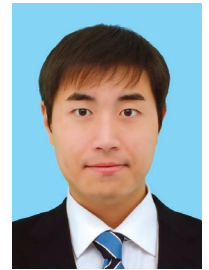


# Challenges & Outlook for Japan's Economic Diplomacy in Asia



Author Satoshi Izumi

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## Foreword

With roughly half of the world's GDP and with three mega-FTA concepts, the Asia-Pacific region is a major engine of growth for the global economy and can also be regarded as the center of free trade. The region will therefore become a pivotal point for further globalization. This article will examine the outlook for Japan's economic diplomacy in Asia.

## Japanese Trade Policies

Although many regard the economic situation as improving with Abenomics, Japan still faces difficult challenges which will be hard to resolve, such as a declining population, decreasing birth rate and aging population, as well as enormous government debt. Domestic structural reforms to improve productivity and address the birth rate and aging issues and support for new industries are required. But promotion of overseas economic activities could not only bring about economic growth through exports, but also promote domestic system reform, and hence be considered an effective policy measure.

The most important international trade policy is that on services trade, which is thought to have great growth potential. In comparison to other industrialized nations, Japan lags in many areas except for the intellectual property right royalties, for which it holds the world's second-largest share. In services trade, the originality and quality of technology tends to be valued, and thus by avoiding price competition Japan can maintain its comparative advantage over developing countries. Package-style infrastructure exports, which the public

sector and the private sector have been jointly pursuing in recent years, and environment-related businesses are both typical examples of where Japan's strength in soft technology has been demonstrated. Preparing and achieving an environment which is advantageous for related companies to expand abroad through economic partnership agreements and others will be crucial in Japan's future trade policies.

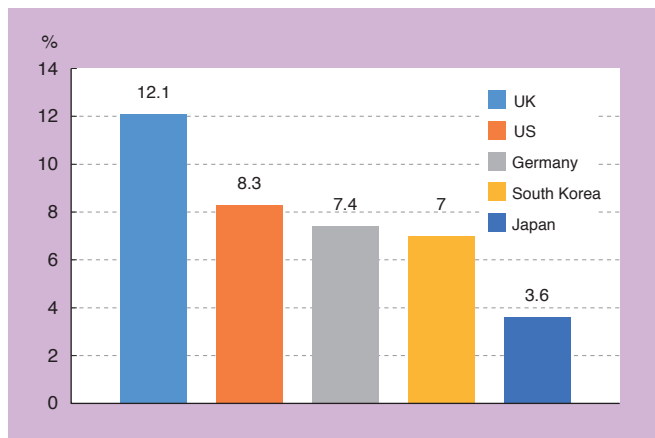
## Status & Challenges of Japan's Economic Diplomacy in East Asia

The East Asian region, where many newly developing nations exist, is increasingly becoming an attractive market with the expansion of the middle-income class through economic growth. But there are several challenges that Japanese companies engaged in services trade will face as they try to enter the East Asian markets.

First, the largest obstacle when promoting services trade is the existence of state-owned enterprises which obstructs fair competition, and the absence of transparent rules for government procurements. State-owned enterprises tend to have unfair relationships with the government, and their advantage over private enterprises through preferential treatments and subsidies has been an issue. In the Asia-Pacific region where diversity of political and economic regimes is a characteristic, there are many countries where state-owned enterprises continue to maintain monopolistic positions or are prioritized in national economic policies, including Vietnam which is still on the path toward a market economy. Moreover, state-owned enterprises are favored in the bidding process of government procurements and public works to provide employment opportunity measures, and therefore it is still the case that foreign enterprises find it difficult to enter into local infrastructure construction, its management, and operation. The governments of developing nations still tend to engage in aggressive market interventions as an economic entity, but for Japan to expand its services exports to ASEAN countries, reforms are needed to change the current structure where state-owned enterprises monopolize the local market and hinder achieving fair competition. But this is a difficult challenge as is evident from the lack in progress of liberalization of services within the ASEAN Economic Community.

The slowdown in economic growth in some of the East Asian developing nations is a potential risk to Japanese enterprises that aim to capture the local market for the long haul. In middle-income countries such as Malaysia, Thailand, China, and Vietnam, the "middle-income trap" is beginning to set in, where economic growth stagnates before the country becomes an advanced nation. There are a wide range of factors to the "middle-income trap", and circumstances unique to each country also have an impact, but the conversion of the growth model from the quantitative expansion model to the increase in

CHART  
**Ratio of services exports to GDP (2015)**



Source: WTO Statistics database and UN "National Accounts Main Aggregates"

productivity model is generally attributed as the cause. In order to become a member of the advanced nations, policies are required to nurture competitive enterprises, human resources, and industries. But in East Asian countries where resistance from the vested interests groups is strong, and because of the way the countries are managed, the reality remains that structural reform is slow in making progress.

Promotion of regional economic integration could lead to becoming the driving force to push for reforms by eliminating domestic resistance, and therefore contribute to the resolution of the “middle-income trap”. In fact, countries like Malaysia and Vietnam signed the Trans-Pacific Partnership (TPP), including the state-owned enterprises clause. Unfortunately, the TPP is not to be put into effect because of the withdrawal of the United States, but those countries would try to avoid falling into the middle-income trap by referring to its state-owned enterprises clause. In comparison to the TPP, the Regional Comprehensive Economic Partnership (RCEP), in which all of the major countries in East Asia participate, cannot be expected to develop the competition requirements, and therefore these mega-FTA have their differences. Japan is participating in all the mega-FTAs in the Asia-Pacific region — the TPP, RCEP, and China-Japan-Korea FTA — and can be said to be in a position to be a “hub”. It should henceforth work to further engage in regional cooperation in East Asia.

### Importance of Japan-China-Korea Cooperation

In thinking about Japan’s East Asia trade policy strategy, the role of the CJK FTA has far more significance than improved market access to the Chinese market. Japan, China, and South Korea together make up 90% of the GDP of the ASEAN+3, and 70% of that of the countries participating in the RCEP negotiations. Thus, promoting high-level economic integration among the economic superpowers of East Asia carries great significance in speeding up the East Asian regional economic integration movement.

In addition, when looking at the cooperation of the three countries from the standpoint of multilateral rule-making strategy, the CJK FTA serves as grounds for negotiations with China, which is in competition with the US over rule formulation in East Asia, and thus it could also become the basis for multilateral rule formulation in East Asia. If an agreement can be formulated with China on the disciplines of state-owned enterprises or government procurements, this can serve as pressure on the ASEAN countries and India, and boost future services export strategy.

However, as is apparent from the content of the China-Korea FTA agreement of 2015, China maintains a cautious posture towards liberalization strategy in trade and investment. For the CJK FTA to achieve high standards, Japan must be ready to make substantial concessions.

On the other hand, negotiations on environmental policies with China, which is strengthening its measures on environmental issues by signing the COP 21 Paris agreement, will become an important step in formulating future environmental rules in East Asia.

### Japan’s Economic Diplomacy Strategy in Asia in Post-TPP Era

Finally, I would like to summarize my thoughts on Japan’s economic



*Young people are also working on economic diplomacy. Youth delegates of the Pacific Economic Cooperation Council at Yangzhou, China in 2016*

diplomacy strategy in Asia.

First, Japan needs to take the initiative in the rule-making process through the multilateral framework in the region. The global trend for trade and commerce rules is currently shifting from border measures such as elimination of tariffs and free trade in goods, to domestic measures such as easing of regulations on foreign companies’ entry. With this current situation in mind, Japan should aim to achieve an environment conducive to fair competition in services trade of Free Trade Area of the Asia-Pacific (FTAAP) magnitude, using multilateral frameworks such as RCEP or APEC. Also in the area of environmental policies, Japan should promote multilateral policy coordination and standardization in order to formulate favorable conditions for exports of highly environment-friendly infrastructure in which Japanese enterprises have a technological advantage. A collaborative relationship between Japan, China, and South Korea will contribute to raising the quality of the multilateral rule-making process.

Second is the promotion of a “custom made” type of economic cooperation which matches each of the different domestic economic and social situations. Achieving sustainable economic growth in newly emerging countries in Asia is imperative for Japanese enterprises to secure new markets to enter. Currently, the causes of the “middle-income trap” that the newly emerging countries in Asia are facing differ in each country. Therefore, there is a need to not only formulate uniform rules but also develop economic cooperation packages that meet the economic and social realities of each country to complement these rules. Developing business infrastructure such as stock markets, competition environment and legal systems for Public Private Partnership (PPP) will lead to an environment conducive for Japanese businesses to absorb the services demand in newly emerging countries in Asia. Moreover, there are still many countries in ASEAN that lag behind on environmental measures, and there is a need to support an environment-related legal system that matches the individual degree of progress in each country, such as royalties on intellectual property rights.

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*Satoshi Izumi is a graduate student at the School of International and Public Policy, Hitotsubashi University. He is studying International Political Economy in the Asia-Pacific region.*