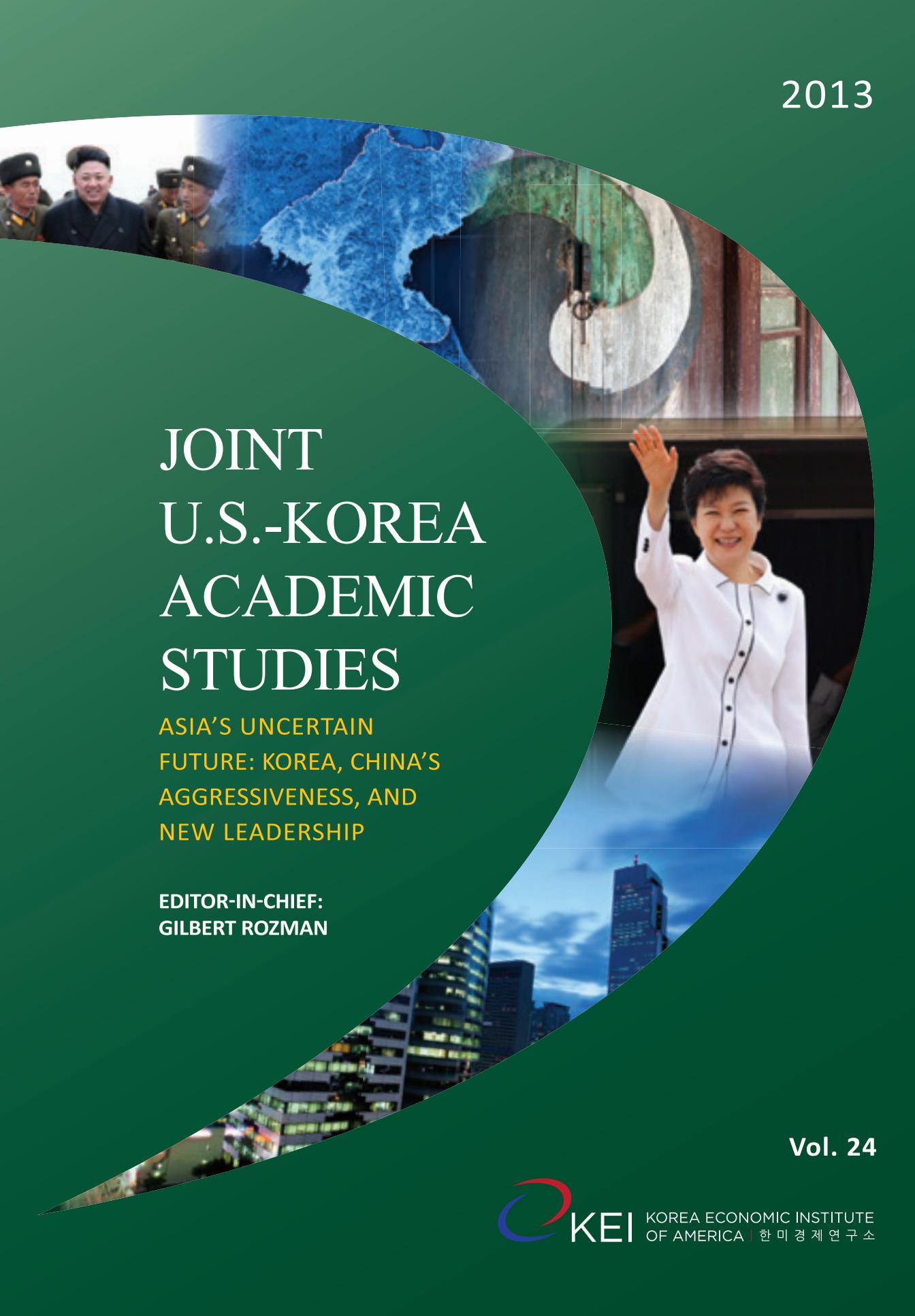


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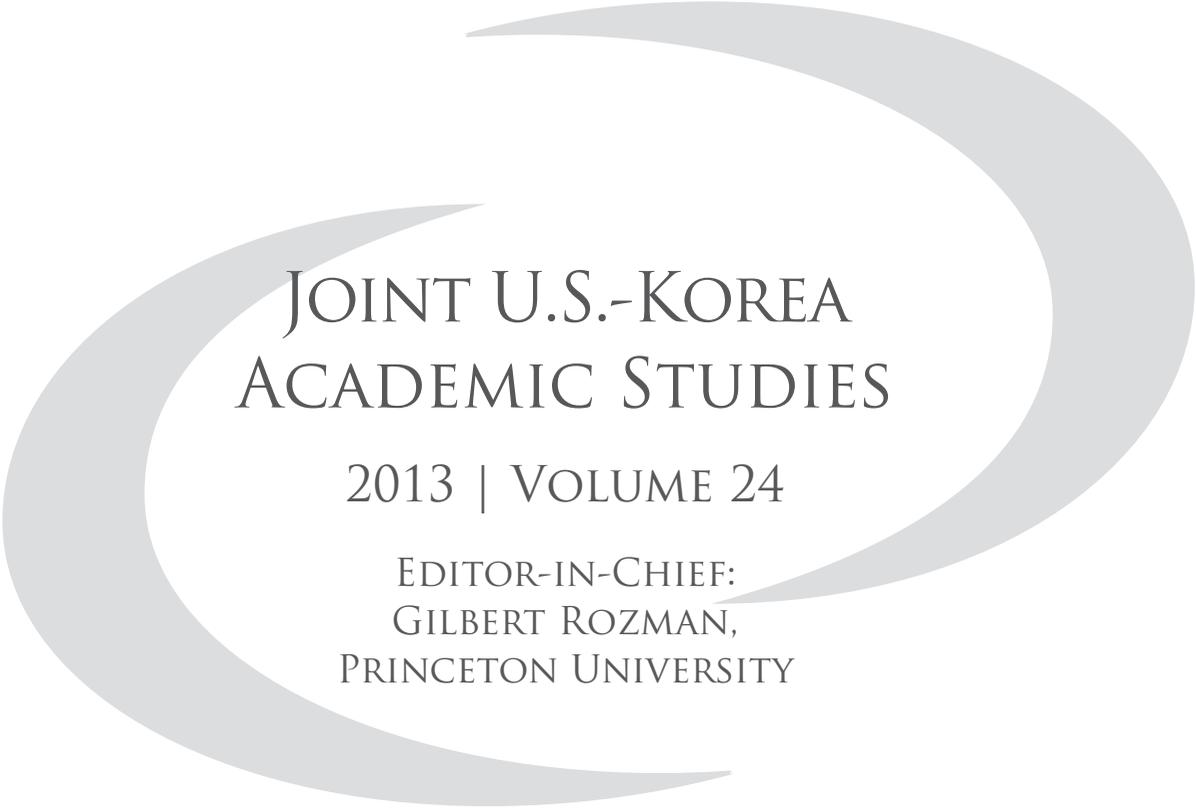


# JOINT U.S.-KOREA ACADEMIC STUDIES

ASIA'S UNCERTAIN  
FUTURE: KOREA, CHINA'S  
AGGRESSIVENESS, AND  
NEW LEADERSHIP

EDITOR-IN-CHIEF:  
GILBERT ROZMAN

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CJK ECONOMIC TRILATERALISM:  
THE PROSPECTS AND PERILS  
OF A NEW FTA

# The Japanese Perspective

T.J. Pempel

On November 20, 2012, at the Japan-China-ROK Economic and Trade Ministers' Meeting in Phnom Penh, Cambodia,<sup>1</sup> Ministers Edano Yukio, Chen Deming, and Bark Tae Ho, announced that they were launching negotiations to forge an FTA among their three countries. The announcement and the negotiations were the next logical step in a series of deepening and more institutionalized economic ties among the three countries that had been advancing for at least two decades.

China, Japan, and South Korea's increasing economic interdependence has been the immediate consequence of deepening cross border investment and trade, both linked to the growing significance of East Asia's regionally based multinational production facilities. UNCTAD estimates that intra-Asian investment now accounts for at least 40 percent and as much as 50 percent of total Asian FDI.<sup>2</sup> Investment and trade have soared in tandem, with particular gusto since the 1997-98 financial crisis (see Figures 1-4). By 2001 China had become the ROK's number one target for outgoing investments and in 2002 China-Hong Kong became South Korea's largest export market, replacing the United States. China has also replaced the United States as Japan's number one trading partner and has also become a major destination for outgoing Japanese FDI. China-based Japanese firms have become a key engine in Japan's still limp economic growth. Chang-Jae Lee's chapter provides more extensive data on these ties and the rising interdependency that has resulted. In addition, China is the major destination for Taiwanese FDI and is far and away Taiwan's leading economic and trade partner.

Paralleling Northeast Asia's regional economic integration has been the expansion and deepening of regional institutions. For Japan, Korea, and China, the most important of these started in mid-1995 when ASEAN initiated an expansion in its geographical reach by inviting the three Northeast Asian countries to join them in the ASEAN+3, which then expanded from a series of meetings among senior officials into an annual meeting of heads of state. It has since been active in promoting financial cooperation through the Chiang Mai Initiative (CMI) as well as two regional bond market initiatives. CMI has deepened its resources, become multilateralized in its holdings now known as Chiang Mai Initiative Multilateralization, decoupled itself steadily from rigid IMF conditionality, and now has a single contractual agreement to allow members to draw on emergency funds.<sup>3</sup> Japan, along with Korea and China, has been an active proponent of these initiatives.

In addition, all three countries are active members in the virtual alphabet soup of regional institutions complementing the ASEAN+3: APEC, ARF, and the East Asia Summit (EAS). The three were also active in the now suspended Six-Party Talks as well as at least twenty other functionally specific institutional fora.<sup>4</sup>

The three have, since about 2001-2002, also become active promoters of bilateral and multilateral FTAs or Economic Partnership Agreements (EPAs).<sup>5</sup> Virtually non-existent in East Asia at the time of the crisis, such trade pacts quickly became a favored state instrument designed to improve intraregional trade ties while exerting national influence over trade policies in ways not dependent on the flagging negotiations in the WTO's Doha Round. In May 2010, the Asian Development Bank (ADB) noted that the East Asian region was number one world wide in terms of FTA activity, with 45 in effect, and another 84 in various stages of preparation.<sup>6</sup> At the same time, the three have yet to finalize any bilateral or trilateral FTAs with one another.

This generally cooperative and deepening economic and regional institutional interdependence among China, Korea, and Japan contrasts with their deteriorating political and security relations. Almost simultaneous with the signing of the 2012 trilateral agreements, China and Japan became engaged in a highly contentious quasi-military confrontation over the Senkaku/Daiyou Islands. As two political democracies aligned with the United States through security alliances, Japan and the ROK enjoy substantially better relations than those between Japan and China. Nonetheless, Japan-ROK relations have also deteriorated as a consequence of their own maritime dispute—the Dokdo/Takeshima island. Japan’s leadership finds itself in a complex and often contradictory set of relations with China and South Korea as it seeks to sort out policy options on economic trilateralism: deepening economic interdependence and enhanced multilateral linkages combined with rising security tensions. Can or should security tensions be played down in hopes of forging deeper and presumably mutually beneficial economic and institutional ties? Or, conversely, would such enhanced ties work to the disadvantage of Japan by bolstering the security strengths of China on the one hand and the economic competitiveness of South Korea on the other, both to the detriment of Japan? This chapter seeks to sort out where Japan’s leaders now stand along with the internal debates about perceived benefits and likely obstacles to future actions.

## TRILATERAL ECONOMIC INSTITUTIONALIZATION

At the heart of trilateral institutional relations is the annual trilateral summit. Since first agreeing to meet together under the rubric of ASEAN+3, the three met regularly on the sidelines of different formal meetings, often with no more than high-sounding but non-committal post-conference announcements. They eventually agreed to hold an institutionally-independent leaders’ meeting on an annual basis, motivated in part by the desire to forge a more expeditious mechanism through which to deal efficiently with issues specific to themselves and not constrained by the slow moving, consensus-oriented “ASEAN Way.”

Since the first of these trilaterals took place in Fukuoka, Japan in December 2008, the agendas for cooperation in economics (as well as in the political and security arenas) have grown rapidly with each successive meeting. Thus, in the Beijing meeting of October 9, 2009, the three countries agreed to work toward mutual trust in the political arena; they went on to stress the possibilities for win-win cooperation in a host of economic areas based on complementarities in “key areas such as business, trade, finance, investment, logistics, intellectual property, customs, information, science and technology, energy...” along with other items ranging from cultural exchange to green technology.<sup>7</sup>

The following year in Jeju, Korea, the three went much further, issuing a Trilateral Vision Statement for 2020. They also committed themselves to the “institutionalization and enhancement of [the] Trilateral Partnership”<sup>8</sup> by creating a permanent secretariat, headquartered in Seoul, which came into place in 2011. Additionally in May 2010, the three began a joint study to forge a trilateral FTA, and they committed to establishing a joint investment treaty as well.

The May 2011 meeting took place in Tokyo soon after the triple disaster in Fukushima with the result that most of the official statements promised further cooperation but made few concrete agreements.<sup>9</sup> The Fifth Trilateral Summit in Beijing, in contrast, announced cooperative efforts

across a wide range that included disaster relief, integrated transportation, customs protection, and nuclear safety to mention but a few. Unmentioned were the territorial disputes among the three. And most tangibly, just before the summit, the three signed a Trilateral Agreement for the Promotion Facilitation and Protection of Investment among Japan, China, and the ROK.<sup>10</sup> By the time the first CJK Trilateral Summit actually took place, "...not only had negotiators from the three countries already met in the form of six consultation rounds to hammer out the provisions, but they had also concluded five solid rounds of negotiations – all spanning a period of about three years. These concerted consultations and negotiations, prior to high-profile moves survived some of the worst political relations between especially China and Japan starting in 2005, and even when the APT [ASEAN+3] process had ground to a halt."<sup>11</sup> The trilateral investment treaty represents a substantial step toward systematizing and formalizing the rules governing all cross-border investments among the three.

At the same time, as Saadia Pekkanen makes clear, the treaty does not throw open the borders of all three. Each of these countries remains relatively restrictive of incoming FDI: the OECD's FDI Restrictiveness Index for 2012 ranks China as the first, Japan as the sixth, and South Korea as the fifteenth most restrictive environment among the fifty-five nation states that it analyzes.<sup>12</sup> Yet, as she notes, the very fact of "institutionalization can constrain the actions and conduct of public and private interests in different jurisdictions, provide a binding rules-based framework for dealing with trade partners, help support business operations across borders, secure the momentum and speed of regional economic integration, and potentially boost national economic welfare over the long term." In short, this FDI commitment to trilateralism by all three was far from trivial.

In a follow up to the investment treaty, the three countries announced in November 2012 at a summit in Phnom Penh, that they would begin negotiations to craft a trilateral FTA. The potential economic benefits to each country would be enormous, not least for Japan. China, Japan, and South Korea depend on each other for about 20-30 percent of their external trade. Japan's *Nikkei* reported if the trilateral FTA is concluded with the easing of tariffs on manufactured and other goods, Japan's exports would be expected to increase by \$60 billion.<sup>13</sup> Only 14 percent of Japan's exports are covered by existing FTAs (or EPAs) in contrast to 56 percent for ASEAN, 45 percent for Hong Kong, 25 percent for China, and 28 percent for South Korea. It has a considerable distance to go in order to catch up to East Asia's rapidly moving FTA train. All of these points lay the groundwork for asking just how likely such a trilateral trade agreement is to be realized and what possible impediments remain to the steadily deepening as well as enhanced institutionalization of both trade and financial links among China, Japan, and Korea.

## JAPAN: ECONOMICS AND NEIGHBORS

For the first four to five decades after the end of World War II, Japan's political economy followed a highly consistent course. Japan's postwar foreign policy pivoted on its close ties to the United States, both militarily and economically. Defense expenditures were kept low, balanced out by U.S. security guarantees and bases on Japanese territory. Moreover, to spur the economic recovery of its most important Cold War ally in East Asia after World War II, the United States opened its markets to Japanese exports without requiring reciprocal access for American products in Japan. For decades, Japan's economy remained one of the most resistant to FDI and foreign manufactured imports of any other industrial democracy. The United States

and Japan became major trading partners. Until the latter half of the 1980s, approximately 11 percent of all U.S. exports went to Japan, while 20 percent of imports came from Japan. For Japan, some 36-39 percent of their exports went to U.S. markets, while 23 percent of total imports came from the United States. Endemic to Japan's domestic economic success were strong formal and informal impediments to competition from foreign investment and foreign manufactured goods. The persistence of such protectionism continues to haunt and impede Japan's current economic situation, as it has since the 1990s.

Though Japan took a "low posture" in its regional policies following the highly disruptive domestic disputes over the 1960 revision of the bilateral security treaty, it normalized relations with South Korea in 1965 and those connections were enhanced by the agreement between Kim Dae-jung and Obuchi Keizo to put past animosities on the back burner and to work to improve bilateral ties. (The subsequent death of Obuchi removed the personal chemistry between the leaders of the two countries that had been vital to the warming relations, leaving their agreement more aspirational than practical.)

Japan was also quick to normalize ties to China following the surprising Kissinger-Nixon visits in 1971; Tanaka Kakuei opened normal diplomatic relations in 1972. After 1978, China broke with earlier policies to embark on what has since been 35 years of greater openness to FDI and trade as well as closer engagement with the United States and other democracies. Japanese investors were among the first to leap at the business opportunities presented by these transformed China markets. In 1978 Japan and China signed the "Japan-China Peace and Friendship Treaty." Shortly after that, the Japanese government entered into its first long-term commitment to provide ongoing ODA to China. In the subsequent thirty years, China was the largest single recipient with Japan accounting for approximately 60 percent of all aid received, approximately 3.4 trillion yen in loans and grants.<sup>14</sup> In the aftermath of the Tiananmen massacre, the Japanese government was also the first major country to re-engage with China and to break with the diplomatic and economic sanctions imposed by other Western powers.

Yet Japan's relations with China have become far worse in the last two to three years while those with South Korea have been highly problematic. It is necessary to ask what went wrong in the interim. To me the answer lies in Japan's domestic political economy and can be reduced to two key changes over the last two decades: first, Japan's economy has been largely stagnant, representing a stark contrast to the phenomenal growth in GDP the country enjoyed from 1952-1990, as well as a contrast to the blistering economic performance of China and the less white hot but nonetheless substantial growth achieved in the ROK; and second, partly in response to this twenty years of economic torpor, Japanese domestic politics has become far more nationalistic, introspective, and suspicious of its relationships with the ROK and China. Neither trend bodes well for future political or economic ties between Japan and its two neighbors.

## ROOTS OF JAPAN'S SOURING RELATIONS

Current internal debates about how best to connect to its two most immediate neighbors are intimately linked to competing Japanese domestic perceptions about how best to deal with its own economic problems in conjunction with its regional and global political and security concerns. Broadly stated, Japan's deteriorating political relations with China and South Korea are a function of the political leadership's unwillingness or inability to take the politically painful

steps needed to carry out deep structural changes in the domestic economy, domestic tensions exacerbated by growing insecurity regarding the changing nature of the security environment Japan now confronts. The two of course are linked. The failure to revitalize the Japanese economy through structural reforms has deprived policymakers of a key tool in their prior regional diplomatic toolbox—namely regional economic muscle. Since past strength hinged on the economic dynamism the country demonstrated from the early 1950s into the very early 1990s, current economic limitations, in turn, foster growing concern about the regional and global security situation. Absent the extensive diplomatic leverage that comes from economic strength, Japan's political leaders have instead retreated to a policy of seeking electoral support by appeals to introspective populism, the results of which are periodic diplomatic disasters with China and South Korea.

From today's vantage point it is difficult to recall that twenty years ago Japan's economy was the envy of the world. Its GNP was soaring; its banks were among the most dominant in the world; Ginza coffee shops catered to Japan's nouveau riche with expensive cakes flaked with real gold; and one triumphalist business executive declared that all Japan might need to buy from the United States were mop handles and buckets. From that self-congratulatory perch, Japan has fallen far. Once an economic model to be emulated, it is now an economic lesson in what to avoid. The statistics cataloging Japan's economic decline are cumulatively depressing. Throughout most of the last two decades GDP growth staggered along at an anemic zero to one percent. The country has seen dramatic falls in its global ranking in per capita GDP, along with its labor and capital productivity, while fiscal policies have whipped up a devilish brew of mounting public sector debt, sustained deflation, rising youth unemployment, and visible homelessness in its major cities. Stock market indicators in 2013 stood at half the level they enjoyed twelve years before and only one-quarter the level at the end of the 1980s. Japan's global and regional economic weight has consequently been eviscerated. Between the early 1990s and today, Japan's share of global GDP shriveled to 8 percent, a share almost equal to that which it had held in 1970. Japan has surrendered virtually all of the gains in global economic weight that it had accumulated between 1970 and 1990. The country that once led the world in the introduction of tantalizing consumer products currently struggles to shed the label "Galapagos Tech"—an evolutionary wonder producing goods for only self-absorbed residents of Japan insulated from broader trends of globalization. Consequently, Japan, the initial catalyst for the region's economic success, has become ever less the driver or beneficiary of East Asia's enhanced regional economic strength.

In contrast, over the last thirty years, Chinese economic growth has soared, while South Korea has transformed its own economy, achieving substantial success particularly in the aftermath of the 1997-98 financial crisis. Of symbolic significance, in 2011 China replaced Japan as the world's second largest economy in nominal GDP and China has been eclipsing Japan as the economic engine of the region while simultaneously using its economic muscle as a tool in its regional diplomacy, as noted in Scott Harold's chapter.<sup>15</sup> Even countries skeptical of China's long-term political goals are finding it in their self-interest to accommodate to its enhanced economic and diplomatic muscle.

South Korea, hard hit by the 1997-98 crisis, went through a series of domestic economic restructurings, opened many of its previously closed markets, pursued FTAs with its major

trade partners and has recently negotiated bilateral trade pacts with both the United States and the European Union, two of its major markets, while enjoying an average growth rate of 4.9 percent in its GDP from 1998-2010.<sup>16</sup> As Chang-Jae Lee's chapter makes clear, South Korea has been an active proponent of FTAs with most of its major trading partners and to date has signed eight FTAs with forty-five countries and is actively negotiating still others. Given the extent to which many South Korean and Japanese products compete vigorously for global markets, South Korea's domestically difficult decisions embracing higher levels of economic openness throw down an undeniable challenge to neighboring Japan with its reluctantly sluggish baby steps away from prior protectionist policies.

In addition to China and South Korea, other countries have also closed their once-wide economic gaps with Japan on living standards and wealth. Japan, long the economic leader in the region, has fallen back in the pack. One recent comparison of per capita GDP noted that: "For years, Japan was Asia's richest and most powerful economy. It was the first Asian economy to industrialize, and the emerging Asian tigers—Hong Kong, Singapore, South Korea, Taiwan and later China—merely followed in its tracks. Now, however, Japan is steadily being overtaken."<sup>17</sup> Japanese citizens now lag behind their richer counterparts in Singapore, Hong Kong, and Taiwan, with South Korea poised to pass Japan within five years.

The enhanced economic competitiveness of so many of Japan's neighbors provides a stark indictment of Japan's rickety macro-economy and its waning capacity to influence events within the region. One indication of Japan's shrinking role in the regional economic picture has been the reduced centrality of Japanese capital to investment across East Asia. Japan was the largest investor by far during the 1980s (nearly a 5:1 margin over the number two investor, the United States). During the 1990s Japan retained its number one position, but its lead declined to only 1.5 times that of the United States. By the 2000s, Japan had fallen into the number two slot.

It is not as though policymakers deliberately ignored the nation's economic slide, but for the first decade after Japan's bubble burst, the prevailing policy emphasis driven by the political orientation of the ruling LDP, emulated the long-term model that had kept the party in power: outsized government spending for public works and construction with little attention to the rising share of public debt or to the country's vast problem with non-performing loans. Most importantly, little attention was placed on encouraging the structural reforms in domestic industry and the regulatory structures that would move the country beyond its longstanding focus on exports to a more sophisticated service orientation based on domestic-driven demand. For the better part of two decades the government's prevailing policies have sought to shore up, rather than build from, the country's initial keys to growth—enhanced exports and domestic market protection. Such an approach has stood in stark contrast to the recommendations of the 1985 Maekawa Commission, which concluded that Japan's long-term economic success would require domestic structural reforms, greater domestic liberalization, and a focus on improved living standards for Japanese consumers.<sup>18</sup>

The impediments to change have been far more political than economic. In particular, the LDP concentrated its policymaking firepower on efforts to continue its electoral supremacy by impeding substantial structural reforms of the nation's economy. Doing so would have required a reconfiguration of the party's electoral base and the probable loss by many LDP parliamentarians of their cherished Diet seats. Protection of the party's office holders took

priority over remedying the nation's plummeting total factor productivity. Low-productivity, but politically powerful sectors, such as agriculture, medical delivery, food services, and construction, remained largely immune from political challenge. As a consequence, as one McKinsey study showed, even Japan's ten largest companies in fifteen of sixteen industrial groups (autos were the lone exception) today "are less global than their overseas peers, as measured by the percentage of revenues, assets, and stock ownership outside Japan."<sup>20</sup>

Koizumi Junichiro sought to break the deadlock of such failing policies by eliminating the stranglehold of the LDP's old guard. His administration tackled the problem of non-performing loans head on, and he challenged many longstanding LDP sacred cows (including construction, toll roads, and the postal system). Yet economically savvy as his targets may have been and adroit as he may have been at catalyzing a reconfiguration of the LDP's political base, he proved far less deft in his regional foreign policy. He enraged both China and South Korea with his regular visits to the Yasukuni Shrine. Koizumi further inflamed Japan-China tensions by ending ODA to China, declaring on November 24, 2004 while en route to an ASEAN meeting that it was time for China to "graduate" from receiving Japanese aid.<sup>21</sup> Koizumi also embraced George W. Bush and the U.S.-Japan alliance by taking a host of steps that expanded the role and sophistication of Japan's Self-Defense Forces and their coordination with U.S. military forces, among which was the specific identification of China as a potential enemy of Japan.<sup>22</sup> These moves conflicted quite explicitly with China's goal of enhancing its own influence over the shape of regional security and economics and moved Japan away from its prior tight engagement with Asia in favor of a reinvigoration of its security ties with the United States.

The successes achieved by Koizumi in breaking the stranglehold of several of the LDP's most economically unproductive but political entrenched sectors were, moreover, quickly squandered by his successors. After achieving a stunning electoral success in the 2005 Lower House elections, Koizumi neglected to institutionalize his dual economic and electoral victories. Instead he allowed the party to revert to type as two of his three short-term successors, Abe Shinzo and Aso Taro, assiduously reversed his reforms, returning the party to control by its old guard, and ensuring the continued pursuit of protectionism and cronyism.

Simultaneously, Abe and Aso added fuel to Japan's regional frictions by their fulsome embrace of Japan's most xenophobic instincts, calling among other things for constitutional revision, a return to "traditional values," "super-sizing" the abductee issue and other fears centering on North Korea,<sup>23</sup> injecting enhanced nationalism into school textbooks and classroom instruction, and seeking to create an "arc of freedom and democracy" that most observers saw as a not-very-subtle effort to "contain" China.

The electoral rebuttal to the LDP was severe. The long-dominant party lost badly in the Upper House elections of 2007 and was subsequently crushed by the DPJ in the Lower House elections of 2009. When the DPJ came into office it carried a policy platform committed to sweeping economic reform efforts and improved relations with the other countries of Asia.<sup>24</sup> The party proposed stronger ties with China and South Korea through deeper economic integration and enhanced diplomatic engagement. It advocated "constructive dialogue" to resolve contentious territorial disputes with the two countries and argued that it would restore trust with its neighbors by admitting Japanese aggression during World War II and promising to make no official visits to the Yasukuni Shrine. A major economic delegation of some 600 Japanese business leaders, led by DPJ strongman Ozawa Ichiro, symbolized the DPJ's effort

to improve both economic and diplomatic relations with China. At home the DPJ's economic policies, focused on "putting people's lives first" as the DPJ pumped billions of yen into creating a stronger social safety net and expanding child welfare allowances, along with cutting road tolls and reducing the (almost non-existent) taxes on small businesses. Such programs, though highly popular with voters, were extremely costly. More frustratingly, they did little to advance the needed structural economic reforms.

Even if the DPJ agenda was promising, leaders proved inept at implementation. Three successive DPJ prime ministers suffered from major gaffs: Hatoyama Ichiro faced both a personal financial scandal as well as troubles with the United States over the relocation of the marine corps base at Futenma; Kan Naoda, as Japan's sixth prime minister in five years, resigned after a disastrous failure to deal adequately with disaster relief during the March 11, 2011 triple disaster at Fukushima; Noda Yoshihiko, though perhaps a far more astute politician, took the economically positive but politically suicidal step of raising the consumption tax in an effort to deal with the country's massive public debt problem. As one cynical summary of the three years of DPJ government concluded "it has reneged on, failed to implement and even reversed many of its campaign pledges," leading it to be trounced by the LDP in the December 2012 elections. The one legacy of DPJ government that might well prove useful in dealing with Japan's economic malaise was Noda's halting efforts to have Japan join negotiations for the TPP.

## JAPAN AND ITS CURRENT FREE TRADE OPTIONS: OBSTACLES AND OPPORTUNITIES

Japan faces the possibility of joining as many as three looming multilateral Asia-Pacific FTAs. The trilateral CJK trade pact under negotiation with China and Korea is obviously one; TPP is a second; the third is the Regional Comprehensive Economic Partnership (RCEP). All three would advance the agenda of free trade in the wake of the stagnation in negotiations at the Doha Round of WTO liberalizations,<sup>25</sup> requiring various degrees of trade and FDI liberalization on the part of Japan. But the three are quite different in their probable trade inclusiveness (and the political pain likely to be demanded) as well as in the countries that would be included (creating different mixes of "allies" and "adversaries").

The economics of Japan's ties to China and Korea certainly speak to the advantages of the trilateral FTA. The long-term benefits to Japanese exporters might reach as high as \$60 billion.<sup>26</sup> The existing trilateral investment treaty means an economically and administratively valuable precedent is already in place. Yet at the same time, Japan and Korea previously engaged in eighteen months of negotiations toward a bilateral trade pact in 2004-2005 only to have the talks end in failure, due essentially to Japan's reluctance to liberalize its agriculture and other politically protected sectors. As one Korean diplomat noted at the time: "Seoul was ready to sign a 'high level, comprehensive' agreement with Tokyo even though that would be painful for many small and medium South Korean companies in protected industries... We are prepared to weather domestic resistance to [a trade agreement] but if we start on the basis that a certain Japanese ministry [Agriculture] offers us, we would be subjected to severe domestic criticism."<sup>27</sup>

The economics of Japan's ties to China and Korea certainly speak to the advantages of the trilateral approach. Should a trilateral FTA be signed, this three-country economic bloc

would be the world's third biggest behind NAFTA and the EU. The combined economies would cover 1.5 billion people and amount to \$14 trillion in gross domestic product. The long-term benefits to Japanese exporters might reach as high as \$60 billion.<sup>28</sup> A trilateral FTA would also allow Japan and South Korea to more easily tap into China's huge market. China certainly wants to be involved in such an FTA to help it check the economic and security influence of the United States in East Asia. In this regard China envisions the CJK FTA as an important alternative to TPP, which is being strongly pushed by the United States. Three rounds of negotiations are set for 2013.

Because Korea and China are considering a bilateral FTA that would not include Japan, it is clearly worrisome to both countries that Japan may be entering the trilateral talks only as a way to "keep in check rapid progress in Seoul and Beijing," as Huh Yoon cynically opined.<sup>29</sup> He noted, it is one thing to get together to talk; it is quite another to reach an agreement.

Offsetting the possible difficulties Japan might face in liberalizing its market are two distinct upsides to the CJK FTA from Japan's perspective. First, given the high levels of economic protection in China along with the preeminence of SOEs as well as China's political desire to forge a trilateral FTA, the economic demands for liberalization of the Japanese market could be much less than those of joining the TPP. Furthermore, China's sense of urgency in creating an FTA mechanism to offset some of the appeal of the TPP appears to have made it more amenable to softening diplomatic tensions with Japan over the Senkaku/Diaoyu controversy.

The TPP, in contrast, is likely to make the strongest demands for structural economic changes within Japan. The TPP has become the signature trade target of the Obama administration which sees it as an Asia-Pacific expansion of NAFTA and an important component of its "pivot" toward Asia. If U.S. views prevail, the eventual agreement will be a "comprehensive and high standard agreement for the 21st Century" that would eliminate most tariffs, systematize trade regulation among all members, and be comprehensive in covering all trade related issues, including, for example, rules of origin and labor protections. Moreover, it would encompass not simply trade but the promotion of economic development and collective growth.<sup>30</sup>

In early 2013, incoming Prime Minister Abe convinced his reluctant LDP to endorse his decision to enter into TPP negotiations, starting with the seventeenth round scheduled for May 2013 in Lima, Peru. This came only after hints in his meetings with Obama that there might be "carve outs" for politically sensitive economic sectors at least prior to entering the negotiations per se. Abe has played that theme consistently in attempting to win domestic political support for joining the negotiations. After returning from his D.C. visit he told a crowd of 3,500 lawmakers, party members, and guests who had gathered for the annual convention of the ruling LDP: "I will protect Japan's agriculture and its food at all costs. I ask you to please trust me, believe in me."<sup>31</sup>

Despite the probability of far greater difficulty in liberalizing politically sensitive sectors of Japan's economy should Japan opt for TPP, the benefit in terms of shoring up Japan's relations with the United States could make the risk worth taking. After all, the United States is at the core of TPP while China and Korea are not. Equally important economically, if Japan joins under the strict standards of the TPP, the country would receive a major impetus toward structural reform and enhance its appeal to other countries seeking additional FTAs.<sup>32</sup>

In mid-April the other countries agreed to allow Japan to enter negotiations. Clearly, the earlier Japan gets into discussions the greater its voice is in the give-and-take of negotiations, and the more substantial the structural reforms Japan makes to its economy, the greater the long-term benefits are likely to be. However, big changes in the quest for macro-economic benefits can exact high costs from micro-economic losers and the greater the likelihood of costly political repercussions. Criticisms of Japan's concessions to the United States just to enter negotiations began soon after Abe's return.<sup>33</sup>

Finally, RCEP was begun only in December 2012, advanced primarily by ASEAN, though China is also enthusiastic (again since the United States would not be involved). It aims to be the largest free-trade bloc in the world, comprising all ten ASEAN nations and the six other countries with which the group has FTAs. The grouping includes more than three billion people, has a combined GDP of about \$17 trillion, and accounts for about 40 percent of world trade. Negotiations are slated to begin in early 2013 and to conclude by the end of 2015. The idea for the RCEP was first introduced in November 2011 at the ASEAN Leaders Summit in Bali, as officials attempted to reconcile two existing regional trade architectures. China pressed for the East Asia Free Trade Agreement, which restricted the grouping to ASEAN+3. Japan has long favored the Comprehensive Economic Partnership in East Asia of the ASEAN+6 countries. ASEAN leaders struck a balance with the RCEP, adopting essentially the Japanese membership formula, but also adding an open accession scheme that would allow other members to join so long as they agree to comply with the grouping's rules and guidelines. Plans for RCEP would create a minimalist FTA with no member forced to adopt policies with which it disagrees and allowing for major carve-outs of sensitive industries. As such, the domestic economic demands of RCEP would be far less for Japan than joining TPP or the CJK FTA. Yet, the United States is notably absent from RCEP, a serious concern for policymakers anxious to bolster security ties to it and also to avoid being swamped in multilateral bodies dominated by China. RCEP would most likely reflect substantial Chinese influence throughout any negotiations.

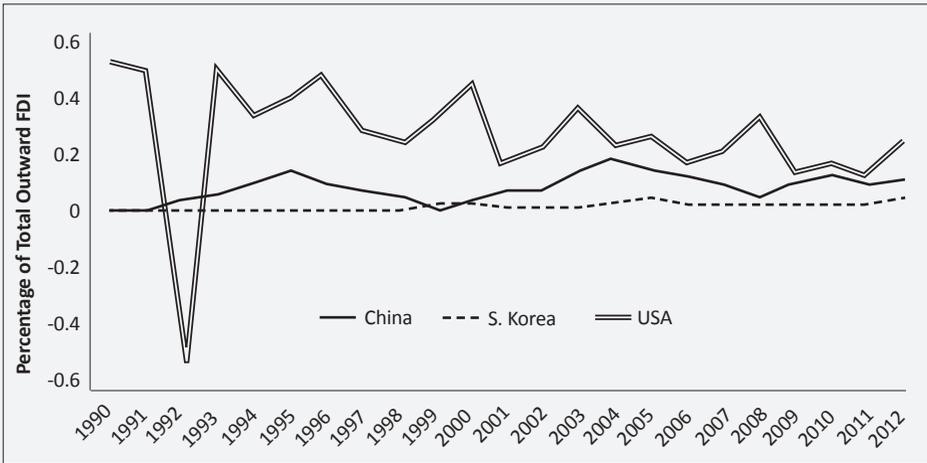
Japanese leaders will certainly strategize about how to approach each of these three potential pacts in light of both economic and political goals. Economically, RCEP would be the least painful domestically and it would offer some political benefit by enhancing the centrality of ASEAN+6, which Japan has long promoted. But at the same time RCEP would not include the United States and would do little to spur significant structural reforms at home, and hence RCEP would be of minimal long-term economic benefit to Japan. TPP would be painful at home but would be exceptionally valuable in many ways. Barfield and Levy concluded: "An agreement with the United States, Japan, Australia, New Zealand, and Chile at its core would have the economic heft to set a new standard for Asian integration. Furthermore, if the TPP remains open to new members as expected, it could serve as the foundation for a Pacific Ocean-spanning free trade area."<sup>35</sup> Most critically for Japan, it would create enormous pressures for precisely the kinds of structural reform that could return it to economic strength regionally and globally.

The CJK FTA may provide Japan, both politically and economically, with a "Goldilocks' solution," not quite as painful domestically as TPP but not as economically vapid as RCEP. The trilateral would also offer the possibility of improved diplomatic and political relations with two countries that are among Japan's most important trade partners but among its most nettlesome neighbors. Intriguingly, a strategy that included Japanese participation in both TPP

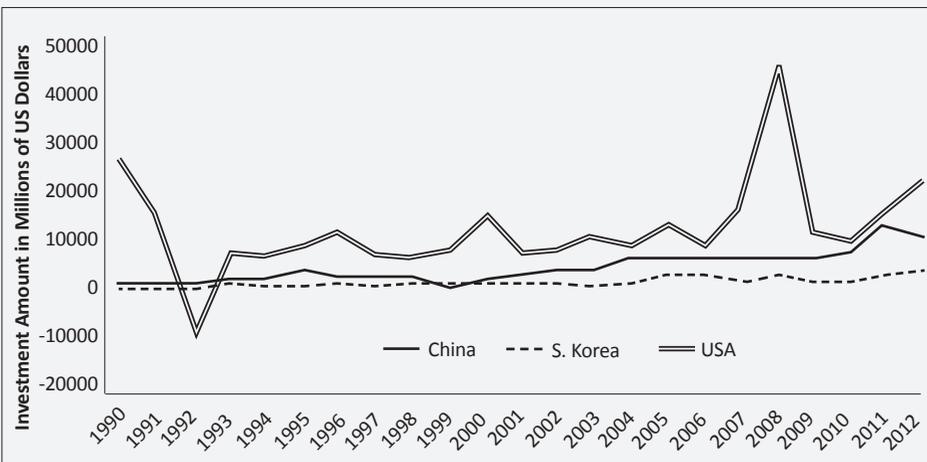
and the CJK FTA could well achieve far more than either in isolation—closer ties with both the U.S. on the one hand and China and Korea on the other, along with enhanced trade ties with three of Japan’s major markets, as well as economic and diplomatic outcomes that would address a host of problems currently vexing the country’s domestic economy. The only real impediment to pursuit of such an approach remains Japanese politics. Whether the new LDP government and Abe in particular are willing to take such a bold step is far from certain. Clearly Abe’s past behavior and statements make one skeptical. Yet the LDP enjoys a powerful majority in the Lower House and if it can gain similar leverage in the July 2013 elections for the Upper House, the political muscle would be there if, perhaps, not the political will.

### APPENDIX

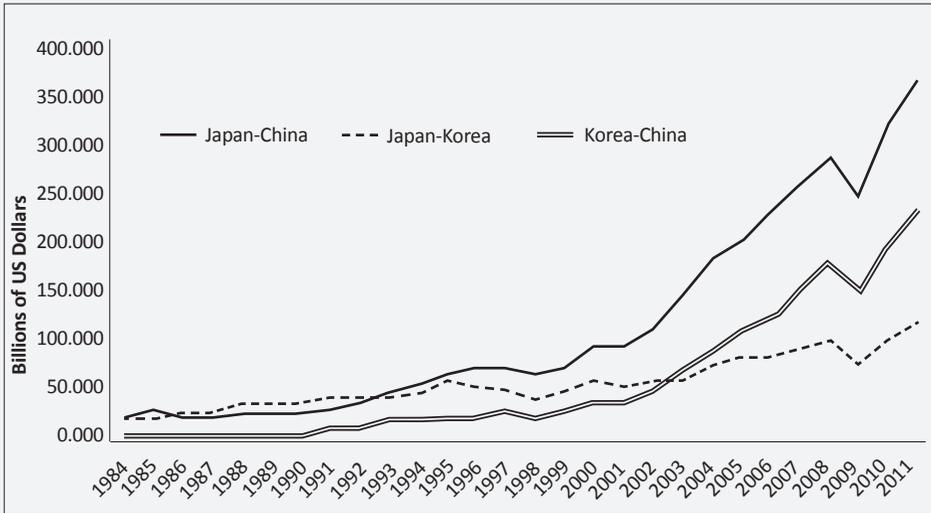
**Figure 1. Percentage of Japanese Outward Foreign Direct Investment by Country**



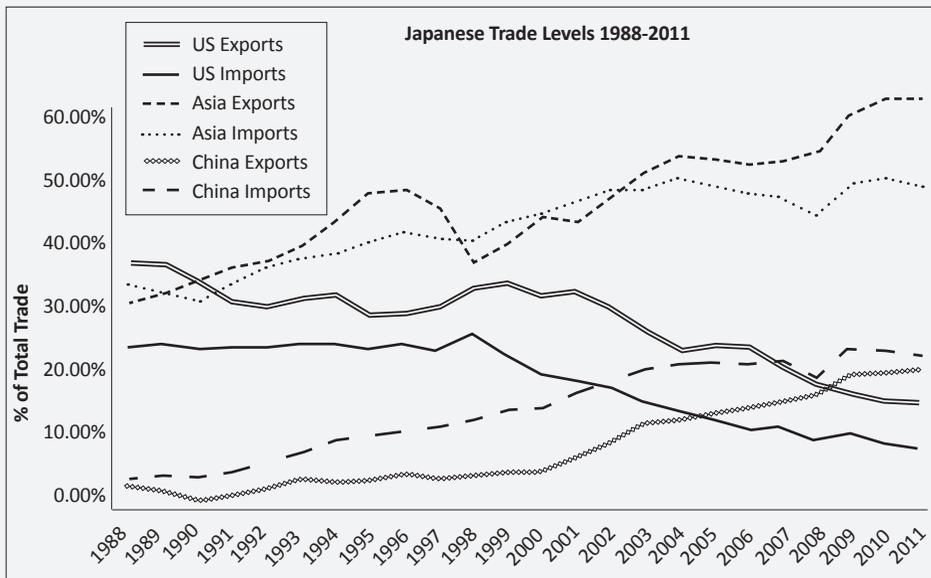
**Figure 2. Japanese Outward Foreign Direct Investment by Country**



**Figure 3. Intraregional Trade Volume in Northeast Asia (1984-2011)**



**Figure 4. Japan's Trade with Major Partners**



Source: Prepared from Ministry of Finance, Trade Statistics. <http://www.jetro.go.jp/en/reports/statistics/>

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