summit (the 10 ASEAN member states) was the creation of the ASEAN Community by 2015. To achieve this goal, ASEAN leaders adopted the "Master Plan on ASEAN Connectivity". This plan was drafted by the ASEAN Secretariat with the cooperation of the Asian Development Bank (ADB), the Economic Research Institute for ASEAN and East Asia (ERIA), the Economic and Social Commission for Asia-Pacific (ESCAP), the World Bank, and others. The plan aims to promote: 1) improved linkages within ASEAN, 2) the planning of infrastructures within the community (worth a total of USD 380 billion), and 3) the regional prioritization of the Mekong region, thereby 4) facilitating the economic growth of ASEAN, helping to alleviate inter-ASEAN economic disparities, further integrating ASEAN,

and creating an ASEAN Community.

The 13th ASEAN Plus Three Summit (13 countries: the 10 ASEAN member states plus Japan, China, and Korea) sought to reaffirm that the ASEAN Plus Three Summit itself is an important vehicle for the establishment of the East Asian Community and that in its creation ASEAN will play a central role. At the same time, it was acknowledged that the East Asia Summit and the ASEAN Regional Forum (ARF) could facilitate and play a complementary role in the creation of the East Asian Community.

Lastly, at the 5th East Asia Summit (16 countries: the 10 ASEAN member states, Japan, China, Korea, India, Australia, and New Zealand; also referred to as “ASEAN Plus Six”): 1) U.S. Secretary of State Hillary Clinton and Russian Foreign Minister Sergei Lavrov were invited as special guests and it was decided that the two countries could become official members of the East Asia Summit; 2) a report was presented on the completion of the Comprehensive Asia Development Plan (CADP) by ERIA; and 3) it was decided that both the East Asia Free Trade Area (EFTA) and the Comprehensive Economic Partnership in East Asia (CEPEA) schemes supported respectively by China and Japan would be welcomed.

The outcomes of these three meetings demonstrated that there had been no major changes to the framework underlying regional cooperation in East Asia since its substantial emergence after the Asian Financial Crisis, especially with regard to the creation of the East Asian Community. It was reaffirmed that the ASEAN Plus Three, supported by China, was a key instrument for creating the East Asian Community, and at the same time it was recognized that the East Asia Summit supported by Japan could play an auxiliary role in the community's formation. Nevertheless, there was an intense power struggle between Japan and China over who would lead regional cooperation initiatives in East Asia, and as a result, although statements issued clearly indicated that ASEAN would play the central role, there was little choice at the summit but to espouse both the EAFTA and CEPEA schemes as foundations for the creation of the East Asian Community. One thing different about this East Asia Summit from previous years was that the United States and Russia participated as official members.

This basic framework, however, was to see an abrupt and dramatic change. This change was brought about by Prime Minister Naoto Kan's

sudden announcement during his Policy Speech (October 1, 2010, during an extraordinary Diet session) that the government would be considering participation in the Trans-Pacific Partnership (TPP; also known as the Trans-Pacific Strategic Economic Partnership Agreement), followed by the “The Yokohama Vision – Bogor and Beyond” declaration at the 18th APEC Summit (November 13 & 14, 2010), which in called for the creation of an “APEC community” in connection with the TPP.

Prime Minister Kan’s Policy Speech comprised eight parts, the sixth of which was titled “Implementing Active Diplomacy to Open Up the Country and Build the Future”. In it, Kan mentions of the TPP for the first time:

...Japan will work together with the United States, the Republic of Korea, China, ASEAN countries, Australia, Russia, and other countries to build a better environment for shared growth and prosperity for the countries of the Asia-Pacific region. Economic partnership agreements (EPAs) and free trade agreements (FTAs) will be important bridges in this regard. As part of this, we will look into participating in such negotiations as those for the Trans-Pacific Partnership agreement (TPP) and will aim to build a Free Trade Area of the Asia-Pacific [FTAAP].

This sudden announcement of considering joining the TPP represented a “battle of estimates”—the Cabinet Office, the Ministry of Economy, Trade and Industry, and the Ministry of Ministry of Agriculture, Forestry and Fisheries had all released estimates — that would spark a debate which divided public opinion. In response, the Kan cabinet issued its Basic Policy on Comprehensive Economic Partnerships (adopted by cabinet resolution on November 9, 2010), which asserted that: 1) “the networks of high-level EPA/FTAs formed by major trading countries are expanding” but that “Japan is falling behind”; 2) that the FTAAP is necessary to achieve the “strong economy” outlined in Japan’s New Growth Strategy (adopted by cabinet resolution on June 18, 2010); 3) that to realize the TPP, it is necessary to have the resolve to “open up the country” (the “Heisei Opening”), and to do that, it is necessary to institute domestic reforms regarding the agricultural sector, the movement of people, and regulatory reforms. The basic policy of the Kan cabinet regarding the TPP is to continue to gather TPP-related data, commence negotiations with the countries concerned,

track public opinion on the issue, and make a decision by June of 2011 as to whether to join the TPP.

Let us look now at the key features of the TPP. According to Kouichi Ishikawa (2010): 1) The TPP was an FTA among four countries (the P4: Brunei, Chile, New Zealand, and Singapore) that entered into force in May of 2006, but with origins in an agreement formed in 2001 between New Zealand and Singapore. 2) It is a high-standard FTA, realizing wholly free trade, with no categories excepted. It is a comprehensive FTA that includes trade of goods and services, government procurement, intellectual property rights, and much more (investment is excluded), and it even has ancillary agreements concerning labor and the environment. 3) The reason it was named the Trans-Pacific Strategic Economic Partnership Agreement is that there was a strategic intent to expand it as an APEC FTA. 4) The TPP began to receive broader attention after President Obama announced in November of 2009 his administration's commitment to joining the TPP. The goal of the U.S. in joining the TPP is to avoid being excluded from EPAs in East Asia. 5) One cause for concern is whether Vietnam, which is a high-tariff country, can achieve the high free-trade standard of eliminating 100 percent of its tariffs, which the partnership calls for. Furthermore, there is the question of whether Malaysia, with its *Bumiputra* policy, can open up its government procurement system. Although Ishikawa does not mention it, the TPP involves a total of nine countries when one adds the current member countries (the P4) and countries in negotiations (five at present) to join. The countries and the size of their respective economies (nominal GDP in 2009; source: IMF) are as follows.

- 1) Member countries: Brunei (USD 10 billion), Chile (USD 162 billion), New Zealand (USD 118 billion), and Singapore (USD 182 billion)
- 2) Negotiating countries: U.S. (USD 14,119 billion), Australia (USD 994 billion), Peru (USD 127 billion), Malaysia (USD 193 billion), and Vietnam (USD 93 billion)

If Japan (USD 5.68 trillion) were to join the TPP, Japan and the U.S. alone (USD 19.187 trillion) would account for a combined 91.5 percent of the total (USD 20.973 trillion), making the partnership in essence a bilateral FTA between the U.S. and Japan (*Nihon Keizai Shimbun*, October 28, 2010).

Next, let us examine the Yokohama Vision presented at the 18th APEC Summit, which called for an “APEC community”. According to the Yokohama Vision, the “APEC community” envisioned is one that is: 1) tightly integrated (a “community that promotes stronger and deeper regional economic integration”); 2) robust (a “community with higher quality growth”); 3) secure (a “community that provides a more secure economic environment”), and that the way to create an APEC community is by realizing an FTAAP to serve as its foundation, one which should be pursued by developing regional partnerships such as ASEAN+3 (EAFTA), ASEAN+6 (CEPEA), the TPP, and others. In point of fact, the biggest issue at the 18th APEC Summit was finding ways to create an FTAAP that would bring about free trade throughout all of APEC’s 21 member economies (*Nihon Keizai Shimbun*, November 15, 2010). In addition, unlike the ASEAN+3 (EAFTA) and ASEAN+6 (CEPEA) schemes, which have not advanced beyond the planning phases because of the struggles for leadership between China and Japan, the TPP is already in force and is actually functioning, at least among the P4. As the TPP may expand to nine members at the next summit (November 2011 at Hawaii, the US), and the strategic intent behind the TPP was to expand it to become a future APEC FTA, it is only natural that it has suddenly become the focus of much attention. The goal at the end of the pathway to creating an FTAAP through TPP is not an East Asian community, but an APEC community, so we must conclude that the goal has been fundamentally modified, i.e. the focus has been changed from regional cooperation in East Asia to regional cooperation along the Pacific Rim.

The purpose of this paper is to discuss the future course that Japan should take regarding regional cooperation in light of the changes to the schemes addressed so far. In the second section below, I shall examine the motives of the U.S. in favoring schemes such as the TPP and FTAAP in relation to how it intends to correct global imbalances that currently affect it (large deficits in its balance of payments). This naturally necessitates a discussion of efforts by China to address global imbalances affecting it (large surpluses in its balance of payments), as in this respect it is mirror image of the U.S. In the third section, I present an analysis of Japan’s economy in the wake of the global financial crisis, noting that the conventional model of East Asian economic development (often called “triangular trade”) has reached its limits as regards to corrections to the trade imbal-

ance between the U.S. and China. As such, initiatives to exploit demand within Asia and to develop the Mekong region have grown in importance. In the fourth and last section, I note that the TPP debate is arguably more of a political, diplomatic, and security issue than an economic one. I conclude by addressing how the TPP relates to the new National Defense Program Guidelines and by discussing the path that Japan should take.

II. THE UNITED STATES' STRATEGY FOR REDRESSING GLOBAL IMBALANCES AND CHINA'S RESPONSE

1. U.S. strategy

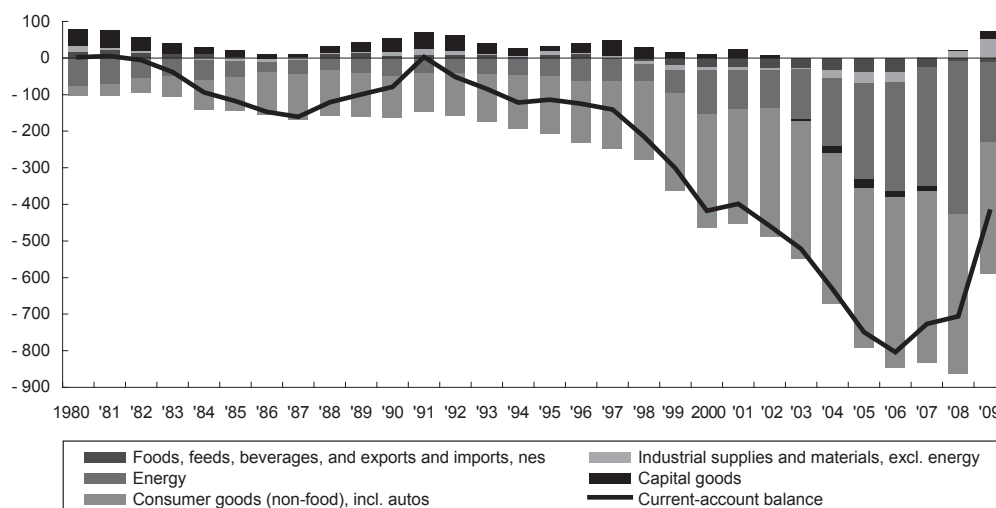
The weight of the global economic crisis foreshadowed by the collapse of Lehman Brothers in September 2008 (commonly known in Japan as the "Lehman Shock") led in fiscal 2009 to the first instance of negative global economic growth (-0.6%) in the last 60 years. The following is a breakdown of some of the figures for that year, with the growth figures in parentheses: developed countries (-3.2%) [the U.S. (-2.4%), the Euro Zone (-4.1%), Japan (-5.2%)], emerging Asian economies (6.6%) [China (8.7%), India (5.7%), and ASEAN5 (1.7%)].

As UNCTAD [2010] points out, the existence of global imbalances can be listed as one of the causes of the global economic crisis, a point which is widely acknowledged today. The developments leading up to the growth of global imbalances before the economic crisis are gradually being analyzed and elucidated. In short, these global imbalances can be summarized as a paired disequilibrium between the trade deficit of the U.S. and the trade surplus of East Asia, and particularly China. The deficit in the U.S. balance of current account (BOCA) in 2006 amounted to as much as 6 percent of its GDP, while China's surplus was as much as 7 percent of its GDP. The U.S. deficit in BOCA is inextricably linked to its investment-savings balance. The corporate sector saw an excess in savings in the 2000s as a result of the collapse of the IT bubble, but the growing budget deficit spurred on by the Bush administration's tax cuts and military spending, as well as the excessive consumer spending associated with the housing bubble, became the major factors that caused the U.S. to post significant deficit levels in BOCA. The U.S. BOCA was financed by East Asian countries (particularly China) that purchased U.S. Treasury securities with their foreign currency reserves increased via exports to the U.S. It is for

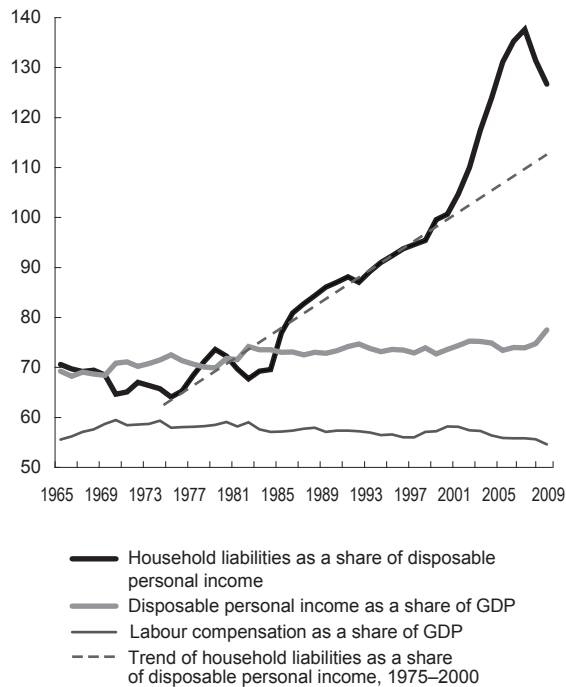
that reason that the two sides are often portrayed as mirror images of each other, but in fact neither position was sustainable. The lessons learned from the global economic crisis are at the heart of the intensity of calls to correct global imbalances, specifically the need for rebalancing.

The chief cause of the U.S. BOCA deficit is the excessive reliance on imports for consumer goods (Chart 1). The import of consumer goods is driven by individual consumption in the U.S. The country saw a drop in the household savings rate (nearly 0.0%) and a rise in consumer spending (71% of the GDP in 2009). Such growths in consumer spending, however, have proven unsustainable. The reason is that the increase in individual consumption was not supported by an increase in jobs or higher wages (i.e. an increase in compensation for labor), but instead was debt-financed, and essentially was “jobless-growth” (Chart 2). The factors that made it possible to finance consumer spending through debt instead of disposable income were: 1) low interest rates, 2) inflated asset prices (housing prices in particular) that translated into a “asset effect”, and 3) financial deregulation. With the global economic crisis consumer spending saw a sudden decline. The reasons were: 1) a decrease in asset prices (housing prices in particular) that translated into a “negative asset effect”, 2) reluctance on

Chart 1. CURRENT-ACCOUNT BALANCE AND TRADE BALANCE BY END-USE CATEGORY IN THE UNITED STATES, 1980–2009 (*Billions of dollars*)



(Source) UNCTAD, *Trade and Development Report 2010*, United Nations, New York and Geneva, 2010, p.45.

Chart 2. HOUSEHOLD LIABILITIES, DISPOSABLE PERSONAL INCOME AND LABOUR COMPENSATION IN THE UNITED STATES, 1965–2009 (Per cent)

(Source) UNCTAD, *op. cit.*, p.45.

the part of financial institutions to extend loans or credit, and 3) unemployment.

Testifying before the U.S. Senate Banking Committee, on July 21, 2010, Federal Reserve Board (FRB) Chairman Ben Bernanke said to the surprise of many that the country's economic outlook remained "unusually uncertain". The reasons for this statement lie in falling housing prices, declining bank credit, rising unemployment, and other indicators of the general stagnation of the American economy. Bernanke testified, "An important drag on household spending is the slow recovery in the labor market and the attendant uncertainty about job prospects." This means that there are weak prospects for a self-sustaining recovery rooted in a recovery in the job market, leading in turn to increased consumer spending and home buying, more capital investment, and to greater credit lending by banks.

The strategy adopted by the Obama administration to extricate the U.S. economy and reduce its BOCA deficits is one of: 1) curbing the import

of consumer goods (especially from China), and 2) creating jobs by growing American exports.

With regard to the former, one tactic is to pressure China into revaluing the yuan, but that has been met with resistance by China, leading to the new proposal of setting targets for BOCA. The U.S. suggested at the G20 Summit (October 22 & 23, 2010, at Gyeongju, South Korea) placing a limit on current account deficits and surpluses at no more than 4 percent of a nation's GDP. As of 2009, in terms of the GDP of the larger G20 countries, those running a surplus were, in descending order: Saudi Arabia (6.1%), China (6.0%), South Korea (5.1%), Germany (4.0%), and Japan (2.8%). Those running a deficit were: Australia (-4.4%), India (-2.9%), the U.S. (-2.7%), France (-1.9%), and the UK (-1.1%). In terms of future prospects for BOCA as a function of GDP (changes from 2010 to 2015), the figures are: China (4.7% to 7.8%), Germany (6.1% to 3.9%), the U.S. (-3.2% to -3.3%), and Japan (3.1% to 1.9%). Based on the facts described above, the American proposal has been seen as an indirect tactic targeting China — as direct appeals to revalue the yuan have failed— designed to get the country to tighten the reins on its trade surpluses and decrease its exports by revaluating its currency (*Nihon Keizai Shimbun*, October 23, 2010).

The Obama administration's National Export Initiative falls under the latter strategy. In his 2010 State of the Union Address (January 27, 2010), President Obama stated,

...we need to export more of our goods, because the more products we make and sell to other countries, the more jobs we support right here in America. So tonight, we set a new goal: We will double our exports over the next five years, an increase that will support two million jobs in America.

Actually, President Obama foreshadowed this initiative in earlier remarks made in Tokyo (November 14, 2009 at Suntory Hall), where he touched on the need to correct global imbalances by saying, "One of the important lessons this recession [brought about by the global crisis] has taught us is the limits of depending primarily on American consumers and Asian exports to drive growth..." He went on to say that

...in the United States, this new strategy [for economic growth] will

mean that we save more and spend less, reform our financial systems, reduce our long-term deficit and borrowing. It will also mean a greater emphasis on exports that we can build, produce, and sell all over the world. For America, this is a jobs strategy. Right now, our exports support millions upon millions of well-paying American jobs. Increasing those exports by just a small amount has the potential to create millions more.

It is in precisely this context that we should seek to understand the motives of the U.S. in supporting the TPP, FTAAP, and APEC community. At the most recent APEC CEO Summit (November 13, 2010), President Obama: 1) expressed a desire to improve domestic employment by leveraging more exports to Asia by saying, "In this region, the United States sees a huge opportunity to increase our exports in some of the fastest-growing markets in the world," and also 2) implicitly addressed correcting global imbalances by calling on countries with large surplus (such as China and Japan) to take steps to grow their domestic demand, saying, "...going forward, no nation should assume that their path to prosperity is simply paved with exports to America." Underlying this speech is an awareness of the struggles over leadership in economic cooperation and integration in the Asia-Pacific region. As Robert Schollay (2010) has noted, in the East Asian region, where growth has been remarkably strong, the U.S. harbors strong concerns over the progress of any regional economic integration initiative that would exclude it (ASEAN+3 and ASEAN+6), and through the TPP it has made clear its strong intent to maintain and deepen its economic involvement in East Asia. The U.S. strategy for trans-Pacific regional integration is to leverage an American-led TPP to create an FTAAP and use that as a basis for an APEC community. This American strategy, as Peng Hong Cai [2010] has pointed out, also represents an attempt to keep China's growing power in East Asia and the Pacific Rim in check. In that sense, it must be kept in mind that the TPP issue is not merely one of economics, but also an issue that has political, diplomatic, and security dimensions.

2. The Chinese response

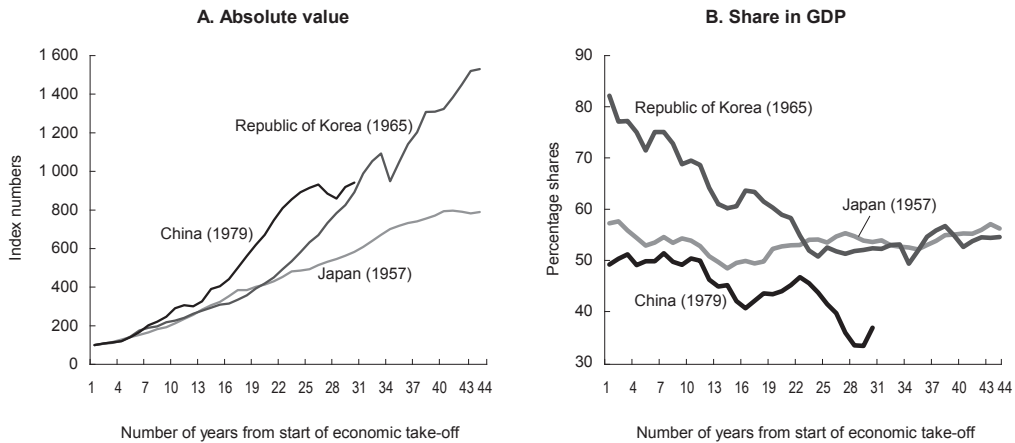
As UNCTAD (2010) has outlined, the main issues that China faces are redressing its external imbalances (large surpluses in BOCA) and in-

ternal imbalances (between consumption and investment). More than 30 years have passed since China embarked on its path of economic reforms (its policy of “reform and openness”) in 1978, an investment and export-led growth path that has brought about phenomenal economic development for the country.

There is a reason that China’s policy-makers emphasized the role of exports after its economic reforms. That is, per capita income in China was low, hence there was a limit to what could be achieved through domestic demand. It is common knowledge that China’s exports have driven domestic production. Exports backed by foreign investment have increased the country’s labor productivity, and that high level of productivity has allowed it to lower prices, become more competitive globally, and in turn expand its exports. On the other hand, China’s exports have been dominated by imported intermediate goods, with domestic added value accounting for only around half of its total revenues. The fact that domestic added value makes up such a relatively small share of exports is a reflection of the small degree to which exports have contributed to job creation in China. In fact, in 2007, there were only 70 million people employed in China’s export sector, which amounts to less than 10 percent of China’s entire workforce and only about 20 percent of wages and compensation.

Rates of individual consumption in China —regardless of whether they are viewed on a per capita or a GDP basis— are low by international standards. Per capita consumption in 2008 was a mere USD 758. Low and declining levels of individual consumption is a phenomenon not limited to China; it is common among rapidly industrializing countries during their economic takeoff periods. In fact, both Japan and South Korea experienced periods lasting roughly two decades after their economic takeoffs in which consumer spending levels fell, after which those ratios went on to turn around and rise. The main reasons were capital accumulation for the purposes of industrialization and high rates of gross fixed capital formation. What is peculiar about China is that, unlike Japan or South Korea, in the mid-2000s, even after 25 years had passed since its economic takeoff, the ratio of individual consumption fell sharply against the GDP, while the investment ratio surged (Chart 3). One can give two reasons for the drop in individual consumption rates. One is a high marginal propensity to save in household saving habits. This stems from employment instability and limited funds for expenditures on government medical care, education,

Chart 3. HOUSEHOLD CONSUMPTION IN CHINA, JAPAN AND THE REPUBLIC OF KOREA FROM START OF ECONOMIC TAKE-OFF (Index numbers on a logarithmic scale, initial year = 100, and percentage shares)



: UNCTAD secretariat calculations, based on *UNCTAD Handbook of Statistics* database; World Bank, *World Development Indicators*, and *Global Development Finance* database; and Japan, Economic and Social Research Institute (ESRI), *Annual Report on National Accounts of 2010*, Part 1.1.

: The year in brackets indicates when economic take-off began. For the definition of these dates, see note 17 in the text.

(Source) UNCTAD, *op. cit.*, p.45.

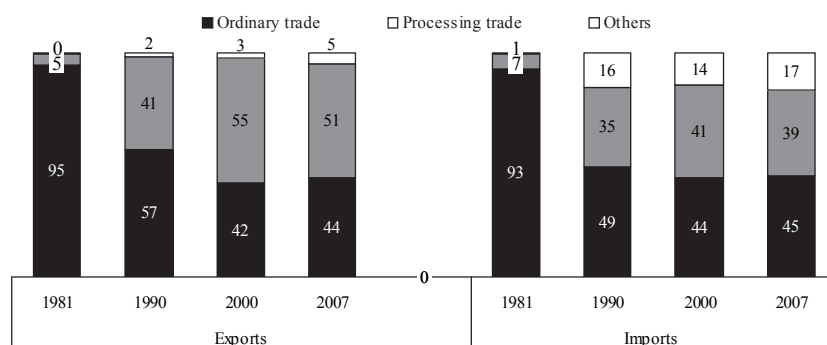
and pension plans following the reforms to state-owned enterprises in the mid-1990s. In other words, the social security system is still inadequate in China. The other reason involves the profits of state-owned enterprises. Compensation for labor peaked in the mid-1990s and then fell, which was caused by an increase in the profits of state-owned enterprises relative to the national income, while in contrast household incomes fell relative to the same (i.e. an imbalance between employee compensation and corporate profits). This is in part due to structural changes that occurred in the Chinese economy. After the mid-1990s, the value added by China's agricultural sector dropped, while the value added by the industrial and service sectors rose. However, due to the reforms to state-owned enterprises, wages in the latter sectors decreased. Furthermore, the contribution by foreign companies to job creation and wage increases was low. In addition, since there was an abundant supply of laborers willing to work at low-wages (unlimited supply of labor), growth in employee wages was held in check. Hence, savings rates in the household and corporate sectors that even ex-

ceeded the high investment ratio resulted in large surpluses in BOCA on one hand and imbalances between consumption and investment on the other.

Let us take a closer look at trade by China as it relates to global imbalances. Francoise Lemoine [2010] holds that the performance of Chinese exports over the past 30 plus years has been outstanding. China made particularly significant advances in trade in the 2000s. For the period from 2001 to 2008, the annual average growth rate was 24 percent for exports and 22 percent for imports. As for China's share of global trade, its exports and imports took up 9.0 percent and 7.0 percent respectively in 2008. China's share of the world's manufactured exports grew rapidly from 1.4 percent in 1990 to 4.4 percent in 2000 and to 12.6 percent in 2007. This was not merely a growth in volume. It represented a major transition in the makeup of China's exports from its traditional exports (textiles, clothing, toys, and miscellaneous goods) to more high-tech exports. For example, the ratio of electronics to the total went from 13 percent in 1995 to 21 percent in 2000 and 30 percent in 2007, while at the same time the proportion of textiles fell, going from 33 percent in 1995 to 26 percent in 2000, dropping all the way to 17 percent in 2007.

The chief driver of trade by China has been processing trade, for which China has become a global production center. International manufacturing has become more modularized since the 1990s, and with this trend, labor-intensive processes have been relocated from high-wage to low-wage countries. Amidst this new international division of labor, China has become a major base for global production. In terms of processing trade versus ordinary trade, the former has made major gains against the latter: for exports, processing trade rose from 5 percent vs. 95 percent in 1981 to 51 percent vs. 44 percent in 2007, and for imports, it grew from 7 percent vs. 93 percent in 1981 to 39 percent vs. 45 percent in 2007 (Chart 4). China's processing trade has the following characteristics:

- 1) Processed exports contain many imported components. The overwhelming majority of China's high-tech exports are attributable to assembly of high-tech parts.
- 2) Processing trade accounts for the majority of China's export surpluses.
- 3) Processing trade is characterized by geographical asymmetry in China's balance of trade. Specifically, components and intermediate goods are

Chart 4. China's Processing and Ordinary Trade (% of Total Exports or Imports)

(Source) Francoise Lemoine, "Past Successes and New Challenges: China's Foreign Trade at a Turning Point", *China & World Economy*, Vol.18, No.3, 2010, p.5.

imported from other Asian countries, and finished goods are exported to the U.S. and EU. In this triangular trade model, China has a trade deficit with other Asian countries but a trade surplus with the U.S. and EU.

In spite of these phenomenal achievements, there are also serious flaws in trade by China. First, China's trade sector has two very distinct tiers. Chinese companies (both private and state-owned) play only a limited role in processing trade and are mostly engaged in ordinary trade. Hence, local subsidiaries of foreign companies are overwhelmingly responsible for the export of high-tech products, and the gap in technological capabilities between foreign and domestic companies is widening. Second, overseas trade operations are concentrated along the China's coastal areas. Despite making up only 35 percent of China's GDP in 2007, the five areas comprising Beijing, Shanghai, Guangdong Province, Jiangsu Province, and Zhejiang Province accounted for 73 percent of the country's foreign trade (66% in 1995). In terms of reliance on trade, these five areas represented 124 percent, the coastal areas as a whole represented 93 percent, and inland China 13 percent (Chart 5). This concentration of trade operations along the coast is inhibiting the spread inland of technological innovation and profits derived from foreign trade. Third, Chinese exports are characterized by an unrelenting specialization in downmarket products. By combining high levels of productivity using imported technologies and capital with low-wage labor, Chinese exports have attained an extremely

Chart 5. The Five Provinces Leading China's Foreign Trade, 2007

	Share in China's GDP (%)	Share in China's foreign trade (%)	Foreign trade in percent of GDP
China	100	100	66
Beijing	4	4	67
Shanghai	5	13	171
Jiangsu	10	17	110
Zhejiang	7	9	81
Guangdong	12	30	160
Five provinces above	35	73	124
Coastal area	59	91	92
Inland area	41	9	13

(Source) Francoise Lemoine, *op. cit.*, p.10.

high degree of global competitiveness. China still specializes in supplying the world with low-priced products. In 2003, 72 percent of Chinese exports were low-priced products, 17 percent were mid-ranged, and 11 percent were high-cost products. The makeup of Chinese exports is such that even high-tech products are concentrated in the lower price ranges (Chart 6). For this reason, the unit value of Chinese exports is extremely low, amounting to about one-third that of products from Japan and the EU. This is one reason that the undervalued renminbi (a weak yuan) can support low-priced Chinese exports. On the other hand, imports to China are

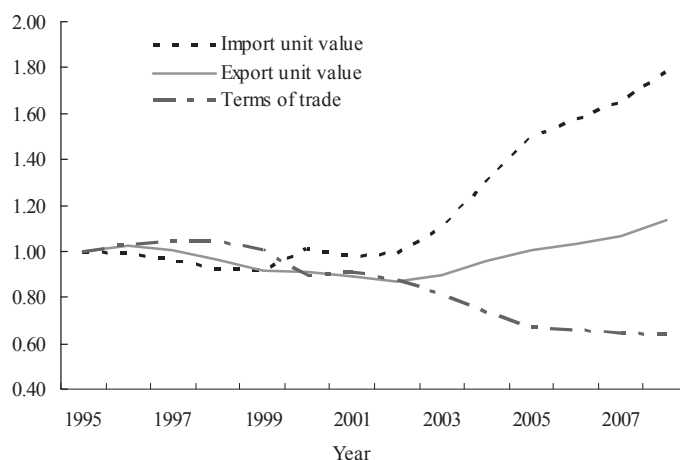
Chart 6. China's and India's Exports by Price/Quality Range: Share of Low, Medium and High Price Products in Total Exports (in Percent)

	1995	2003
China	Total exports	
High-price products	10	11
Medium-price products	20	17
Low-price products	70	72
Total trade	100	100
India	Total exports	
High-price products	15	18
Medium-price products	29	26
Low-price products	56	56
Total trade	100	100

(Source) Francoise Lemoine, *op. cit.*, p.11.

mostly mid-ranged and high-priced products. Due to this scissor effect between imports and exports, the fourth problem is that Chinese terms of trade rapidly deteriorated (Chart 7). Between 1997 and 2005, the price of Chinese exports to the U.S. fell 1.5 percent annually, but the cost of imports rose by more than that. China's foreign capital-dependent export-oriented industrialization policies mobilized low-wage labor to the export sector and penetrated the world's markets for low-priced products. This has, however, allowed developed nations to avoid competition in high-priced product markets, and to enjoy favorable terms of trade by importing low-priced products. As a result, the fifth problem is that in the 2000s, the external imbalances and internal imbalances became much more pronounced. Because the increase in Chinese exports proceeded much more rapidly than domestic production and domestic economic activities, the country became increasingly dependent upon foreign demand. In 2007 the dependence on foreign trade reached 66 percent, and the trade surplus had reached 7 percent of the GDP. China's large surplus in BOCA, i.e. its global imbalance, is a reflection of its domestic imbalance. As foreign demand (exports) increased, the link between domestic private consumption and the Chinese economy weakened. The ratio of household consumption to GDP fell from 46 percent in 2000 to 35 percent in 2007, but the investment ratio reached 40 percent. In these respects, China's economic development has become based on a model of unbalanced growth biased toward

Chart 7. Evolution of China's Export and Import Unit Value and Terms of Trade (1995=1)



(Source) Françoise Lemoine, *op. cit.*, p.12.

exports and investment. Such an economic development model is far from sustainable.

It should also be noted that the leaders of China themselves are well aware that its current economic development model, namely the investment- and export-driven development model, is unsustainable. Not long ago (October 27, 2010), the Communist Party of China published through the state-run Xinhua News Agency an outline of its 12th Five-Year Plan (2011—2015). The plan was adopted at the Fifth Plenum of the 17th Central Committee of the Communist Party of China, which concluded on October 18, 2010. The main goals are as follows (*Nihon Keizai Shimbun*, October 28, 2010):

- 1) To make the rate of increase in household revenues and incomes the same as the GDP growth rate
- 2) To achieve major decreases in energy consumed to generate the same monetary amount in GDP
- 3) To commence levying an environmental protection tax
- 4) To study ways to push through real estate tax reform
- 5) To create mechanisms to handle labor disputes
- 6) To protect maritime interests

The direction that the new Five-Year Plan seeks to take is first to accelerate the shift in its economic course to one that values the quality of economic growth over the rate of economic growth. Second, the plan seeks to achieve growth that strikes a good balance between environmental concerns and the correction of regional disparities and gaps between the rich and poor. This is symbolized by the plan's stated goal of "development marked by harmony between people and nature". Third, the plan strives to reduce China's dependence on exports and switch over from a model of export-driven growth to one driven by domestic demand and higher domestic consumption.

It is interesting to note that, as Yuji Miura (2010) has already pointed out, the goals of the new Five-Year Plan outlined above were things that were previously incorporated into the 11th Five-Year Plan. The previous plan was rooted in the strategic notion of creating a "Harmonious Society", which was viewed as a logical extension of the "Scientific Development Concept" and "Common Prosperity" vision. Based on this notion, the old

plan called for: 1) a transition to domestic demand-led growth, 2) the transition to a recycling-based economy, 3) the transition to a high value-added economy, 4) the creation of a Harmonious Society, and 5) the further advancement of economic reforms and “openness”.

The failure to meet these goals was tied to the global economic crisis. To overcome the effects of the crisis, China introduced a major economic stimulus package worth RMB four trillion, and by doing so was able to effect a recovery in growth levels, but the growth model remained dependent upon investment and exports, as it had been before. As a result, numerous side effects of this model began to manifest themselves in more serious ways. For example, dependence upon investment brought about a real estate bubble, environmental destruction through overdevelopment, the squandering of resources, the widening of economic gaps between rich and poor and among different regions, and others, while the continued dependence on exports led to increased exposure to vulnerabilities brought about by fluctuations in external demand (and as a consequence a loss of jobs and output), trade friction, increased pressure to revalue the currency, and many more. The new Five-Year Plan seeks again to create the Harmonious Society by achieving Common Prosperity, but the key to that is the transition to an economic growth model driven by domestic demand, and in particular the growth of household consumption. To that end, fundamental reforms in the civil sector, such as increasing labor’s share of income, improvements to social security programs, etc. are essential. The Chinese economy is at a crossroads, and its path will be determined by whether it can make the transition to a domestic demand-led economic growth model so that it can simultaneously correct external and internal imbalances.

III. JAPAN’S ECONOMY IN THE WAKE OF THE GLOBAL ECONOMIC CRISIS

1. The problem of triangular trade in the Asia-Pacific region

The two biggest factors in the development of the economies of East Asia before the global economic crisis were the formation of modularized networks of international production and the practice of triangular trade. As Chart 8 “Major Flow of Intermediate Goods and Finished Goods in Asia (Electrical / Electronic)” shows, in the period from 1998 to 2008, the exports of intermediate goods from Japan, South Korea, Taiwan, and ASEAN countries to China and Hong Kong increased by a factor of 3.2, 10.9, 4.9,

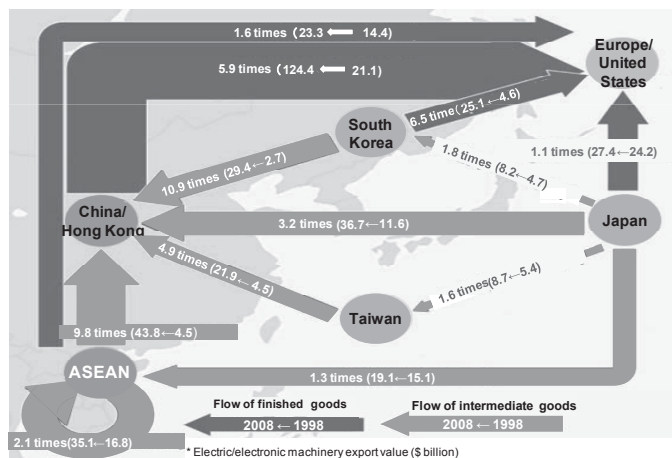
Chart 8. Presence of China and South Korea increasing in the electrical/electronic fields

○ Division of labor is making particular progress in the electrical/electronic fields. Over the past 10 years, exports of finished goods from China and South Korea to Europe and the United States have increased about 6-fold.

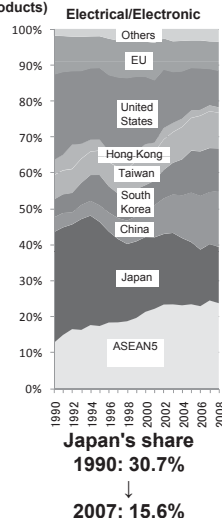
○ Japan's exports of intermediate goods have expanded, but its share in the world's intermediate goods exports to East Asia has decreased. There has been an increase in establishment of local production bases.

Model flow of assembling parts in Asia and exporting the finished goods to Europe and the United States

Major Flow of Intermediate Goods and Finished Goods in Asia (Electrical/Electronic)



Regional Shares of the Export Value of the World's Intermediate Goods to East Asia (Major Products)



(Source) METI (The Japanese Ministry of Economy, Trade and Industry), *White Paper of International Trade and Economy 2010*, p.174.

and 9.8, respectively. Meanwhile, exports to the U.S. and EU of finished goods assembled in China and Hong Kong from imported intermediate parts also saw a major jump during this period, increasing by a factor of 5.9. However, the decline in demand in Western economies brought about by the global economic crisis caused a massive drop in exports from East Asia to the U.S. and EU. Thus, the limitations of development based on the conventional triangular trade pattern were exposed.

Masahiro Kawai (2010) holds that: 1) the recent global economic crisis means that it has become nearly impossible for Japan to sustain growth that is led by foreign demand dependent upon western markets and the country must therefore make the transition to an internal demand-driven economic development model, but 2) because Japan is plagued by the problem of an aging population and low birth rates, domestic demand will not be enough to sustain growth, so the country should incorporate the vitality of the rapidly growing markets in Asia, i.e. internal Asian demand, by pursuing regional economic integration with Asia. He also identifies the fol-

lowing five challenges as important to the future of Asia:

- 1) The development of broad regional infrastructures in Asia (ADB, *Infrastructure for a Seamless Asia*, 2009)
- 2) The promotion of a “Green New Deal” for Asia: Utilizing Japanese environmental technologies
- 3) The reinforcement of social security policies such as medical care, health care, and education in Asia’s emerging economies
- 4) The formation of region-wide economic partnerships encompassing all of East Asia
- 5) The stabilization of currencies and finance in Asia

2. Incorporating internal demand in Asia into Japan’s economy and developing the Mekong region

Faced with new problems and economic conditions in the wake of the global economic crisis, the Japanese government and business community (and particularly the Japan Business Federation, or Nippon Keidanren) responded immediately and launched new policies. Two key components of these policies were: 1) incorporating internal demand in Asia into Japan’s economy, and 2) developing the Mekong region. The former entails taking the production networks that have been formed in East Asia so far, transforming them into production and sales networks, and leveraging them to expand the consumer markets in East Asia. Mekong development, on the other hand, involves building infrastructures in East Asia in order to facilitate economic integration and correct economic disparities in the region (i.e. overcoming the so-called “ASEAN divide”).

In a speech titled “Overcoming the Economic Crisis to Rekindle a Rapidly Developing Asia” (May 21, 2009, Tokyo), then Prime Minister Taro Aso put forth the Asian Growth Initiative (a plan to double the scale of Asia’s economy by 2020 by providing aid to Asia in the form of ODA grants and loans totaling USD 67 billion). The argument presented was that Asian economies, which have till now been driven by exports, should be shifted to internal demand-based economies, but to do so it would be necessary to enlarge Asia’s middle class by creating broad regional infrastructures and improving social security and education systems. Particular emphasis was placed on Mekong region development (Chart 9).

Prime Minister Yukio Hatoyama also placed a high priority on the de-

Chart 9. Domestic and foreign integrated economic measures

○ Adding to domestic demand expansion, Japan will promote domestic and foreign integrated economic measures aiming to grow with Asia by promoting expansion of domestic growth of Asia, the “Growth center in the world.”

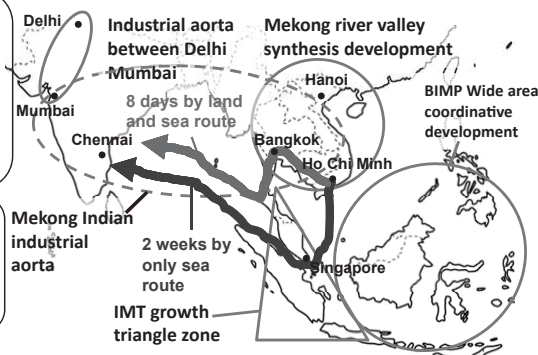
(1) Drive forward the concept of doubling the size of Asia's economy

- Cooperation in maintenance of the large area infrastructure and the social security system, etc. to expand domestic demand of Asia.
- Promote economic cooperation with Asia such as system sharing is promoted (utilizing APEC 2010 in Japan).

By utilizing the Economic Research Institute for ASEAN and East Asia (ERIA), establish the foundation for distribution infrastructure (industrial aorta, etc.) aiming for market integration of east Asia. (Right figure)



June 3, 2008
ASEAN board of directors when ERIA is established



e.g. Approx. 2 weeks is needed to go from Ho Chi Minh (Vietnam) to Chennai (India) via sea route of Strait of Malacca.
When the land /sea route connecting Cambodia and Thailand is established, it will be shortened to 10 days and will be 8 days if Japanese traffic technology etc. were to be introduced.

Note: BIMP: Brunei, Indonesia, Malaysia, and the Philippines.
IMT: Indonesia, Malaysia, and Thailand.

(Source) METI, *White Paper of International Trade and Economy 2009*, pp.271-272.

velopment of the Mekong region. Hatoyama held the first Japan-Mekong Summit Meeting (November 7, 2009, Tokyo), where he stated, “...I believe that with regard to the manner in which we redress intraregional gaps and develop jointly, the Mekong region will hold the key in the open and transparent East Asian community initiative that I have been advocating,” and proposed what would become the Japan-Mekong Action Plan 63, and initiative pledging JPY 500 billion in ODA over three years to assist with development in the Mekong region.

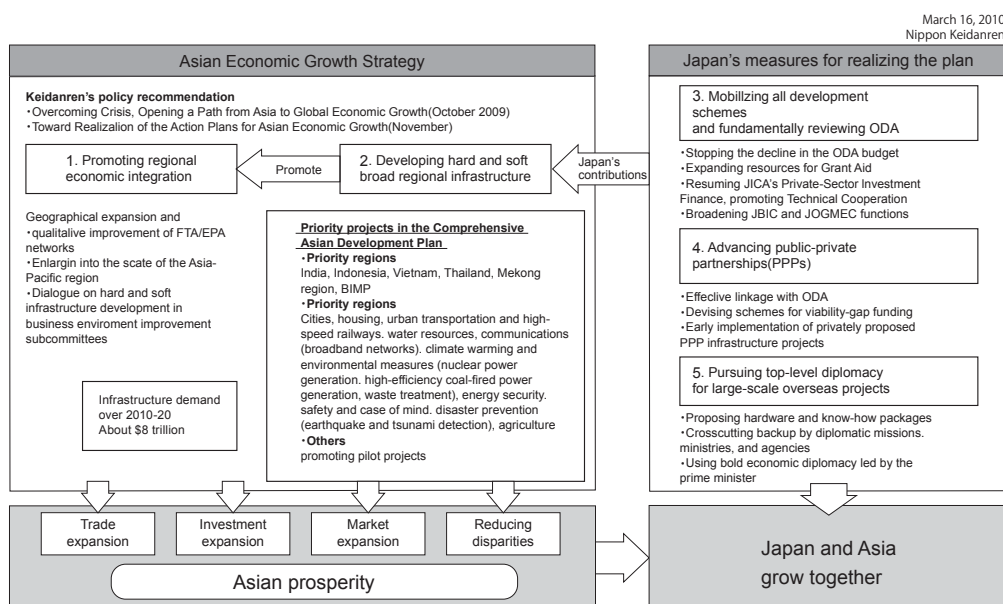
At the same time, members of the Japanese business community have likewise come up with ambitious proposals. Nippon Keidanren, in a proposal titled “Overcoming Crisis, Opening a Path from Asia to Global Economic Growth” (October 20, 2009), expressed its belief in the potential for sustained growth in Asia, noting its 1) expectations for Asia playing not only the role of the “Factory of the World”, but also new roles as an “end consumer market”. The proposal also expressed the view that growth of the middle

class has been remarkable in China, India and ASEAN countries, but that it is important for Asia to make the transition to internal demand-led economies by cultivating regional (i.e. intra-Asian) demand, and to achieve this, 2) “market expansion and trade investment stimulation through the promotion of regional economy integration, and the resolution of bottlenecks for growth by developing both ‘hard’ and ‘soft’ infrastructures, are required.” Nippon Keidanren subsequently issued a proposal called “Toward Realization of the Action Plans for Asian Economic Growth” (November 17, 2009), which outlined the following seven steps of action:

- 1) Promote regional economic integration to facilitate economic activities. Expand the coverage of and improve the economic network formed by accumulated comprehensive EPAs and FTAs.
- 2) Provide stable medium- and long-term funding. Make efforts to prevent another financial crisis and to stabilize Asian currencies. To create markets for the issuance and distribution of bonds and other securities in Asia and facilitate the circulation of the massive private savings in the Asian region as investments.
- 3) Advance broad regional infrastructure development. Take steps to redress intraregional economic gaps by creating region-wide distribution infrastructures, thereby paving the way for the deployment of international production networks.
- 4) Enhance the development of “soft” infrastructures, including legal systems, mechanisms for training human resources, and technological cooperation schemes.
- 5) Boost demand within Asia. Domestic demand is growing with the rapid rise of the middle class in Asia. Take steps to transform economies into those fueled by domestic demand-led growth.
- 6) Balance environmental concerns and economic growth.
- 7) Promote the reform of Japan's ODA and other official flows.

Nippon Keidanren has also released a proposal concerning infrastructure creation called “Promoting Regional Infrastructure Development for a Prosperous Asia” (March 16, 2010) (Chart 10).

One work that can be cited as the most comprehensive amalgam to date of the plans of the Japanese government and business community (Nippon Keidanren) that we have looked at so far is the Comprehensive

Chart 10. Promoting Regional Infrastructure Development for a Prosperous Asia

(Source) The Japanese Federation of Economic Organizations' Home Page, March 16, 2010.

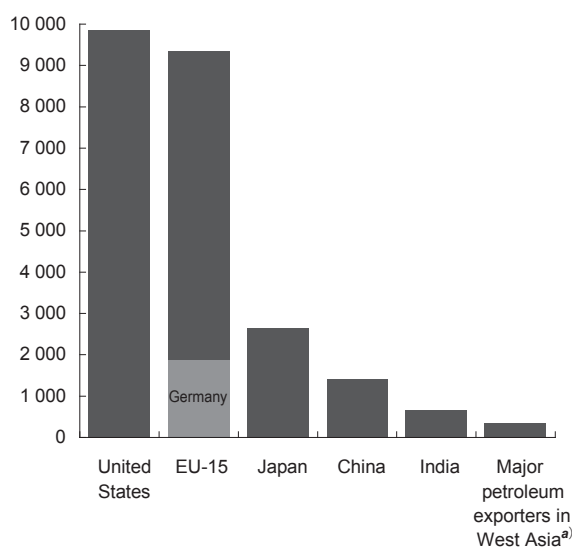
Asian Development Plan (CADP), compiled by ERIA. As mentioned above, CADP was submitted by the Japanese delegation at the 5th East Asia Summit (October 30, 2010, Hanoi). Fukunari Kimura (2010), one of the researchers central to the drafting of CADP, argued that production networks unique to East Asia have formed in the region, and that we are seeing increasingly advanced stages in the agglomeration of industry and the fragmentation of production processes. Nevertheless, according to Kimura, the degrees of both economic development and economic disparity in East Asia are large, and CADP aims to incorporate international production networks in areas that have fallen behind in economic performance and to correct East Asia's economic disparities. From our perspective, however, this is a typical example of a public-private sector partnership. To begin with, one can conclude that the motives of the Japanese government are to revive and revitalize the Japanese economy by including Asia and Japanese government projects in Asia as one of the main pillars of its New Growth Strategy (adopted by cabinet resolution on June 18, 2010), which consists of 21 government projects in seven fields. Next, given that the more than 600 individual projects called for to achieve CADP's goal of dou-

bling the scale of the economies of Asia —projects that are worth a staggering total of about USD 290 billion (roughly JPY 25 trillion)— the goal of the business community is likely to seize as many business opportunities as possible while receiving government aid for market development and infrastructure construction projects in East Asia. Investment funds are expected to fall short particularly for broad regional infrastructure development projects such as the one in the Mekong region, so the idea is to cover those funds through public-private partnerships (PPPs). It is probably no secret to many that behind these PPP projects lurks a strong desire to “regain ground” from China, which is increasing its presence and influence in East Asia, particularly in the Mekong region.

IV. PROSPECTS

Though originating in the United States, the economic crisis has had a tremendous impact on the global economy, and particularly the economies of East Asia. This was because the U.S. was by far the world’s greatest consumer (Chart 11-1 and Chart 11-2). The monetary amount of U.S.

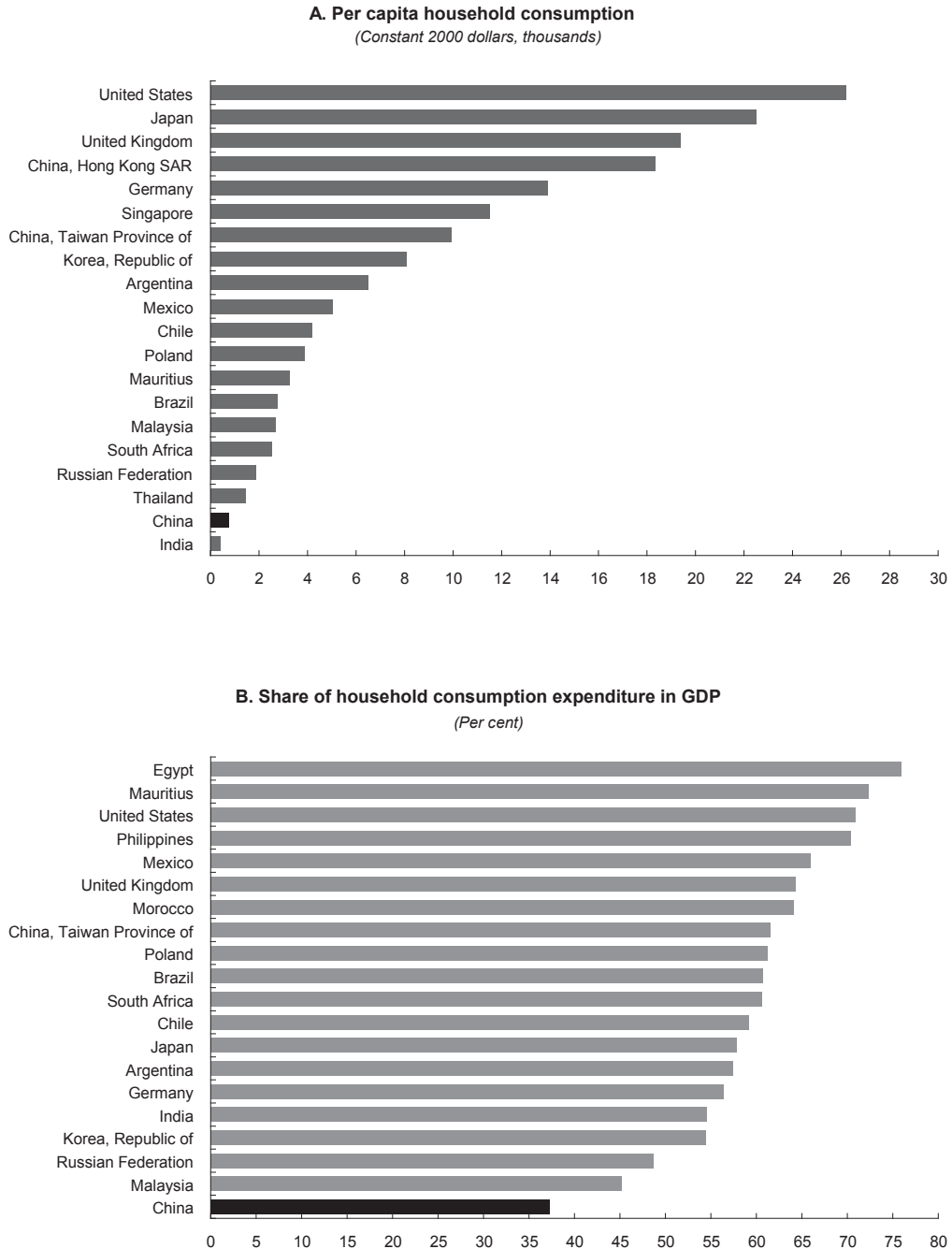
Chart 11-1. HOUSEHOLD CONSUMPTION IN SELECTED COUNTRIES AND COUNTRY GROUPS, AVERAGE FOR 2007–2008 (*Billions of dollars*)



(Source) UNCTAD *op. cit.*, p.44.

a) Bahrain, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, Syrian Arab Republic and United Arab Emirates.

Chart 11-2. PER CAPITA HOUSEHOLD CONSUMPTION EXPENDITURE AND SHARE OF HOUSEHOLD CONSUMPTION EXPENDITURE IN GDP IN SELECTED COUNTRIES, 2008



(Source) UNCTAD *op. cit.*, p.49.

consumption before the crisis accounted for about 16 percent of the world's total production output, with a significant portion of it attributable to imports. During the period from 2000 to 2007, the U.S. dependence on imports rose from 15 to 17 percent, creating an increase in global demand equivalent to USD 987 billion. Hence, a decrease in American consumption translates into a global decline in production and exports to the U.S.

UNCTAD (2010) has studied the effects of declines in U.S. consumer demand on the global economy and has determined that it causes two serious problems. The first involves the question of which countries are able to take up the slack caused by downturns in U.S. consumption. If levels of consumption are scored on a scale of zero to 100 where the U.S. scores 100, China's score is a mere 20, meaning that it cannot make up for U.S. declines. Another problem lies in the makeup of imports. While U.S. imports are dominated by consumer goods, the imports of China and emerging economies are mostly made up of producer goods and raw materials, energy supplies, foods and such, so structurally speaking it is a leap to expect such countries to make up for declines in American consumption. The UNCTAD (2010) report presented a bleak outlook, namely that the world economy after the global economic crisis will not be able to recover easily from the deflationary trend caused by the stagnation in trade and output.

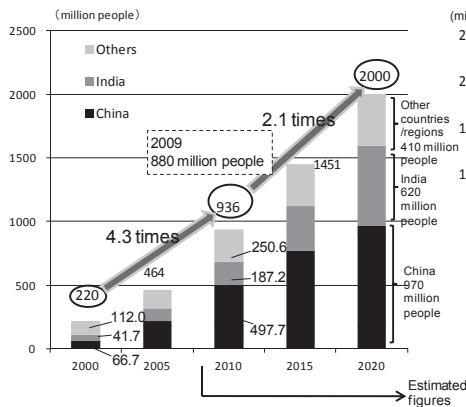
The UNCTAD (2010) report makes a very valid point in that in the framework of the U.S.-China trade imbalance it is hard to argue for decoupling, leaving coupling as the favorable alternative. Nevertheless, as noted in the *White Paper on International Economy and Trade* of METI (2010 Edition), the middle-income population of Asia (households with a disposable income from USD five thousand to 35 thousand) is rapidly growing, jumping from 220 million in 2002 to 940 million in 2010. This segment is expected to reach two billion people in 2020 (Chart 12). The UNCTAD (2010) report is undoubtedly correct in concluding that China alone cannot take up the equivalent slack caused by a drop in U.S. individual consumption levels. However, as Chart 13 "Asian region expected to become the world's major consumer market" shows, if we take 2008 as an example, the value of U.S. consumption was USD 9.86 trillion, while the total for all of Asia (which here refers to Japan, China, NIES3 [South Korea, Taiwan, and Hong Kong], ASEAN nations, and India) reached USD 6.62 trillion, or 67.1 percent of the U.S. figure. Furthermore, when one looks at the projected figures for 2020, Asia is expected to surpass the U.S., with USD 15.78

Chart 12. Middle- and high-income segments expanding in Asia

○Middle-income population in Asia is expected to swell to 2 billion. High-income population in Asia excluding Japan will exceed that of Japan within the next 5 years.

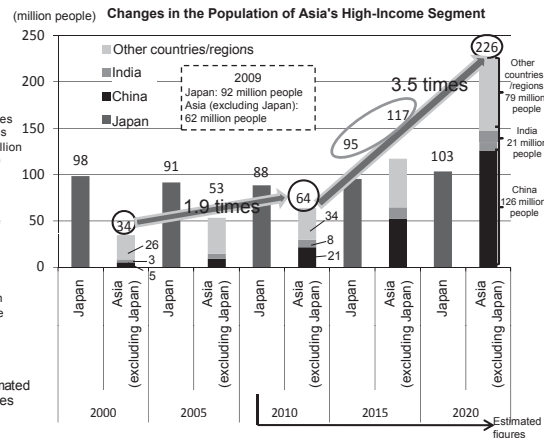
Asia's middle-income population will more than double within the next 10 years.

High-income population in Asia (excluding Japan) to exceed that of Japan within the next 5 years



Notes: Number of households by household disposable income. "Asia" denotes China, Hong Kong, Taiwan, India, Indonesia, Thailand, Vietnam, Singapore, Malaysia, and the Philippines. Figures for 2010, 2015, and 2020 are estimates by Euromonitor International. Source: Compiled using data from Euromonitor International 2010.

* Asia's middle-income segment denotes the segment with household disposable income of \$5,000 or more and less than \$35,000.
Asia's high-income segment denotes the segment with household disposable income of \$35,000 or more.



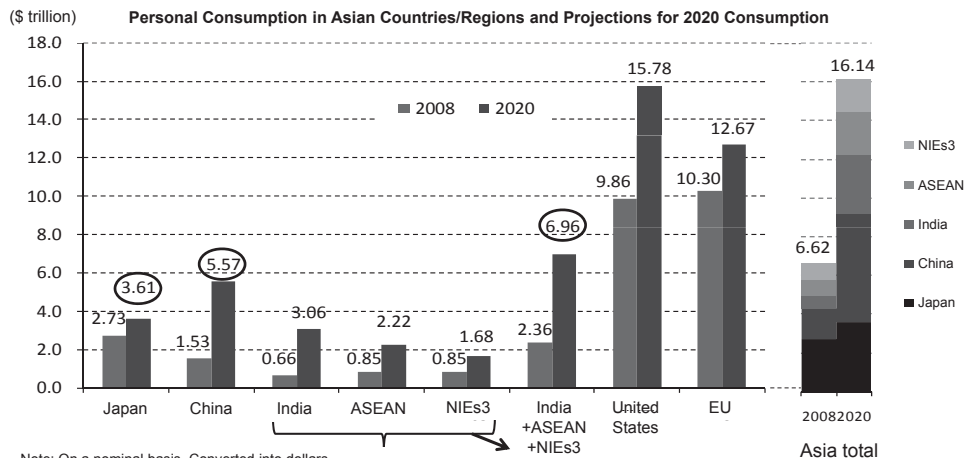
Notes: Number of households by household disposable income. "Asia" denotes China, Hong Kong, Taiwan, India, Indonesia, Thailand, Vietnam, Singapore, Malaysia, and the Philippines. Calculated by multiplying the percentage of households of each income segment by the population.

(Source) METI, *White Paper of International Trade and Economy 2010*, p.187.

Chart 13. Asian region expected to become the "world's major consumer market"

○China is expected to overtake Japan to become Asia's largest consumer market by 2020.
○Asia's overall consumption is likely to expand to about 4.5 times that of Japan, surpassing Europe and leveling with the United States.
○Business opportunities will further increase for the Japanese industry.

Asia's consumption is expected to expand to about 4.5 times that of Japan by 2020.



Note: On a nominal basis. Converted into dollars.

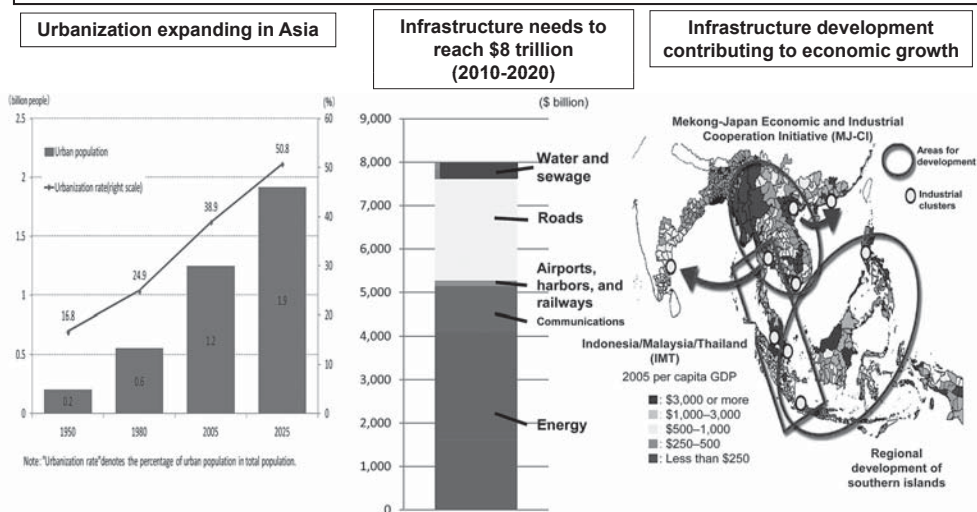
(Source) METI, *White Paper of International Trade and Economy 2010*, p.187.

trillion for the U.S. and USD 16.14 trillion for Asia. Given these data, Japan should choose a course in which it joins Asia in its growth, contributes to it, and together enjoys the fruits of prosperity in the 21st century. To this end, however, it is necessary to overcome the bottlenecks created by under-developed infrastructures (industrial, lifestyle-related, and logistics infrastructures; specifically, those for energy [power], communications, transport [airports, harbors, railways, and roads], and running water and sanitation). According to a study by the ADB (2009), over the 2011 to 2020 period about USD eight trillion in infrastructure investments will be needed (Chart 14), and if such investment is provided the real income of developing countries in Asia would be raised by about USD 13 trillion.

It is necessary for Japan to take steps toward regional cooperation (regional integration) for a harmonious and mutually prosperous future with the growing and thriving countries of Asia, and especially the countries of East Asia, with which Japan already has close economic ties. To do so, Japan should work to build an East Asian community. It is with this ideal in mind that I wish to revisit the issue of the TPP and conclude this exami-

Chart 14. Infrastructure Development to Promote Growth in Asia

- Infrastructure needs are expected to build up in Asia in line with urbanization (\$8 trillion by 2020).
- Infrastructure development is expected to bring significant economic benefits through upgrading industrial clusters and forming efficient industrial corridors.



(Source) METI, *op. cit.*, p.207.

nation.

First, it would be worth examining the historical developments in terms of regional cooperation (regional integration) in the Pacific Rim that have led up to the TPP. Keeping in mind that the latter half of the 1980s saw a rise in a tendency toward regionalism across the globe, which culminated in the 1990s in the formation of the EU (1992) and NAFTA (1993), the first leader to propose regional cooperation in East Asia was then Prime Minister of Malaysia Mahathir Mohamad. In 1990 Mahathir put forth a concept called the East Asian Economic Group (EAEG). The idea behind the EAEG was to form an East Asian economic zone that excluded the U.S.

Facing such developments, the U.S. was forced to rethink its strategies for East Asia. The U.S. response, delivered by then Secretary of State James Baker, was one that was severely critical of Mahathir's vision, calling the EAEG "drawing a line down the middle of the Pacific" and separating the United States from East Asia. The U.S. is located at the conceptual "hub of the wheel" that forms the Asia-Pacific region, with the U.S.-Japan alliance forming the hub, the U.S.-Korean alliance to the north, the ASEAN nations to the south, and further to the south is the alliance with Australia. The structure of this strategic framework is such that when its spokes are connected to the whole the common interests represented by APEC emerge. Put differently, because the U.S. has vital interests in the Asia-Pacific region, it was unable to accept the EAEG, from which it was excluded, so instead it proposed APEC, and leveraging its powerful military might it sought to restructure and strengthen alliances and make up for the influence it had lost in the region.

After the strategic announcement by Secretary Baker, APEC was suddenly pushed to the center of the limelight. It is a well-known fact that after the 5th APEC ministerial meeting held in 1993 in Seattle under strong pressure from President Bill Clinton (which was also the first informal summit), APEC, which was still a loose deliberative body that had only formed a few years earlier in 1989 and did not yet to have the substance befitting an economic cooperation organization, was thrust into a central role within the United States' Pacific Rim policy. One fact we must not overlook here is that APEC was originally conceived as a deliberative body for the purpose of international economic cooperation in the Asia-Pacific region, but it has since come to be perceived in U.S. strategy as an integral

part of the country's security policy. Furthermore, the exact same thing could be said of APEC even after the collapse of the Soviet Union and the socialist states of the Eastern Bloc from 1989 to 1991 —i.e. the end of the Cold War— with respect to U.S. policy in East Asia.

In February of 1995 the U.S. Department of Defense laid out its strategic vision for East Asia (called the "United States Security Strategy for the East Asia-Pacific Region"). This strategy was developed under then Assistant Secretary of Defense for International Security Affairs Dr. Joseph Nye, and is often referred to as the "Nye Initiative". The main points of this strategic vision were: 1) that the U.S. had become increasingly dependent upon the economic opportunities (trade, investment, employment, etc.) provided by economic development in East Asia; 2) the American security presence and bilateral military alliances had helped provide the "oxygen" for East Asian development, 3) to support security commitments and ensure economic development in East Asia, the U.S. would maintain a force of around 100,000 military personnel (47,000 in Japan and 36,000 in South Korea). It is clear from this document that economic and security matters were viewed as one issue, or two sides to the same coin.

The next major development in regional cooperation in East Asia came in 1997 with the Asian financial crisis. The IMF, which was under the strong influence of the United States, issued the wrong "prescription" for the problem, which only worsened the crisis. This led to unprecedented levels of distrust in the IMF and the U.S. and exposed the incompetence and wholly dysfunctional nature of APEC, which led in December of 1997 to the 1st ASEAN+3 Summit and the beginning of a new form of regional cooperation that was capable of dealing with the crisis. The structure of the ASEAN+3 was more or less the same as that of EAEG, and in fact was viewed as a resurrection of EAEG. I have already noted that not only the ASEAN countries but also China has put its support behind this ASEAN+3 framework. Japan, on the other hand, though it is a participant in ASEAN+3, supports the ASEAN+6 scheme following the East Asia Summit forum that began in 2005. The reason for the addition of three additional countries (India, Australia, and New Zealand) to ASEAN+3 was two-fold: Japan wanted to offset the expansion of Chinese influence in ASEAN+3 by adding another major power, namely India, and 2) the inclusion of Australia and New Zealand —and particularly Australia given its alliance with the U.S.— would allow Japan to save face when deferring to

the U.S., which is characteristic of Japanese diplomacy, by letting another country act as a surrogate voice for wishes of the U.S. As these two points illustrate, Japan places a high priority on relations with the U.S. even in the context of creating an East Asian community.

In his paper "Observations at the Yokohama APEC Summit on the past, present, and future of the Asia-Pacific region" (in Japanese), Akio Watanabe (2010) argues that the options in front of us can be boiled down to two choices: following the Asia-Pacific cause or the East Asia cause. He asserts that if we view the matter from a higher-order, broader perspective, the correct choice is to follow the Asia-Pacific cause (i.e. the APEC-sided view), because, he states, since the 1960s economic development in the Asia-Pacific region has been possible because of the generally stable international climate, and the foundation for that has been the ability of the U.S. to guarantee security, as well as the existence of the Japan-U.S. security arrangement. As Nobuhiro Suzuki (2010) and others have warned, it will not just be agriculture that suffers losses in the TPP. Its effects will be seen in no small measure on textiles, leather products, footwear, sheet copper and many other industrial products, and because the TPP is a comprehensive FTA, there is ample danger of difficult times besetting a broad range of other fields, such as finance, medical care, labor mobility, and many more. The following question then arises. Given these hazards, why did the Kan cabinet bring up the issue of TPP participation? As Makoto Taniguchi (2011) has pointed out, the reasons involve the recent destabilization of relations among East Asian powers (specifically the friction with China over the Senkaku Islands, the North Korean problem, and the dispute with Russia over the northern territories). One might conclude that Japan is beginning to distance itself from other Asian countries and strengthening ties with the U.S. once more in the interests of security. In fact, the new National Defense Program Guidelines (adopted by cabinet resolution on December 17, 2010), which set forth the principles for defense capabilities for the decade from 2011 to 2020, corroborate this conclusion in a rather straightforward manner.

The new National Defense Program Guidelines differ from the previous guidelines in the following ways. First, they represent a fundamental rethinking of the concept of "basic defense" (exclusively defensive "static defense"), which has been at the foundations of the defense forces since the National Defense Program Guidelines were first established in 1976,

in that they introduce the concept of “dynamic defense”. The guidelines stress that:

“...Japan’s future defense forces need to acquire dynamism to effectively deter and respond to various contingencies, and to proactively engage in activities to further stabilize the security environment in the Asia-Pacific and to improve the global security environment. Japan should no longer base its defense on the traditional defense concept, “Basic Defense Force Concept,” which places priority on ensuring deterrence through the existence of defense forces per se.

The second point concerns the Japan-U.S. alliance. The guidelines go on to state:

In light of the significance of the Japan-U.S. Security Alliance as described above, Japan will further deepen and develop the Alliance to adapt to the evolving security environment. In doing so, Japan will continue to engage in strategic dialogue and specific policy coordination with the United States, including bilateral assessment of the security environment and bilateral consultations on common strategic objectives, and roles, missions and capabilities.

They even go so far as to declare, “...Japan will strengthen its cooperation with the Republic of Korea and Australia, which are allies of the United States [...], through bilateral initiatives and multilateral cooperation involving the United States.” The third and last point concerns relations with China. In response to the rise in Chinese military might, the guidelines set forth principles for strengthening the defense of the Nansei Islands in which the Self Defense Forces are not currently stationed. This marks a shift in the focus of defense force deployment from the north (defense against attacks from the USSR/Russia) to the southwest (defense against attacks from China).

The major change in course that joining the TPP would necessitate, namely a change taking Japan away from its commitments to regional cooperation in East Asia, where ever closer economic ties are being built with China and other countries in the region (leading to the creation of an East Asian community), and instead in a direction driven by Japan’s military al-

liance with the United States (the creation of an APEC community), would amount to “abandoning Asia to take sides with America”, so to speak, as well as going against the wishes of the majority of the people of Japan.

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