

Japan's response to the Rise of China: Implications for Regional Institutions.

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Glossary of Terms

Term	Definition
ACFTA	ASEAN China Free Trade Agreement
ACU	Asian Currency Unit
ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
AFTA	ASEAN Free Trade Area
AJCEP	ASEAN-Japan Comprehensive Economic Partnership
APEC	Asia Pacific Economic Cooperation
APT	ASEAN Plus Three
APTFMM	ASEAN Plus Three Finance Minister's Meeting
ARF	ASEAN Regional Forum
ASEAN	Association of South East Asian Nations
ASEAN-ISIS	ASEAN Institute of Strategic and International Studies
ASEAN-PMC	ASEAN Post-Ministerial Conference
ASEM	Asia-Europe Meeting
ASO	Asian Security Outlook
BSA	Bilateral Swap Agreement (finance)
CAREC	Central Asian Regional Economic Cooperation
CBMs	Confidence Building Measures
CCP	Chinese Communist Party
CEPEA	Comprehensive Economic Partnership in East Asia
CLMV	Cambodia, Laos, Myanmar and Vietnam
CMI	Chiang Mai Initiatives
CMIM	Chiang Mai Initiatives Multilateralization
CPS	Country Partnership Strategy
CSCE	Conference on Security and Cooperation in Europe
DJP	Democratic Party of Japan
DMC	Developing Member Country/ies
EAFTA	East Asia Free Trade Area
EAS	East Asia Summit
EPA	Economic Partnership Agreement
ERIA	Economic Research Institute for ASEAN and East Asia
ERPD	Economic Review and Policy Dialogue
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GMS	Greater Mekong Subregion
GOJ	Government of Japan
IMF	International Monetary Fund
IR	International Relations
ISG	Inter-Sessional Group
JACEP	Japan ASEAN Comprehensive Economic Partnership

JSDF	Japan Self Defence Force
JSF	Japan Special Fund
LDP	Liberal Democratic Party
MAFF	Ministry of Agriculture, Forestry and Fishery
METI	Ministry of Economy, Trade and Industry
MITI	Ministry of International Trade and Industry
MOD	Ministry of Defense
MOF	Ministry of Finance
MOFA	Ministry of Foreign Affairs
MOU	Memorandum of Understanding
NTS	Non-Traditional Security
OCR	Ordinary Capital Reserve (ADB's main window)
ODA	Official Development Assistance
OREI	Office of Regional Economic Integration
PD	Preventive Diplomacy
PKO	Peace Keeping Operations
PLA	People's Liberation Army
PPP	Purchasing Power Parity
PRC	People's Republic of China
RCI	Regional Cooperation and Integration (ADB Strategy)
REMU	Regional Economic Monitoring Unit (precursor to OREI)
RMB	Renminbi, aka the Yuan
ROOs	Rules of Origin
SCO	Shanghai Cooperation Organisation
SOM	Senior Officials Meetings
TA	Technical Assistance
TAC	Treaty of Amity and Cooperation
TMD	Theatre Missile Defence
UNSC	United Nations Security Council
USD	US Dollars

Abstract

This dissertation set out to establish why it was that East Asian regional organizations were proliferating even under the condition of a Sino-Japanese rivalry. In particular, it examined the effects of the rise of China on Japan's regional policy and its outcomes.

To do so, the dissertation adopted an eclectic approach, testing each of the main international relations theories against the story of Sino-Japanese relations within the studied regional institutions of East Asia. It adopted such an approach because no one theory of international relations was able to explain both the cause of and actual outcomes of institution building.

Throughout all the regional institutions examined, one trend emerged. Whether in trade, finance, security or development, East Asian regionalism has become 'networked.' This networked outcome is more flexible than European or American-type regionalism, allowing for any dyad to calibrate their commitments as they please without reference to a regional standard. But as long as agreement on common rules for East Asia remains unforthcoming, this networked regionalism will not lead into more formalistic, deeper cooperation.

This trend toward a 'networked' or bilateral-type of regionalism was traceable back to Japan's response to China's rise. Rather than trying to build a regionally hegemonic core around which institutions for trade, finance, aid and security might be built, Japan has sought to go it alone. In the field of security, this was understandable from a realist perspective, but only after a constructivist strategy had failed earlier. In the field of aid, Japan was better able to coordinate with China in a manner that liberalism suggests, but even here Japan was building up alternative bilateral structures. In the field of finance, Japan has competed with China in a manner realism would predict, but due to world level factors this has in fact spilled over into greater regional cooperation. Likewise in the field of trade, Japan has competed with China, giving rise to a situation in which institution building is actually harmed.

In conclusion, this dissertation was able to contribute to the literature by revealing the mechanisms by which a bilateral relationship impacts on institution building and to theorize about some of the likely institutional outcomes in the various fields.

Declaration

This work contains no material which has been accepted for the award of any other degree or diploma in any university or other tertiary institution to Joel Rathus and, to the best Adelaide Graduate Centre of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text.

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SIGNED

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Conventions

In this dissertation Japanese name order is used when referring to Japanese, i.e. 'Surname First-name.' Thus the current PM of Japan will be written as Hatoyama Yukio. *Chuu*, *Tsuu* and *Chou* sounds in Japanese are rendered *chū*, *tsū* and *chō* in the English.

Similarly, Chinese name order is used when referring to Chinese, i.e. 'Surname First-name.' Thus the current General Secretary of the Chinese Communist Party of Japan will be written as Hu Jintao.

A partial exception to this rule applies to Japanese or Chinese people who are published in English; in that case the citation will read as per Western name order.

In this dissertation the first person 'I' is used throughout. While not standard in Academic writing *per se*, as discussed in the Theory chapter, I am leery of presenting myself as a scientist with some objectively testable claims. Thus the use of I is a signal to you, the gentle reader, that this is my informed opinion.

Unless otherwise noted, \$ refers to US dollars. An effort is made to always label amounts as US\$ in any case. Yen and RMB are called as such without using notation (¥) to avoid any confusion.

1 Introduction

1.1 The Puzzle

Asia, however it is constructed, is the most economically dynamic region in the world and increasingly important strategically. This shift has given rise to a literature which describes Asia as the pilot of great power rivalry, and even conflict, in the current era.¹ What has also posed a puzzle to traditional international relations theory is the so-called 'anaemic' development of its regional institutions.² Asian regional institutions are regarded by some academics as 'different' from their counterparts, particularly when compared to the European experience.³ However, with the passing of time, the push towards regional organizations in East Asia has strengthened together with growing East Asian regionalism. However images of what the region ought to look like are not held in common in the region. In particular the two 'big players', Japan and China appear to be championing rival views.⁴

In the case of post-War Europe, it took France and Germany working together to drive the regional agenda. The circumstances were more favourable for cooperation between France and Germany, as both were allied with the US and in opposition to the Soviets in the Cold War period.⁵ In the post-Cold War period they grew even closer, both economically and politically, resulting in a European common currency and the beginnings of a European common foreign policy. Japan and China on the other hand spent more than three decades in opposing camps, with little communication and no intention to cooperate in fostering East Asian regionalism. And, despite a brief respite in the 1980s, the political relationship between Japan and China has in general continued to worsen in the post-Cold War period.

¹ Aaron Friedberg, "Ripe for Rivalry," *International Security* 18, no. 3 (1994)., In particular for Sino-Japanese relations see, Gerald Segal, "The Coming Confrontation between China and Japan," *World Policy Journal* 10, no. 2 (1993). And later, June Dreyer, "Sino-Japanese Relations:," *Journal of Contemporary China* 10, no. 28 (2001); Kent Calder, "China and Japan's Simmering Rivalry," *Foreign Affairs* March/April(2006). And Daniel Kliman, "China: Japan's Rising Power Conundrum," in *Japan Chair Platform* (Center for Strategic and International Studies, 2009).

² Markus Hund, "Asean + 3: Towards a New Age of Pan East Asian Regionalism. A Skeptics View.," *The Pacific Review* 16, no. 3 (2003). David Jones and M Smith, *Asean and East Asian International Relations: Regional Delusion* (Cheltenham: Edward Elgar Publishing, 2006). Gilbert Rozman, *North East Asia's Stunted Regionalism* (Cambridge: Cambridge University Press, 2004).

³ Aaron Friedberg, "Will Europe's Past Be Asia's Future?," *Survival* 42, no. 3 (2000)., Giovanni Capannelli, "East Asian and European Economic Integration: A Comparative Analysis," in *Working Paper Series on Regional Economic Integration* (Manila: Asian Development Bank 2009).

⁴ Takashi Terada, "Forming an East Asian Community: A Site for Japan-China Power Struggles," *Japanese Studies* 26, no. 1 (2006).

⁵ Christopher Hemmer and Peter J Katzenstein, "Why Is There No Nato in Asia? Collective Identity, Regionalism and the Origins of Multilateralism.," *International Organisation* 56, no. 3 (2002).

Over this same period however, regional organizations in East Asia have expanded in number, scope and prominence in the region's international affairs. But with the European experience in mind, we might reasonably have expected that the lack of a Sino-Japanese axis would fatally undermine regionalist efforts in East Asia. Indeed, we might expect that Sino-Japanese rivalry and competitive regionalism would be played out in Southeast Asia, with the smaller countries in the region becoming caught up in either Japanese or Chinese designs.⁶ And yet, in spite of this tense bilateral relationship of the region's great powers, regionalism (or least the appearance thereof) is on the rise in East Asia as testified to by the explosion of regional institutions in post-Cold War era.

1.2 The Arguments

There are broadly two hypotheses that might explain this puzzle of why despite the tense Sino-Japanese relationship regionalism appears to be progressing nevertheless. Firstly, that some other, higher order variable is at work driving East Asian regionalism, and the Sino-Japanese bilateral is *not* so important. This argument would typically suggest that the United States provides the extra-regional muscle required to even out the differences between Japan and China, thereby allowing the regionalist project to advance.⁷ The second possible hypothesis is that the Sino-Japanese bilateral relationship *is* important for understanding the developments of East Asian regionalism.⁸ This argument would suggest that East Asian regionalism is somehow being driven forward by the Sino-Japanese rivalry.

⁶ Michael Wesley, "Jealous Suitors: Sino/Japanese Competitive Regionalism and the Future of East Asia," in *China-Japan Relations in the Twenty-First Century: Creating a Future Past?*, ed. Michael Heazle and Nick Knight (UK: Edward Elgar Publishing 2007); Masafumi Iida, "Japan-China Relations in East Asia: Rivals or Partners?," in *Nids Joint Research Series No.3 China's Shift: Global Strategy of the Rising Power* ed. Masafumi IIDA (Tokyo: National Institute for Defence Studies, 2006); Jian Yang, "Sino-Japanese Relations: Implications for South East Asia," *Contemporary South East Asia* 24, no. 2 (2003); Takashi Terada, "Forming an East Asian Community: A Site for Japan-China Power Struggles," *Japanese Studies* 26, no. 1 (2006).

⁷ Usually couched in terms of the US providing the stable political base on which regional technical cooperation can occur, such as "the United States has played a pivotal role in shaping the political-economic arena in which East Asia's putative regionalism is being played out, but it is significant that the emerging ASEAN+3 agenda in particular is being driven by systemic issues—especially regulatory policy for the finance sector—rather than simply attempting to balance US power in a more conventional sense." Mark Beeson and Mark Berger, "The Paradoxes of Paramourty: Regional Rivalries and the Dynamics of American Hegemony in East Asia," *Global Change, Peace and Security* 15, no. 1 (2003). p. 41, this view is shared by Shiraishi Takashi see, Takashi Shiraishi, "Gaikō Meisō Wo Manaita Kokka No Mitorizu No Soushitsu," *Chūo Kōron* February(2010).

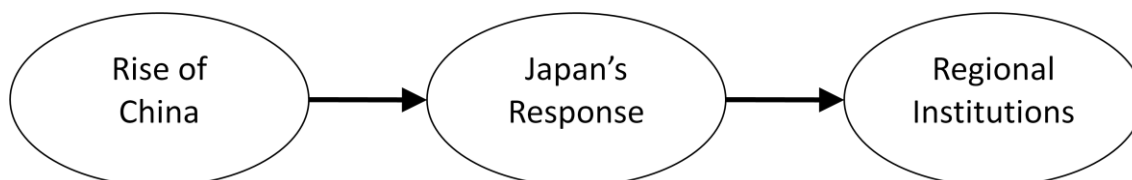
⁸ Mie Oba, "Regional Arrangements for Trade in Northeast Asia: Cooperation and Competition between China and Japan," in *Asia's New Institutional Architecture*, ed. Vinod Aggarwal and Min Gyo Koo (Springer: Leipzig, 2008); Joel Rathus, "China, Japan and Regional Organisations: The Case of the Asian Development Bank," *Japanese Studies* 28, no. 1 (2008); Michael Heazle, "Sino-Japan Relations and Japan's Emerging Foreign Policy Crisis," (Brisbane: Griffith Asia Institute, 2005).

The first of these hypotheses is perhaps the one most readily accepted due to its Ockham's razor-like directness, but it is far from satisfactory. In the first place, there is no reason why the US would loan its muscle to help Japan and China to build regional organizations which excluded, or might exclude, the US itself. And in the second instance, the role of the US in East Asia is itself arguably the largest and most important difference and source of distrust between the two.

The second of these hypotheses, that East Asia's regionalism is somehow being driven by the tense (untrusting) nature of Sino-Japanese relations, presents its own set of problems. The history of international relations suggests that bilateral tensions ought to weaken regional cooperation, not be a cause for more of it. However, if regional institutions (despite their growth in number and scope) were in fact weak, and this weakness is due to the poor bilateral relationship between China and Japan, then it is possible we can harmonize expectations with observations. With this explanation of how a poor bilateral relationship among the two big powers in a region might still be responsible for a form of regionalism in mind, it is worthwhile examining and testing this second hypothesis.

This thesis further develops the hypothesis that the Sino-Japanese relationship is significant by proposing a two-step argument. The first argument focuses on how the tense Sino-Japanese relationship impacts on regionalism by proposing that it is Japan's efforts to maintain its influence in the region in the face of the rise of China which is the driver of much of this regionalism and much of the change in regional institutions. The second argument deals with the implications arising from the first argument, and proposes that Japan's response of limited cooperation or competition with China is a major cause of the 'bilaterally-networked' regionalism currently on display in East Asia, which is suggestive of a basic weakness in the region's institutions. The causal chain can be pictorially represented as in the below figure;

Figure 1 Flow of Argument



As a logical argument, this thesis should be understood as follows; the worsening bilateral relationship between Japan and an increasingly powerful China is an important factor in causing Japan to look at regionalism and regional institutions as a means to hold onto its influence. *And*, Japan's turn to regionalism and regional institutions to preserve its influence

is a major factor in the growth and development of regional institutions of a bilaterally-networked variety. *Thus*, the worsening bilateral relationship between Japan and an increasingly powerful China is a major factor in the emergence of a bilaterally-networked type of regional institutionalism.

This argument is couched, or rather hedged, in terms of the Sino-Japanese relationship being a 'major factor' in the development of regional institutions. This is an important point. As will be discussed in the theory section, there is no point in arguing that something is the only cause (or even the only major cause) of something else in international relations. The purpose of this line of argument is rather to show that Sino-Japanese relationship has had an impact, to quantify that impact, and to elucidate some of the mechanisms of that impact. Of course other factors, not least the role of the US, will be discussed along the way, but the focus remains on the China-Japan relationship.

In order to do so, this thesis poses three questions, which guide and structure each of case study chapters, four through seven: What are the developments in said regional institutions; what is the meaning of these institutional developments for the regional influence of Japan relative to China; and how important a role has Japan played in these developments?

Additionally, this thesis will develop in chapter two a theoretical framework in order to explain the linkage between a bilateral relationship and regional institutional development. This theoretical framework is built-up from the three main schools of international relations, realism, liberalism and social constructivism in the eclectic manner advocated by Peter Katzenstein. As such, in the conclusion of each study, the thesis will explain which variables were most important and show that more than mere power is determining the development of regional institutions in East Asia today.

1.3 The Research: Method, Methodology and Limits

This section addresses the problem of research method. It is not enough to argue the theoretical cause of why Japan's response to the rise of China occurred and the changes in regional organizations, one must demonstrate the link – i.e. how did it happen? The focus of this section, therefore, is not on explaining the theoretical 'why' and rather towards explaining the concrete 'how.'

To do so, this thesis will construct a research model aimed at explaining the development and functioning of regional institutions. This is a descriptive task, and as such a close inspection and understanding of the history of the regional organizations' functioning is

required. The literature on institutional change will be reviewed to construct a model for charting change in the functioning of regional organizations. In particular, the taxonomy of Michael Wesley will be examined. The model will need to be constructed to be able to answer these questions without filtering out or second guessing the answer (i.e. be biased towards a balance of power explanation).

To do so, this thesis will adopt a retrospective approach. It will look at the institutional functioning and then trace back to Japan's foreign policy to the extent it is possible. The research method based on reading academic, journalistic and official documents and in interviewing officials of the various institutions or their handlers in the Government of Japan or other involved parties over the course of two years field work undertaken in Japan at Meiji University, with brief trips to Korea and China. This field work was made possible by a *Monbukagakusho* Scholarship. A list of interviews by affiliation can be found in Appendix 1.

1.3.1 Definitions and taxonomy: Region, Regionalism, Regional Institutions

This section is focused on regional institutions, how to define them and how to understand change within them. This section does not deal with the many possible causes of change, this will be addressed in the theory section, the focus remains squarely on understanding 'how (along what lines) do regional institutions change?'

It is necessary, however, to first define the **region** which is to be examined. As has been noted, there is nothing natural about a region which marks itself out as such. Regions are politically constructed and not infrequently contested labels for a geographical area.⁹ In the case of East Asia, as represented below in Figure 2, I define the region to be composed of the ten members of the Association for South East Asian Nations (ASEAN), Burma, Cambodia, Brunei, Laos, Vietnam, Thailand, Malaysia, Singapore, Indonesia, Philippines, plus the five members of North East Asia (Japan, China, North and South Korea, Mongolia). East Asia thus defined is the core group within the regional institutions to be examined. In its own category is Taiwan, where it is a member or quasi-member of a regional institutions, is also considered a 'regional' member but due to its stateless status it cannot be 'core' in same way as others. The next layer adds to this Australia-New Zealand and their Pacific island dependencies. Also included is South Asia; India, Pakistan, Bangladesh, Sri Lanka, Nepal, Bhutan. These are the non-core members of the East Asian region. Other members of regional organization are peripheral members, or more accurately non-regional members. This out-group includes nations of Central and Western Asia as well as, importantly, United States.

⁹ Peter J Katzenstein, *A World of Regions* (Cornell: Cornell University Press, 2005).

Figure 2 East Asia



Source: Generated by Author

Regionalism, at its most basic, refers to cooperation within a region, such as the East Asian region defined above. While early research on regionalism was carried out with a focus on Europe,¹⁰ Christopher Dent provides a definition of regionalism in the East Asian context as “structures, processes and arrangements that are working towards greater coherence within a specific international region in terms of economic, political, security, socio-cultural and other kinds of linkages.”¹¹ However, many authors have noted these arrangements may arise from either non-official, usually market-related, or from official, governmental action.¹² In the literature the former is called *regionalization*, while the latter is called *regionalism*. This overlap has led to some confusion as the word regionalism carries two meanings; the general meaning of all regional cooperative activities both official and non-official (regionalization), and the specific meaning of regional cooperation at the official level. Additionally, further confusion can arise between ‘true’ regionalism and bilaterally-networked (also sometimes called ‘hub-and-spoke’) regionalism. In the case of the

¹⁰ Perhaps most importantly from this school of early regionalists is Bela Balassa, *The Theory of Economic Integration* (Homewood: Irwin, 1961).. Also significant was Ernst Haas, *Beyond the Nation-State: Functionalism and International Organization* (Stanford: Stanford University Press, 1964). Haas viewed regionalism as a response to regionalization via the spill-over process.

¹¹ Christopher Dent, *East Asian Regionalism* (London: Routledge, 2008). p. 7

¹² For the best discussion of these terms in relation to East Asia see Paul Evans, "Between Regionalism and Regionalization," in *Remapping East Asia*, ed. T J Pempel (Ithaca: Cornell Uni. Press, 2005).

former, a single set of harmonized rules applies equally to all regional members. Whereas in latter case, even as overall regional interdependence and cooperation is built up, bilaterally-networked regionalism by virtue of its structure does not promote a single, harmonized rule set. Instead, national sovereignty and the freedom to choose partners and to differentiate the level of cooperation within each partnership are preserved.

This dissertation takes the definition of regionalism as exclusively formal government policy, while also considering that even within this definition different kinds of regionalism exist. Regionalism is held to be 'state-led, government level policy initiatives such as inter-governmental dialogues and treaties aimed at co-operation and integration at the regional level.'¹³ Regardless of the type of regionalism, there is a close link therefore between regionalism and regional institutions, with regional institutions seen as the successful output of regionalist projects.¹⁴

The definition of **regional institution** itself has been a subject of extensive debate. Liberal theorists have far from helped matters, Robert Keohane himself noting ruefully that the definition of an international institution as "some sort of establishment of relative permanence of a distinctly social sort" is grossly unsatisfactory.¹⁵ This broad definition would include such things as sovereignty and international law, even the balance of power, in addition to more obvious organizations such as the United Nations and International Monetary Fund - and would serve to prevent rather than facilitate discussion on the subject by confusing what it is exactly that is under examination.

To clarify matters, the difference between 'institution' and 'organization' needs to be made explicit. While all international organizations are institutions, being semi-permanent establishments of a distinctly social sort, the reverse statement is not true. This is because institutions include formal and informal expectations, whereas organizations are limited only to the formal and explicit.¹⁶ How far along the dimension of formal/informal, explicit/implicit one sets the limit for an institution affects directly the subject matter. My definition of regional institution is based on Michael Wesley's definition of regional organizations.¹⁷ Wesley's definition is composed of five elements: regional membership, generalized ongoing commitments to cooperate in selected issue areas, internally consistent written

¹³ This definition is based on Christopher Dent, *East Asian Regionalism* (London: Routledge, 2008). p. 7

¹⁴ Peter J Katzenstein, "Regionalism and Asia," *New Political Economy* 5, no. 3 (2000). p. 360, although Katzenstein notes that while "Asian regionalism is an idea whose time has come...Yet Asian regionalism has yet to be described adequately in terms of formal institutions."

¹⁵ Robert Keohane, "International Institutions: Two Approaches," *International Studies Quarterly* 32, no. 4 (1988). p. 382

¹⁶ *Ibid.* pp. 380-1

¹⁷ Michael Wesley, ed. *The Regional Organizations of the Asia-Pacific* (New York: Palgrave Macmillan, 2003). p. 5

and unwritten rules or norms of acceptable action, formal and defined procedure for taking collective action, and regular meetings of members giving a 'rolling' agenda.

In East Asia, this definition would cover the Asian Development Bank (ADB), the Chiang Mai Initiatives (CMI) and ASEAN Regional Forum (ARF), but would have some difficulty including the East Asian Free Trade Area (EAFTA). In particular, this emergent trade area stumbles at point four, defined procedures for taking collective action. In order to include the EAFTA, I will accept informal and *ad hoc* procedures for taking collective action at the regional level. This concession is further justified as the EAFTA is trending towards formal negotiations at the East Asia summit and ASEAN Plus Three (APT), and might therefore be considered as an agenda item of these larger institutions. Lastly, cutting out the EAFTA is simply not feasible in a study of East Asian regionalism, as the trade dimension looms large in official and academic discussions.

It is also necessary to clarify some of these elements in light of the extant conditions of East Asian regional institutions. Firstly, the focus on the regional membership of these institutions is critical. Sensitivity to the unique regional structure, as opposed to global structures, allows a deeper understanding of the functioning and development of these institutions; changes in the regional order are probably more significant for these organizations than global fluctuations.

This is not to say that regional institutions must possess an 'exclusively' regional membership. At least for East Asia, and elsewhere, the US is a critical non-regional member. Rather, the majority of membership should be regional and regional members should be somehow favoured in the decision making process. If the majority of the membership do not identify with the region, then the organization should be better understood as *inter-regional*, not regional.¹⁸ In principle, the headquarters or secretariat should be situated in a regional member country. While not necessarily a criterion of a regional organization, I will limit my examination to those regional organizations to which China and Japan are both members.¹⁹

With regard to the second point, 'generalized ongoing commitments to cooperate in selected issue areas'; I would add that these selected issue areas should be limited to issues within the geographical scope of the region. A regional institution in principle deals with regional problems, or regional implications of extra-regional problems, exclusively.

¹⁸ Joseph Camilleri, "Communication: East Asia's Emerging Regionalism: Tension and Potential in Design and Architecture," *Global Change, Peace and Security* 17, no. 3 (2005).

¹⁹ This excludes ASEAN itself, but brings in wider groupings which include Japan and China. It excludes the Shanghai Cooperation Organization (SCO), the Central Asian Regional Economic Cooperation (CAREC) etc.

Implied within the fourth and fifth criteria is level of representation. A regional institution, in order to be official and formally competent to undertake coordinated action ought to be attended by a minister or a ministerial-level representative. There are significant non-ministerial groupings, such as the Meeting of East Asian Central Bankers, or Heads of Defence Colleges meetings, which often occur on the sidelines of ministerial meetings. These are not considered regional institutions, as they do not occur at the government level.

Taxonomy: Sites of change

But what changes exactly are we looking for? Terms like functioning are far too broad to be of much use. Fortunately, Michael Wesley has provided a typology of the possible sites of change in regional institutions: Membership, Scope, Authority, Capability, and Diffusion.²⁰ These categories are also generally accepted in the Rational Design of International Institutions project, which also singles out the 'decision making procedure/rules' as a site of change to be examined.²¹

Membership is a central issue when discussing regional institutions. By their nature regional institutions are exclusive – with membership available to those states that lie within the 'region.' However, as has been noted "regions are... not only geographically given but also politically made."²² Membership is thus open to interpretation. Australia is particularly sensitive to such interpretations, and is constantly pressing its claim that Australia is part of the region (in hopes of gaining admittance to regional organizations under the ASEAN banner). Australian government's view membership as beneficial not merely for the political and economic advantages offered, but also because in Wesley's words, it moves Australia from being 'in the region' to being 'of the region.'²³

Geographical location is not enough though. Regional membership has to be politically won and membership in regional institutions is therefore hotly contested. This is because membership in regional institutions is one of the clearest indications of the shape of a region. Apart from the material benefits one hopes to gain from being a member of an 'exclusive' grouping; regional institutions provide an opportunity to build community.²⁴

²⁰ Michael Wesley, ed. *The Regional Organizations of the Asia-Pacific* (New York: Palgrave Macmillan, 2003). Chapter 10

²¹ They called it control, and focussed more on vote weighting. Barbara Koremenos, Charles Lipson, and Duncan Snidal, "The Rational Design of International Institutions," *International Organization* 55(2001), p. 1

²² Nobuo Okawara and Peter J Katzenstein, "Japan and Asia-Pacific Security: Regionalization, Entrenched Bilateralism and Incipient Multilateralism," *The Pacific Review* 14, no. 2 (2001). p. 166

²³ Michael Wesley, "The Politics of Exclusion: Australia, Turkey and Definitions of Regionalism.," *Pacific Review* 10, no. 4 (1997).

²⁴ Robert Keohane, "Multilateralism: An Agenda for Research," *International Journal* 45(1990).

Japan too is aware of this, and faces an uphill battle fighting ghosts of its imperial past to win the prize of regional acceptance and full regional membership.²⁵ Japan is also aware that as a core member, it can sponsor other states who are candidates for regional institutions. As its position in region comes increasingly under the shadow of a rising China, Japan is indeed looking to get some states with similar interests (including managing China) involved in the region through such groups. Membership is thus a possible site of contention between Japan and China which might have effects on regional institutions.

One of the other sites of change Wesley identifies is *Scope*. This refers to the number of issue areas that an institution has the mandate to address. Thus when a regional institution such as ASEAN added to its declared areas of cooperation such elements as 'food security' in the 1980s, or 'pollution' in the 1990s, this is expansion of scope. An expansion of scope in regional institutions reflects an expansion of areas that regional states are willing to discuss, if not necessarily act on. Since changes in scope are largely undeclared, such as the ARF 1995 Concept Paper, tracking changes in scope is a matter of watching what the organization states it is willing to discuss. Tracking developments in this site is important, especially as Japan presses scope to expand even as China moves to slow said expansion.

Most important for any institution though is its *Authority*. Authority refers to the organization's ability to extract compliance from its membership to the institutions' agreements or norms. This is the 'action' part of regional institutions and the link to causation. It is also therefore the most difficult to measure.²⁶ Wesley identifies, with reference to Max Weber, two levels within authority; power and legitimacy.²⁷

Power deals with the instrumental cost/gain analysis of decisions of states. The more powerful an institution, the higher the costs from defaulting on an agreement and the greater the implications of exiting from it. Legitimacy deals with "the internalization of regional perspectives and identifications that inform state decision-making."²⁸ Authority is a crucial variable because it rests among ideas of functioning and even 'worth' of regional institutions. However, in East Asia the preference for non-powerful, but still legitimate institutions makes investigations into state compliance more difficult. I use *Authority* to mean the extent to which regional states follow, rather than default from, agreements reached. It is related to the concept of *Diffusion* discussed below.

²⁵ Although its island geography has helped to create an identity of insulation for Japan, so called *Shimakuni Konjō*.

²⁶ Michael Wesley, ed. *The Regional Organizations of the Asia-Pacific* (New York: Palgrave Macmillan, 2003). pp. 215-6, the case of APEC and differing judgments of authority.

²⁷ Ibid. p. 215

²⁸ Ibid. p. 208

Diffusion looks at the rate of increase and decrease in number of regional institutions. There is some overlap with scope, as new institutions need not be formed if pre-existing ones can expand their scope to cover the issue area competently. There is also some overlap with authority, as legitimate groupings will not attract competition from the creation of new ones.

The key issue is when and why states decide to commit their resources to forming a new organization, or when and why states decide that an organization is unsatisfactory and ought to be discontinued. Fortunately, measuring the diffusion of regional organizations is a relatively easy task. A historical approach of looking when organizations come and go is all that is required. However, proposed organizations, even if they fail to materialize, can also count as a significant indication of the shape and direction regional organizations are heading, and should also be included.

Capability deals with the increases and decreases of the material resources available to an organization, thus elements such as staff and funding are considered. However, this thesis uses the term *resources* as simpler shorthand for the same. Resources as a site of change is somewhat more complex than first impressions might suggest. While it would seem obvious to look at the budgets, staffing and available resources of regional organizations, these figures are rarely made available to the public. Almost all regional organizations have been built out of a policy of minimalism, whereby all activities were run through each state's department of Foreign Affairs. This has meant that institutional capabilities, at least in East Asia, have started with low baselines – only one studied here began its existence with a centralized bureaucracy, like a secretariat.²⁹

Japan has been one of the more prolific contributors to the purse of regional institutions. Resources are thus a site where we might see Japan's policy change towards regional organizations being clearly played out. Where, how, and how much, Japan spends on boosting the capability of regional institutions has significant implications, and Japan's choices will be coloured by China's movements. These kinds of circumstance are able to show how regional organizations have changed in light of Japan's response to China, and are precisely the subject matter this thesis aims to investigate.

The last element to be discussed is *Rules*. Wesley did not explicitly identify rules as a site of change in regional organizations, but his discussion around normative change makes it clear that formal rule change is significant. The rules surrounding decision making are crucial. A change in formal voting weights indicates more about who is in control of an

²⁹ Ibid. p. 222

organization than perhaps any of the above factors and must therefore be considered. Also considered are rules about agenda setting and voice, i.e. who is able to speak, on whose behalf, and about what. Finally, rules might sometimes be used to control access on what terms to the regional public goods created.

Lastly, as Wesley states, “identifying change is a subjective process: even if change is defined at its simplest as institutional variation over time, the definition of what constitutes significant institutional variation remains in contest.”³⁰ As I will be examining these areas of institutional change to test other hypotheses, the significance of any change to regional politics is not addressed. Part of the reason is that most change in organizations is usually incremental rather than episodic, and simply not enough time has passed to make any sort of a judgment call.³¹

Not all of these categories of institutional change will be discussed in each case study chapter.

1.3.2 Case Study Selection and Approach

There are four case studies discussed in this thesis, and a word ought to be said on their selection. This section will first comment (in abstract) on case study selection, and then discuss the merits of the four case studies contained within this dissertation.

While it may be theoretically possible to study all cases, practicality speaks for limiting the sample size to something that is both manageable and from which we might usefully generalize. Formally, it is a question of large-n or small-n samples for case study. A large-n, or a large number of case studies, is useful when largely undifferentiated and relatively simple objects cases are being compared.³² While a large-n case study may be statistically preferred, regional organizations are too complex for this approach. Moreover, the examination of Japan’s policy response as a source of institutional change makes infeasible statistical approaches. As Kenneth Walt notes, “Statistical manipulations cannot provide direct evidence about the perceptions and motivations that inspired a particular ...decision. Nor take into account novel contextual features of a given case.”³³ For this, the small-n case study approach is preferred. However, while the small-n approach is more manageable, it is questionable whether the findings will be significant – i.e. whether

³⁰ Ibid. p. 6

³¹ Ibid.. Six reasons for incrementalism in institutional change: long periods of stagnation because high-start cost and sunk cost dissuade people to change, also learning and cooperation effects, routine-ization and adaptive effect make judgment of success easier, the competency trap, and a desire not to learn another new system. p. 119, 143

³² Stephen Van Evera, *Guide to Methods for Students of Political Science* (Ithaca: Cornell University Press, 1997).

³³ Stephan Walt, *The Origin of Alliance* (New York: Cornell University Press, 1987). p. 11

generalizations might be drawn from this study.³⁴

Mill's method of difference would direct us to find, ideally, cases that are identical in all but one independent variable and which differ in their outcomes. Unfortunately, as it is impossible to find perfectly matched cases, the challenge is to demonstrate that the difference in outcomes (at these regional organization organizations) is due to changes of the independent variable (Japanese foreign policy). The most important method for demonstrating this is process tracing, to show how the independent variable affects the results, outcomes which would not have otherwise occurred due to other background differences between the cases.³⁵

Bearing in mind these problems, which may limit the significance and confidence of the findings, four case studies have been selected: the East Asian Free Trade Area, the Chiang Mai Initiatives, the ASEAN Regional Forum and the Asian Development Bank. I shall now discuss what they share, and how they differ and what other factors make the case useful or interesting.

Firstly, these institutions share a core regional membership. While the title of the various grouping 'Asian', 'East Asian' or ASEAN-regional might suggest that these are operating in different geographical areas and with too diverse a membership to compare apples with apples, this is not the case. In each grouping, the dynamics of East Asian international relations are central. Moreover, in each grouping both Japan and China are key members, whether formally equal or otherwise. Thus, in each of these institutions we ought to be able to get an indication of how Japan's response to China is affecting the organization itself.

Secondly, these institutions have differing mandates which might make comparing like units problematic. The four cases I have selected run the gamut from trade, finance, security, and economic development. The diversity of the cases will only help in reaching a conclusion, even if limited, about the trend in regional organization development. The apples-apples problem is not as significant as whether the barrel they are in is itself rotting; in other words, an examination of the same property in different objects. Since the interest is not in what these institutions are doing, so much how they are changing and how to describe those changes theoretically, the like-units problem is not a major hurdle to

³⁴ Although, as discussed above, this author doubts that any Grand Unifying Theory of IR will be attained, philosophically such a theory would only occur with end of the enlightenment project and the final proof of determinism over free will.

³⁵ Andrew Bennett and Colin Elman, "Case Study Method in the International Relations Subfield," *Comparative Political Studies* 40, no. 2 (2007). pp. 174-5

analysis.³⁶

I do not take a strict line to temporal limits. The examination of the bilateral relationship is focused on the period since the end of the Cold War (1989), this is in spite of the fact that China commenced rising a roughly decade prior to that. This is because it was in the early nineties the rise of China accelerated and took on a new significance for Japan. For the case studies, China's accession is generally taken to be the starting point in preference to an arbitrary fixed time. Although some discussion of the organization and Japan's role within it prior to China's membership is warranted to establish the background, Chinese accession to these organizations is a marker of its rise and usually the beginning of a new Japanese approach to said organization.

1.4 The value of the research

There have been dissertations written on respectively 'the rise of China', 'Japan's approach to China' and 'Japan's approach to regional institutions.' While there has been discussion on what the rise of China means for regional institutions generally, there has yet to be a serious study of the response of other actors. Regional institutions are not formed in a vacuum, a cybernetic process of mutual construction and re-construction of the region is occurring in all the players. Japan has been selected as it is the most significant of these 'other' players because of its historical role in East Asian regionalism. While it is unlikely that the Japan response can be generalized to the rest of the region, it is immediately apparent that any successful East Asian regionalism must involve Japan.

Although solidly within the general field of international relations, this study crosscuts several sub-fields. In particular, as it is a look from bilateral to multilateral relations across diverse areas of cooperation, the study will by necessity have to draw from a broad range of international relations and other theories. The first part of chapter two will therefore focus on reviewing the available literature, and seek to extract from the vast body of work those elements which are useful to this study.

The crux of the puzzle is this link between a bilateral relationship and multilateral relations. In international relations theory, bilateral relations and multilateral organizations are often discussed in isolation. This is an unfortunate oversight, and one which limits the development of international relations theory as a whole.

³⁶ Rather, such novel features among the cases are not a barrier, but an opportunity for theory making. See, Stephan Walt, *The Origin of Alliance* (New York: Cornell University Press, 1987). pp. 14-15

There are two advantages in studying the causal link via Japanese foreign policy. Firstly, by examining the casual link between the rise of China and regional organization development through Japanese foreign policy, it is possible to view the 'feed-back' process in international relations unfold. Rather than an $[A \Rightarrow B]$ simplified billiard ball view of affairs, by following the impact of China on Japan, then Japan on regional institutions - whereby $[A \Rightarrow B \Rightarrow C (\Rightarrow A)]$ - though more convoluted, is also more valuable, both to practitioners and theorists alike. In short, it answers the mechanistic question about how (and why) the rise of China actually affects regional politics. Secondly, by approaching the issue in this way, we can observe and theorize about a still little understood area of international relations, namely the impact of bilateral relations on multilateral affairs. Put simply, what occurs to a self-defined group of state actors when two of the key members do not get along?

1.5 The Structure of the thesis

The thesis is structured as follows. Chapter Two deals with the theoretical part of the research. It will explain how the thesis will develop an analytical toolkit built from the relevant parts of the three major schools of international relations theory and explain how the eclectic approach can be used to weave a single story from the different theoretical perspectives. It also demonstrates the value of this approach over a traditional, one theory-based approach.

Chapter Three will deal with the impact of the rise of China on Japan. It will first discuss China's rise in absolute terms, and then in relative terms to examine how this rise is impacting on Japan and Japanese regional leadership across the spectrum of power, identity and interdependence. It demonstrates that according to international relations theories focusing on each these variables Japan's scope for regional cooperation with China is severely limited. Additionally, the chapter looks inside the black box of Japanese politics, policy-making and society to demonstrate that internal changes have occurred which also limit the scope for cooperation with China.

Chapter Four will deal with one of the specific implications of the emerging East Asian community in the field of preferential trade liberalization deals, the East Asian Free Trade Area. It will show how Japan's decision not to cooperate with China has prevented the formation of a hub Free Trade Area in East Asia, which might function as a template for wider regional cooperation. Indeed this decision encouraged Japan to pursue a bilateral strategy in its Free Trade Agreements ASEAN which has resulted in a bilaterally-networked type of trade regionalism.

Chapter Five will deal with another of the specific implications of the East Asian community in the field of monetary cooperation, the Chiang Mai Initiatives. It will show how Japan's distrust of China is fuelling a bidding war for the provision of financial stability – a game that has heated up as the world is rocked by a financial crisis. Japan's inability to reach an agreement with China prior to the financial crisis trapped the nascent institution of the Chiang Mai Initiatives at the level of a network bilateral agreements. Even after the crisis, the so-called 'multilateralized' Chiang Mai Initiatives still suffers from stove-piping and institutional weaknesses which can be linked to the Sino-Japanese relationship.

Chapter Six will deal with the ASEAN Regional Forum. It will show how Japan's frustrations with expanding Chinese control of the agenda of the ARF has caused it to scale back its expectations and energies directed at the ARF. This in turn has caused Japan to look for new security partners to solve its security problem. Japan has responded by adopting a two-prong response; firstly, elevating the importance of bilateral and a mini-lateral security network of cooperation with US, Australia and India, and secondly, by continuing to press for a Confidence Building Measures regime at the ARF at a no cost signalling of Japan's benevolent intent in Southeast Asia.

Chapter Seven analyses the Asian Development Bank. It will show how China's rising power at the regional level is not being translated into greater formal powers within the ADB. Rather China has sought to increase its influence through informal means. While this approach by China has allowed Japan to more confidently cooperate with China in the field of regional economic development, such as in the ADB's Regional Cooperation and Integration Strategy, there remain tensions over leadership in the actual regional projects. At the same time, the ADB has been a site of competition between Japan and China over the geographical and sector distribution of ADB projects in China. Interestingly, even as the ADB has been used to solve and coordinate such issues between, the institution itself remains robust and does not exhibit the same level of networked bilateralism as the other case studies.

The final chapter, the Conclusion, pulls together the shared themes and trends which emerge from the case studies. Specifically, it contributes to the international relations theoretical debate about Asian politics by noting that realism, while relevant in every case, is incapable of explaining fully the story of East Asian institution building. Additionally, the conclusion also notes that the weakness of the Sino-Japanese bilateral relationship, and its consequent limits on Japan's ability to cooperate with China, is responsible for the trend across all the case studies towards a networked type of regionalism.

2 Theory and Method

2.1 International Relations Theory

This section discusses the various international relations (IR) theories. However, establishing which theory is useful and which to ignore before the study is even undertaken is not good research method. To resolve this, the study takes an inductive approach based on the analytical eclecticism of Peter Katzenstein, and thus will build up an 'analytical toolkit' tailored to the problem.

This review will look at each of the major international relations theories, their assumptions and core ideas, and establish what significance and relevance each has to the thesis. Each theory will therefore be examined in light of what contribution it can make to explaining bilateral relationships and the impact, or link, to the development of regional institutions. The purpose of this review is also to develop an original theoretical argument, namely that no one theory is able to satisfactorily capture the dynamics of East Asian regional institutionalization, and that an eclectic approach is more appropriate.

2.1.1 International relations theory and East Asia's institutions

The rise of the 'Rest' has implied questioning of the received knowledge from the West, and international relations theory is no exception. As Kishore Mahbubani writes,

Western thinkers are having considerable difficulty finding the right paradigm to describe a world where non-Western powers are emerging...[they have] a tendency to extrapolate the future of East Asia and the Pacific as the past of Europe and maybe have not grasped that Asia has learnt from the West's mistakes and will develop to be the strongest economic force.³⁷

Thus, it is not immediately apparent why theory developed in the West should apply in Asia, especially after considering learning effects.³⁸

In particular, mainstream international relations theory has been challenged by East Asian regional institutions. As Amitav Acharya notes in his discussion on Asian international institutions, "realist-liberal-constructivist debates in international relations theory are not

³⁷ Kishore Mahbubani, "The Pacific Way," *Foreign Affairs* 74, no. 1 (1995).

³⁸ This is a sort of political analogy to the 'advantages of backwardness', that Asia might learn from the West's mistakes without having to repeat them. Ironically, the 'advantage of backwardness' as a theory can be traced back to a American Scholar writing on the East European development experience. See, Alexander Gerschenkron, *Economic Backwardness in Historical Perspective* (Cambridge, Massachusetts: Belknap-Harvard University Press, 1962).

always interesting or helpful.”³⁹ Some are even more critical of the relevance of current international relations theory to Asia. In his article, “*Getting Asia Wrong*”, David Kang argues that because the dominant three international relations theories (but particularly realism) were formed in the West, they are simply not relevant to the unique circumstances found in contemporary Asia.⁴⁰ Specifically, Kang notes that, “it is an open question whether Asia, with its very different political economy, history, culture, and demographics, will ever function like the European state system.”⁴¹ This cultural relativist view is generally taken up by the political left.⁴² The political right, such as Mearsheimer, is more willing to draw lessons from Europe.⁴³

Others believe that international relations theory need not adapt at all. Friedberg, for instance, has argued for the continuing relevance of realism to Asia.⁴⁴ Even within the ranks of the ‘Asianists’ many have challenged Kang’s claim that unique Asian cultural/historical factors undermine mainstream international relations theory. Acharya argues against Kang’s formulation, by stating “Western realist pessimism need not be countered by Asian cultural historicism.”⁴⁵ Indeed, most current research by Asian scholars makes use of international relations theory, even while adapting it to regional circumstances.⁴⁶ It is clear that Asian political experience is different to that of the West, but it is a case of a different mix of the same variables, and the language of international relations should therefore apply.

2.1.2 The limits and validity of international relations theory

Before pushing on to the vicissitudes of international relations theory, a word ought to be said about its limits and character. There are two key charges levelled against international

³⁹ Amitav Acharya, *Regionalism and Multilateralism : Essays on Cooperative Security in the Asia-Pacific* (Singapore: Eastern Universities Press, 2003). p. 161

⁴⁰ David Kang, "Getting Asia Wrong," *International Security* 27, no. 4 (2003).

⁴¹ Ibid. p. 58, see also Berger in Ikenberry G. and Michael Mastanduno, "International Relations Theory and the Asia Pacific," (2003). p388 for the new approach which argues that the “*primary sources of tension [in Asia]...are not geo-strategic, ...economic development, ...or the character of international institutions...rather they are the products of deep-rooted historically based suspicions and animosities, frustrated nationalism, and distinct conceptions of national identity and their differing understanding of the national mission in international affairs*”

⁴² Giovanni Arrighi, *Adam Smith in Beijing* (London: Verso, 2007). pp. 314-322

⁴³ Most clearly in, John Mearsheimer and Zbigniew Brzezinski, "Clash of the Titans," *Foreign Policy* (2005). For other uses of western-style realist theory on Asian politics see, Denny Roy, "Hegemon on the Horizon," *International Security* 19, no. 1 (1995)., Thomas J. Christensen, "China, the U.S.-Japan Alliance, and the Security Dilemma in East Asia," *International Security* v23, no. i4 (1999).

⁴⁴ Aaron Friedberg, "Ripe for Rivalry," *International Security* 18, no. 3 (1994).

⁴⁵ Amitav Acharya, "Will Asia's Past Be Its Future?," *International Security* 28, no. 3 (2004). p. 157

⁴⁶ For review and example see, Kai He, "Institutional Balancing and International Relations Theory: Economic Interdependence and Balance of Power in Southeast Asia," *European Journal of International Relations* 14(2008). Constructivism being particularly popular

relations theory; that it is not ‘theory’ and that it is of limited use in Asia. The first claim I will address by demonstrating that theory in the social sciences is different to that of the natural sciences, but that it still has value. I will refute the second claim by demonstrating the lack of dogmatism in current Asian international relations theory.

From the outset, it is necessary to acknowledge that ‘theory’ in international relations is not like ‘theory’ in the natural sciences. The key difference is in the ability to conduct repeatable, ‘fail-able’ experiments to test hypotheses – where hypotheses are generally about the *cause* of an event. As Richard Lebow, a noted philosopher remarks about social science theory, “a theory that convincingly explains a phenomenon that has occurred in the past, can fail to predict its reoccurrence even when the constellation of seemingly relevant variables and backgrounds condition are the same.”⁴⁷ In the natural sciences an experiment can be repeated, while controlling for different variables, to test a hypothesis. In international relations, this ability to construct experiments does not exist.⁴⁸ For instance, it is impossible to remove Hitler from World War II, and test whether he was in fact the *causative* element or whether Germany would have waged war anyhow.

Causation poses some serious problems to the researcher - although that has not stopped the term from being used. Walt, for example, introduces causation by writing, “In simplest terms, a state’s grand strategy is a theory explaining how it can ‘cause’ security for itself”, or that by doing XYZ the state will generate ABC.⁴⁹ Another solution is to find so-called ‘naturally occurring’ experiments, such as that of North Atlantic Treaty Organization in Europe and South East Asian Treaty Organization in Asia and ask why did one fail and the other not?⁵⁰ Steve Smith described this positivist tradition, belonging to the natural sciences, as being a path that the social sciences should not take.⁵¹

This problem with causation has meant that international relations grand theories have moved away from trying to explain ‘why’ things happened, and instead focus on ‘how’ and ‘how was it possible’ questions aimed at generating the second best outcome, understanding.⁵² Since demonstrating causal links is so difficult (indeed, since complexity theory has found its way into the mainstream many have ruled out ever understanding

⁴⁷ Richard Lebow, *Coercion, Cooperation, and Ethics in International Relations* (New York: Routledge, 2007). p. 425

⁴⁸ Stephen Van Evera, *Guide to Methods for Students of Political Science* (Ithaca: Cornell University Press, 1997). Chapter 1

⁴⁹ Stephan Walt, *The Origin of Alliance* (New York: Cornell University Press, 1987). p. 2

⁵⁰ Christopher Hemmer and Peter J Katzenstein, “Why Is There No Nato in Asia? Collective Identity, Regionalism and the Origins of Multilateralism.,” *International Organisation* 56, no. 3 (2002).

⁵¹ Steve Smith in Paul Viotti and Mark Kauppi, eds., *International Relations Theory* (London: Allyn and Bacon, 1999).

⁵² Alexander Wendt, “On Constitution and Causation in International Relations,” *British International Studies Association* (1998).

causation in the social world as being just too complex),⁵³ even when a change is demonstrated a debate can occur on its significance.⁵⁴ Far from throwing ones' hands in the air in defeat, an appreciation for the limited predictive power of theory is good thing, after all who saw the end of the Cold War coming?⁵⁵

2.1.3 Analytical Eclecticism as the way forward

Katzenstein's pragmatic approach is consciously designed as an alternative to the positivistic international relations tradition.⁵⁶ Instead, the focus of IR theory is moving to understanding the 'constitutive parts' (significant factors) of an event.⁵⁷ The advantage is that each element as it is understood, can be re-integrated into our conceptual framework without any dogmatic grand theory getting in the way or imposing expectations on what ought to be important.⁵⁸ This process of identifying the factors pertinent to a defined problem is the essence of Peter Katzenstein's approach, which he has called 'analytical eclecticism.'

While Katzenstein's approach can be detected in his earlier work, the turning point in terms of formally laying down the gauntlet was his article, "*Japan, Asian-Pacific Security, and the Case for Analytical Eclecticism*" in 2001.⁵⁹ Unimpressed with the grand debate about paradigmatic value occurring very publicly in the pages of renowned journals such as *International Security* during the mid-1990s, Katzenstein argued against "the privileging of parsimony" and suggested that "the complex links between power, interest, and norms defy analytical capture by any one paradigm."⁶⁰ It was apparent to Katzenstein and many others that nothing was going to be achieved by these debates. Indeed, the perverse situation arose where liberal and realist scholars were trying to claim the other's argument as a sub-section of their own theory even as social constructivist railed against the very rationalistic

⁵³ James Rosenau, *The Study of World Politics*, vol. 1 (New York: Routledge, 2006). p. 114-5

⁵⁴ Michael Wesley, ed. *The Regional Organizations of the Asia-Pacific* (New York: Palgrave Macmillan, 2003). p. 6

⁵⁵ According to Dr Michael E Herman, a former British Intelligence operator, one eccentric analyst in the department saw the cold war ending, predicting within a month its downfall and general shape. This analyst was systematically wrong however about everything else. Michael E Herman, "Reflections" (paper presented at the Threat perception in a complex environment: intelligence gathering in the Asia-Pacific, University of Adelaide, 18-19 Sept 2006).

⁵⁶ Vinod Aggarwal et al., "Roundtable: Peter J Katzenstein's Contribution to the Study of East Asian Regionalism," *Journal of East Asian Studies* 7(2007). p. 379

⁵⁷ Alexander Wendt, "On Constitution and Causation in International Relations," *British International Studies Association* (1998).

⁵⁸ Peter J Katzenstein and Rudra Sil, "Rethinking Asian Security: A Case for Analytical Eclecticism," in *Rethinking Security in East Asia*, ed. Peter J Katzenstein, J J Suh, and Allen Carlson (California: Stanford, 2004).

⁵⁹ Peter J Katzenstein, "Japan, Asia Pacific Security and the Case for Analytical Eclecticism," *International Security* 26, no. 3 (2001).

⁶⁰ Ibid.

assumption which underpinned both.⁶¹ Katzenstein's reformulation is even more appropriate as leading figures within the various paradigms have acknowledged that analytical purity had resulted in theory becoming inbred, unable to adapt to the changing international environment. Even the arch-structural realist Kenneth Waltz, in his more recent work has written that "systems populated by units of different sorts in some ways perform differently... more needs to be said about the status and role of units in neo-realist theory", a startling admission that power is not the only factor in explaining the action of states.⁶²

Recognizing that these different paradigms were based on different assumptions and geared toward tackling different problems, Katzenstein asserted that there was no point in trying to prove which of the theories was better – and, indeed that there may be more to gain by analytical diversity than any attempt at creating a grand unifying theory of international relations.⁶³ This analytical diversity comes from the fact that each international relations theory is working on one (or few related) modules or factors in explaining international relations. Katzenstein describes these as the modules of power, efficiency and identity. In this schema, the conceptual module of power corresponds to paradigm of realism, the module of efficiency to liberalism, and identity to social constructivist theory. And while these assumptions or variables do not fall exclusively within any one theory, a fact which has led some to characterize these theories more as 'paradigms', the theories discussed (realism, liberalism and social constructivism) can be logically differentiated because each shares an approach which is focused principally on one or other of these basic concepts.⁶⁴

When examining a specific problem, using any one theory to identify the significant or casual factors before conducting the research is dangerous, and likely to cause confirmation bias. Instead, Katzenstein proposes that by view one puzzle through the lenses of each of the three dominant international relations theories one is able to 'triangulate' which of the factors are important in that instance.⁶⁵ Katzenstein also provides

⁶¹ Alexander Wendt, "Constructing International Politics," *International Security* 20, no. 1 (1995)., Robert Keohane, "The Promise of Institutional Theory," *International Security* 20, no. 1 (1995). And later Robert Keohane and Kenneth Waltz, "Correspondence: The Neo-Realist and His Critic," *International Security* 25, no. 3 (2000).

⁶² Waltz in Peter J Katzenstein, "Cultural Norms and National Security : Police and Military in Postwar Japan," (Ithaca1996)., 16

⁶³ ———, "Japan, Asia Pacific Security and the Case for Analytical Eclecticism," *International Security* 26, no. 3 (2001).

⁶⁴ Kuhn and Lakatos in Peter J Katzenstein and Rudra Sil, "Rethinking Asian Security: A Case for Analytical Eclecticism," in *Rethinking Security in East Asia*, ed. Peter J Katzenstein, J J Suh, and Allen Carlson (California: Stanford, 2004). Stephan Walt, "International Relations: One World, Many Theories," *foreign policy* 110(1998).

⁶⁵ Although theoretically the triangular approach need not be limited to the big three IR theories, the pie can be sliced in many ways Peter J Katzenstein and Rudra Sil, "Rethinking Asian Security: A Case for Analytical Eclecticism," in

an example of how to conduct an analytical eclectic study of Japan's security policy (especially vis-à-vis China), showing how applications of realism-liberalism, realism-constructivism, and liberalism-constructivism identify different facets of Japanese policy but can also connect these otherwise disparate threads together to reveal the major trend and major factors in Japan's policy.⁶⁶ Indeed, the relevance of the analytical eclectic approach is all the greater specifically because it was formulated with Japan and East Asia in mind.⁶⁷

The purpose of this approach is to allow the analyst to look at the data and identify for themselves which of the factors identified by theory are significant and warrant further investigation. Katzenstein's analytical eclecticism is thus a warning about trying to use grand theory to explain specific phenomena where instead we ought to be making theory to explain observed 'puzzles' or events, what Keohane describes simply as "conditional, context specific generalizations."⁶⁸ This turn toward pragmatism in the field of international relations has been a long time coming, but is increasingly accepted by the research community as valid.⁶⁹ For these reasons, relating first to the difficulties of unproblematically connecting theory developed in the West to Asia and secondly the problem arising in the international relations theory literature itself, this thesis adopts Katzenstein's analytical eclecticism as a way forward.

In order to make the eclectic approach work, however, it is important to understand the factors which each theory identifies as significant in explaining international relations. In order to build up this theoretical toolkit, each theory will be discussed in turn, in order to identify which factors are regarded as significant, how it is relevant to the puzzle at hand, and what the theory would then expect.

2.2 The Relevance of Realism

The dominant paradigm in international relations theory is realism. Its proud and lengthy service record not only lends it authority but also makes it the traditional, even default, starting point of international relations analysis. While realism can cite such greats of Western thinking as Machiavelli and Thucydides in its intellectual lineage, its precepts are

Rethinking Security in East Asia, ed. Peter J Katzenstein, J J Suh, and Allen Carlson (California: Stanford, 2004). p. 17

⁶⁶ Peter J Katzenstein, "Japan, Asia Pacific Security and the Case for Analytical Eclecticism," *International Security* 26, no. 3 (2001). p. 117

⁶⁷ The approach is also used by Japanese scholars themselves, a review of some of these attempts can be found in Suelo Sudo, *Kokka No Taigai Koudou* (Tokyo: Tokyo University Press, 2007). p. 187-94

⁶⁸ Robert Keohane, "International Institutions: Two Approaches," *International Studies Quarterly* 32, no. 4 (1988).

⁶⁹ Friedrich Kratochwil and Jorg Friedrichs, "On Acting and Knowing: How Pragmatism Can Advance International Relations Research and Methodology," *International Organisation* 63(2009). p. 707

not uncontested; within the paradigm there are many different and competing sub-theories. The classical realist position, as derived from Hans Morgenthau's 'political realism', rests on the belief that statesmen define the national interest in terms of power, and that no other factor warrants serious consideration.⁷⁰ To a classical realist, the source of international politics is human nature, and the drive to control or *animus domanandi*. Thus conflict is almost inevitable as states jostle for position. The development of Waltzian neo-realism (or structural realism) shifted the explanation for this competition to the structure of the international system while remaining pessimistic about cooperation. For Waltz, the anarchical nature of world politics meant that the only rational behaviour for a state was to accumulate power in order to purchase its security. Neo-realism thus focuses on the structural level and pays little attention to the contents of the so-called 'black box' of the state.⁷¹

Realism therefore stresses the primacy of the state, the pursuit of national survival and preference for self-help. For the Realist thinker, the state is the only actor in international relations worthy of attention as it alone possesses true agency, i.e. the ability to make decisions and act on them.⁷² Further, realists believe that states prize their national security above everything else (or anyone else), as the state must survive or else it is nothing. Lastly, because survival is too important to trust to other states, realists believe that self-help is the dominant means of purchasing security. For realists, international relations are amoral, power-orientated affairs.

Arguably the most important concept in realist thinking is the balance of power. There are several definitions of the balance of power, but all revolve around the distribution of power in the system.⁷³ The common understanding, based on the European experience, is that the balance of power is prescriptive. This means that power equilibrium between states is a situation which ought to be aimed for as it promotes peace. Thus, 'to maintain the balance of power' means that states aim to prevent the rise of a *hegemonic* peer, more powerful than the society of states can tolerate.⁷⁴ There are basically two possible strategies employed to achieve these ends, 'balancing' or 'band-wagoning.' Mearsheimer also discusses a 'buck passing' strategy and others have theorized 'under-balancing' (both

⁷⁰ Hans Morgenthau, *Politics among Nations : The Struggle for Power and Peace* (New York: Knopf, 1967). p. 5

⁷¹ Kenneth Waltz, *Theory of International Politics* (Reading: Addison-Wesley Pub. Co., 1979).

⁷² *Agency* is a very important term in international relations theory. It refers to making and acting out decisions, but more specifically *agency* means that the element in question has *causative power*. That it can make things happen and therefore is an *explanation* of events. This gets back to the positivist tradition in international relations theory.

⁷³ Richard Little, *The Balance of Power in International Relations: Metaphors, Myths and Models* (Cambridge: Cambridge University Press, 2007). Chapter 3 'From Myths to Models'.

⁷⁴ Stephan Walt, *The Origin of Alliance* (New York: Cornell University Press, 1987).

terms have been used to describe Japan's China posture).⁷⁵ This interpretation of the balance of power would see the current balance of power between the two as positive, since neither enjoys a decisive advantage in national power.

Likewise, realists do not assume that power parity causes peace, and note that a security dilemma, whereby two (or more) states get drawn into a spiral of costly military build-up aiming to preserve a 'balance' defined differently by each, is always a possibility. Christensen has even noted the likelihood of such a spiral in the Sino-Japanese relationship.⁷⁶ However, these views are ahistorical and do not look at the trends in national power over time. For such a view one need not abandon realism, as Power Transition theory examines precisely this.

2.2.1 ...to the China-Japan relationship: Power Transition

Power Transition theory is related to the balance of power, focusing on the movement of the balance of power over time. It draws different and startling conclusions from mainstream realist thinking about the causes of tension and conflict in the world. Developed by Abramo Organski in the aftermath of World War II, the key idea in power transition theory is that power parity leads to instability, and indeed can be a cause of war. As opposed to realists who generally focus on the international political factors, Organski posited that the most important changes to the balance of power in the system came not from alliances and clever diplomacy but from internal power growth, in particular industrialization – although the theory does not rule out the role of alliances as an intervening factor.⁷⁷ Organski believed that industrialization brought with it not just much great material power, but also new willingness in the industrial countries to use this power to shape the world in their image (i.e. establish a world order). This willingness was based on a larger, better organized government and a popular nationalism which tended to occur in what he called the 'stage of transitional growth in power.'

As Organski understood it , the chief problem with world politics was that states entered this stage of transitional growth in power at different times; moreover it occurs at different speeds between and within counties. As he writes,

Industrialization has proceeded unevenly throughout the world. The result has been that first one nation and then another has experienced a sudden spurt in power...it is these sudden sprints in power that keep upsetting the distribution of power in the world,

⁷⁵ John Mearsheimer, *The Tragedy of Great Power Politics* (New York: Norton, 2001).

⁷⁶ Thomas J. Christensen, "China, the U.S.-Japan Alliance, and the Security Dilemma in East Asia," *International Security* v23, no. i4 (1999).

⁷⁷ See, Woosang Kim, "Power, Alliance and Major War," *Journal of Conflict Resolution* 33, no. 2 (1989).

threatening the established order of the moment and disturbing world peace.⁷⁸

These sprints are a reflection of what is called the S-curve.⁷⁹ The S-curve describes the rapid expansion of power when a country first enters industrialization, and the subsequent slowing of growth rates at the stage of power maturity. This pattern allows other powers further back a chance to 'sprint' past (See Appendix 2).

The Power Transition Model describes the position in which Japan finds itself in today vis-à-vis China. The time when Chinese national power will surpass that of Japan is drawing closer, and both are aware that this fact will fundamentally change their relationship yet it is not clear Japan would easily accept a Chinese redefinition of its role. Power transition theory would expect that the bilateral relationship would worsen as long as the power balance remains at the cross over point (i.e. power parity). To secure its position from the rising challenger, power transition theory (as per realism) would expect Japan, as the incumbent, to attempt to increase its national power by building up its military and seeking allies with the possibility of war.

However, clearly there are also cases of peaceful power transition. Zhu Zhiqun, who focuses on the power transition between China and the US, develops a model to explain such occurrences. He believes that the chances of peaceful power transition are increased when the following occur: incorporation into the system of the challenger, respect for the dominant power's interests by the challenger, respect for the rising power's interests by the dominant power, societal links which are extensive and strong, and national leadership on both sides committed to peace.⁸⁰

While Zhu does not discuss the relative weighting of these elements, the model is a starting point. I would suggest that Zhu has actually overlooked two elements of central importance; the speed of transition and the power potential of the challenger. All things being equal, power transition theory would expect a rapid rise to be more destabilizing. But power transition theory would also expect that if the power potential of the challenger is either too small or "so large that its dominance, once it becomes industrialized, is virtually guaranteed" then things are likely to be more stable.⁸¹

⁷⁸ A F K Organski, "Power Transition," in *International Politics and Foreign Policy*, ed. James Rosenau (New York: Free Press of Glencoe, 1961). p. 369

⁷⁹ For more on this thinking see, Paul Kennedy, *The Rise and Fall of Great Powers* (New York 1987). Also, Peter Turchen, *War and Peace and War: The Rise and Fall of Empires* (United States: Plume, 2007).

⁸⁰ Zhiqun Zhu, *Us-China Relations in the 21st Century* (London: Routledge, 2006). p. 23

⁸¹ A F K Organski, *World Politics* (New York: Knopf, 1958)., pp. 334-337

Intriguingly, China's rise is both rapid and seemingly endless, making predictions of its impact on regional stability more difficult. But even putting aside the speed and scale of the transition, it is clear that China satisfies (or certainly claims to satisfy in its rhetoric) most of these conditions identified by Zhu. Indeed, as Levy notes, "Power Transition theory is correct to identify the rise of China as the leading problem of the coming decades, but applications of the theory place too much emphasis of its impact on the global hierarchy and not enough on the Asian regional hierarchy."⁸² In other words, as Organski initially proposed, while regional order is subordinate to the global, historically wars arise from regional, rather than global, power transitions.⁸³ A peaceful transition may include significant tensions, and these tensions may indeed impact on the operations of international institutions, in particular at the regional level.

2.2.2 ...to regional institutions: regional hegemony

However, neither realism nor power transition theory speak directly to multilateral relations, and what little is said is dismissive of such organizations' significance. This view is most strongly pressed by the renowned aggressive realist John Mearsheimer, who believes "institutions have minimal influence on state behaviour."⁸⁴ This pessimism about international institutions is a characteristic of realists of all stripes, notwithstanding the occasional attempts made by some to be more optimistic about the relevance of international institutions in understanding international relations.⁸⁵

Realist analysis tends to relegate international institutions to a function of the balance of power. The development and functioning of such institutions are functions of a changing balance the power between states, and not significant in and of themselves.⁸⁶ For the realist thinker, if an organization were to weaken it would be due to state rivalry, if it were to strengthen it would be due to a rise in the amount of band-wagoning in the system. Specifically, realists tend to think that 'strong' institutions are those which are underwritten by a hegemon. However, if institutions are underwritten by hegemonic power, would a

⁸² Jack Levy, "Power Transition and the Rise of China," in *China's Ascent; Power, Security and the Future of International Politics*, ed. Robert Ross and Zhu Feng (Ithaca: Cornell University press, 2008). p. 32

⁸³ Ibid.p. 25, This corresponds with Nazli Choucri and Robert North's theory of lateral pressure, which describes the tendency, indeed necessity, of rising powers to expand their external activities (for raw material and markets) in order to sustain their rapid growth. Thus a positive feedback loop develops, whereby continued growth is dependent of external expansion and it is only a matter of time before a rising power's external interests clash with the hegemon's or other status-quo powers (such as Japan).

⁸⁴ John Mearsheimer, "The False Promise of International Institutions," *International Security* 19, no. 3 (1994).

⁸⁵ Charles Glaser, "Realists as Optimists: Co-Operation as Self-Help," *International Security* 19, no. 3 (1994-5). R Schweller and D Priess, "A Tale of Two Realisms: Expanding the Institutions Debate," *The International Studies Review* 41, no. 1 (1997).

⁸⁶ Amitav Acharya, *Regionalism and Multilateralism : Essays on Cooperative Security in the Asia-Pacific* (Singapore: Eastern Universities Press, 2003). p. 282

power transition necessarily involve the dissolution of all international institutions? Zhu has noted the surprising dearth of research linking multilateralism and power transition, “multilateralism in international relations offers a new and unique perspective for the study of power transition and great power relations.”⁸⁷ To establish the link in realist thinking between power transition and regional organizations, an understanding of the role of hegemony at various levels in institutional formation and maintenance is necessary.

Hegemony is typically defined as “being able to dictate, or at least dominate, the rules and arrangements by which international relations, political and economic, are conducted.”⁸⁸ To exert dominance, a hegemon usually must possess the strongest military and richest economy. The Hegemonic Stability theory, first put forward by Charles P. Kindleberger in the mid-1970s, suggested that only a hegemon has the requisite power to create/enforce such rules and in so doing bring about order and stability.⁸⁹ In other words, hegemony is a necessary condition for international institutions. From this perspective, the end of a hegemon would equal the end of its institutions.

A regional hegemony?

While balance of power concepts such as hegemony and power transition are typically discussed at the global level, the concepts are equally applicable at the regional level. In the realist camp, Hans Morgenthau has noted, “we have spoken thus far of the balance of power as if it were one single system comprehending all nations actively engaged in international politics. Closer observation, however, reveals that such a system is frequently composed of a number of subsystems which are interrelated with each other, but which maintain within themselves a balance of power of their own.”⁹⁰ Mearsheimer too, has long discussed hegemony in terms of regional hegemony, describing global hegemony as a regional hegemon which has successfully suppressed the emergence of other regional hegemons.⁹¹ More recently, Destradi has developed systemic definitions of regional power, based on role and strategy in addition to simple political weight.⁹²

There is, however, an important caveat when discussing ‘regional hegemony’ and power

⁸⁷ Zhiqun Zhu, *Us-China Relations in the 21st Century* (London: Routledge, 2006). p. 22

⁸⁸ Joshua Goldstein, *Long Cycles* (Yale University Press, 1988). p. 281

⁸⁹ Kindleberger initially wrote the Hegemonic Stability theory to explain the role of the US in the world economy, and to explain the recovery from the great crash. The idea is developed across two books, and the link to public policy and thence politics was made by Ken Galbraith. See *World in Depression* by Kindleberger and *The Crash of 1929* by Ken Galbraith.

⁹⁰ Morgenthau in Douglas Lemke, *Regions of War and Peace* (Cambridge: Cambridge University Press, 2002).

⁹¹ John Mearsheimer, *The Tragedy of Great Power Politics* (New York: Norton, 2001).

⁹² Sandra Destradi, "Empire, Hegemony and Leadership; Developing a Research Framework For the Study of Regional Powers," in *GIGA Working Paper Series 79* (Hamburg: German Institute for Global and Area Studies, 2008). pp. 10-12

transition. That caveat is that the regional 'hegemon' is not truly hegemonic; indeed it is better to call these states regional great powers. The difference is elementary, a regional great power *might* be able to dominate the region and act hegemonically to create and maintain regional institutions, but only as long as the global hegemon does not interfere. Moreover, as Mearsheimer notes, the global hegemon will usually interfere to the degree required to prevent the rise of a peer competitor. This interference by the global hegemon means that achieving 'regional hegemony' is difficult, as an aspirant regional great power will likely face derailing attempts by the global hegemon.

The importance of global hegemonic intervention in regional stability is underlined by Lemke who notes that, "when great powers do not interfere, [power] parity and dissatisfaction with the local status quo are expected to increase the probability of war within local [regional] hierarchies."⁹³ Realism therefore leads to a catch-22 for the development of regional institutions. If the global hegemon is absent then the likely resultant regional instability will complicate efforts at regional institution building. As Pederson explains, "in regions where institutionalization has failed or stagnated, a [global] hegemon has normally been lacking."⁹⁴ However, if the hegemon is present then any regional great power's effort to build up institutions will likely be derailed by the hegemon in an effort to head off future peer competition.

From the realist view, the most likely way that regional institutions could come into being is where a regional great power (without world hegemonic ambitions) constructs institutions which also support the global order of the hegemon, and thus win the hegemon's support. These are not 'pure' regional institutions as the world hegemon continues to play a big, even leading role, in the institutions; examples might be North Atlantic Treaty Organization in Europe and the Asia Pacific Economic Cooperation (APEC) in Asia. This view does not however explain regional institutions such as the ARF or the ASEAN Plus Three, where regional powers have come together to manage common security or economic interests either without US membership or with the US playing a formally secondary role to the regional states.

The implication of the realist theory is that institutions are generally formed by a global hegemon-regional great power alliance (such as US-Japan) acting together to create and enforce rules. The rise and possible replacement of the previous great power by another regional great power, probably at odds with alliance institutions, does not bode well for

⁹³ Douglas Lemke, *Regions of War and Peace* (Cambridge: Cambridge University Press, 2002). p. 51

⁹⁴ Thomas Pedersen, "Cooperative Hegemony: Power, Ideas and Institution in Regional Integration," *Review of International Studies* 28(2002). And even specifically, that the biggest power in the region tends to initiate institutionalization, p. 678

these institutions although it does not follow that they will necessarily perish, or perish immediately. Even as the regional balance shifts against its ally, to the extent that the global hegemon commits to that alliance, the institutions should continue to function. If the global hegemon exits the region, or swaps partner to the rising regional great power (or in the extreme case is itself replaced by the rising power), then we would expect to see major changes in the these institutions.

From a power theory perspective then, a power transition must render inoperable the former regional hegemon's institutional arrangements.

2.3 The Relevance of Liberalism

Others however question this direct link between power distribution and institutional functioning.⁹⁵ Liberal thinkers paint a more hopeful picture. Liberalism has, in this regard, played the role of checking the excesses of realism. The fundamental difference between the two paradigms lies in the problem they wish to solve: for realists, the aim was to understand why states go to war; whereas for liberals, the puzzle has been trying to explain why states cooperate.⁹⁶

The liberal theory of international relations can trace its roots back to John Locke during the Enlightenment; but its stock has fluctuated over time. In the 20th century, liberalism has tended to experience strong support after war. In the inter-war period (1919-1939) liberal theory gained strength. However, the idealism of the times did not manifest itself in the desired 'world government'. Instead, liberalism was dealt a serious blow with both the Second World War (exactly what the League of Nations was constructed to stop) and the subsequent Cold War. At the end of the Cold War, liberalism underwent something of a renaissance. Throughout the 1990s, as the world geared up to enjoy the 'peace-dividend', and as the UN gained legitimacy and European Union formed, liberalism again became increasing persuasive. Not insignificant was the phenomenon of seeing the most powerful country in the world, America, couching its foreign policy goals in liberal terms; although the Bush administration's promotion of democracy by force of arms has again weakened the appeal of the liberal viewpoint.

⁹⁵ "Power distribution ought to be examined to see if realist expectation that institutional designs reflect interests of the power states." Amitav Acharya and Alastair Iain Johnston, "Comparing Regional Institutions," in *Crafting Cooperation*, ed. Amitav Acharya and Alastair Iain Johnston (Cambridge, MA : Cambridge University Press, 2007). p. 19 Also see Duffield in *Ibid*.

⁹⁶ J J Suh, Peter J Katzenstein, et al, eds., *Rethinking Security in East Asia: Identity, Power and Efficiency* (California: Stanford University Press,2004).

While originally premised on the assumption that humans would naturally cooperate when it is rational, liberalism has undergone many transformations. Current liberal (or so-called neo-liberal) thinking has accepted many of the assumptions of neo-realism. Neo-liberalism accepts the proposition that the world is anarchical, but does not accept that *ipso facto* zero-sum, competitive policies are the most rational means to achieve state interests.⁹⁷ Liberals are willing to factor in to their analysis of state behaviour other variables such as regime type (republican liberals), interdependence (commercial liberals), and (importantly for this thesis) participation in international institutions (liberal-institutionalism).⁹⁸

2.3.1 ...to the China-Japan Relationship: Regime Type and Interdependence

Where realism identifies power as the key to understanding state behaviour, liberalism examines differences in domestic regime type and the extent of interdependence. Liberalism is generally more optimistic than realism about the prospects of a peaceful power transition with minimal negative effects on regional institutions, but even here the message is mixed.

Regime Type

In the liberal tradition, the democratic peace thesis is the most succinct explanation of how regime type affects international relations. Miller has convincingly demonstrated that liberal compatibility of regimes is an intervening variable for peace.⁹⁹ However, China has a non-liberal non-democratic political regime. Whatever might be said about its economic regime, this thesis is limited to observing that the China-Japan dyad is lacking a political factor which might otherwise ameliorate tensions in the relationship. Unfortunately, this does not tell us anything about the direction or limits on the relationship other than that.

A better explanation of how the differing regimes types in Japan and China might complicate bilateral relations is to be found in Mark Haas's model of the mechanisms by which ideological differences, in particular those surrounding the political regime, affect perceptions of threat and consequently impact on the ability to cooperate.¹⁰⁰ Indeed, the gap in ideology between China and Japan will make it harder for Japanese leaders to understand China's internal and external policies and to explain those policies to the Japanese people. Moreover, the authoritarian nature of Chinese politics makes the 'us-them' divide starker, and facilitates painting the Chinese as an 'out-group' in Japan. This

⁹⁷ Andrew Moravcsik, "Liberal International Relations Theory," in *Progress in International Relations Theory*, ed. Colin Elman (Cambridge: Belfer Center for Science and International Affairs, 2003).

⁹⁸ Stephan Walt, "International Relations: One World, Many Theories," *foreign policy* 110(1998).

⁹⁹ Benjamin Miller, *States, Nations and the Great Powers: The Sources of Regional War and Peace* (Cambridge: Cambridge University Press, 2007). p. 61

¹⁰⁰ Mark Haas, *The Ideological Origins of Great Power Politics, 1789-1989* (Ithaca: Cornell University Press, 2005).

can complicate Japan's regional efforts, especially where 'values' (c.f. China) is made a condition of membership. This will be discussed further as a part of social constructivism later, as the line blurs from regime type into national identity.

Interdependence

Liberal theory also identifies the extent of interdependence, especially commercial interdependence, as a factor in positive state relations.¹⁰¹ According to Staley, free trade and commerce (by making territory non-contiguous with economic opportunity) reduces the pressure to go to war. For this reason, interdependence is seen as facilitating cooperative bilateral relations.¹⁰² However, ever since England and Germany, despite the heavily liberalized trade between them, bled each other white in World War I, the significance of interdependence has been questioned. Indeed, one recent statistical analysis has shown that dyadic trade interdependence is an insignificant variable in predicting a war.¹⁰³

Interdependence theory identifies the growing cost of defaulting to autarky from an international trade regime, locking states into a complex interdependence which limits their ability to pursue selfish interests. However, Keohane notes that this complex interdependence need not be symmetrical or necessarily have positive outcomes.¹⁰⁴ Growing dependence in both China and Japan for imported energy and mineral resources underlines the relevance of this point; their growing external dependence could push them either together or apart.

Indeed, asymmetries of interdependence are used for political advantage and are in Keohane's view the foundations of state power. Also from the trade perspective, quality of trade is important. Growing relative volume of trade and growing trade in strategic assets (e.g. weapons systems) is regarded as leading to greater interdependence effects on the relationship than increasing absolute volumes of trade in non-strategic goods or components and which involve little or no technological transfer.¹⁰⁵

Another causal logic that liberal independence theory identifies is the formation of a commercial middle-class opposed to nationalist, aggressive policy by the elites. And while commerce has been positively linked to the development of an increasingly liberal middle

¹⁰¹ Although from the outset it should be noted that interdependence does not lead ipso facto to cooperation. Paul Viotti and Mark Kauppi, eds., *International Relations Theory* (London: Allyn and Bacon, 1999). p. 215

¹⁰² Robert Keohane, *Power and Governance in a Partially Globalized World* (New York: Routledge, 2002). p. 48

¹⁰³ Omar Keshk, "Trade Still Follows the Flag," (2004).

¹⁰⁴ Robert Keohane and Joseph Nye, *Power and Interdependence* (1977).

¹⁰⁵ Stephen Brooks, *Producing Security* (Princeton University Press, 2007).

class, even in the case of China¹⁰⁶, the link between middle class values and foreign policy is uncertain – and ought to be treated with prejudice in non-democratic regimes such as China's.¹⁰⁷

Thus, while Liberalism identifies some features which might facilitate Japan-China cooperation, the story is mixed at best.

2.3.2 ...to regional institutions: liberal-institutionalism

Liberalism, with its roots in idealism and legalism, has focused on international institutions. While previous manifestations of liberal thought had suggested that institutions can also shape state calculation of interest, the current model (so-called neo-liberal institutionalism) does not dwell on these questions. Whereas realism views the formation and effectiveness of international institutions as a function of the balance of power, liberalists view institutional formation and change as a reflection of the convergence (or otherwise) of state interests - in other words, the pursuit not of power *per se*, but of efficiency; and of absolute rather than relative gains.

One of the earlier theories designed to explain how states can move toward closer cooperation through interdependence is Ernst Haas's neo-functionalism, and its concept of *spill-over*.¹⁰⁸ For Haas, solving the larger coordination problems could happen as a consequence of smaller ones being solved – i.e. that once mechanisms were in place to coordinate trade, it would only be a matter of time before other areas, including national security would be drawn into interdependent cooperation.¹⁰⁹ But this has not occurred in Asia, and regionalism has remained 'stunted' in institutional terms.¹¹⁰

Institutionalism's difference from realism is due in part to the different foci of each theory, with realism biased towards bilateralism and liberalism towards multilateralism. Indeed, to engage in multilateral (institutional) diplomacy (as compared to bilateralism) is *prima facie* an unusual stratagem for a realist. Bringing in additional players (the heart of multilateralism) always carries the risk of being 'ganged up upon' as it lessens each states' power, included the instigator of the multilateral framework.¹¹¹ Whereas the realist view has identified hegemony, i.e. intense power concentration, as the *sine qua non* of institutional

¹⁰⁶ Alastair Iain Johnston, "Chinese Middle Class Attitudes Towards International Affairs: Nascent Liberalisation," *China Quarterly* (2004).

¹⁰⁷ Takashi Shiraishi, "Japan in Asia: Re-Strategizing Japan's Foreign Policy", in *GRIPS Seminar* (Tokyo2009).

¹⁰⁸ Haas's neo-functionalism is built from Mitany's functionalism. See, Ernst Haas, *Beyond the Nation-State: Functionalism and International Organization* (Stanford: Stanford University Press, 1964).

¹⁰⁹ Paul Viotti and Mark Kauppi, eds., *International Relations Theory* (London: Allyn and Bacon,1999).

¹¹⁰ Gilbert Rozman, *North East Asia's Stunted Regionalism* (Cambridge: Cambridge University Press, 2004).

¹¹¹ John Gerard Ruggie, "Multilateralism: The Anatomy of an Institution," *International Organisation* 46, no. 3 (1992).

formation, liberal theory does not accept this claim.¹¹²

Many international relations scholars have noted that hegemony is a relatively rare commodity whilst international institutions are comparatively easy to come by. Keohane explains this institutional 'commonness' with reference to micro-economics, suggesting that political market failure to provide such international public goods as security is the chief cause of institutions.¹¹³ More deeply, this is an argument which draws from game theory, specifically the 'Stag Hunt' game.¹¹⁴

Of course liberal thinkers do not simply discount the role of power in the development of institutions. Oran Young identifies two different types of institutions; those formed by/for the hegemon and those which are arrived at by negotiation amongst more or less formally equal powers.¹¹⁵ The ability of institutions to survive or be formed 'after hegemony' is therefore considered more likely in the case of the 'cooperative' rather than 'dictated' institutions.

Indeed, the realist view of regional institutions has been explicitly challenged by liberal theorists. As Pedersen notes, "to think of regional institutions as spear headed by a hegemonic power begs the question, why hegemons should need such institutions?" Pedersen develops this thinking into the cooperative hegemony concept, which suggests that regional institutionalization can come around even in instances where there is no clear-cut hegemon providing the major regional powers can cooperate.¹¹⁶

In the case of two (or more) large regional powers, what is needed for 'cooperative' regional institution building is political leadership. Young identifies the need for leadership across three areas; material, entrepreneurial and intellectual.¹¹⁷ Although Young does not believe that the material leadership (power) element needs to be controlled by only one actor, it is clear that changes in the material capabilities of the players will necessitate some change

¹¹² Robert Keohane, *After Hegemony* (Princeton: Princeton University Press, 1984).

¹¹³ Ibid.

¹¹⁴ A Stag Hunt game is one in which the players both benefit more from cooperation than if *either* party defaults. In other words, it is in the players interest both to cooperate, and to ensure that the other player also cooperates. It is called a Stag Hunt because only when both hunters in the game cooperate can they catch a Stag (worth 4 points), and if either defaults then they can catch only one rabbit (1 point) each, (total 2 points). It is therefore clearly in their interests to cooperate, and merely adequate communication should allow this.

¹¹⁵ Oran Young, "Review: International Regimes: Towards a New Theory of Institutions," *World Politics* 39, no. 1 (1986).

¹¹⁶ Thomas Pedersen, "Cooperative Hegemony: Power, Ideas and Institution in Regional Integration," *Review of International Studies* 28(2002).

¹¹⁷ Oran Young, "Political Leadership and Regime Formation: On the Development of Institutions in International Society," in *International Institutions: An International Organisation Reader*, ed. Lisa Martin (Massachusetts: MIT Press, 2001).

in the institution if the leadership deficit is not filled in other ways. For East Asia, this view is supported by Yoshimatsu, who has noted that great power politics has not impeded functional bargaining at the heads of government level (so-called inter-governmentalism).¹¹⁸

The problem with cooperative hegemony is that it implies unproblematically that the actors are sharing the same expectation of the institutions to be formed cooperatively. This is not necessarily the case. Pedersen discusses two different types of cooperative hegemony; offensive and defensive. The offensive type, which “comparatively weak revisionist states will tend to opt for” is geared toward power aggregation to resist external threats and/or shore up internal markets. Whereas the defensive type, which would “appeal to consolidating or retrenching superpowers [such as Japan]”, is geared towards providing stability.¹¹⁹ Indeed, Pedersen notes that “regional institutionalization is seen as typically the product of a grand strategy pursued by comparatively weak or declining big powers.”¹²⁰ The basic rationale for this can be found in March and Olsen’s discussion of institutions as ‘frozen decisions’ or ‘history encoded into rules.’¹²¹ From their perspective, institutions support the status quo. And Japan, which is interesting in defending the status quo, is thus likely to become increasingly interested in institutions.

In conclusion, from the liberal perspective, while the distribution of material power is a key factor in the creation and maintenance of institutions, the distribution need not be hegemonic (i.e. clustered in one power) provided that the institution-making actor has sufficient entrepreneurial and intellectual leadership. From a liberal view then, regional institutions ought to be able to develop in spite of the lack of hegemony due to the logic of interdependence.

2.4 The Relevance of Social Constructivism

The last theory to be discussed is social constructivism. Social constructivism is the most recent theory to gain admission into the club of dominant paradigms in international relations, gaining prominence only in the 1990s. The chief proponent of social constructivism is Alexander Wendt. The theory’s central claim is that what shapes actor

¹¹⁸ Hidetaka Yoshimatsu, "From Distrust to Mutual Interests: Emerging Cooperation in Northeast Asia," *East Asia* 22, no. 4 (2005).

¹¹⁹ Charles Kupchan, "After Pax Americana: Benign Power, Regional Integration and the Sources of a Stable Multipolarity," *International Security* 23, no. 2 (1998). p. 688

¹²⁰ Thomas Pedersen, "Cooperative Hegemony: Power, Ideas and Institution in Regional Integration," *Review of International Studies* 28(2002).

¹²¹ James March and Johan Olsen, "The New Institutionalism: Organizational Factors in Political Life," *American Political Science Review* 79(1984).

decisions is the subjective meaning applied to the objective world rather than the objective world directly.¹²² Sorensen notes that this socialization (perhaps through institutions which help states to achieve their interests cooperatively) breaks the automatic link between anarchy and self-help arguments in rationalist theory.¹²³ Thus the structure of the international system may be anarchy, but that anarchy alone does not explain why states behave in a self-help fashion.

The international structure is therefore not regarded as 'causative' by Wendt, rather, social practices explain why states act in a self-help manner. There is no *a priori* reason why states could not act in a cooperative fashion due to implications attributed (meaning given) to anarchy. As Wendt puts it, "anarchy is what states make of it" - thus competitive state behaviour is not an unchangeable fact.¹²⁴ As Katzenstein explains "rationalist theory factors out of its analysis the actor identities that are often consequential for the definition of actor interests."¹²⁵ The implication of this is that state level politics are to be regarded as a function of national identity, rather than of 'like units' differentiated only by power distribution.¹²⁶

2.4.1 ...to China-Japan relations: Nationalism and National identity

For social constructivists, the chief determinant of national behaviour is national identity. 'National identity' theory states that nations conceive of their interests on the basis of their interactions over time with the outside world, and thus interests and behaviour patterns are formed within the context of a relationship.¹²⁷ States behave in a given way depending on what they believe their role in the international community is, i.e. the rationale of appropriateness. Social constructivists would identify compatible and symmetrical identities as essential for harmonious relationships. In the context of Asia, Kang points out that hierarchical identities and the greater acceptance of authority explains the lack of balancing towards China, with the notable exception of Japan.¹²⁸ These relational identities are necessary in attempting to understand the Sino-Japanese relationship.¹²⁹

¹²² Wendt in Peter J Katzenstein, "Cultural Norms and National Security : Police and Military in Postwar Japan," (Ithaca 1996), p. 59.

¹²³ In Robert Keohane, *Power and Governance in a Partially Globalized World* (New York: Routledge, 2002). p. 71

¹²⁴ Alexander Wendt, "Anarchy Is What States Make of It," *International Organisation* 46, no. 2 (1992), pp. 394-5

¹²⁵ Peter J Katzenstein, "Cultural Norms and National Security : Police and Military in Postwar Japan," (Ithaca 1996), p. 22.

¹²⁶ Ibid. p. 24.

¹²⁷ Alexander Wendt, "Collective Identity Formation and the International State," *American Political Science Review* 88, no. 2 (1994).

¹²⁸ Kang in Ikenberry G. and Michael Mastanduno, "International Relations Theory and the Asia Pacific," (2003).

¹²⁹ Benjamin Self, "China and Japan: A Facade of Friendship," *the Washington Quarterly* 26, no. 1 (2002). p. 81

There is a also link here between the liberal theory (regime type) and constructivism. But where liberalism limits itself to shared political values (ideally liberal democracy), constructivism focused on shared ideas of 'self' and 'other' in society. State's interests are determined by these ideas (sometimes called constitutive norms), especially in the high politics of national security.¹³⁰ Indeed, Henry Nau has demonstrated that threat perception is a function of identity. This is because, "state identities determine whether countries see each other as friends or foes and thus whether relative power differences between countries are threatening or not."¹³¹ Attempts to make constructivism more concrete have resulted in mathematic modelling such as in Rosenau's threatening identities.¹³² Simpler models and demonstrations of how identity affects policy can be found in Legro; although both Legro and Rosenau draw their raw data from public perception polling or 'kremlinological' speech analysis of politicians' public addresses.¹³³

Also significant for constructivists is the level of nationalism in a society. Nationalism is seen as anathema to the kind of collective identity building that constructivists identify as promoting of peaceful, cooperative international relations.¹³⁴ However, what is significant in each is the extent of the 'we-feeling' or in-group identification, usually inferred from a belief in a shared destiny and high levels of inter-societal trust. In the case of China and Japan, it is clear that this we-feeling is severely truncated, and presents both the greatest obstacle to regionalism and most powerful argument for a regional reconciliation.

2.4.2 ...to regional institutions: regionalism and regional identity

Social constructivism is also important as it underscores the emergence of regionalism, and is thus closely associated with the development of regional institutions. Some would describe this as an institution of regional multilateralism, i.e. expectations of how regional multilateralism should operate.¹³⁵ From this view, regional institutions are a material manifestation of the underlying regional ideational structure of what it means to be East Asian, i.e. of the regional identity.¹³⁶

¹³⁰ Peter J Katzenstein, "Cultural Norms and National Security : Police and Military in Postwar Japan," (Ithaca 1996), p. 60.

¹³¹ Nau in Ikenberry G. and Michael Mastanduno, "International Relations Theory and the Asia Pacific," (2003), pp. 219-223.

¹³² David Rousseau, *Identifying Threats and Threatening Identities: The Social Construction of Realism and Liberalism* (Stanford: Stanford University Press, 2006).

¹³³ Jeffrey Legro, *Rethinking the World* (Ithaca: Cornell university press, 2005).

¹³⁴ Richard Herrman, "Linking Theory to Evidence in International Relations," in *Handbook of International Relations*, ed. Walter Carlsnaes et al (London: Sage, 2002). p. 131

¹³⁵ James Caparaso, "International Relations Theory and Multilateralism: The Search for Foundations," *International Organisation* 46, no. 3 (1992). p. 602

¹³⁶ Muthiah Alagappa, ed. *Asian Security Practice: Material and Ideational Influence* (California: Stanford Uni Press, 1998).

'Regional identity', like national identity, is about the 'we-feeling'- but at a regional level. In the European experience, it is argued that the shared 'deep institutions' like Roman law are the foundations of regionalism.¹³⁷ However, there is no consensus over what deep institutions Asian countries might share. Some suggest a common experience of being colonized, however as Frost points out this experience of being carved up has done more to un-wind regional identities than to foster them.¹³⁸ Others point to shared 'Asian values' as a deep institution that might hold the region together. However, there is no consensus about what these values might entail, as the region is split between the religious traditions of Buddhism, Hinduism, Islam, Confucianism and (to an extent) ancestor worship. Nor is it clear how these might contribute to Asia's regional community building or its institutions.¹³⁹

Of course the lack of some internal uniting feature might not be a problem if the contrast to an out-group is sufficient. Here the new moves in Asian regionalism might be examined from a constructivist view as a response to globalization and the encroachment of the West into the region's cultural space – in particular the American form of political and economic liberalism. Additionally, there is more than a little doubt about the membership of East Asia. - not merely the status of Taiwan but the role of Japan itself. Indeed, China's ambivalence towards Japan as a member of Asia has a long history.¹⁴⁰

Constructivism sees institutions as also helping to establish collective identities but does not shed light on why certain institutions arise and other do not, nor the stability of said institutions.¹⁴¹ The results of Kydd's model suggest that a hegemon must be trustworthy in order to promote cooperation. An untrustworthy hegemon not only fails to promote cooperation but can prevent it from occurring between otherwise trustworthy states. Thus it is more than mere power underwriting institutions, rather it is the expectation that the power to make these institution work will delivered reliably.¹⁴² Kydd's model closely fits to work by Mattli, which identified a trusted, undisputed regional leader as preconditions for integration

¹³⁷ Vinod Aggarwal et al., "Roundtable: Peter J Katzenstein's Contribution to the Study of East Asian Regionalism," *Journal of East Asian Studies* 7(2007).

¹³⁸ Ellen Frost, *Asia's New Regionalism* (London: Lynne Rienner, 2009). p. 217

¹³⁹ Xiaoming Huang, "Do Asian Values Matter?," *Politics and Policy* 35, no. 1 (2007).

¹⁴⁰ The fact that Japan was thrown out of the Chinese regional system for failing to support a Chinese anti-piracy security organization in the mid-1600s is a precedent suggesting that Japan might again this tension between the two is grounded in some basic features of the two societies. See, Kenneth Pomeranz and Steven Topik, *The World That Trade Created* (New York: M.E. Sharpe, 2006).

¹⁴¹ Emanuel Adler, "Constructivism and International Relations," in *Handbook of International Relations*, ed. Walter Carlsnaes et al (London: Sage, 2002). p. 104

¹⁴² Andrew Kydd, *Trust and Mistrust in International Relations* (Princeton: Princeton University Press, 2005). pp. 119-120

– as well as the role of a crisis to trigger regional identity formation.¹⁴³ From a constructivist view then, regionalism and regional institutional development is caused by the nature and vigour of a common regional identity.

2.5 The Argument from Eclecticism

Having identified the factors which the various international relations theories assign significance to when seeking to explain bilateral relations and its effect on regional institutional development the task of building up an analytical toolkit is complete. As a result, what has become clear is that the expectations of the various international relations theories are inconsistent. The factors identified as significant by realists would suggest a worsening bilateral relationship, even as liberals would be more hopeful. At the same time, Liberalism and constructivism would allow that regional organizations could remain functioning (possessing a dynamic all their own) even as Sino-Japanese relations are transformed, the realist position being the outlier. See table,

Table 1 Expectations of the International Relations theories

Theory	Factor	Area	Expectation
Realism	Power transition	Bilateral relations	Worsen
	Regional hegemony	Regional Institution	Weaken
Liberalism	Inter-dependence	Bilateral relations	Improve
	Institutionalism	Regional Institution	Progress
Constructivism	Nationalism	Bilateral relations	Uncertain
	Regionalism	Regional Institution	Uncertain

To wit, the first hypothesis (realism - power theory), would predict that if there is power transition then the relationship will worsen, and as there is no clear regional hegemon, then regional institutions will suffer. The second hypothesis (liberalism - efficiency), would predict that if there is interdependence then the political relationship will improve, and regional institutions will be developed and strengthened to support and manage the interdependence. The third hypothesis (constructivism – identity) suggests that if the national identities compete then the relationship will suffer but that while competing national identities would hinder regionalism, regionalism could also help manage and ameliorate the bilateral competition.

This theoretical toolkit also helps to generate hypotheses about the kind of regionalism

¹⁴³ Mattli in Douglas Webber, "Two Funerals and a Wedding? The Ups and Downs of Regionalism in East Asia and Asia-Pacific after the Asian Crisis," *Pacific Review* 14, no. 3 (2001). p. 343

which might be on display in East Asia today. Realists, who identify power as the key variable, would tend to dismiss the possibility of regionalism in the case of a power transition and no clear single regional leader. For these analysts, any regionalism which occurred would be of a bilaterally-networked variety, with Japan and China competing to be the hub. In the context of the thesis question, if Japan chooses not to cooperate with China due to fear of its growing power, then networked regionalism would be the outcome. Liberal thinkers on the other hand would be more positive, suggesting that true regionalism is both possible and, given time and practice at cooperation, likely. But even liberalism acknowledges that international cooperation does not suddenly occur, and that a period of bilaterally-networked regionalism is likely. From a liberal perspective, bilaterally-networked regionalism is still a form of regional cooperation and thus not reflective of competition *per se* but rather the functional needs of the region at that time. The difference between these two camps of thought lies, ironically, in the meaning they apply to such limited cooperation. To a social constructivist, bilaterally-networked regionalism – even when focused on Japan and China – does not necessarily imply a competition for regional hegemony or the current functional solution to regional problem but rather is a manifestation of where the us/them identity dichotomy is drawn. The inability of Japanese and Chinese to see themselves bound together in a shared regional future, for whatever reasons (political, economic, cultural), would be considered the case for a bilaterally-networked regionalism to emerge. Thus while realists would expect such weak regionalist structures to be blown away by the first crisis and liberals would expect bilaterally-networked regionalism to coalesce into a uniform regional code, social constructivists would look to how regional identities are formed to gauge the likely trajectory and success of a regionalist project.

With the theoretical toolkit in place, this dissertation will examine the impact on regional institutions of the Sino-Japanese relationship. Each institution, and each site of change within each institution, will be examined along lines identified above. In each case study, an argument will be developed as to whether the institution, or institutional element, is weakening or progressing and why. It may be due to a regional hegemony, or lack thereof, or an endogenous function of the institution itself, or due, in some part, to an emerging regional identity. The dissertation now turns to the Sino-Japanese relationship itself, to examine how the relationship has changed, and what that may mean for the development of regional institutions.

3 The Rise of China

3.1 Introduction

In this chapter I will discuss the background to the problem, which is in essence the Sino-Japanese relationship. Much has been written on this relationship, but the focus here is on reaching an understanding of how the rise of China has impacted on Japan and how that in turn has coloured Japan's policy towards East Asian regionalism. The chapter will examine three key areas. The first is an overview of China's rise in absolute terms, i.e. looking at how China has changed. The second is a comparison with Japan's stagnancy in order to demonstrate the speed and extent of China's rise relative to Japan. The third area is an examination of how Japanese foreign policy making process itself has changed over time.

This chapter develops an argument that China's rise has impacted on Japan in a way that reduces Japan's interest in cooperation with China on regionalism and regional institutionalization. From each of the theoretical perspectives developed in the previous chapter, it seems likely that Japan and China would be rivals to some extent rather than strategic partners, regardless of how they try to portray themselves in public. Moreover, even an examination of how Japan's policy making process has changed over time suggests that Japan has less room to cooperate with China, notwithstanding the potentially huge benefits such cooperation might have for Japan and for the region.

3.2 The Rise of China

The rise of China is a term used to describe the rapidly increasing role of China in world affairs since the end of the Cold War. This section will briefly examine the growth of Chinese national power in both military and economic terms, as well as discuss the rising expectations within China for a role commensurate with its power.

3.2.1 Chinese military power

While attempts have been made to convert military power into comprehensible units, comparing military power is more an art than a science. Firstly, even in an age of unprecedented military transparency, the true power of military hardware is hard to measure and only rarely made available for external scrutiny. And, in the case of China, the military is not transparent, and often not even an attempt is made by China to explain its defence and weapon- acquisitions decisions. This discussion on Chinese military power will focus on the military spending and to a lesser extent on some of the key weapons acquisitions. This section will briefly recount the rapid rate of growth of Chinese spending

since 1990, and as well as the beginning of a Chinese blue water navy, to show the rise of China in military power terms.

Estimating the Chinese military budget has been one of the great problems for China watchers. There is comparatively little information provided by the Chinese authorities about their defence apparatus and goals, indeed China has only recently started publishing a Defence White Paper. Previously, China had made clear that it did not think it could make any strategic gains by being more transparent. Without a doubt China was weak militarily in the 1990s, but China did not wish to help people understand just how weak.¹⁴⁴ Moreover, in the minds of the old guard of the People's Liberation Army (PLA), there was an outright disbelief that transparency was a legitimate approach to security.¹⁴⁵ China published its first Defence White Paper in 1995, which dealt more with its expectations from the disarmament processes and less about China's own military modernization. In the earlier period, the chief conduit for information about defence spending had come from internal sources. Recently however, information is beginning to be available through official Defence White Papers and budget information. And yet, as David Shambaugh notes, not even the PLA itself is aware of total military spending.¹⁴⁶ Certainly, many believe that not even the Chinese government knows for sure the actual amounts, because:

...budgeted functions are hidden under construction, administrative expenses and under state organizations such as the Commission On Science Technology and Industry for National Defence (COSTIND)...further sources of income outside the national defence budget include official local and regional government expenses for local army contributions, pensions, militia upkeep and off-budget income from PLA commercial enterprises and defence industries, as well as income from international arms sales...[and] Analysis is complicated by purchasing power parity disparities...between cost in China and the cost of an equivalent item in other countries.¹⁴⁷

The accuracy of China's defence budget reports, however, is increasing all the time. Although whether this is due to a true commitment to transparency, or whether it is simply a

¹⁴⁴ David Shambaugh, "China's Military Modernization: Making Steady and Surprising Progress," in *Strategic Asia 2005-6: Military Modernisation in an Uncertain Era*, ed. Ashely Tellis and Michael Wills (Washington: National Bureau of Asian Research, 2005).

¹⁴⁵ Rosemary Foot, "China in the Asean Regional Forum: Organisational Processes and Domestic Modes of Thought," *Asian Survey* 38, no. 5 (1998). p. 432 see also Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005)., and Thomas J. Christensen, "China, the U.S.-Japan Alliance, and the Security Dilemma in East Asia," *International Security* v23, no. 14 (1999).

¹⁴⁶ David Shambaugh, "China's Military Modernization: Making Steady and Surprising Progress," in *Strategic Asia 2005-6: Military Modernisation in an Uncertain Era*, ed. Ashely Tellis and Michael Wills (Washington: National Bureau of Asian Research, 2005).

¹⁴⁷ "Global Security," <http://www.globalsecurity.org/military/world/china/budget.htm>.2007, March

function of the PLA's declining role Chinese political life and its concomitant decline as an economic force, is debatable.¹⁴⁸ However, these White Papers are not clear where the budget goes, noting only that personnel, operations and equipment each take roughly a third of the total – leaving third parties in the dark as to what China is doing behind the screen. Moreover, China claims that the budget is accurate, which is patently untrue (as their internal sources admit).¹⁴⁹ The real figures are probably nearly double that of the official figures.¹⁵⁰ And if Purchasing Power Parity is factored in then the 'real' spending might be doubled up again, although this figure would probably not help to understand China's true ability to project military force.¹⁵¹

Regardless of whether one uses the official data or expert opinion, it is apparent that Chinese military spending is increasing rapidly. Part of the reason for this rapid growth may not be strategic opportunism on behalf of China but rather a reflection depressed spending until 1990.¹⁵² However, this kind of explanation is not likely to satisfy regional states who wonder why China is expanding so rapidly its capabilities when there are no pressing threats. Certainly the role of Taiwan as a factor pushing Chinese military modernization cannot be ignored.

China is also acquiring sophisticated weapons systems. Specifically, China is looking to acquire a blue water navy and increasing its strategic missile forces, both with Taiwan in mind.¹⁵³ *Sovremenny*-class guided missile destroyers with Sunburn sea-skimming anti-ship missiles are specifically built to neutralise *Aegis*-class destroyers and aircraft carrier battle groups. China acquired two such destroyers in 2000, and has since received delivery two more with options to purchase still more. Moreover, China continues to build up its strategic missiles, and in the mid-nineties conducted nuclear weapons tests in Xinjiang. Apart from its nuclear capability, China is deploying more short-range ballistic missiles and medium-range ballistic missiles which can threaten ships at ranges of more than 1,000km.¹⁵⁴ Both

¹⁴⁸ ———, "China's Military Modernization: Making Steady and Surprising Progress," in *Strategic Asia 2005-6: Military Modernisation in an Uncertain Era*, ed. Ashely Tellis and Michael Wills (Washington: National Bureau of Asian Research, 2005). p. 79

¹⁴⁹ Ibid. pp. 79-80

¹⁵⁰ Michael Heazle, "Sino-Japan Relations and Japan's Emerging Foreign Policy Crisis," (Brisbane: Griffith Asia Institute, 2005). p. 20

¹⁵¹ Dwight Perkins, "China's Economic Growth: Implications for the Defense Budget," in *Strategic Asia*, ed. Ashely Tellis (Washington: National Bureau of Asian Research, 2005). p. 382

¹⁵² David Shambaugh, "China's Military Modernization: Making Steady and Surprising Progress," in *Strategic Asia 2005-6: Military Modernisation in an Uncertain Era*, ed. Ashely Tellis and Michael Wills (Washington: National Bureau of Asian Research, 2005). p. 80

¹⁵³ Modelski and Thompson in 'Sea power' argue that a blue water navy is the telling mark of hegemon.

¹⁵⁴ David Shambaugh, "China's Military Modernization: Making Steady and Surprising Progress," in *Strategic Asia 2005-6: Military Modernisation in an Uncertain Era*, ed. Ashely Tellis and Michael Wills (Washington: National Bureau of Asian

of these capabilities increase China's ability to project force into Taiwan, but also beyond that to Japan.¹⁵⁵ China's also shocked the world in 2007 by demonstrating the ability to 'knock-out' satellites, bringing China into the era of Space warfare. More recently, China's effort to acquire an aircraft carrier is being cited as a signpost of the rise of a maritime great power.¹⁵⁶ China expects to acquire its first air-craft carrier by 2012.¹⁵⁷ All these acquisitions show that China's force projection capabilities are growing rapidly.

3.2.2 Chinese economic power

Economic power is in many ways easier to measure than military power. The data available to a researcher though governments and international organizations like the IMF is more reliable and plentiful. However, there are questions around which data set gives the best indication of economic power. One key dispute, of particular significance to China, is between Gross Domestic Product (GDP) as measured in Purchasing Power Parity (PPP) terms or Exchange Rate terms. In 2009, the Chinese economy was valued at nearly US\$5 trillion in exchange rate terms, whereas in Purchasing Power Parity terms it was worth the equivalent of \$8.7 trillion according to the International Monetary Fund (IMF). Because Purchasing Power Parity is a measure which factors in the cost of living, China appears much wealthier in PPP terms. The 'low value' of the Renminbi means that measures in exchange rate terms tend to exaggerate poverty. For measuring national power however, exchange rate terms provide a better measure. This is because the exchange rate captures the *relative* purchasing power of the nation in the world, not the domestic *absolute* wealth enjoyed by its citizens.

Another area of debate is around the reliability of China's official economic statistics.¹⁵⁸ Some have argued that China's economic reporting, through the National Bureau of Statistics, is in the words of Holz 'Fast, Clear and Accurate.'¹⁵⁹ However this view is the

Research, 2005). p. 91

¹⁵⁵ Michael D Swaine, "China's Regional Military Posture," in *Power Shift: China and Asia's New Dynamics*, ed. David Shambaugh (Berkeley: University of California Press, 2005). Japan should be wary of missile aimed for Taiwan, as even the DF31 short-range missile can cover Japan p. 274

¹⁵⁶ Jagannath Panda, "The Modernization Drive of the PLA and the New Defense White Paper," *China and Eurasia Forum Quarterly* 5, no. 1 (2007). pp. 22-24, China has made no effort to explain what the new aircraft carrier (and its group) would be tasked to do. Taiwan is of course an issue, but for Southeast Asian countries these capabilities are worrisome – even Australia stepped up defence spending (submarine warfare) in the face of this challenge. The author's name is misplaced in the title in Hindi, but for reference purposes author appears to be one Jagannath Panda.

¹⁵⁷ "East Asian Strategic Review," (Tokyo: The national institute for defense studies, 2007). p. 125

¹⁵⁸ It is interesting that perceptions of misreporting have actually reversed themselves over the decades since the cold war ended. In the early nineties, it was generally believed that Chinese GNP was actually 2 to 4 times lower than reported., see Paul Dibb, "Toward a New Balance of Power in Asia," in *Adelphi Papers* (Oxford: International Institute of Strategic Studies, 1995). p. 26

¹⁵⁹ Carsten Holz, "Fast, Clear and Accurate": How Reliable Are Chinese Output and Economic Growth Statistics?," *The*

minority among economists, who have become more sceptical of China's reporting since the Asian Financial Crisis. However, Holz acknowledges China recent economic reports are both 'more and less reliable than most think.' Arguing that it is unlikely that there is a systemic campaign to politically pressure on the National Bureau of Statistics to report favourably, Holz places faith in the institutions to report factually, arguing that the Bureau "is unlikely to be purposefully falsifying data... [as] the evidence on falsification of economic growth data is invalid, or at least highly problematic... [rather] the NBS appears to be making sincere efforts to prevent data falsification."¹⁶⁰

Others hold a more jaded position. Rawski for instance points out that many economists, Chinese and American, are sceptical of much of data produced by China. Focusing on the Asian Financial Crisis period, Rawski suggests that official data was exaggerated by a factor of four based on his analysis of correlates with economic growth.¹⁶¹ He is also more sympathetic to a political explanation, such as local authorities becoming "obsessed with ... GDP growth rates [as] the leading criteria for evaluating cadre performance," and therefore falsifying figures and interfering in the reporting process.¹⁶²

Regardless of whether the official statistics are incorrect because of technical difficulties or the political climate in China, and whether they over- or under-report Chinese growth, it is apparent that China's economy has undergone drastic change since the Deng reforms in 1979. The growth figures, despite their problems, are indicative – with double digit growth nearly every year for two decades. During the early 1990s, the Chinese economy was growing at 14%, and even during the Crisis years of 1997-8 still maintained high growth. In 2008 China's economy was still growing at roughly 10%, well ahead of Western developed nations and Japan.¹⁶³ Indeed, there is talk of China over taking the US as the largest economy in the world by 2040.¹⁶⁴ It is these figures and perceptions that characterise the so-called rise of China.

The economic development of China has also had significant effects on Chinese society. As James McGregor puts it in *One Billion Customers*, "China is <simultaneously> undergoing the raw capitalism of the Robber Baron era of the late 1800s; the speculative financial mania of the 1920s; the rural-to-urban migration of the 1930s; the emergence of the first-

China Quarterly 173(2003).

¹⁶⁰ Ibid. pp. 161-2

¹⁶¹ Thomas Rawski, "What Is Happening to China's GDP Statistics?," *China Economic Review* 12, no. 4 (2001).

¹⁶² Gilley in Ibid.

¹⁶³ "World Economic Indicators," (International Monetary Fund, Various Years).

¹⁶⁴ James Wolfensohn (former head of the World Bank) has predicted that China will grab the crown from the US as the world's richest country by 2040, see "Rich Nations 'Ignore' Power Shift," *BBC Online*, 21 September 2007.

car, first-home, first-fashionable clothes, first-college education, first-family vacation, middle-class consumer of the 1950s, and even aspects of social upheaval similar to the 1960s."¹⁶⁵ Chinese society is therefore suffering a kind of nation-wide social dislocation. Unemployment (and underemployment) is rife, and inequality is growing out of control challenging the basic tenets of the communist system. Indeed, this has led some to note that the bottleneck (environmental, unemployment and inequity issues) in Chinese development is coming in the year 2015, roughly as China overtakes Japan¹⁶⁶ - a situation that realists would identify as dangerous to the bilateral relationship.

3.2.3 China's 'new' great-power identity

It is increasingly apparent that China is now pursuing a great power role in world affairs. In some ways this is nothing new, as China has been interested in playing such a role since the inception of the People's Republic in 1949. Indeed, ever since Sun Yat-sen, Chinese leaders have all believed that China belongs in the 'great power club' by virtue of its size, population and civilization.¹⁶⁷ And while China was a considered 'big' military power, politically it was hamstrung by being economically backward and inward looking. Moreover, the very sovereignty of China was contested (by the recognition by Western states of the Republic of China on Taiwan) until the 1970s. All these circumstances are now changed, and China feels the century of humiliation is over and is craving a new identity with itself at the centre of Asia.

However, there remains a question about how much of these shockwaves are due to China's sheer size as it rises, and how much is due to it wilfully causing a ruckus. In other words, now that China is able to change the system, at least at the regional level, just how interested is it in doing so? How dissatisfied is China with the US-led world order it finds itself waking up to in the late 20th and early 21st century? According to Alastair Iain Johnston, China is not dissatisfied at this stage. Indeed, he describes China as a status-quo power based on its participation and good faith in international institutions.¹⁶⁸ However, he also highlights the real possibility for China to become more dissatisfied and attempt to rip up the rulebook. Even Johnston, who is generally sympathetic towards China in his work, admits that there is some evidence that China is interested in a little revisionism, and is keen to resume the mantle of a great power.¹⁶⁹

¹⁶⁵ James McGregor, *One Billion Customers* (New York: Free Press, 2005).

¹⁶⁶ Heungkyu Kim, "On China's Internal Stability," in *2nd Berlin Conference on Asian Security* (Berlin: Stiftung Wissenschaft und Politik, 2007). Approval required. p. 5

¹⁶⁷ Yunling Zhang and Shiping Tang, "China's Regional Strategy," in *Power Shift: China and Asia's New Dynamics*, ed. David Shambaugh (Berkeley: University of California Press, 2005). p. 48-50

¹⁶⁸ Alastair Iain Johnston, "Is China a Status Quo Power," *International Security* 27, no. 4 (2003).

¹⁶⁹ Ibid.

Why is China interested in Great power-ism? One of the key drivers of Chinese popular nationalism is the Chinese Communist Party itself. With the collapse of the Soviet Union, and increasing domestic criticism of Mao Zedong thought, the ideological underpinning of loyalty to the Chinese Communist Party (CCP) in the masses was critically weakened. The popular fears and anger about the direction the CCP was taking the country came to a head in Tiananmen Square in 1989. The protesters were challenging the legitimacy of, and questioning the loyalty of the people to the People's party.¹⁷⁰ In the aftermath of these events, the CCP rediscovered the value of nationalism and commenced a large-scale nationalist propaganda campaign, aimed particularly at the young.¹⁷¹ The campaign hoped to foster a 'defensive' nationalism, of loyalty to the CCP and China; however, the campaign contained not merely celebration of the achievements of the Chinese people, but a most definite criticism of the Western Powers (and especially Japan) as the hostile 'other.'¹⁷² This led to the appearance of the more virulent form of Chinese popular nationalism in 1990s. The source of Chinese nationalism at the popular level is due to economic growth and government propaganda. Takahara Akio has shown the link between China's nationalism and rapid economic growth, and demonstrated that public opinion has emerged as a factor in China's foreign policy decision making.¹⁷³

This in turn has given rise to the idea that China is aiming to open a new 'pole' to counter the US-led world order. China uses the rhetoric of multi-polarity and emphasises multilateralism in its rhetoric to contrast itself with the US as the uni-polar power and US preference for unilateralism. However, Thomas Christensen has noted that multi-polarity is actually a euphemism for rising Chinese power, and does not extend to legitimize Indian nuclear ambitions, let alone Japan's efforts to become a 'normal' country.¹⁷⁴ This multi-polarity then is a part of China's dissatisfaction with the world order, and an attempt to open a Sinic pole (or Sinic Zone). However, either this dissatisfaction is not yet strong enough to warrant strong rebuke of the Western world order or China is simply not strong enough to do so – and probably both.

The most important of China's interests in re-shaping the world revolve around the 'lost territories', especially Taiwan. Chinese military posturing over the Straits in the mid-1990s,

¹⁷⁰ Initial complaints of the students focussed on food, allowances and jobs.

¹⁷¹ Suisheng Zhao, "A State-Led Nationalism: The Patriotic Education Campaign in Post-Tiananmen China," *Communist and Post Communist Studies* 31, no. 3 (1998).

¹⁷² ———, "Chinese Nationalism and Its International Orientations," *Political Science Quarterly* 115, no. 1 (2000).

¹⁷³ Akio Takahara, "The Rise of China and Security in East Asia," in *Japanese Responses to Globalization: Politics, Security, Economics, Business*, ed. Glenn D Hook and Harukiyo Hasegawa (New York: Palgrave Macmillan, 2006). p. 73

¹⁷⁴ Christensen 2001 in Alastair Iain Johnston, "Is China a Status Quo Power," *International Security* 27, no. 4 (2003).

and Naval posturing earlier in the South China Sea, demonstrated forcefully to the world these tensions. With regards to Taiwan the threat of the use of force to 'resolve' the issue has not been taken off the table. This is due to popular ethnic nationalism which makes state concession impossible even if it were desired by the CCP.¹⁷⁵ Indeed, in 2005 China passed the anti-secession law which made war 'automatic' in the event that Taiwan makes its *de facto* independence *de jure*. In the South China Sea, disputes over Mischief Island and the like have been handled more cautiously. This is because China regards these territorial disputes as international, rather than domestic (like Taiwan).¹⁷⁶ However, while China has officially taken the use of force off the table in resolving the territorial problems in the South China Sea by signing the ASEAN-Treaty of Amity and Cooperation (effectively shelved the issue), China has not dropped its claim.

What China learnt from its neighbour's expressions of dissatisfaction was that China did not have the power to change the regional system, even if it could challenge it somewhat. In the case of the Taiwan Straits crisis of 1995-6, what China saw was a 'hardening' of the US-led order in response.¹⁷⁷ Apart from the immediate dispatch of two US aircraft carriers, America moved to both sell more sophisticated weapons to the Taiwanese and to strengthen the US-Japan alliance. While China should have been able to see that its provocative manoeuvres could trigger a security dilemma, it was not adequately sensitive about the likely response to its actions by the other parties. More shocking to China was the response of South East Asia to its maritime posture on the South China Sea. With Vietnam in the lead, the ASEAN powers acted to balance against China's power.¹⁷⁸ China has learnt that it is still not strong enough to attract bandwagoners in all but the weakest of regional states, such as Burma. Rather strong positions by China have been balanced against thus far.

This triggered China's policy of reassurance and the so-called 'peaceful rise' thesis. China has been sensitive since Deng's tour of Southeast Asia to the potential of a security dilemma centred on its military modernization.¹⁷⁹ To combat this, China has launched its co-called 'charm offensive' aimed squarely at reassuring its neighbours of its benign intent in late 1990s. Central to this was China's accession to the ASEAN-Treaty of Amity and

¹⁷⁵ Benjamin Miller, *States, Nations and the Great Powers: The Sources of Regional War and Peace* (Cambridge: Cambridge University Press, 2007). pp. 90-1

¹⁷⁶ Justin Hempson-Jones, "The Evolution of China's Engagement with International Governmental Organisations," *Asian Survey* 45, no. 5 (2005). p. 719

¹⁷⁷ China however did not fully mobilize, so probably China was fishing to be deterred, recognising that a real war would not be in the national or the regime's interest.

¹⁷⁸ Joshua Kurlantzick, "China's Charm Offensive in Southeast Asia," *Current History* 105(2006). p. 272

¹⁷⁹ Yunling Zhang and Shiping Tang, "China's Regional Strategy," in *Power Shift: China and Asia's New Dynamics*, ed. David Shambaugh (Berkeley: University of California Press, 2005). p. 49

Cooperation in 2003, which obliges China not to use force to resolve international disputes.¹⁸⁰ China very much likes to see, and portray, itself as both important and a positive force in the region. For example, during the Sumatran Tsunami disaster in 2004, China played a small (but appreciated) role in disaster relief. While both the financial and material support was almost embarrassingly small compared with the US, Japanese and Taiwanese contributions, the Chinese media exaggerated the effect and appreciation and made sure that at least the message was not lost on its own citizens.¹⁸¹ According to one poll in 2007, the Chinese rated themselves as quite a lot more important to both world affairs and regional affairs than Japan, although this view was not reciprocated by other Asian countries¹⁸² - suggesting a perception gap between China and other Asian nations.

China increasingly strives to present itself as a force for regional stability. At the 2004 Bo'ao forum, Hu Jintao stated "the very purpose of China's foreign policy is to *maintain world peace*," implying a strong status-quo tendency. Wen Jiabao has declared China will never be a hegemon, even after it is a world power.¹⁸³ Thus, at the 16th Communist Party Congress the official doctrine was to take advantage of the positive environment of "a 20 year period of strategic opportunities" to focus on domestic priorities.¹⁸⁴ The 'peaceful rise' thesis, as it is known, is central in the formulation of this policy of reassurance.¹⁸⁵

As China emerges more clearly as a great power in the light of the World Financial Crisis, some within China (while emphasising the US relationship under what is being termed the G2) have begun to look at Japan as a possible partner. For example, Li Changchun, a standing committee member of the Political Bureau of the Chinese Communist Party, has repeatedly made the offer of a 'Japan-Chinese partnership' to further the region; identifying what he believes are 'basic differences' between the West (the US and Europe) on the one

¹⁸⁰ Joshua Kurlantzick, "China's Charm: Implications of Chinese Soft Power," in *Carnegie Endowment Policy Brief* (2006).

¹⁸¹ John Tkacik and Dana Dillon, "China's Quest for Asia: Beijing Fills a Vacuum," *Policy Review*, no. 134 (2005/6).

¹⁸² "World Publics Think China Will Catch up with the Us - and That's Okay," www.worldpublicopinion.org. 2007, November

¹⁸³ Qingguo Jia, "'Peaceful Rise': China's Policy of Reassurance," in *Asia Pacific and a New International Order*, ed. Purnendra Jain, Felix Patrikeeff, and Gerry Groot (New York: Nova Science Publishers, 2006). p. 136

¹⁸⁴ Jisi Wang, "China's Changing Role in Asia," in *Asia Programs* (The Atlantic Council of the United States, 2004). Historically minded readers might note a disturbingly similar rhetoric of twenty years peaceful development was previously employed by Adolf Hitler prior to World War II.

¹⁸⁵ Of course, the main reason is to preserve its national security by minimising the chance of balancing against it. But there are domestic political reasons as well for the vigorous counter to the China threat theory, such as the CCP's need to maintain legitimacy in domestic politics. If the CCP could not defend the 'honour' of China it could lose nationalist the support it relies on. Indeed, by portraying the china threat theory as evidence of a conspiracy to keep china down, the CCP can use it as a whetstone to build a stronger national identity. See, Yong Deng, "Reputation and the Security Dilemma: China Reacts to the China Threat Theory," in *New Directions in the Study of China's Foreign Policy*, ed. Alastair Iain Johnston and Robert Ross (Stanford: Stanford University Press, 2006). p. 202-3

hand and China and Japan on the other.¹⁸⁶ Of course, the Japanese are continuing to doubt Chinese intentions in such a proposal.¹⁸⁷

3.3 The Rise of China: Impacts on Japan

It is apparent then that China has increased its absolute power in both military and economic terms, and that it is seeking a greater role commensurate with its power. This has led some to believe that China is a revisionist power seeking to deliberately restructure the world, or at least region, in its favour. Francis Fukuyama, writing in the *Wall Street Journal*, declared that “the Chinese know what they are doing...they want to organise East Asia in a way puts them in the centre.”¹⁸⁸ Such views tend to paint China’s rise as a negative force, but what are the impacts of China’s rising power on Japan?

This next section looks at the effect of rising Chinese power on Japan. It is therefore relational, and examines China role in limiting or stimulating Japanese foreign policy from the perspectives of power transition, interdependence and identity theory. In particular, it will demonstrate how China and Japan have recently entered the zone of power parity. Further, it will demonstrate that the growing interdependence between the two tells a mixed story at best about the there future projects for cooperation. Lastly, it will show that the Japanese government and people are increasingly coming to view China as a threat. This outlook is not positive for their bilateral relationship, and the implications for regional institutions are generally poor.

3.3.1 The rise of China versus Japan: evidence of power transition?

For Power Transition theory to be relevant there would need to be a closing of the power gap between Japan and China defined in both traditional military terms and industrial prowess. To investigate whether and how a power transition is in effect, I will examine the Chinese military spending and China’s economic growth compared to that of Japan.

Economic power transition

In the mid-nineties, China turned the corner and entered into the phase of transitional growth in national power. In economic terms, this has been reflected in double digit growth and the consequent exponential growth rate. At roughly the same time, Japan too turned a corner, but rather than leading to rapid and continued growth under the Japan miracle, it led to an economic dead-end. Japan’s economic growth has all but flat-lined, and what growth

¹⁸⁶ Yoichi Funabashi, "Japan Should Resuscitate Its Feeble Diplomacy." 2009, 29 April

¹⁸⁷ Ibid.

¹⁸⁸ Francis Fukuyama, "America's Challenge in Asia," *The Wall Street Journal*, 2 March 2005.

there is to be found is usually attributed to China's power house economy.

Indeed, in 1994, China overtook Japan in terms of size of economy as calculated by the Purchasing Power Parity method. This method, which corrects for the domestic cost of living, is useful for establishing the strength of the domestic economy, however it is problematic to use the method to make national comparisons; China is not a major Foreign Direct Investment (FDI) and Official Development Assistance (ODA) power like Japan even though their economies may have been similar in Purchasing Power Parity terms. A more appropriate means for comparing international economic strength is in exchange rate terms, although this too carries its own share of problems. Not least among these problems is that the Chinese currency is effectively pegged to the US dollar, whereas the yen has been rather more volatile. Notwithstanding the current spike brought on by the Global Financial Crisis, the the Japanese yen has been generally depreciating since the mid-1990s. These effects both distort and under-emphasize Japanese growth over this time. In exchange rate terms, Japan is still the number two ranked economy in the world. However, it may only be a matter of time before China catches up in exchange rate terms as well. Some earlier projections suggest 2012 as the cross-over point, but the effects of World Financial Crisis in 2008-9 might well make this year (2010) the year China surpasses Japan in these terms. See Figure 3 overleaf,

Figure 3 China and Japan's GDP in Exchange Rate Terms

NOTE:
This figure is included on page 51 of the print copy of
the thesis held in the University of Adelaide Library.

Source: International Monetary Fund, World Economic Outlook Database

Further evidence for a Power Transition in the economic field can be found in the changing make-up of the two economies. Power Transition theory in fact expressly focused on industrialization. China's development of an industrial and manufacturing base dynamic enough to leapfrog up the value added chain, even as Japan de-industrialises (amid much complaining about hollowing-out) should ring alarm bells for a Power Transition theorist.¹⁸⁹ Indeed, as Michael Green suggests, "Japan in spite of – indeed because of – its economic travails is set to become a larger actor in international affairs."¹⁹⁰

From a zero-sum perspective, the industrial weight of the region seems to be moving to China from Japan. There are signs that the so-called vertically integrated model, in which Japanese companies operating in China source hi-tech parts and components from Japan, is being replaced with a more 'horizontal' pattern. In this new and emerging pattern of trade, Japanese companies in China locally source parts and components from companies operating in China. In 1995 Japanese multinationals in China sourced only 29.1% of their parts and components from local companies, by 2001 this had increased to over 50%, including in hi-tech areas such as precision instruments, and remains at roughly 50%

¹⁸⁹ The economic explanation for this phenomenon is called agglomeration, usually accredited to Paul Krugman and Terry Venables. A simple explanation of which can be found in Paul Krugman and AJ Venables, "Globalization and the Inequality of Nations," *The Quarterly Journal of Economics* 60, no. 4 (1995).

¹⁹⁰ Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). pp. 6-9

since.¹⁹¹ While some these locally sourced parts and components come from Japanese affiliates¹⁹², it is clear that a new triangular trade pattern has replaced the Japan-led 'flying geese' model.

Military power transition

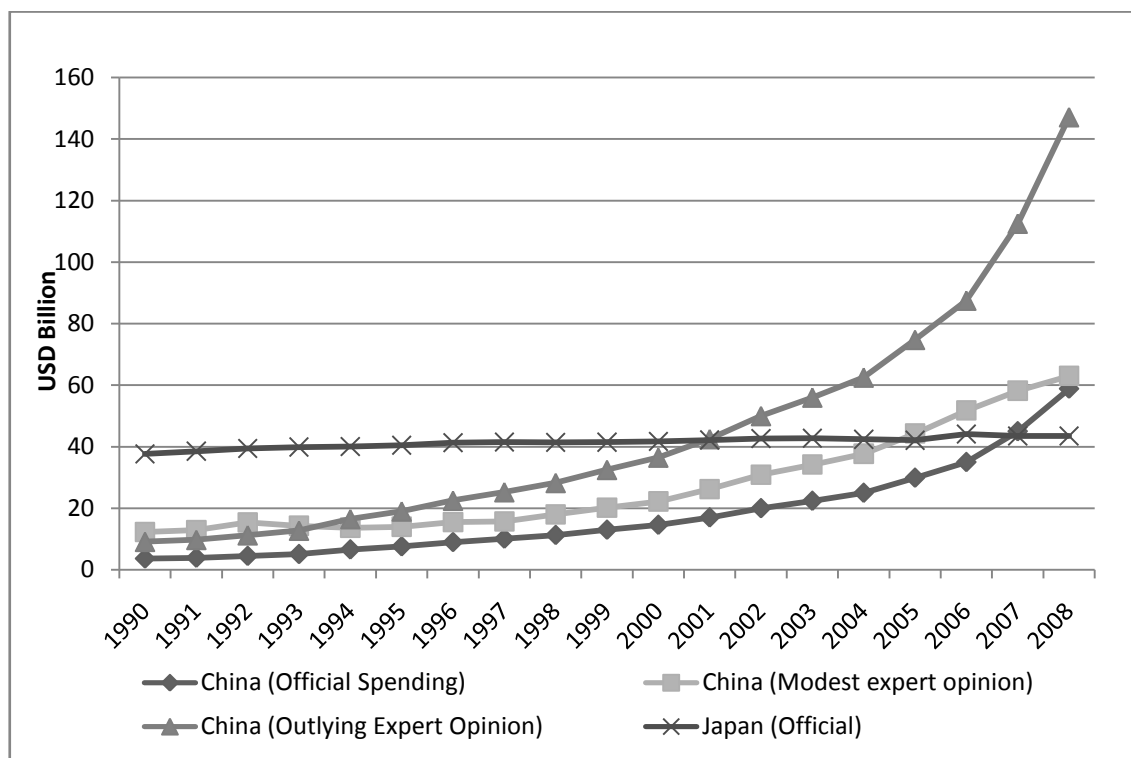
We have already seen that China's defence spending is rising rapidly in absolute terms. In order to maintain the current balance of power Japan would either have to spend more, and/or increase the 'value' of its alliance portfolio. Yet Japan has failed to balance internally against China by increasing its own defence expenditure. Japanese defence spending has instead remained stable in both absolute amounts and relative to GDP due to the above mentioned economic slump. This has effectively allowed China to very rapidly expand its military power relative to Japan. Indeed, according to the Stockholm International Peace Research Institute China's military spending officially overtook Japan in 2007.¹⁹³ However, as mentioned previously, due to vagaries in the Chinese reporting, it is unsure quite when the 'cross-over' occurred and how far ahead China is at the present, see Figure 4 overleaf.

¹⁹¹ "Survey of Japanese Affiliated Firms in Asia and Oceania," (Tokyo: Japan External Trade Organization), Various years.

¹⁹² However, International assembly operations taking place in China are largely handled by foreign affiliates (roughly 80%). Guillaume Gaulier et al, "China's Integration in East Asia," *Econ Change* 40(2007). p. 40

¹⁹³ Stockholm International Peace Research Institute, Military Expenditure Database.

Figure 4 China vs. Japan Military Spending



Source: Stockholm International Peace Research Institute (Military Expenditure Database), and the US Department of Defence.

Even though China has overtaken Japan in military spending, at the present Japan is probably still ahead in terms of actual military power. While military spending is usually a good indicator of military prowess, in the case of China it is important to factor in that the PLA budget was systematically not prioritised during the previous two decades.¹⁹⁴ This means that even after the budget official overtakes Japan, one might expect that it would take another couple of decades before China's military hardware catches up with that of the Japanese armed forces.

While China's rise in effect poses a challenge to the US-led security order in East Asia, which Japan through the US-alliance is an integral part of, it is still hard to imagine a Chinese led security order for a variety of reasons. China has not yet demonstrated much interest in being the primary security provider for Asia. China is in fact a beneficiary of the US-led order in Asia and China benefits from the US Navy securing the Sea Lanes of Communication to the Persian Gulf for its oil and to Southeast Asia for trade. As Shambaugh notes, "a close reading of Chinese military doctrinal manuals gives little, if any,

¹⁹⁴ David Shambaugh, "China's Military Modernization: Making Steady and Surprising Progress," in *Strategic Asia 2005-6: Military Modernisation in an Uncertain Era*, ed. Ashley Tellis and Michael Wills (Washington: National Bureau of Asian Research, 2005). p. 80

evidence that power projection beyond China's immediate periphery is a priority...more to the point, there is no evidence of assertive PLA attempts to develop force multiplier capacities."¹⁹⁵ Chinese military presence in the Asia region, while growing, is still smaller in scale than that of Japan.¹⁹⁶

Notwithstanding China's rising defence spending vis-à-vis Japan, Colonel Gui Xinning, research fellow at the Institute of Strategic Studies in China's National Defence University believes that "China is the weaker side... when compared to the Japanese military... nowadays the strongest military power – in terms of conventional weapons – is Japan."¹⁹⁷ This view is supported by Japan's professional armed services. In private Japanese military officers concede that the opaqueness of the Chinese military probably reflects basic weakness rather than strength, and Japan should remain calm and avoid causing anxiety in China by rapidly building up Japanese military strength; a view completely at odds with Japanese political rhetoric.¹⁹⁸ Clearly, Chinese leaders are paying close attention to the balance of power, but close attention to power is not the mark of a revisionist country rather it is the neglect of power realities which is more dangerous.¹⁹⁹

A power transition is occurring and China has entered the cross-over zone, even if there is some uncertainty about whether China has yet surpassed Japan. Indeed, the absence of clarity about who is dominant militarily and economically, ironically, is clear evidence that the players are in the transition zone of maximum instability.

3.3.2 The rise of China and Japan: evidence of interdependence?

Interdependence is identified by Wan as an intervening variable that helps to explain the limits on Japan's foreign policy responses to China.²⁰⁰ Insofar as this is the case, it is also clear that interdependence is in itself insufficient force to push Japan and China closer politically but still suggests that they are more likely to cooperate in regional institutions.²⁰¹ Unlike power transition, as an 'efficiency seeking' logic interdependence is not limited to only two players. Thus, this next section will discuss interdependence in the Sino-Japanese relationship with reference to trade and investment patterns between each other and in

¹⁹⁵ Ibid. p. 95, These ideas hark back to Deng Xiaoping's position of low profile and not taking a leadership position.

¹⁹⁶ Lam Peng-Er, "Japan's Human Security Role in Southeast Asia.," *Contemporary South East Asia* 28, no. 1 (2006).

¹⁹⁷ Dennis Van Vranken Hickey, "Japan Military Modernisation: View from China," in *China and Japan at Odds*, ed. James C Hsiung (New York: Palgrave Macmillan, 2007). pp. 105-6

¹⁹⁸ No crisis of confidence in Japan's military, as some experts have apparently boasted the MSDF could destroy the Chinese navy in two hours Ibid. p. 106

¹⁹⁹ Jeffrey Legro, *Rethinking the World* (Ithaca: Cornell University Press, 2005). p. 174-5

²⁰⁰ Ming Wan, *Sino-Japanese Relations* (Washington D.C.: Stanford University Press, 2006). p. 210, pp. 227-8

²⁰¹ Michael Yahuda, "The Limits of Economic Interdependence: Sino-Japanese Relations," in *New Directions in the Study of China's Foreign Policy*, ed. Alastair Iain Johnston and Robert Ross (2006).

third markets, especially in the region.

Bilateral trade interdependence

The economic relationship between China and Japan is very dynamic. In terms of volumes of trade, Japan's exports to China have grown rapidly from US\$6 billion in 1990 to over US\$124 billion in 2008, a roughly twenty-fold increase in almost as many years. At the same time Japan's imports have increased from US\$12 billion to more than US\$143 billion over the same timeframe. The percentage of Japan's total trade with China (its trade dependence on China) has also risen from less than 5% in 1990 to over 15% in 2008. China's trade dependence on Japan over this time has however been falling, indeed China is now less trade dependent on Japan than *vice versa* (see Figure 5). While in absolute terms the trade interdependence between China and Japan has gone up since 1990, the *relative* balance of dependence is moving against Japan.

Figure 5 Sino-Japan Trade Relations

NOTE:
This figure is included on page 55 of the print copy of
the thesis held in the University of Adelaide Library.

Source: International Monetary Fund, Direction of Trade Statistics

Japan's dependence on China also extends to its food supply. China has for the last several years ranked as Japan's second largest source of food imports, behind only the US and providing nearly twice as much as the number three ranked, Australia. In 2006, China was responsible for 17% of Japan's food imports, up from previous years.²⁰² Again, the

²⁰² "Japan's Food Import/Export Statistics," <http://www.jetro.go.jp/en/reports/statistics/>. Accessed, April 2010.

inverse is not true as China is still self-sufficient in food production. And although that might change in the future, Japan is hardly able to become a major supplier of food for China. This is not to say that the Chinese food market is unimportant for Japan. Indeed, mainland China has consistently rated as in the top three (number three in 2004-6) of Japan's food export destinations. In 2007, 15.8% of Japan's food exports worth some US\$400m went to China. Moreover, Hong Kong has also rated in the top three (number two in 2004-6) claiming in 2007 another 17.9%, or US\$467 million, of Japan's food exports. Taken together, Japanese food exporters are very dependent on China market.²⁰³

Regional patterns of trade: Flying Geese to triangular pattern

Arguably the most important change in the structure of the East Asian economy since the Cold War has been the rise of China and the stagnation of Japan. The effect of this change has been to undermine the prior economic order which was characterised by a strong Japan driving the region's economic development, the so-called Flying Geese Model. The Flying Geese Model was premised on Japan as the head goose, leading in technology and manufactures and transferring redundant industries 'down' to the next developing economy. However, the rise of industrial China has led to the so-called triangular trade pattern in East Asia, and the collapse at least in part of the prior pattern.²⁰⁴ China, as a latecomer, ought to have been a low-tier goose, yet its staggering economic growth is pushing it towards pole position as it overtakes other developing economies in Asia - even increasingly vying with Japan for dominance in regional economies, see Figure 6 and Figure 7 overleaf. If trends continue, then this triangular pattern may lead to a new order of a 'Greater China-centred production network' – rather than one centred on Japan.

²⁰³ Of course, most of Japan's agriculturalists are producing not for export, so Japan's farmers on the whole are not dependent, but exporting primary producers (usually specialists) are sending a third of what they make to China.

²⁰⁴ Daisuke Hiratsuka, "Competitive Strategy in the Six Asean Countries," in *Asean-Japan Competitive Strategy*, ed. Daisuke Hiratsuka and Ippei Yamazawa (Tokyo: Institute for developing economies Japan External Trade Organisation, 2003).

Figure 6 Japan and China Exports to ASEAN5

NOTE:
This figure is included on page 57 of the print copy of
the thesis held in the University of Adelaide Library.

ASEAN5 refers to Indonesia, Malaysia, Singapore, Thailand and the Phillipines
Source: International Monetary Fund, Direction of Trade Statistics

Figure 7 Japan and China's Imports from ASEAN5

NOTE:
This figure is included on page 57 of the print copy of
the thesis held in the University of Adelaide Library.

ASEAN5 refers to Indonesia, Malaysia, Singapore, Thailand and the Phillipines
Source: International Monetary Fund, Direction of Trade Statistics

As can be seen in the graphs above, China is increasingly dominating intra-regional trade. Not only does China now import more from regional states than Japan, its export profile is also larger than Japan's to these states – especially if Hong Kong is included.²⁰⁵ Indeed, according to surveys conducted by the Japan External Trade Organization, Japanese multinationals active in Southeast Asia were sourcing raw materials and Parts and Components from China more often than Japan.²⁰⁶ Moreover, as China's trade profile is shifting towards increasingly complex goods such as cars and consumer electronics, Southeast Asian countries are coming under pressure. Chinese trade increasingly competes for a greater share in third markets, such as in office machinery - an area where ASEAN traditionally has been competitive.²⁰⁷ And even Japan is beginning to lose its competitive advantage in machinery and transport equipment to China.²⁰⁸ While China is not yet in a position to challenge the supremacy of Japan in these sectors, the economic landscape is changing in China's favour.

Another significant impact of the rise of China on the regional economic order has been in FDI. Southeast Asian economies were 'feeling the squeeze' as China took not only a larger share of the labour-intensive industries, but also, they believed, an increasing share of Japanese FDI.²⁰⁹ Indeed, Japanese investment to Southeast Asia fell off steeply in the early 2000s while China continued to attract FDI, see Figure 8. Although, Japanese FDI to Southeast Asia has since returned Eichengreen suggests that this too is a function of the growth of China as an export destination.²¹⁰

²⁰⁵ Andrew MacIntyre and Barry Naughton, "The Decline of a Japan Led Model of the East Asian Economy," in *Remapping East Asia*, ed. T J Pempel (Ithaca: Cornell Uni. Press, 2005). p. 90

²⁰⁶ "Part 2 Future Business Development, Procurement of Raw Materials and Parts, Measures against New Influenza a(H1n1), Exports and Imports, Average Salary," in *Survey of Japanese Affiliated Firms in Asia and Oceania* (Tokyo: Japan External Trade Organization, 2010). p. 29

²⁰⁷ "China's Industrial Rise: East Asia's Challenge," (Canberra: Department of Foreign Affairs and Trade - Economic Analytical Unit, 2003). pp. 39-55

²⁰⁸ It is important to note that neither Japan nor Southeast Asia has faced an export contraction in absolute terms, thus China's export growth is affecting the balance or proportions within expanding trade. Put another way, all are growing but China is growing the fastest. Athukorala Premachandra, "The Rise of China and East Asian Export Performance: Is the Crowding-out Fear Warranted," *The World Economy* 32, no. 2 (2009).

²⁰⁹ Malaysia's Prime Minister Mahathir Mohammad aired this concern, noting that "there's not much capital going around. Whatever there is gets sucked in by China", and he claims that 16,000 jobs were lost in Penang alone in 2002 as major hi-tech producers move capacity to China. Chandler and Eckholm in Shaun Breslin, "China's Rise to Leadership in Asia - Strategies, Obstacles and Achievements" (paper presented at the Regional Powers in Asia, Africa, Latin America, the Near and Middle East, Hamburg, 2006). p. 11

²¹⁰ Barry Eichengreen and Hui Tong, "Is China's FDI Coming at the Expense of Other Countries?," *National Bureau of Economic Research Working Paper Series* 11335(2005).

Figure 8 Japanese FDI to China and ASEAN5

NOTE:
This figure is included on page 59 of the print copy of
the thesis held in the University of Adelaide Library.

Source: Prepared by Japan External Trade Organization from Ministry of Finance Balance of Payments Statistics and Bank of Japan foreign exchange rates. Accessed: April 2010

John Ravenhill supports Eichengreen's argument that despite the appearance of China's rise somehow 'stealing' FDI earmarked for Southeast Asia and despite Southeast Asia losing some market share in the third countries, China has a net positive influence on these countries by increasing inter-regional intra-industry trade.²¹¹ This adds up to a region which is increasingly reliant on China as the driver of growth and development, and subsequently less reliant on 'traditional' markets in Japan and the US. In the face of increased competition from China, Japanese firms in Southeast Asia have moved to producing more complex, high tech items – abandoning certain lines of production to China.²¹²

Increasingly, Japan's imports of final goods are coming from China, which accounts for nearly a third of Japan's total global imports. This has happened mainly at the expense of Southeast Asia, which lost much of its market share. At the same time Japan has become increasingly dependent on China for supply of capital goods, including important basic technologies necessary for business growth such as telecommunications equipment and computers.²¹³ As Gaudier argues, "The changes that have taken place in Japan's trade

²¹¹ John Ravenhill, "Is China an Economic Threat to Southeast Asia?," *Asian Survey* 46, no. 5 (2006).

²¹² Southeast Asia still had several advantages on China, logistics in the case of Singapore, Malaysia and the Philippines. Daisuke Hiratsuka, "Competitive Strategy in the Six Asean Countries," in *Asean-Japan Competitive Strategy*, ed. Daisuke Hiratsuka and Ippei Yamazawa (Tokyo: Institute for developing economies Japan External Trade Organisation, 2003). pp. 297-300

²¹³ A six-fold increase over the decade to 2003 of capital goods from China to Japan as Japan's exports of capital goods

pattern as a result of China's emergence can be viewed as a switch from bilateral to triangular trade. Japan's trade which used to be dominated by the exports of final goods to North America and Europe has been driven by exports of Parts and Components and semi-finished goods to China where they are processed and assembled and then re-exported to Western markets and also to Japan."²¹⁴ The effect of this triangular trade pattern is to increase Japanese dependence on China.

3.3.3 The rise of China to Japan: evidence of contested national identity?

China's rising great power identity also impacts on Japan. One of the weaknesses with the realist theory is that it does not specify the direction of balancing. Thus China's rise could, in theory, encourage Japan to balance against US hegemony. Yet this balancing is not occurring. The most important reason why is the way national identity is constructed by each side of the China-Japan bilateral relationship. From a constructivist perspective, the basic problem is naturally one of identity; Japan and China have mutually constructed images of the other as a 'threat' to one extent or another and self-images as the 'first in Asia' - a position that objectively only one can hold. Moreover, contested history has given rise to a victim identity on both sides, making civil patriotism appear more dangerously nationalist to the other. Benjamin Self calls this "duelling nationalism and national identity"²¹⁵, a situation of contested identity which makes further instability in the relationship more likely.

Underlying this situation of duelling nationalism is the issue of history. Japanese society as a whole has not been very concerned or knowledgeable about their war history. Even worse, this lack of understanding is even more marked in the youth of Japan. As Tamamoto notes, "people were victims of a war abstractly conceived...this ahistorical imagination [has]...left little room for recalling Japanese aggression."²¹⁶ While Zhou Enlai was willing to grant that the Japanese people were also the victims of Japan militarism, an acknowledgement of Japan's role as aggressor was/is a necessary component for reconciliation. Not that there have not been attempts to resolve the history issue before, but these have run into trouble. Koizumi had proposed a shared textbook in 2001, although it was not until 2006 that the idea was taken up by the Foreign Ministers (Asō Tarō and Li Zhaoxing).²¹⁷ In 2010, the finding joint textbook was finally launched but even then

slowed. Guillaume Gaulier et al, "China's Emergence and the Reorganisation of Trade Flows in Asia," *China Economic Review* 18(2007). pp. 218-222,

²¹⁴ Ibid. pp. 218-222

²¹⁵ Mike Mochizuki, "China-Japan Relations: Downward Spiral or New Equilibrium?," in *Power Shift: China and Asia's New Dynamics*, ed. David Shambaugh (Berkeley: University of California Press, 2005). p. 138

²¹⁶ Masaru Tamamoto, "How Japan Imagines China and Sees Itself," *World Policy Journal* 22, no. 4 (2005). p. 60

²¹⁷ Even the shared history textbook which this to be the outcome of this processes is to have separately authored

interpretations of key events remain different and different versions will be provided to each country.²¹⁸

China acts (up)

The view that Japan is not yet 'suitable' to act as an equal internationally, or within a Chinese-led conception of the region, is based in part on the popular nationalism fostered by the CCP since 1989. While the CCP is playing with fire by allowing the nationalist sentiment to grow, the CCP is aware of this as China's leadership remembers that 1935 protest against Japan turned on China's government. The CCP has several times banned large protests (such as in 2005 in Tiananmen Square) to prevent a possible such re-occurrence - it is likely however that the horse has already bolted.²¹⁹ As Zhao notes, "while nationalism may be used by the regime to replace the discredited communist ideology as a new base of legitimacy... It was clear that rising nationalism in 1995-1997 ran into a criticism of Chinese foreign policy, especially the seemingly too soft stance toward the United States and Japan."²²⁰ The military, the bastion of the Chinese nationalism, is probably the most thus affected. As Shambaugh notes "the anti-Japanese sentiment one encounters among the PLA at all levels is palpable. Distrust of Japan runs deep, transcends generations, and is virulent among the generation of PLA officers in their forties and fifties [who are the decision makers]."²²¹

The politics of taking a pro-Japanese line in China is hardly new; CCP Party General Secretary Hu Yaobang lost his job in the 1980s in part because of excessive friendship with Japan.²²² Moreover, a series of intellectuals (such as Ma Licheng) and pop figures (Zhao Wei, Jiang Wen) have been 'named and shamed', in some cases threatened with death for seeming to take a pro-Japan line.²²³ Although China officially denies fostering anti-Japanese nationalism for political gain, and insists history is a real issue being taken up in the interests of justice alone²²⁴, this view is unlikely to wash with the Japanese.²²⁵ This

chapters, casting some doubts about how 'joint' the textbook will in fact be, or be viewed. See Caroline Rose, "Sino-Japanese Relations after Koizumi and the Limits of 'New Era' Diplomacy," in *China, Japan and Regional Leadership in East Asia*, ed. Christopher Dent (Cheltenham: Edward Elgar, 2008). p. 56

²¹⁸ Ko Hirano, "Japan-China History Report to Break New Ground," *Japan Times*, January 21 2010.

²¹⁹ Rana Mitter, "Remembering the Forgotten War," *History Today* (2005). p. 19

²²⁰ Suisheng Zhao, "Chinese Nationalism and Its International Orientations," *Political Science Quarterly* 115, no. 1 (2000). p. 23

²²¹ David Shambaugh, *Modernising China's Military* (California: University of California Press, 2002).

²²² Jian Yang, "Sino-Japanese Relations: Implications for South East Asia," *Contemporary South East Asia* 24, no. 2 (2003). p. 386

²²³ Peter Gries, "China's 'New Thinking' On Japan," *The China Quarterly* (2005)., see also Willy Wo-Lap Lam, *Chinese Politics in the Hu Jintao Era: New Leaders, New Challenges* (London: M.E. Sharpe, 2006). pp. 200-208

²²⁴ History seems to be factor in Chinese tourist decisions about were to go. In 2005, more Chinese travelled to Korea than to Japan. See, Uno Shigeaki and Tang Yangxia, *Tenki Ni Tatsu Nicchū Kankei to Amerika* (Tokyo: Kokusai Shoin,

perception gap represents a weakness in the Sino-Japanese relationship, limiting China's freedom of action in its approach to Japan with potentially quite negative results.²²⁶ Some China-watchers note that, notwithstanding that Hu and Wen preferred a soft line on Japan,²²⁷ they are restricted especially on the Yasukuni and historical points, by a nationalist sentiment which could turn against the CCP.²²⁸

Japan reacts

This has created what Wan Ming called a re-enforcing pattern, whereby nationalist/anti-Japanese acts by Chinese causes a backlash in Japan.²²⁹ This dynamic was played out during the mid-1990s to the mid-2000s, as nationalist groups in China and Japan were engaged in a re-enforcing spiral of mutually aggravation by entering the disputed territory of the *Senkaku* islands (*Diaoyutai* in Chinese).²³⁰

Chinese anti-Japanese nationalism has affected the Japanese popular sentiment directly. The abuse that Chinese nationals heaped on the Japanese soccer team in the 2004 Asia Cup, and the subsequent rioting and violence, resulted in major deterioration of the Japanese public sentiment towards China, see Figure 9.²³¹ Shortly after Chinese fans booed the Japanese national anthem, a poll was conducted by the *Asahi Shimbun* which revealed a significantly worsened impression of China.²³² The large-scale protest which broke out in Shanghai in 2005, ostensibly over a newly approved history textbook which it was claimed whitewashed Japan's wartime atrocities in China, represented a watershed of negativity in the Sino-Japanese relationship. The extent of the anti-Japanese feelings displayed, blurring some legitimate feelings of injustice with a large dose of irrational hatred, made many Japanese begin to consider whether China could ever be considered a friend.²³³ Indeed, 2005 represents the lowest score of feelings of trust towards the Chinese in Japan according to the poll. Of course some, such as Gavan McCormack, doubt that this nationalism will play a significant role in Japanese foreign policy making despite its prevalence and volume.²³⁴

2008).p. 319

²²⁵ "Chinese Government Distances Itself from China-Japan Feud," *Kyodo News*, 13 June 2005.

²²⁶ June Dreyer, "Sino-Japanese Relations:," *Journal of Contemporary China* 10, no. 28 (2001).

²²⁷ Jian Kong, *Chūgoku Nashi De Yatte Ikenai Nihon* (Tokyo: Kondankai Press, 2008). pp. 206-10, Willy Wo-Lap Lam, "Wen Jiabao's Softly Softly Approach to Japan," *Asia Sentinel*, 15 April 2007.

²²⁸ "East Asian Strategic Review," (Tokyo: The national institute for defense studies, 2007). P99, You Ji, "Abe and China: A New Opportunity," *PacNet Newsletter*, October 27 2006.

²²⁹ Ming Wan, *Sino-Japanese Relations* (Washington D.C.: Stanford University Press, 2006). p.73

²³⁰ Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). p. 85-7

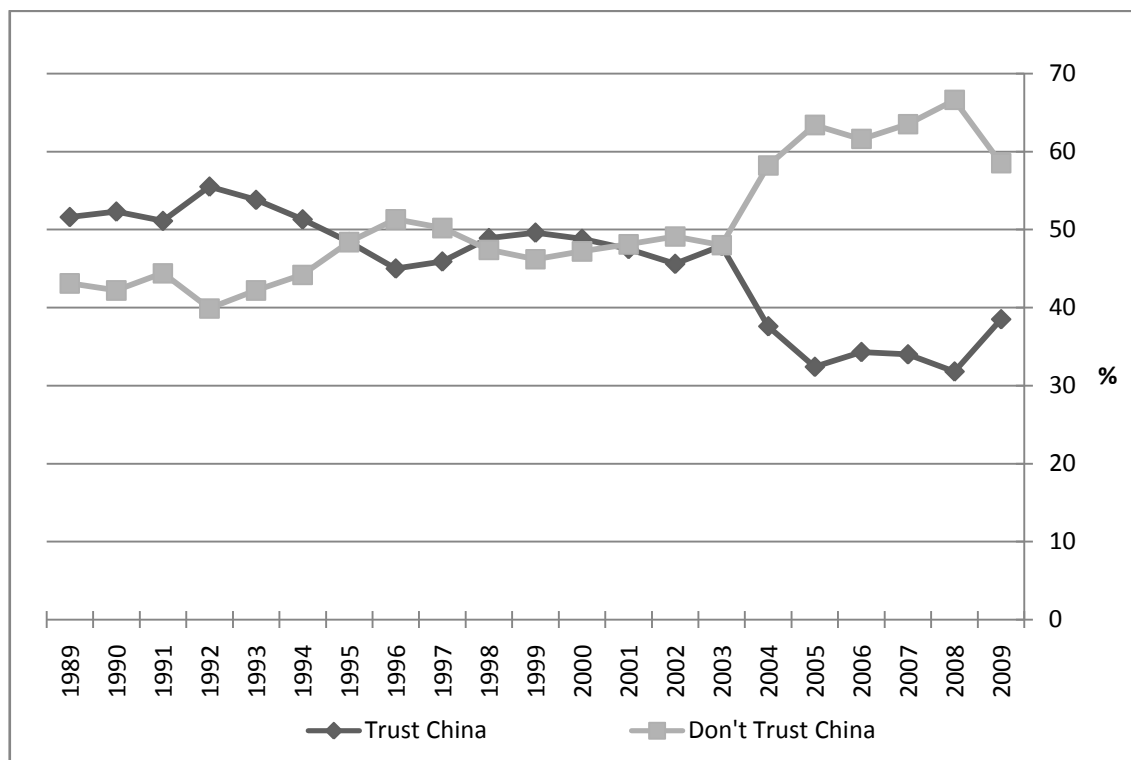
²³¹ Ming Wan, *Sino-Japanese Relations* (Washington D.C.: Stanford University Press, 2006). p. 73

²³² *Ibid.* pp. 72-3

²³³ Peter Gries, "Nationalism, Indignation and China's Japan Policy," *SAIS Review* 25, no. 2 (2005).

²³⁴ Gavan McCormack, "Nationalism and Identity in Post-Cold War Japan," *Global Change, Peace and Security* 12, no.

Figure 9 Popular Opinion Poll: Japanese Public Trust towards China



Source: Author's Translation of Cabinet Office, Public Opinion Polling.

The 2005 protests challenged Japan's aspirations of leadership. Tkacik notes that "A desire to demonstrate to Asia that China, not Japan, is the dominant regional power was the animate force behind the government-organised anti-Japanese riots and boycotts of Japanese goods in the spring of 2005."²³⁵ These thoughts and feelings were displayed most clearly in the infamous 'small Japan' (小日本) placards. As Lam Peng Er has observed, one of the triggers of the 2005 anti-Japanese protest was Japan's bid for a United Nations Security Council (UNSC) permanent seat, at a popular level many Chinese do not believe Japan has the moral authority to take this position until the history issue is resolved.²³⁶ The protests certainly scuttled Japan's dream of increased influence.²³⁷

What is particularly disconcerting for the Japanese is the apparent role the CCP played in allowing these protests to go ahead; presumably aware of the potential effect on the bilateral relationship, but nevertheless also willing to take this risk in order to complicate

3 (2000).

²³⁵ John Tkacik and Dana Dillon, "China's Quest for Asia: Beijing Fills a Vacuum," *Policy Review*, no. 134 (2005/6).

²³⁶ Peng Er Lam, "Japan's Deteriorating Ties with China: The Koizumi Factor," *China: an international journal* 3, no. 2 (2005). p. 279

²³⁷ Rana Mitter, "Remembering the Forgotten War," *History Today* (2005). p. 21

Japan's bid for a seat at the Security Council.²³⁸ Japan increasingly sees itself as unable to change the international system. Judged from their Whitepapers, Yamakage argues that Japan focuses on reacting to great power relations, in particular China, rather than trying to shape them.²³⁹

In conclusion, an identity dilemma exists between China and Japan. The perception gap between how Japan views itself in relation to China and how China sees view itself in relation to Japan has widened. Some therefore see Japan's attempt to move from bilateralism and a pursuit of a unique identity, to a pursuit of an Asian identity linked to a multilateral diplomacy as it is challenged by China's rise.²⁴⁰

3.4 Japan's Foreign Policy Making in Transformation

Japanese foreign policy making has undergone a transformation since the end of the Cold War. Many writers have attempted to characterise this transformation. Japan has become more assertive in world politics, as its bid for the UNSC demonstrates. While Japan was considered a 'reactive state' during the Cold War, it was also considered by many to be highly pragmatic – notwithstanding misgivings by the US administration about Japan's apparent disinterest in providing for its own national security.²⁴¹ Increasingly Japanese foreign relations are acquiring a moralistic or 'emotional' edge, such as towards North Korea. This change appears to be due largely to the 'generational change' going on in Japan, as the old political leaders and people with memories of the war disappear and a new, younger and more self-confident generation pick up their voting slip and take up posts in the Diet and the Ministries. It is these Japanese who, unlike their peers, believe that Japan can, indeed, should, be active in the creation of the world, rather than merely reactive – a belief that Japan, again, has something worthwhile to offer the world.

However, it is not merely the society that has changed; the institutions which are responsible for making foreign policy formulation have themselves evolved, leading to an increasing 'democratization' of foreign policy making. This 'democratization' is due to three inter-related phenomena. The first is the rise of the Prime Minister and Cabinet as a source

²³⁸ Chan Che-po and Brian Bridges, "China, Japan and the Clash of Nationalisms," *Asian Perspective* 30, no. 1 (2006). p. 152

²³⁹ Susumu Yamakage, "Japan's National Security and Asia Pacific Regional Institutions in the Post Cold War Era," in *Network Power: Japan and Asia*, ed. Peter J katzenstein and Takashi Shiaishi (Ithaca: Cornell Uni press, 1997). p. 277

²⁴⁰ Takehiko Yamamoto, "Nihon No Higashi Ajia Kyōdōtai Gaikō," in *Higashi Ajia Kyōdōtai No Kōchiku*, ed. Satoshi Amako and Takehiko Yamamoto (Tokyo: Iwanami, 2007).p. 158

²⁴¹ Takashi Inoguchi and Paul Bacon, "Japan's Emerging Role as a 'Global Ordinary Power'," *International Relations of the Asia Pacific* 6, no. 1 (2006).

of foreign policy making.²⁴² The second is the rise of foreign policy as a 'vote-getting' issue, and Diet members responding to growing popular interest in Japanese foreign relations.²⁴³ The third is the concomitant fall in the influence of the ministries over foreign policy making, with the Ministry of Foreign Affairs (MOFA) becoming more involved in implementing policy than creating it.²⁴⁴ While the MOFA was criticised for kowtowing to China, no doubt some will miss the stability and long-term planning these insulated policy elites brought.

These societal and institutional changes are particularly significant for the Sino-Japanese relationship. Prior to the end of the Cold War there was a consensus in the MOFA and society at large that China had to be accommodated in certain regards so as to bring it into the Western camp. This mode of thinking was carried over into the post-Cold War period. MOFA continued this policy under the rubric of 'engagement', hoping to socialise China into the liberal world order. China however has not yet signed onto the 'liberal' package, unlike its 'other' Taiwan. The PRC also continues to make Japan's history problematic, unlike Taiwan. This posturing by the Chinese over history, even as 'Japan-sponsored' growth has allowed China's trade to grow rapidly and living standards soar, seems ungrateful to many Japanese.²⁴⁵ But while the MOFA urged patience, the growing social antipathy towards mainland China and the Chinese has enabled the right wing to gain greater control of the China relationship – as evinced by the popularity of Koizumi standing up to the Chinese by visiting the Yasukuni shrine. The changing balance of power within the foreign policy making organs of Japan, while perhaps expressing certain legitimate concerns of the Japanese people that had previously been hidden, do not bode well for a cooperative relationship.

3.4.1 ...at the Head of State level: generation shift, instability and populism

Thus far the Prime Ministers of Japan have been men usually aged in their sixties. With the passing of the sixtieth anniversary of the end of war in 2005, a new post-war generation came to the prime ministership. Abe Shinzo's Prime Ministership (2006-7) marked this transition. Abe, born in 1954, was not merely the youngest PM in Japan's post-war history but also the first to be born after the War. The Japan that Abe grew up in was a country enjoying high growth and high hopes for the future. In the shadow of the Cold War, Japan

²⁴² Tomohito Shinoda, *Koizumi Diplomacy: Japan's Kantei Approach to Foreign and Defense Policy* (Washington: University of Washington, 2007).

²⁴³ Kevin Cooney, *Japan's Foreign Policy since 1945* (New York: M E Sharpe, 2007).

²⁴⁴ Koji Murata, "Domestic Sources of Japanese Policy Towards China," in *Japan's Relations with China: Facing a Rising Power*, ed. Lam Peng-Er (Oxon: Routledge, 2006).

²⁴⁵ Author first heard this opinion expressed by Japan's Ambassador to Australia HE Hideaki Ueda, "Speech" (paper presented at the Conference on the 30th Anniversary of the Australia-Japan Basic Treaty of Friendship, Australian National University, July 2006). See also, Tsukasa Takamine, *Japan's Development Aid to China: The Long-Running Foreign Policy of Engagement* (London: Routledge, 2006). pp.151-2

was an easier place to understand and its role in international affairs not contested greatly. Even Abe's predecessor, Koizumi Junichirō (born 1942) was only three when the war ended and thus was not shaped by the War.

This stands in stark contrast with the politicians of 1960s and 1970s who did much of the work to normalise relations with the mainland. Prime Ministers like Tanaka Kakuei whose personal experiences during the war as a Sergeant in the Kwantung Army in mainland China made him unusually sensitive to the hurt Japan had inflicted on its neighbour and desirous to make amends.²⁴⁶ Indeed, China's leaders were delighted when Tanaka became Prime Minister in 1972. He had signalled his intentions to China as Minister for International Trade and Industry (MITI) Minister when he established the China Division and stated his intent to allow the Export-Import Bank of Japan to commence loans to China.²⁴⁷ Together with his Foreign Minister, Ohira Masayoshi, Tanaka rammed through the normalization of relations with China (1972), against protests from pro-Taiwan Diet-men.²⁴⁸ Even after Tanaka left in 1974 under a cloud of corruption, his influence was still felt in the ruling Liberal Democratic Party (LDP) and subsequent many Prime Ministers were drawn from his faction. Tanaka's influence pushed the LDP politicians towards a pro-China line. Important among these were Fukuda Takeo, who signed the China-Japan friendship agreement in 1978 and Ohira Masayoshi who cleared the way to provide 'yen loans' to China.²⁴⁹ But by the 1990s, Tanaka's influence was waning and a new political logic was rising in the younger LDP politicians.

The early nineties thus marked a period of transition, and indeed confusion, in Japan's China policy. In the first instance, the continuous one-party rule by the LDP, which had provided stability if not ingenuity, to the China relationship was broken by a period of coalition government from 1993. Later, the Japan Socialist Party's PM Murayama Tomiichi personally apologized to China for Japan's war of aggression, and pushed for the Diet to approve a bill that effect.²⁵⁰ But the bill floundered, and a right wing backlash from nationalists in the Diet made clear to the world that Japan had not reached consensus on how to deal with China. The Murayama statement in Diet therefore was labelled "only a personal view."²⁵¹

²⁴⁶ Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). pp. 82-3

²⁴⁷ Tsukasa Takamine, *Japan's Development Aid to China: The Long-Running Foreign Policy of Engagement* (London: Routledge, 2006). p. 44

²⁴⁸ Ibid.

²⁴⁹ Ibid.

²⁵⁰ Caroline Rose, *Sino-Japanese Relations: Facing the Past, Looking to the Future?* (London: Routledge-Curzon, 2006).

²⁵¹ Richard J Samuels, "Securing Japan: The Current Discourse," *Journal of Japanese Studies* 33, no. 1 (2007). p. 136

Prime Minister, Hashimoto Ryūtarō (1996-8) truly had one foot on each side of the divide in the debate over Japan's China policy. Unlike Tanaka, he did not experience the war as a soldier in China, but unlike Koizumi/Abe he did remember the war as a child. Hashimoto was a member of the Tanaka faction, which despite the passing of Tanaka himself, still was considered pro-China. However, Hashimoto's electoral power base included the *Izokukai*, the War Bereaved Association which was nationalistic and less sensitive to China's concerns about history. While the precedent had been set by Nakasone in 1985, Hashimoto also visited the Yasukuni shrine in his official capacity as PM, marking the second official visit by a PM of Japan. However, he avoided the symbolic dates in August, and moreover stopped visiting in his PM capacity after the Chinese protested furiously.²⁵²

Koizumi Junichirō (2001-6) did not however share this view. Indeed, his prime ministership marks the declared end of the 'emotional' or personnel China-guilt sentiment in the Prime Minister. Koizumi's refusal to acknowledge China's legitimacy, either moral or legal, in objecting to his visits to the Yasukuni Shrine are well known, and underpin Koizumi's basic belief that the relationship with China should not be considered 'special' due to the wartime history.²⁵³ Moreover, Koizumi reduced the influence of the 'traditionally' pro-China Tanaka faction within the LDP.

Much has been made of Koizumi's pledge to destroy the LDP if it stopped his reform agenda. Koizumi's first scuffle with the bad-old style politics was with Nonaka Hiromu, a powerful faction leader.²⁵⁴ Nonaka Hiromu headed the Obuchi faction (*heiseiken*), which was the former Tanaka faction, and thus considered pro-China.²⁵⁵ In fact, Nonaka was personally very sympathetic to China having experienced the war first hand, and made no bones about his differences with Koizumi over the history question.²⁵⁶ However, Koizumi was able to 'steal' the LDP leadership in 2001, and in the process weakened the *heiseiken* faction and drove Nonaka from politics, thus ending its pro-China voice.²⁵⁷

²⁵² Daiki Shibuichi, "The Yasukuni Shrine Dispute and the Politics of Identity in Japan," *Asian Survey* 45, no. 2 (2005). p.209, 213

²⁵³ Koizumi strong line seen at October 2002 APEC at which he was requested two separate times by Zhang not to visit the shrine, to which he consistently refused to reply. Akihiko Tanaka, *Japan in Asia, Ajia no Naka no Nihon* (Tokyo: NTT Publishers, 2007). p. 302

²⁵⁴ Hideko Takayama and George Wehrfritz, "Koizumi's Big Step," *Newsweek International*, September 22 2003. p. 26

²⁵⁵ "Koizumi's Ex-Allies--out in the Cold / How the LDP's Once Almighty Heiseiken Became Divided and Fell," *Daily Yomiuri*, 12 May 2006. Although it should be noted Obuchi was hardly pro-China.

²⁵⁶ Ming Wan, *Sino-Japanese Relations* (Washington D.C.: Stanford University Press, 2006). p. 143

²⁵⁷ "Koizumi's Ex-Allies--out in the Cold / How the Ldp's Once Almighty Heiseiken Became Divided and Fell," *Daily Yomiuri*, 12 May 2006.

Koizumi's second victory over the pro-China Diet-men was centred on the figure of Tanaka Makiko, Tanaka Kakuei's daughter and Koizumi's Foreign Minister until 2002. Due to her father's influence, she was also considered a member of the pro-China group. Tanaka Makiko was in fact quite active publicly about her disapproval of Koizumi's visits to the Yasukuni shrine, as "lacking sensitivity."²⁵⁸ For her forthrightness, Tanaka was dismissed from her post, ostensibly for incompetence. By the time he left office in 2006, Koizumi had "deposed the old guard, coincidentally including most of the party's doves on China."²⁵⁹

Koizumi's hardline position ironically gave his successor, Abe Shinzō (2006-7), greater latitude in his dealings with China. Abe adopted a softer line, and avoided the Yasukuni Shrine. However, like Koizumi, Abe did not see the China relationship as 'special.' Apart from the occasional gaffe, such as over the 'comfort women' issue in early 2007, Abe adopted a pragmatic approach to China. Indeed, Abe's lifeline was his management of the China relationship as an area where he could distinguish himself from the larger than life Koizumi. Abe's meeting with Wen in April of 2007 was considered a success by all, and lifted Abe's flagging approval ratings.²⁶⁰ However, Abe was also far from dewy eyed about the Chinese. Together with his Foreign Minister Asō Tarō, Abe proposed a new pillar of Japanese foreign policy – the so-called values diplomacy (*kachi gaikō*). This, together with the auxiliary concept of 'the arc of freedom and propensity' aimed to link the great democracies of the Asia. Conveniently, the 'arc of freedom and prosperity' which links these states together casts a wide net around notably 'un-democratic' China, (see Figure 10), signalling Japan's basic distrust of China's military build-up and scepticism of the so-called 'peaceful rise.'

²⁵⁸ "Asean Steers Clear of Missile Defense Row," *Agence France-Presse*, 20 July 2001.

²⁵⁹ Masaru Tamamoto, "How Japan Imagines China and Sees Itself," *World Policy Journal* 22, no. 4 (2005). p. 112

²⁶⁰ "Japan Pm Approval Rating Rise after Chinese Premier Visit," *Dow Jones International*, 17 April 2007.

Figure 10 Graphic of the Arc of Freedom and Prosperity

NOTE:
This figure is included on page 69 of the print copy of the thesis held in the University of Adelaide Library.

Source: Japanese Ministry of Foreign Affairs homepage.

The anti-Chinese focus of the arc concept was most clearly seen in the values-diplomacy parliamentary league of LDP Diet members formed in May 2007. Chairman, Furuya Keiyu, noted, “We cannot dispel doubts about China’s act of hegemony, including its huge military spending. So China does not share the same common values with Japan.” Another high ranking member, Nakagawa Shōichi (now deceased), stating simply “We must prevent Japan from becoming one of China’s provinces.”²⁶¹ However, Japan’s MOFA has taken care to note that values diplomacy does not ‘push a particular ideology or support regime change’ out of concern of upsetting China.²⁶² Indeed, Tanaka Akihiko notes that the weak point in Abe foreign policy from the first was the ‘disconnect’ between his conservative-nationalist support group, and the values espoused in the arc concept and the détente with China.²⁶³

In July 2007, Abe’s LDP lost to the DPJ in House of Councillors elections. This gave rise to

²⁶¹ Aurelia George Mulgan, “Breaking the Mould: Japan’s Subtle Shift from Exclusive Bilateralism to Modest Minilateralism,” *Contemporary South East Asia* 30, no. 1 (2008).

²⁶² China is always on guard against external driven internal .Ryū Hoshiyama, *Nijūisseiki Nihon Gaikō No Kadai* (Tokyo: Soufusha, 2008). p. 211

²⁶³ Akihiko Tanaka, *Ajia No Naka No Nihon* (Tokyo: NTT publishers, 2007). p. 316

the much disparaged *nejire kokkai* (twisted parliament) and frustrated much of the LDP's agenda. Despite initial resisting, Abe's suddenly stood down in September of 2007 and made way for Fukuda Yasuo's to rise to the post of Prime Minister (2007-8). Fukuda (born 1936) was old enough to remember the War – thus is a member of the previous 'transition' generation like Hashimoto. Moreover, it was Fukuda Yasuo's father, Fukuda Takeo, who signed the China-Japan friendship agreement in 1978. Yet despite these credentials, Fukuda was, in the tradition of his faction, defence minded and watched China's moves in Southeast Asia with particular interest.²⁶⁴ He took a firm line against China over the *Senkaku* islands, and had gone on record during his days as cabinet secretary under Koizumi of supporting a nuclear weapon for Japan.²⁶⁵ But Fukuda also retired the nationalistic Asō, who he perceived an impediment to the China relationship, and made Kōmura Masahiko the Foreign Minister instead. Komura was the head of the Japan-China Friendship Parliamentarians' Union and its vice president was Fukuda's Chief Cabinet Secretary (faction head) Machimura Nobutaka.

Fukuda however also retired suddenly, clearing the way for Asō Tarō to become Prime Minister. At this stage, Japanese politics at the top was too unstable for Asō to manage strategically any of Japan's foreign relations, let alone construct a consensus for the management of China. Instead the bureaucracy mostly ran the relationship, in part explaining its formulaic smoothness (against concerns that Asō's famous slip of the tongue might turn nationalistic). Only piecemeal policy occurred at this time, such as responding to China's decision to send to Somalia anti-piracy escort vessels by trying to push through a similar law in Japan – but even this was paralysed by his administration's political weakness (despite inheriting a supermajority).²⁶⁶

In September 2009, Hatoyama's Democratic Party of Japan (DJP) defeated the LDP in a landslide election – falling just short of taking an absolute majority and forming single party rule. The coalition includes the Social Democratic Party of Japan, heirs to the Socialist Party of Japan and which is considered pro-China. Hatoyama's DPJ fought the election on a manifesto which contained placing greater emphasis on the relationship with China. Moreover, symbolic acts such as the mass visit to China by Diet members in early 2010

²⁶⁴ Part of this is explained by his father's influence again, Fukuda Takeo making a commitment to Southeast Asia in 1977, the Fukuda doctrine. It is reported that Fukuda Yasuo during his first visit as PM to the ASEAN summit in November 2007 paid careful attention to China's behaviour at the meetings. *Nihon Keizai Shinbun*, November 22, 2007. in Tomotaka, "Pursuing a Multi-Dimensional Relationship: Rising China and Japan's Southeast Asia Policy," in *The Rise of China: Responses from Southeast Asia and Japan* ed. Jun Tsunekawa (Tokyo: National Institute for Defence Studies, 2009). p. 181

²⁶⁵ Jonathan Lemco and Scott MacDonald, "Sino-Japanese Relations: Competition and Cooperation," *Current History* (2002).

²⁶⁶ "Somalia Oki Kaijihkan," *Nihon Keizai Shinbun*, June 1 2009. p. 14

suggest that a pro-China swing is underway.

While it is uncertain what will happen under the current administration in Japan. It is clear that a domestic transition has taken place, not just politically but also generationally. The loss of the old China hands who had acted as pipelines to Beijing has meant that the Japanese elite to now feel that they are powerless to influence Beijing's decisions, they feel locked out.²⁶⁷ Politically, the implications of this transition are still uncertain, and the recently elected DJP could yet swing either way on the question of how to manage China.

3.4.2 ...at the Executive level: greater powers and fewer opponents

As the nature of the Japanese body politic at both elite and societal level is being transformed, the relationship between the two is shifting. Japanese politics has been undergoing a transformation since the 1990s, as the emergence of 'normal' politics takes over from the previous 'special' arrangements.²⁶⁸ The decline of bureaucratic influence and the increased power of the executive is one of the most important changes to the way in which Japanese foreign policy is now being made, especially in the case of China policy.

The power shift away from the MOFA accelerated with the end of the Cold War, and in particular the foreign policy train-wreck that was the Gulf War. The Gulf War brought home to Japan the basic fact that the alliance, and Japan foreign policy as a whole, was no longer able to be managed by bureaucrats. This was because in order to enable Japan to take part in Peace Keeping Operations (PKO), a political solution was needed. The enactment of the PKO bill marked a beginning of the cabinet taking an active role and interest in foreign policy. The cabinet has therefore sought to empower itself more in the field of foreign policy making with various cabinet bills.²⁶⁹

These administrative reforms continued under Hashimoto, who was frustrated by the stove-piping of vital intelligence by the ministries. Both the Hanshin earthquake and the terrorist attacks of the *Aum Shinrikyō* in 1995 demonstrated that the Prime Minister's Office was not adequately prepared to take control in the event of a national crisis – an artefact of post-war uncertainty about the possible abuse of emergency powers. By the end of the century Japan had centralised in the executive emergency response powers to make policy.

The review of cabinet law clarified the authority of the Prime Minister and Cabinet Secretary

²⁶⁷ Daniel Kliman, "China: Japan's Rising Power Conundrum," in *Japan Chair Platform* (Center for Strategic and International Studies, 2009).

²⁶⁸ Takashi Inoguchi, *Japanese Politics: An Introduction* (Melbourne: TransPacific Press, 2005). p. 201

²⁶⁹ Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). p. 70

to initiate policy.²⁷⁰ This top-down style of policy formulation was a break with the previous bottom-up approach, whereby cabinet dealt with policy that top bureaucrats had discussed and pre-approved. This reform has allowed Prime Minister Koizumi to react to crises faster than his predecessors. It was under precisely these reforms that Koizumi was able to set up the liaison office at the Situation Centre of Cabinet, forty-five minutes after the attacks on September 11, 2001; and in the press briefing afterwards, the Koizumi administration already had a policy to deliver to the people.²⁷¹ This trend away from bureaucratic dependence continues into the current Hatoyama administration.²⁷²

Regime change: the end of socialist opposition and the rise of the DPJ

The political landscape of the Japan has also changed since in the introduction of electoral reforms in the mid-1990s. The previous multi-seat system had tended to promote politicians who served small interest groups. However, national issues such as foreign policy can be sources of political capital for young aspiring politicians.²⁷³ There is a feeling among Diet members that the populace is becoming more interested in, and aware of, foreign policy issues, and that there are votes to be gained on these issues.²⁷⁴

Unfortunately, grassroots nationalistic organizations are further clouding the historical memory of Japan and impacting on Japan's policy outputs. Such groups as the historical-revisionist *Nippon Kaigi*, which in 1999 had as many as 200 Diet-men in its ranks, and the mighty *Izokukai* which had at its peak 8 million registered voters as members, are particularly active.²⁷⁵ As Shibuichi notes, "In the mid-1990's a new mass constituency for nationalist causes opened up among teachers, [university] students and middle class professionals...[such as] the 'liberal view of history study group' and the 'society for the making a new school textbooks in history'."²⁷⁶ These groups were involved in the so-called 'bloodless revolution' of 1999, in which the national symbols of the Flag and Anthem (both war vintage) were formally made 'necessary' components of Japanese education system.²⁷⁷

²⁷⁰ Tomohito Shinoda, "Japan's Cabinet Secretariat and Its Emergence as Core Executive," *Asian Survey* 45, no. 5 (2005).

²⁷¹ ———, "Koizumi's Top-Down Leadership in the Anti-Terrorism Legislation," *SAIS Review* 23, no. 1 (2003).

²⁷² Tobias Harries, "The DPJ Faces the Bureaucracy," <http://www.eastasiaforum.org/2009/06/25/japan-the-dpj-faces-the-bureaucracy/>

²⁷³ Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). p. 38

²⁷⁴ Dietman Ichita Yamamoto in Kevin Cooney, *Japan's Foreign Policy since 1945* (New York: M E Sharpe, 2007). p. 182

²⁷⁵ Daiki Shibuichi, "The Yasukuni Shrine Dispute and the Politics of Identity in Japan," *Asian Survey* 45, no. 2 (2005).

²⁷⁶ Gavan McCormack, "Nationalism and Identity in Post-Cold War Japan," *Global Change, Peace and Security* 12, no. 3 (2000). p. 251

²⁷⁷ Ozawa Ichirō was a key player in these "nationalistic" educational reforms, *Ibid.*

The early nineties also saw the traditional bastion of one country pacifism, the Japan Socialist Party ending its ideological opposition to the Japan Self Defence Force (JSDF) in order to strike-up a marriage of convenience and seize political power with the LDP. By this act the Socialist Party (which was the strongest opposition party in the Diet at one stage holding 136 seats of 480 in 1990) effectively committed political suicide. It was subsequently reduced to just 14 seats by 1998, effectively taking with them the 'alternative voice' in Japanese politics.²⁷⁸ An essential part of the Japan Socialist Party's 'alternative voice' was its advocacy of a closer relationship with China.²⁷⁹ Indeed, since the split between the CCP and the Japan Communist Party in 1966, the Socialist Party had been the custodian of the China relationship. The Socialist Party had even made managing the China relationship a core element in their challenge to the dominant LDP – as the *primus inter pares* of the opposition parties, the Socialists nearly succeeded in displacing the LDP in the mid-seventies (a factor contributing to the shift towards China during this period). The demise of the Socialist Party of Japan has removed from the political field a pro-China opposition party which might check the excesses of the LDP or other more nationalistic groups in the Diet.

3.4.3 ...at the Bureaucratic level: Decline of the MOFA and the China school

At the macro-level, the ministries, including the MOFA have become less relevant to the formulation of policy as the executive gains greater control. And even as the MOFA declines in relevance, internally MOFA has become less interested in appeasing China. This is due to the decline of the influence of the China School within the MOFA. All this had led to a new foreign policy making environment which more accurately reflects Japan's concerns about China and a Japan more willing and able to take a hardline against China when its interests are threatened.

Weakening of the Ministry of Foreign Affairs

The Cabinet, as the executive, has the prerogative to be sole makers of Japan's foreign policy as empowered under Constitution Art 73(ii). Despite this formal power, it has been a much remarked feature of Japan politics, especially during the Cold War, that the bureaucracies were actually responsible for Japan's policy making, including foreign policy.²⁸⁰ The basic reason for this was clearly not the lack of power, but rather the belief that foreign policy did not get votes. Indeed, it was often argued that the insularity from public opinion allowed the MOFA to construct policy with a long-term vision.²⁸¹ Beginning

²⁷⁸ Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). pp. 38-40

²⁷⁹ Chae-Jin Lee, *Japan Faces China* (Baltimore: John Hopkins University Press, 1976). pp. 19

²⁸⁰ Akihiko Tanaka, "Domestic Politics and Foreign Policy," in *Japanese Foreign Policy Today*, ed. Purnendra Jain and Takashi Inoguchi (New York: Palgrave, 2000). p. 7

²⁸¹ Haruhiro Fukui, "Policymaking in the Japanese Foreign Ministry," in *The Foreign Policy of Modern Japan*, ed. Robert

with Nakasone's decentralization policies of the 1980s, the role of the Ministry of Foreign Affairs as a foreign policy maker has since suffered a series of blows and it is now incapable of acting as decisively as it did in the past.²⁸²

The MOFA had a series of turf wars with other bureaucracies which have chipped away at the ministry's scope and competence. Importantly, management of the US-alliance was shifted from the MOFA to the Japan Defence Agency, which became the Ministry of Defence (MOD). At the same time, control of the ODA budget (a central element of the MOFA's foreign policy making apparatus) was shifted in parts to both the Ministry of Finance (MOF) and the Ministry of International Trade and Industry (MITI), renamed the Ministry of Economy, Trade and Industry (METI) in 2001.²⁸³ With the advent of coalition politics, the bureaucracy also became increasingly politicized. In the early 1990s, certain senior officials at the Ministries were forced to resign due to political purges, reducing the ability of key top level bureaucrats to negotiate with Diet members on behalf of their ministry.²⁸⁴ The MOFA has also been rocked by a series of financial and ethical scandals which further eroded its political influence.²⁸⁵

End of the China school

Even as the bureaucracy lost influence in foreign policy making, the balance of power within the MOFA has changed. The MOFA has itself shifted to the right, and the so-called China School which favours appeasement strategies losing influence to a younger generation of MOFA officials with a background in America. Indeed, the 'young turks' in the North American Bureau, together with their counterparts in the newly minted Ministry of Defence are ideologically closer to the US and its position on China.²⁸⁶ The decline of the China School²⁸⁷ can be linked to the more assertive position taken by the executive

Scalapino (Berkeley: University of California Press, 1977).

²⁸² There are two ways in which foreign policy is created. One is the circulation of *ringisho* a slow process of consensus building moving bottom-up from the Ministry to the Minister to the Diet. The other is a political decision made at the top. According to one involved participant, the China relationship is apparently guided by more of the latter than the former when compared to other relationships. Author's Interview with Ministry of Foreign Affairs Official, 5 February 2010. Tokyo.

²⁸³ Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). pp. 57-9

²⁸⁴ Ibid.

²⁸⁵ In 2001 MOFA officials were found to be overcharging their expenses accounts and pocketing the difference. In 2008, a MOFA official received disciplinary action for staying for one year in a luxury hotel without paying.

²⁸⁶ Kōji Murata, "Domestic Sources of Japanese Policy Towards China," in *Japan's Relations with China: Facing a Rising Power*, ed. Lam Peng-Er (Oxon: Routledge, 2006). p. 45

²⁸⁷ The China School within the MOFA until even the late nineties' had a significant influence. But as Takamine points out, these officials' "loyalty" to Chinese ODA came in part from a fear of being 'put on a list' in China, and being unable to travel there. Tsukasa Takamine, *Japan's Development Aid to China: The Long-Running Foreign Policy of Engagement* (London: Routledge, 2006). p. 79

towards China and the politicization of bureaucracy.²⁸⁸

The first major breaking of the China School happened under Prime Minister Mori Yoshirō(2000-1); specifically, his decision in 2001 to issue a visa to former president of Taiwan Lee Teng-hui. China had strongly warned Japan not to grant Lee a visa, and the China School in the MOFA took the threat seriously; initially a decision was made by Minister of Foreign Affairs Kōno Yōhei not to issue a visa. Mori overrode the decision of the MOFA and the China School, to grant Lee a visa, ostensibly for humanitarian grounds to access a certain medical treatment in hospital.²⁸⁹ Mori's decision was popular. Even the liberal, left of centre Asahi Shimbun supported the stance taken by the GOJ, which appealed to both humanitarian and democratic solidarity for the Left and the rising 'saying no' nationalism of the Right. Criticism began to mount over the MOFA, and in particular the China School's mishandling of the situation. Indeed, Murata Ryohei, a (very) high up official in the MOFA, came out and directly criticised the China School for their approach.²⁹⁰ Within the Ministry itself, it was realized that the current stock of China managers was perhaps too close to China emotionally.

The China School was again snubbed by the Koizumi administration. The loss of Tanaka Makiko as an advocate for a pro-China policy of course greatly reduced the China School's influence at the highest levels of foreign policy making. But aside from that, its reputation was further damaged by a series of crises, such as the 2002 Shenyang incident (in which Chinese police entered a Japanese consulate to seize North Korean refugees).²⁹¹ After its offices were raided by Chinese police, the MOFA was restrained in criticising what was, by any interpretation, a grave breach of diplomatic protocol and national sovereignty. This concession by the MOFA to China did not go over well in Tokyo's Nagatachō – with Koizumi stepping in to heighten the disciplinary actions against the officials involved.

The loosening of the China School's grip on foreign policy making can also be seen in the appointment of Akiba Takeo as the director of MOFA's China/Mongolia Division.²⁹² Akiba was not a member of the China School, but one of the young turks, a fluent speaker of English and on the fast track to the coveted position of vice-minister of foreign affairs.

²⁸⁸ Such as at the 1998 Jiang-Obuchi summit. See, Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). p. 98

²⁸⁹ Kōji Murata, "Domestic Sources of Japanese Policy Towards China," in *Japan's Relations with China: Facing a Rising Power*, ed. Lam Peng-Er (Oxon: Routledge, 2006). p. 43

²⁹⁰ Criticism coming at various times, often in *ad hoc* comments. He rehashes the main points of his issues with the China desk in Ryōhei Murata, *Murata Ryōhei Kaisō Roku Part II* (Tokyo: Minerva 2008). p. 235, "Unprincipled attempt to protect their institutional interests" etc.

²⁹¹ "Ministry's Actions Inadequate," *Yomiuri*, 5 July 2002.

²⁹² Interesting, the "China Mongolia Desk" is the English name. In Japanese, it was just China desk until 2008.

Akiba's appointment represented a further reduction in the China School's influence, and the rise of the 'realist' officials who take a harder line on China.²⁹³ Akiba's replacement by Tarumi Hideo in 2008 did little to change this fact, as both men believe that a firm line must be taken on crucial matters now before China's power grows to the point where Japan's voice will not be heard.²⁹⁴ In fact the climate within the ministry is now such that while the China School has assets it could bring to Japan's China policy formulation (such as language, contacts and cultural knowledge), these assets cannot be accessed.²⁹⁵ Indeed, since 2001 a program has been put in place to train China experts within the MOFA rather than to accept from outside those already with the skills. This is in order to prevent private feelings interfering in policy assessments.²⁹⁶ This shift towards managers developed in house suggests that the China School has faded from relevance.

What we see then in Japan's China policy making is the falling away of the elements which would oppose a containment strategy. While some have called this the fragmentation of Japan's policy-making towards China, fragmentation is only half the story.²⁹⁷ At the level of the executive, generation change has removed those who recall Japan's historical aggression towards the Chinese. The new Japanese leadership is more interested in the future than in the past. While Abe's prime ministership may have marked the height of momentum for 'normalization' of Japan, it is clear that at the popular level the norm of anti-militarism is dying as Japan moves towards constitution reform and the increased importance of Japan's national defence. In the bureaucracies too, those who would oppose a harder line strategy are finding their voice reduced. With the death of these voices, Japan will be more willing to try to check Chinese influence where Japanese national interest clashes with it.

Other Ministries involved in foreign policy

Lastly, the various bureaucracies within Japan have differing and competing views about the rise of China. There is no executive foreign policy oversight in the MOFA to control the various policy initiatives of the METI, the MOF or the Ministry of Agriculture, Forestry and Fishery (MAFF) in the international arena, leading to potential fragmentation of policy towards China.²⁹⁸ Even the Ministry of Health, Labour and Welfare can become involved in

²⁹³ Hiroyasu Akutsu, "Japan: Tokyo and Taipei Try to Tango," *Far Eastern Economic Review*, 12 January 2007.

²⁹⁴ Author's Interview with Ministry of Foreign Affairs Official, 5 February 2010. Tokyo.

²⁹⁵ Kōji Murata, "Domestic Sources of Japanese Policy Towards China," in *Japan's Relations with China: Facing a Rising Power*, ed. Lam Peng-Er (Oxon: Routledge, 2006). p. 45

²⁹⁶ Author's Interview with Ministry of Foreign Affairs Official, 5 February 2010. Tokyo.

²⁹⁷ ———, "Domestic Sources of Japanese Policy Towards China," in *Japan's Relations with China: Facing a Rising Power*, ed. Lam Peng-Er (Oxon: Routledge, 2006). p. 45

²⁹⁸ Yoshifumi Nakai, "Japan's View on the Rise of China and Its Implications," in *Rise of China: Beijing's Strategies and Implications for the Asia-Pacific*, ed. Cheng-yi Lin and Hsin-Huang Michael Hsiao (London: Routledge, 2009). p. 218,

foreign policy making, such as over the issue of food security in China caused by contaminated *Gyōza*. In particular, the Ministry of Finance (MOF)'s basic standpoint on the rise of China is that the phenomena while significant is over-emphasized, MOF officials apparently still citing Paul Krugman's "*What happened to Asia?*" (1998) or Gerald Segal's "*Does China Matter?*" (1999).²⁹⁹ The MOF does not greatly trust Chinese statistics and is suspicious about whether China will actually deliver on international legal promises. Moreover the MOF is the champion for globalising Japan's financial market, and view China as a potential future threat there.

The Ministry of Economy, Trade and Industry is diametrically opposed to the MOF view, regarding China's rise as a reality of profound significance. METI officials believe that for Japan to recover it must compete with China, although they emphasise the complementary nature of the two economies. For this reason, the METI has championed Free Trade Agreements (FTA) across Asia, but there are still concerns that the Japan-China link is not concluded.³⁰⁰ Lastly, the Ministry of Defence (MOD) is highly sceptical of China and its so-called peaceful rise. Kliman notes that, "a majority of uniformed and civilian leaders reportedly believe that over the medium or long term, China will adopt a hostile orientation toward Japan."³⁰¹

3.5 Conclusion

This section has examined the rise of China. It has noted that even as China's national power as measured in both military and economic terms has increased rapidly, Japan has been stagnant in absolute terms. The result of these trends, from a power theoretical point of view, is that Japan and China have entered the zone of power transition. At the same time, from a liberal perspective, it is clear that interdependence is growing – but asymmetrically. The Japanese economy is becoming more dependent on China, while China's dependence on Japan is falling as it emerges as the workshop of the world (a function previously of industrial Japan). This shift suggests that Japan ought to become more interested in having good political relations with China. However, Japan had not made

the process by which this has occurred under the Koizumi administration is the labelling of LDP politicians championing bureaucratic interests as *Teikō Seiryoku* (Anti-reform), thereby blocking legitimate concerns raised at the bureaucratic level from entering political space.

²⁹⁹ Ibid. p. 218

³⁰⁰ Ibid. pp. 223-4, the METI is perhaps concerned that their engagement strategy has worked too well, the encouragement of investment in China has hollowed out Japan, supporting China's WTO accession has prompted China's FTA strategy, and China has not turned into a technocratic development state like Galbraith's *The New Industrial State* suggests, but is FDI fuelled, more political and more unequal in short a different creature to Japan.

³⁰¹ Daniel Kliman, "China: Japan's Rising Power Conundrum," in *Japan Chair Platform* (Center for Strategic and International Studies, 2009).

significant overtures under the LDP, even if the potential to do so has now increased under the DPJ. This seems to be due to the emergence of a dangerous tension between the national identities of the two countries. Due to a series of events in which the 'ugly face' of China was revealed, Japanese officials have all but stopped trusting the People's Republic of China – and, at the popular level perhaps 'Chinese' more widely defined.

Moreover even as a power transition unfolds at the national level, Japan has been changing internally. Generational shift at the level of the political executive, and the evolution in their powers, suggest that Japan will be more likely to take a harder line stance towards China in the international arena. At the same time as the influence of the more cautious voices on China declined, the previous 'brakes' on hawkish policy in the opposition political parties and the corridors of the MOFA became less interested in taking a pro-China line. All this suggests that Japan is now less likely to be patient with China, and more willing to flex its diplomatic muscles.

Viewed from the three theoretical perspectives discussed in this chapter and from the domestic political situation, the outlook for Sino-Japanese relationship is less than glowing. It will take a Herculean effort (on both sides) to undo the damage of years of suspicion, indeed it may require a fundamental change in the nature of either or both of the two countries - hopefully peaceably achieved. The point is that, despite the promise of major mutual gains, Sino-Japanese cooperation has powerful constraints on it. This political fact will help us to explain in later chapters the limited nature of Sino-Japanese cooperation in regional institutions.

4 East Asian Free Trade Area

4.1 Introduction

Within the auspices of the ASEAN Plus Three (APT) grouping, the most important agenda item is that of a Free Trade Area (FTA). Such an FTA would be a symbol of an East Asian community in a similar way that the European Common Market is for Europe; a community predicated on a certain level of trust and reflective of warm strategic relations. However, such an FTA has proved elusive for Asia thus far.

One of the key reasons for this inability to conclude this crucial regional pact lies in the Sino-Japanese relationship. Specifically, Japan's response to China's rising regional economic significance has been to attempt to lock-in its pre-existing advantages. Thus, Japan has not sought cooperative regional leadership with China in the field of trade. This unwillingness to cooperate with China has meant that the common regional institutions for trade have not merely failed to develop; they have developed in ways which complicate any future institutionalization. The inability to form a Japan-China FTA has precluded the formation of hub which might pull in other East Asian economies into a single harmonized regime and instead has created a bilaterally-networked form of trade regionalism. Until now, this link between Sino-Japanese relations and the troubles facing the region's so-called 'noodle bowl' network of trade agreements has not been explored empirically. Exploring this link forms this chapter's contribution to academic understanding.

This chapter argues that realist theories are half right regarding the East Asian Free Trade Area (EAFTA) project. Hegemonic stability is indeed a crucial factor in the creation of a new regional trade institution. However, Japanese regional trade policy is more than merely economic power balancing.³⁰² In order to understand some of the specifics of Japan's policy towards an EAFTA it is necessary to examine variables that liberals and constructivists identify as significant. Liberal-institutionalism does a good job of explaining *how* Japan went about concluding its various bilateral, and ultimately sub-regional, FTAs or - as Japan prefers to call them - Economic Partnership Agreements (EPA). In addition to Japanese domestic political variables, these agreements have acquired a life of their own in the international arena and path dependency effects are in play with each FTA affecting the outcome of others still under negotiation or not yet even conceived.³⁰³ Lastly,

³⁰² Saori Katada, Saadia Pekkanen, and Mireya Solis, "Trading Gains for Control," *International Studies Quarterly* 51(2007). p. 949

³⁰³ Another way of saying this is that negotiators attempt to craft agreements according to previous experience and previous examples, not with reference to the power or other structures which might have initiated the FTA process to

constructivist variables must also be considered, at a minimum as a supplement to realism in order to understand the direction and degree of balancing, and in order to ground ourselves in Japan's political realities and appreciate how limited Japan's policy responses actually are - as opposed to the freedoms that realism would posit.

4.1.1 EAFTA as a regional institution.

Bilateral FTAs as a means for furthering free trade and increasing global welfare are hotly contested within the economic academic community. A debate even surrounds the nomenclature itself. Many economists insist that FTAs be called Preferential Trade Agreements (PTAs) to better describe their effects.³⁰⁴ While bilateral FTAs do 'free (liberalize) trade' between two countries, the effect is to deflect, (or perhaps deliberately, to direct), trade from the lowest cost producer under the global system to the lowest cost producer with the FTA 'alliance.'

Why a country would choose to direct/deflect trade to its FTA partners, while puzzling to an economist, is in political/strategic terms understandable.³⁰⁵ Economically, it is well known that most "PTAs [FTAs] rarely make much of a difference to aggregate national welfare."³⁰⁶ This has certainly been the case for many of Japan's FTA/EPAs with ASEAN (which may well imply such political factors). Apart from the domestic politics, FTA signing ceremonies are a chance for politicians hoping to look competent economically and to get on TV.³⁰⁷ However, it is also possible that states would choose to formalize their trade relationships in an FTA for strategic reasons, such as the protection of domestic industries in the face 'external' competition, securing access to resources or protecting strategic technology. If FTAs are signed for these strategic reasons and especially if they grant significant preferential advantages, the effects can be more than merely trade distorting but can raise or exacerbate political tensions between the FTA in-group and those excluded.³⁰⁸

begin with.

³⁰⁴ Although personally sympathetic to calling a spade a spade and using the PTA name, in the interests of using common language and not confusing the reader whom may well be wondering what Parent Teacher Associations have to do with international politics, this thesis will stick with calling these agreements "FTAs"

³⁰⁵ Even, or especially, to economists, see Jay Menon, "Bilateral Trade Agreements," in *ADB Conference on Long Term Scenarios of Trade and Growth* (Bangkok: ADB, 2006).

³⁰⁶ Michael Wesley, "The Strategic Effects of Preferential Trade Agreements," *Australian Journal of International Affairs* 62, no. 2 (2008). p. 216

³⁰⁷ Pascal Lamy, "Opening Remarks" (paper presented at the Noodle Bowl Conference, Tokyo, 17-18 July 2008). A Thai trade negotiator at the roundtable also stated that it is his belief that bilateral FTAs in East Asia are signed principally to make politicians look good, whether in Thailand or Japan. His comment was probably in reference to then PM Takshin's love of the TV camera and looking like a 'business man'.

³⁰⁸ Michael Wesley, "The Strategic Effects of Preferential Trade Agreements," *Australian Journal of International Affairs* 62, no. 2 (2008). p. 216

On the other hand, some (mostly liberal thinkers) have argued that FTAs in fact increase the prospects for peaceful relationships between the dyad. While possible, it seems to depend greatly on the sort of FTA envisaged. While these studies show a correlation between FTA and peaceful dyadic relations, it is uncertain the extent and direction of causality.³⁰⁹ It may be, in fact likely it is, that FTAs are signed between parties which do not expect to fight each other and so are happy to preference each other.

Part of the reason as to why different studies have drawn different conclusions about the link between peace and an FTA is due to confusion between a Free Trade Area and a Free Trade Agreement; i.e. whether the agreement is bilateral or multilateral. For most this distinction matters little, as both types of FTAs aim to liberalize trade among a group of countries. However, there are important differences in the political implications of membership. Put crudely, bilateral FTAs contain a very real possibility of worsening relations within the region, whereas area-wide FTAs (such as those found in Europe and the Americas) are more likely to boost regional security, albeit with a potential cost to those outside of the region. The reason for this 'peace effect' is that a regional level FTA (or Customs Union in Europe's case) creates an *institution* in which rules are shared, including the attendant norms about conflict resolution.

On the other hand, bilateral FTAs will tend to create competing 'hubs' around the largest economies. In the case that these large economies share an FTA and the rules of the FTA are common to their FTAs with the smaller economies, and those rules (e.g. culmination) are common also to the FTAs among the smaller economies, then little is lost in the *de facto* trade area.³¹⁰ Indeed, the justification for East Asia's bilateral FTAs was as a 'stepping stone' towards a regional FTA, building up from *de facto* and informal arrangements towards the creation of a full-fledged trade institution called the EAFTA.³¹¹

4.2 The EAFTA Agenda Emerges

The formation of a Free Trade Area in East Asia was not initially a mandated APT task. Notwithstanding previous proposals for a preferential trade body, such as Dr. Mahathir's infamous and ill-fortuned East Asia Economic Group, the very structure of the first several APT summits militated against the realization of an EAFTA. Indeed, the first meeting held in

³⁰⁹ According to one statistical survey, nation-states are between half to a third more likely to come into conflict if not in an FTA. Edward Mansfield, "Preferential Peace: Why Preferential Trading Arrangements Inhibit Interstate Conflict," in *Economic Interdependence and International Conflict*, ed. Edward Mansfield and Brian Pollins (Michigan: Ann Arbor, 2003). p. 228, the study acknowledges political benefits to FTAs versus the GATT.

³¹⁰ Richard Baldwin, "The Spoke Trap," in *CNAEC Research Series 04-02* (Seoul: KIEP, 2004).

³¹¹ See, ———, "Multilateralising Regionalism: Spaghetti Bowls as Building Blocks," *World Economy* (2006). p. 1471

Kuala Lumpur 1997 produced separate Joint Statements for Japan and China - an indication of how far from cooperative the two giants were. Moreover, the ASEAN-China joint statement made no real mention of economic matters (save APEC) in spite of the ongoing financial crisis, staying almost entirely with politico-security matters. The joint statement of ASEAN-Japan also made no mention of a free trade agenda within the auspices of the APT; in fact both ASEAN and Japan confirmed the centrality of the WTO and APEC in any further liberalization. The 1999 Joint Declaration on East Asia Cooperation, (the Manila Declaration) also avoided formal suggestion of a Free Trade Area, with the focus jumping ahead to monetary and financial regionalism (discussed in Chapter Five).³¹²

The first formal inclusion of the words Free Trade Agreement in the press releases after the APT came at the fifth summit in 2001, Brunei. A report by the ASEAN-China expert group was considered, and ASEAN endorsed the proposal for a Framework on Economic Cooperation, and importantly the establishment within ten years of an ASEAN-China Free Trade Agreement. Significantly, this was not a plan to move ahead with an East Asian Free Trade Area designed to include all 13 members of the APT. After having successfully concluded difficult negotiations with the US about accession to the WTO, China's Premier Zhu Rongji was poised to seize the initiative at the regional level too.³¹³ In fact perversely, China's promised accession to the WTO made a regional preferential trade area look more attractive.³¹⁴

Although Zhu Rongji had signposted his intentions a year prior at the 2000 APT summit, the Chinese proposal caught Japan unawares. In Japan, the MOFA had viewed the proposal as unrealistic lip service and paid it little attention.³¹⁵ Both the Japanese and international media started to ask how it was that China, a developing country could offer an FTA before

³¹² According to the theory of regional integration put forward by Balassa the first step is a Free Trade Area, and the move to monetary cooperation is thus considered a jump, Bela Balassa, *The Theory of Economic Integration* (Homewood: Irwin, 1961).

³¹³ Zhu Rongji concluded outstanding matters with the US in June on the sidelines of APEC, and had informal agreements with the EU and WTO members going into the 2001 APT.

³¹⁴ This was because having joined the WTO, economic reprisals by the US would be more difficult and because China's promise to open its markets to Southeast Asia for five years before expecting to be reciprocated was in fact already promised in the instrument of accession, in other words the concession had essentially already been conceded. Additionally as a developing country member of the WTO, China may use the enabling cause to conclude an FTA which does not satisfy article 24 of the GATT – meaning that neither it nor its partners in ASEAN need liberalization substantially all trade (i.e. 90%).

³¹⁵ Taniguchi in Shintarō Hamanaka, "Comparing Summitry, Financial and Trade Regionalisms in East Asia, from the Japanese Perspective," in *China, Japan and Regional Leadership in East Asia*, ed. Christopher Dent (Cheltenham: Edward Elgar, 2008). p. 76

Japan.³¹⁶ According to some in the METI, Japan had discussed with ASEAN members whether ASEAN would take up China's offer after 2000 but were told by ASEAN officials that China's offer would not be. The sudden change in tack by ASEAN took Japan by surprise.³¹⁷

What shocked Japan the most about China's proposed FTA with the ASEAN was not the suddenness, nor the economic content, but the implications of the act itself. The proposal seemed to be a strategic play in the East Asian power game, aimed at replacing Japan as the head of Asia's economic order. Of course this view is denied by China. Zhang Yunling, one of the leading figures in the China-ASEAN FTA has said, "I participated in initiation the China-ASEAN FTA, [there was] no[t] any political consideration to isolate Japan, just improving relations with ASEAN."³¹⁸ But as Sheng Lijun notes, the ASEAN-China FTA feasibility study was set up in 2000 *after* Zhu had announced it at the APT – revealing the political nature of the decision. In fact Sheng has discovered that the focus of the FTA study in Beijing (the study by Zhang) was on the geo-political implications of the proposal rather than, as one might expect, the economics.³¹⁹ And as others have noted, a China-ASEAN FTA will also provide China (and ASEAN) with a stronger bargaining position for negotiating an EAFTA with Japan and South Korea.³²⁰ Underlying the ASEAN-China FTA proposal therefore, was "China's strong belief that Beijing should assume a leading role in the process of East Asian integration."³²¹ Japanese politicians and bureaucrats also tended to perceive Chinese intentions in this manner.³²²

One of the unintended side-effects of China's FTA proposal was to prime ASEAN for an agreement with Japan. For Southeast Asian countries, China's comparative advantage in the field of low skilled labour was a challenge. There were already fears that FDI would be

³¹⁶ Somewhat ironically, Peter Drysdale believes that the main cause of the shift to bilateral FTAs for China was Japan's FTA proposal to Korea in the 1990s. According to him this move was read by China as a beginning of new Japanese trade strategy, and its own interest in pursuing bilateral agreements in order not to fall behind also increased. See, Peter Drysdale, "Regional Cooperation in East Asia and FTA Strategies," in *Pacific Economic Papers No.344* (Canberra: Australian National University, 2005). p. 10

³¹⁷ Takashi Terada, "Constructing an 'East Asian' Concept and Growing Regional Identity: From Eaec to Asean + 3," *The Pacific Review* 16, no. 2 (2003). p. 270, provides a good political explanation of this outcome. For an economist's explanation for why this is rational see also Richard Baldwin, "The Spoke Trap," in *CNAEC Research Series 04-02* (Seoul: KIEP, 2004). p. 21

³¹⁸ Author's Communication With Yunling Zhang, personal correspondence, 25 September 2008.

³¹⁹ Lijun Sheng, "China-Asean Free Trade Area: Origins, Developments and Strategic Motivations," in *ISEAS Working Paper: International Politics and Security Issues Series no. 1* (Singapore: Institute of South East Asian Studies, 2003).

³²⁰ Kevin Cai, "The China-Asean Free Trade Agreement and Taiwan," *Contemporary China* 14, no. 45 (2005).

³²¹ *Ibid.* p. 588

³²² See response to Question 1, Motoshige Ito, "What Benefit Will Ftas Bring to the Japanese Economy?," (Tokyo: Foreign Press Centre/Japan, 2004). Ito is one of the top scholars in the trade field in Japan, and is highly involved in the policy process.

redirected from ASEAN to China, the remedy for which could be found in an agreement with Japan.³²³ Politically too, the ASEAN-Chinese FTA had the potential to undermine the ASEAN Free Trade Area (AFTA) – as the bilaterally negotiated early harvest clauses could potentially ‘distract’ a core group from pursuing intra-ASEAN integration. China also benefited in its quest to be recognized as a market economy in the WTO, a victory in ASEAN preparing the way for recognition by Japan and other major economies.³²⁴ It became clear to Japan that some form of counter-offer to ASEAN had to be made.³²⁵

4.2.1 Japan's Initial response: Singapore

In the 2001 APT Press statement, Japan's PM Koizumi Junichirō revealed his intent to make a counter-offer to ASEAN.³²⁶ The first response was a knee-jerk ODA offer, Japan pledging further economic assistance for Southeast Asia, focused on technology and the IT sector.³²⁷ Koizumi also established FTA/EPA Affairs Departments in both MOFA and METI.³²⁸ Japan and ASEAN also agreed to deepen their relationship at the APT by declaring 2003 as their year of exchange. But perhaps the greatest diplomatic coup for Japan came at the end of 2003, the privilege of hosting the first ASEAN summit held outside Southeast Asia. Japan also proposed an EPA to ASEAN just one day after the China-ASEAN FTA framework agreement was announced in November 2002.³²⁹

Yet it was clear that to bring the ASEAN-Japan relationship on par with China, more formal FTAs were needed. In Singapore in January 2002 Koizumi offered a vision of an East Asian community “that acts together and advances together”, and proposed a Japan-Singapore

³²³ Chandler and Eckholm in Shaun Breslin, "China's Rise to Leadership in Asia - Strategies, Obstacles and Achievements" (paper presented at the Regional Powers in Asia, Africa, Latin America, the Near and Middle East, Hamburg, 2006). p. 11

³²⁴ Vincent Wang, "The Logic of China-Asean Free Trade Agreement: Economic Statecraft Of "Peaceful Rise"," in *China in the World, the World in China* (University of Malaya: Institute of China Studies, 2007). p. 25

Article 14 – Recognition of China's Market Economy Status – of the Agreement on Trade in Goods states: "Each of the ten ASEAN Member States agrees to recognize China as a full market economy and shall not apply...Sections 15 and 16 of the Protocol of Accession of the People's Republic of China to the WTO." Section 15 of China's WTO accession protocol deals with Price Comparability in Determining Subsidies and Dumping and Section 16 provides Transitional Product-Specific Safeguard Mechanism. <<http://docsonline.wto.org/DDFDocuments/t/WT/L/432.doc>>.

³²⁵ Lijun Sheng, "China-Asean Free Trade Area: Origins, Developments and Strategic Motivations," in *ISEAS Working Paper: International Politics and Security Issues Series no. 1* (Singapore: Institute of South East Asian Studies, 2003). p. 9

³²⁶ Toru Yanagihara, "Nihon No FTA Senryaku to Kantei Shodō Gaiko," *Kaigai jijiō*, no. April (2004).

³²⁷ "Press Statement by the Chairman of the 7th Asean Summit and the Three Asean + 1 Summits," <http://www.aseansec.org/5471.htm> 6 November

³²⁸ Although MOFA early establishment signposts the significance of political factors see Lai Foon Wong, "China-Asean and Japan-Asean Relations During the Post-Cold War Era," *Chinese Journal of International Politics* 1(2007). p. 392

³²⁹ Mireya Solis and Shūjiro Urata, "Japan's New Foreign Economic Policy: A Shift toward a Strategic and Activist Model," *Asian Economic Policy Review* 2(2007). p. 230

FTA. Singapore was the logical first choice for Japan because it had no agricultural sector. It was therefore believed that an agreement could be reached quickly, effectively responding to China and triggering a round of negotiations with ASEAN as a whole.³³⁰

China moves again

The 2003 APT summit in Bali looked to be a repeat of the previous year's pattern, with China leading and Japan following. China's decision to accede to the Treaty of Amity and Cooperation (TAC) early that year earned China warm praise in the Chairman's press statement, which "welcomed...[China's accession to the TAC] as testimony to our deeper political trust." The same document "encouraged Japan to consider its accession to the TAC."³³¹ Moreover, China's Premier Wen Jiabao pressed ahead with the EAFTA project by signing the Protocol to Amend the Framework Agreement on Comprehensive Economic Cooperation, thereby bringing forward the previously agreed deadline of the China-ASEAN FTA to 2010. Premier Wen also proposed a feasibility study be undertaken about the future establishment of a free trade area in East Asia (as defined as the APT membership).³³²

Wen also pursued the possibility of an FTA within Northeast Asia, i.e. with Japan. In fact, the Premier of the PRC, Zhu Rongji had proposed an FTA among the Plus Three countries (China, Japan and South Korea) at the previous APT in November 2002. Koizumi had responded to this offer coolly, noting "it should be considered."³³³ Wen continued on this proposal by suggesting instead a bilateral China-Japan FTA at the ASEAN Summit in Bali, but again Koizumi was evasive and called for further study.³³⁴ Further study was merely another way of politely saying 'no' to China - a fact made clear by the agreement to commence FTA negotiations with Korea shortly thereafter.³³⁵

³³⁰ Takashi Terada, "The Making of Asia's First Bilateral FTA: Origins and Regional Implications of the Japan-Singapore Economic Partnership Agreement," *Pacific Economic Papers* 354(2006).

³³¹ "Press Statement by the Chairman of the 9th Asean Summit and the Three Asean + 1 Summits, 8 October 2003," <http://www.aseansec.org/5471.htm>.2010, April

³³² ———, "Forming an East Asian Community: A Site for Japan-China Power Struggles," *Japanese Studies* 26, no. 1 (2006).

³³³ Alan Yonan jr., "Asia Economy Watch; Japan, China, S Korea Mull Trade Pact," *Dow Jones International News*, 30 January 2004.

³³⁴ Ibid.

³³⁵ The JKFTA had been under study since 1998, and was intended to be concluded in 2005 according to "The Progress Report of the Trilateral Cooperation among the Peoples Republic of China, Japan and the Republic of Korea," in *the Three-Party Committee* (Vientiane 2004).

4.2.2 The Japan-ASEAN FTA (AJCEP)

Perceiving the prospect for regional leadership with ASEAN at the December 2003 Japan-ASEAN summit in Tokyo, Koizumi proposed a Japan-ASEAN FTA. However, the 2003 summit did not reveal any concrete details about the trade pact. Instead, Koizumi sweepingly proposed that Japan and ASEAN become the central axis of the East Asia grouping - JASEAN axis to which others could be invited. Hoping to sweeten the deal, Koizumi pledged a further US\$3 billion in aid to Southeast Asia and promised to maintain security ties, further liberalise trade and deliver on the “economic partnership.”³³⁶ Intriguingly, despite the origins of this historical summit in Koizumi’s response to ASEAN after China’s FTA pitch, Japan took care to present the Japan-ASEAN summit as something occurring completely independent of China. One official pointedly remarking that the Japan-ASEAN summit “is about Japan and ASEAN, and I do not expect questions about China to be raised.”³³⁷ This summit led to Japan acceding to the Treaty of Amity and Cooperation (in July 2004), Japan again seeming to be playing catch-up with China. Moreover, China furthered its lead signing an agreement for trade in goods as the first ASEAN Plus One FTA in November of that year.

In January of 2005, Japan and ASEAN entered negotiations on an EPA/FTA, the ASEAN Japan Comprehensive Economic Partnership (AJCEP). However, Japan’s progress in Southeast Asia was not mirrored by developments in Northeast Asia with Koizumi’s continued visits to the Yasukuni shrine ending the possibility for any progress with China and Korea. As anti-Japanese riots broke out in cities across China, Wen Jiabao and Hu Jintao called off meetings bilaterally with Koizumi at the APT Summit in Kuala Lumpur in December. With tensions mounting between China and Japan, Koizumi sought to increase Japan’s presence in ASEAN, pledging a further US\$70 million in aid.³³⁸ More importantly, Koizumi also signed the first of the ASEAN-Japan Comprehensive Economic Partnerships with Malaysia.³³⁹ Japan also successfully pressed (over Chinese objections) for the inclusion of Australia, New Zealand and India in the newly established East Asian Summit. The first meeting of which was held in December 2005.³⁴⁰

³³⁶ Vincent Wang, “The Logic of China-Asean Free Trade Agreement: Economic Statecraft Of “Peaceful Rise”,” in *China in the World, the World in China* (University of Malaya: Institute of China Studies, 2007). p. 25, ASEAN was hoping to cut some profits out of the great power game, and would never side clearly with Japan – certainly not for 3bil in aid

³³⁷ Anthony Rowley, “Koizumi to Convince Asean on Integration.,” *Business Times Singapore*, 1 December 2003.

³³⁸ Natsumi Mizumoto, “Koizumi Raps China, Pledges Aid in Talks with Asean,” *Kyodo news*, 13 December 2005., even the handshake between Wen and Koizumi was re-interpreted by the Chinese official as given as a formality only.

³³⁹ *Ibid.*, even the handshake between Wen and Koizumi was re-interpreted by the Chinese official as given as a formality only.

³⁴⁰ China objects to the phrase “the creation of an East Asian Community” be included in the 14 December, 2005 Kuala Lumpur East Asian Summit, stating that that phrase be used only in the APT declaration. A compromise solution calling for “community building in this region” is finally agreed to. Tomotaka Shōji, “Pursuing a Multi-Dimensional Relationship:

4.2.3 Japan leads with CEPEA

The year 2006 marked an evolution in Japan's FTA strategy. In April, Nikai Toshiyuki, Japan's METI minister suggested an FTA among the EAS members. Then in August, Nikai launched the Comprehensive Economic Partnership in East Asia (CEPEA) initiative (for a 'full' EAFTA with the sixteen members of the EAS) at the ASEAN Economic Ministers meeting. The CEPEA idea proposed by Nikai, and approved by Koizumi's Economic and Fiscal Committee, focussed more on non-tariff concerns – chief among them the relaxation of Japan's standards for foreign workers.³⁴¹

However, the true extent of strategic thinking behind the CEPEA proposal is questionable. Firstly, it is apparent that the proposal was decision made on the fly, with little research or preparation before the proposal.³⁴² Secondly, the CEPEA apparently was designed to fit a gap in the 'Asia' section in METI's 2006 Economic Strategy Whitepaper. Moreover, it was not an idea which came from Koizumi, except indirectly via the creation of the EAS.³⁴³ In fact, the CEPEA is best understood as a piece of 'on the fly' diplomacy. Not only did the METI minister reverse the PM's opposition to engaging in an FTA with China, but he did so in way which suited both his personal opinions³⁴⁴ and the bureaucratic interests of the METI. It suddenness provoked a backlash from the Ministry of Agriculture, Forestry and Fisheries (MAFF) and its then minister Nakagawa Shōichi.

Furthermore, as CEPEA entered a research phase, Japan continued to build onto its ASEAN-Japan Comprehensive Economic Partnership (AJCEP) framework, reaching agreements with the Philippines in September and Indonesia (in principle) in November. The CEPEA received minimal reaction from ASEAN, in part because the December 2006 APT Summit in the Philippines had to be rescheduled to early 2007 due to a Typhoon.³⁴⁵

The year 2007 was also very politically active, not least because the APT summit would be held twice. The 10th APT Summit was held in January in the Philippines. The extent of the competition between China and Japan was evident in the Chairman's Statement in which the two rivals each offered a series of inducements in what appeared to be bidding war.³⁴⁶

Rising China and Japan's Southeast Asia Policy," in *The Rise of China: Responses from Southeast Asia and Japan* ed. Jun Tsunekawa (Tokyo: National Institute for Defence Studies, 2009). p. 174

³⁴¹ "Panel Pushes 16-Nation FTA in Asia, Mulls Boosting Foreign Workers," *Kyodo News*, 4/7 2006.

³⁴² Author's Interview with Ministry of Economy Trade and Industry Official Sekizawa Yoichi (FTA/Epa Analyst), 17 November 2009. Tokyo.

³⁴³ Ibid..

³⁴⁴ Ibid.

³⁴⁵ The Philippines domestic political situation did not help either, quite unstable and with rumours of a terrorist plot to attack the APT gathering.

³⁴⁶ Offers of inducements from China and Japan ran, literally, alternately throughout the document, and included a series

However, the most significant event for the development of an EAFTA was the signing by China and ASEAN of a new agreement for trade in services. The ASEAN-China Agreement on the trade in services represented a further challenge to Japan in the field of regional economic leadership. This agreement would later be combined with the China-ASEAN investment pact (signed in 2009) to complete China's comprehensive trade engagement with ASEAN.³⁴⁷

Return to Japan-ASEAN

While the beginning of the year saw Japan and Thailand signed their bilateral EPA (April 2007), the significance of such bilaterals were already beginning to decline in the face of the imminent Japan-ASEAN pact and other region-wide projects. In fact, the key outcomes of the APT Summit (November 2007) were the Second Joint Statement on East Asian Cooperation and the more concrete APT Cooperation Work Plan (2007-2017), discussed later. Another opportunity for advancing a Sino-Japanese trade agreement was missed at the APT. Although the leaders of Japan and China met for two hours on the sidelines, the discussions were by necessity focused on the Senkaku/Diaoyutai islands dispute which was threatening to boil over. Lastly, Japan and ASEAN also reached final agreement on the Japan-ASEAN EPA Framework agreement.³⁴⁸

Due to domestic political unrest (which was manifested in a blocking off of the Bangkok airport), the November 2008 APT Summit was cancelled, returning the focus to the bilateral arena. In December, Japan concluded negotiations with Vietnam on a bilateral EPA/FTA. The negotiations themselves only began in January of 2007, making the Japan-Vietnam EPA one of the quickest – indeed Japan has quickened the pace of negotiations over time, sacrificing inclusiveness in order to get a quicker result.³⁴⁹ This was due largely to trying to

of training seminars (Japan/China), support for disaster reduction (Japan), regional monitoring on infectious diseases (China), US\$67 million for Avian Flu (Japan), establish an Economic Research Institute for ASEAN and East Asia (ERIA, Japan (see APT resources)) and, an Expert Group on EAFTA Report (China, the Report was headed by Zhang Yunling, recommended that an EAFTA be agreed to sooner rather than later, to those ends be negotiated as a single undertaking, but these recommendations were not accepted by either ASEAN or Japan. One doubts if China actually wanted to move this quickly too.) And, for good measure, Korea got in on the inducement-fest offering an APT Center for the Gifted in Science.

³⁴⁷ Carsten Fink, "East Asian Preferential Trade Agreements in Services: Liberalization Content and WTO Rules," *World Trade Review* 7, no. 4 (2008). p. 647, Japan's commitments to ASEAN under their EPA for liberalization of investment are usually substantive – going further than those requirements found in the GATS. The Chinese commitments in the China-ASEAN investment agreement are however almost entirely show – not going further than General Agreement on Trade in Services.

³⁴⁸ Although it took some five years more than China to conclude, and thus interpreted as a signal of Japan's basic disinterest in Southeast Asia by ASEAN.

³⁴⁹ Hidetaka Yoshimatsu, *The Political Economy of Regionalism in East Asia* (New York: Palgrave MacMillan, 2008). p. 154,

fit Vietnam into the AJCEP, which also went into effect in December of 2008.³⁵⁰ But on the issue of trade regionalism, slotting Vietnam into the AJCEP also put Japan on a more equal footing with China in ASEAN. In order to strike a better balance still, Japan also created a new Ambassador post for ASEAN. This put Japan on equal diplomatic footing with China as well.³⁵¹

The result of these moves by Japan and China are graphically represented in Figure 11, which shows all FTAs proposed, under negotiation or concluded by Japan or China in East Asia.

Figure 11 Progress of East Asian FTAs involving Japan and/or China

NOTE:
This figure is included on page 89 of the print copy of
the thesis held in the University of Adelaide Library.

Source: Asian Development Bank, Asian Regional Integration Centre, FTA Database.
Accessed: April 2010

³⁵⁰ The JACEP went into force for five of the eleven members (Japan, Vietnam, Laos, Malaysia and Brunei). "Asean-Japanese FTA to Take Effect Dec. 1," *Japan Times*, 22 October 2008.

³⁵¹ China appointed Xue Hanqin as ambassador at large for ASEAN in December 30 2008, GOJ appointed a Southeast Asian specialist, Katori Yoshinori to the post of ambassador in October 17 2008. Japan announced its intent to post an ambassador at the ASEAN Post Ministerial Conference in July 23 2008, earlier than China who responded in Beijing one day later.

4.2.4 The China factor in Japan's EAFTA policy.

While it is clear that Japan has championed a rival vision of the EAFTA project to that of China, it does not necessarily follow that the China is the cause. Japan's rival EAFTA project may have resulted from other external factors or internal interests. However, this section argues that is the China factor that matters most. This will be demonstrated by examining the timing of Japan's proposals, the partners Japan chose and Japan's negotiating strategy.

Even before the emergence of China on the FTA scene Japan had faced economic pressure to form bilateral trade agreements. The most important of these was the emergence of trade blocs in Europe and North America, which had led some scholars to interpret Japan's EAFTA movements as a defensive response to economic regionalism in the Americas and Europe rather than a coping strategy for China.³⁵² Japan was aware of the detrimental effect of tariff liberalising trade agreements which excluded Japan. In fact, even before China proposed its FTA to ASEAN, Japan and Korea begun to study a possible bilateral FTA as early as 1998. To explain its changing position on FTAs, Japan adopted in 1999 a new "White Paper on Trade."³⁵³ This document discussed broadening Japanese trade strategy to include both multilateral and bilateral trade negotiations and marked a break with Japan's previous policy WTO-centred non-discriminatory trade negotiations. It did not mention China, but rather the emergence of outside trade blocs, as the cause of a shift in Japan's trade policy.

However, while the negative effects of these trade blocs were becoming harder to dismiss, many within Japan continued to discount their import.³⁵⁴ This perception of the utility of FTAs rested on the growing feeling that although Japan's trade was not being hurt directly, Japan was suffering indirectly by not being a part of the rapid expansion of trade within these Free Trade Areas. But as the extent of damage was hidden and might only be gauged indirectly, it was difficult to mobilize political support for a strategic reassessment.

Yet Japan was lagging behind in terms of such agreements. A survey by the World Customs Organizations found that in 2008 only 3.1% of Japan's trade was with FTA or Customs Union partners (China scored lower, 1.6%) as compared to nearly a third (30%) percent for the US, and two-thirds or above for EU member countries (66-75%, inc.

³⁵² LC Jar et al., "From East Asian Ftas to an Eafta: Typology of East Asian Ftas & Implications for an Eafta," (Seoul: Korea Institute for International Economic Policy, 2006). p. 102

³⁵³ "White Paper on International Trade," (Ministry of International Trade and Industry 1999).

³⁵⁴ Howard Wall, "Has Japan Been Left out in the Cold by Regional Integration," *Monetary and Economics Studies* (2002).

Germany and France).³⁵⁵ Moreover, compared with countries within these regional arrangements, Japanese traders faced on average higher tariff rates. Japan's trade is increasingly concentrated in East Asia, where the average higher tariff rates of these countries pose an additional burden for Japan's exporters; this is particularly true in key markets such as Indonesia and sectors like automobiles.³⁵⁶ Indeed, correlations between the economies of the APT and US/EU are declining, while at the same time the APT economies have increasingly moved together against 'external' economies.³⁵⁷ These phenomena, regardless of their causes³⁵⁸, implied that the region was 'naturally' ready for an FTA proposal.

The last of these external arguments suggested that the stalled Cancun WTO negotiations have also given a general impetus to defect to bilateral and regional FTAs; even though these alternative modes come at a cost to real progress on trade liberalization.³⁵⁹ Indeed, Japan's Working Group on Economic Partnership Agreements in the Council on Economic and Fiscal Policy pointed out that bilateral EPAs not only allow for close economic cooperation in investment and transport, but may in fact achieve a better result for Japan than would be possible under the WTO process.³⁶⁰

Yet these pressures alone or in combination do not predict when or with whom Japan would attempt to conclude bilateral FTAs. If these extra-regional pressures were sufficient, one would expect Japan to approach China and Korea *first* in the process of building up a regional trade bloc.³⁶¹ The reason why Japan preferred to launch an FTA with ASEAN and not China reflected political realities. Moreover, the timing of Japan's FTA proposal, even if not solely determined by China's ASEAN FTA bid, was certainly triggered by it. The

³⁵⁵ See Annex II of "Survey on Free Trade Agreements (September 2008)," <http://www.wcoomd.org/files/1.%20Public%20files/PDFandDocuments/Harmonized%20System/SurveyFTA20080915.pdf>, 2008, December

³⁵⁶ Lydia Yu-Jose, "Philippines-Japan Economic Partnership: Where Is the Philippines in Japan's Plan," in *Discussion paper series* (Manila: the Philippine Institute for Development Studies, 2004). p. 15. She notes that, "As is apparent from the simple average figures for tariff rates (the U.S, 3.6%; the E.U., 4.1%; China, 10%; Malaysia, 14.5%; the Republic of Korea, 16.1%; the Philippines, 25.6%; and Indonesia, 37.5%), East Asia, the region where Japanese products account for the highest percentage in trade, has the highest tariffs."

³⁵⁷ Indeed intra-regional trade in East Asia is higher than that of NAFTA, Masahiro Kawai, "Evolving Economic Architecture in East Asia," (Tokyo: ADB Institute Discussion Paper No. 84, 2007). pp. 7-8

³⁵⁸ Various interpretations, East Asia is now subject to common supply shocks (Oil, US market movements etc), other interpretations emphasize China's role in production.

³⁵⁹ Peter Drysdale, "Regional Cooperation in East Asia and FTA Strategies," in *Pacific Economic Papers No.344* (Canberra: Australian National University, 2005). p. 13

³⁶⁰ Especially for car exporters, this view supported by Tanaka Hitoshi (Vice Minister of Foreign Affairs until 2005). See, Aurelia George Mulgan, "Japan's FTA Politics and the Problem of Agricultural Trade Liberalisation" (paper presented at the Symposium on Australia and Free Trade Agreements, Australian National University, 1-2 November 2007).

³⁶¹ Indeed, this is precisely what officials in the METI have been advocating.

Chinese proposal was a foreign policy crisis of sorts which allowed for a reconfiguration of strategy.³⁶² The political rationale for Japan's FTA policy is openly explained in Japan's 2004 Diplomatic Blue Book itself.³⁶³

Apart from the direct pressure explanation for Japan's switch to an FTA-led regional trade policy, the rise of China has also indirectly contributed to Japan's push for FTAs with ASEAN. Indeed, Singapore's Prime Minister Goh Chok Tong's initial offer of an FTA to Japan's PM Obuchi in 2000 was seen as an attempt to balance China's rising presence in Singapore (and ASEAN).³⁶⁴ Whilst on the Japan side, Yatsu Yoshirō the second chairman of the LDP's select commission on FTAs said in interview in November 2004, "if Japan lags behind China in the EPA formation, we will suffer serious economic damage. I would like to work positively in an EPA with ASEAN." At least in the minds of Japanese decision makers there existed a clear link between the rise of China and Japan's FTA strategy towards ASEAN.³⁶⁵

Moreover, the manner in which Japan approached FTA negotiations suggested that the China factor was important. The counter case is put forward by Katada, who argues that, "if Japan's trade initiatives were aimed primordially to counteract China's leadership bid, then it would have responded in kind to the surprise announcement of China's FTA with ASEAN by quickly negotiating a sub-regional trade agreement focussed mostly of tariff elimination. Instead, because of the demands of the Japanese business community, the Japanese government opted for a more protracted route unlikely to reap swift leadership gains."³⁶⁶ However, this confuses intention and output. As demonstrated previously, Japan was hoping for swiftly realized FTAs (hence the bilateral approach) which would create such leadership gains. Japan's interest only appeared to be primarily commercial once domestic-side political actors (like MAFF) became involved and negotiations got bogged down. Why the political ends of Japan's strategy were confused once the bureaucracy got involved is explained by liberal-institutionalism. This confusion arose because for a long

³⁶² Shiraishi Takeshi has suggested that Japan had been thinking aloud about a Japan-ASEAN FTA, see Takashi Shiraishi, "Nihon Asean No Kakudai FTA (Jiyuu Boueki Kyoutei) Wo Teishou Suru" *Chūo Kōron* 117, no. 2 (2002).. This thinking aloud was deliberate after a request by Fukuda Yasuo then Secretary of the LDP in 2000 or early 2001 well before the Chinese had made a move. And further, that it was Japan's likely future move to sign an FTA which prompted China's sudden, early FTA offer to ASEAN, argues Shiraishi Takeshi.

³⁶³ "Gaikō Seisho," (Tokyo: Ministry of Foreign Affairs (Japan), 2004).

³⁶⁴ Ashihara Yoshihiro, "Nihon Shingapōru Epa," in *Kaisetsu: FTA/EPA Kōshō*, ed. Watanabe Yozumizu (Tokyo: Nikkyōhyō, 2007). p. 47

³⁶⁵ *Nihon Nogyō Shimbun*, 6 November 2004 in Hidetaka Yoshimatsu, "Japan's Economic Diplomacy Towards East Asia: Fragmented Realism and Naive Liberalism," *S. Rajaratnam School of International Studies Working Paper* 146 (2009). p. 9

³⁶⁶ Saori Katada, Saadia Pekkanen, and Mireya Solis, "Trading Gains for Control," *International Studies Quarterly* 51(2007). p. 950

time MOFA and METI had built up capacities (and standard operation procedures) in trade negotiation with an exclusive focus on non-preferential trade at the WTO.³⁶⁷ These biases in the negotiation teams towards what Araki calls 'aggressive legalism', were always unlikely to win political points with Japan's negotiating partners in Asia. From 2000 to 2004, the number of personnel involved in FTA negotiations across the departments increased from about 4 to 80 and it was these former-WTO negotiators which were transferred to bilateral trade negotiations.³⁶⁸

From this perspective, it is indeed possible to see how domestic actors can affect the output of policy. In setting Japan's FTA policy, the MOFA, METI and the MAFF operated separately and equally (see Appendix 3). Neither was able to veto the other and establish executive control. Each Ministry maintained its own task force for dealing with FTAs, and each ministry sent a (usually senior) bureaucrat to manage FTA negotiations.³⁶⁹ Moreover, METI must co-opt 'agriculture' Diet men on FTA matters or potentially face opposition on internal industrial policy via issue-linkage.³⁷⁰ As a result, international trade negotiators have noted that dealing with 'Japan' is actually dealing with multiple and divided policy makers (i.e. Japan is not a unitary actor). This problem has led Mulgan to conclude that, "Japan does not have one FTA strategy or policy; it has several. There is no single body producing trade policy for Japan. Nor is there an independent body capable of coordinating and unifying conflicting domestic interests on trade issues."³⁷¹ These negotiators already have assumptions built up from their WTO experiences, preferring that each agreement be legally tight regardless of potential political fall-out.³⁷²

From a realist perspective we should have expected that Japan would seek to realize a sub-regional trade agreement aimed at swift leadership gains,³⁷³ but this did not occur. Instead, while Japan is responding to international factors that realism highlights, the contents of the response are being coloured by Japan's unique domestic political landscape. By incorporating this perspective into explaining Japanese policy it is easy to

³⁶⁷ Satoshi Bando, *Ajia Kyoudou Tai to Nihon* (Tokyo 2006), p. 96

³⁶⁸ Bilateral divisions have 65 personnel, the multilateral division has 16 personnel "Saori Katada, Saadia Pekkanen, and Mireya Solis, "Trading Gains for Control," *International Studies Quarterly* 51(2007). p. 955,

³⁶⁹ Aurelia George Mulgan, "Japan's FTA Politics and the Problem of Agricultural Trade Liberalisation" (paper presented at the Symposium on Australia and Free Trade Agreements, Australian National University, 1-2 November 2007). pp. 16-17

³⁷⁰ Ibid. pp. 15-6, This is made all the more inflexible because consensus is required for a proposed bill to go from the Policy Affairs Research Council (PARC) committees to the Diet for ratification.

³⁷¹ Ibid. p. 17

³⁷² An example might be the labour liberalization provisions in the JPEPA, which if actually followed will see thousands of Philippines be thrown out of Japan once their visa expires if their language proficiency is shown to be inadequate.

³⁷³ Saori Katada, Saadia Pekkanen, and Mireya Solis, "Trading Gains for Control," *International Studies Quarterly* 51(2007). p. 950

see how a large structural phenomenon such as the rise of China might produce a policy neither principally focussed on managing China nor adequate to the task.

4.3 Membership: Excluding China?

Despite all the activities and agreements which describe the development of the EAFTA, an FTA between Japan and China has not been realized. Indeed, a China-Japan FTA is not even close to realization, with no formal movement as of April 2010. Further, this is true not merely for a bilateral arrangement but even for a trilateral pact with Korea or a plurilateral pact with ASEAN.³⁷⁴ The greatest chance for China-Japan FTA is the CEPEA, but here China's position is negative raising doubts of its actual chances of realization.

4.3.1 Bilateral: The political impossibility of China

Despite repeated requests from the Chinese side, Japan has been quite opposed to proceeding with a bilateral FTA with China. The underlying reason for this is that China is likely to benefit significantly more if an agreement is concluded. Some have suggested that China could expect to increase its GDP growth by as much as a whole extra percentage point.³⁷⁵ In contrast, even in the best case scenario, Japan's GDP growth might be increased a mere 0.07%, according to one study.³⁷⁶

Yet this disparity does not imply that Japan ought to be uninterested. Quite the contrary, from an economic perspective, the absolute gains for Japan from an FTA with China should still be very large. Japan has FTAs with much smaller countries like the Philippines (gains so small as to be immeasurable); so, turning away China because it is not an economically worthwhile partner is an argument that few would accept. Indeed, most agree that economically China is Japan's logical FTA partner. According to modelling by Cheong, "an East Asian FTA [with ASEAN included] will bring more economic benefits... compared to a CJK FTA, but the difference would not be great."³⁷⁷ In other words economically Japan should order its preferences for China first, then ASEAN. It is puzzling then that Japan would reverse that order. Cheong continues, "According to the estimation, China is found to be a more suitable FTA partner to both Japan and Korea. In other words, both Japan and Korea will gain more benefits by forming an FTA with China rather than concluding a

³⁷⁴ After the trilateral in October 2009, Hatoyama proposed study of a trilateral FTA between China, Japan and Korea was agreed. This study involves officials for the first time, in addition to academics and private persons.

³⁷⁵ If capital accumulation were allowed. Inkyo Cheong, "Estimation of Economic Effects of Ftas," in *East Asian Economic Regionalism*, ed. Richard Baldwin, Inkyo Cheong, and Choong Yong Ahn (Dordrecht: Springer, 2005). p. 146

³⁷⁶ Ibid. p. 146

³⁷⁷ Ibid. pp. 150-3, p. 147

bilateral FTA with each other."³⁷⁸ Likewise, Japan ought to give preference to China ahead of Korea, but here too the order is reversed. Indeed, compared to other developing countries the economic structure of Japan and China are extraordinarily complementary, especially in the services sector.³⁷⁹ Considering the costs of conducting negotiations across a large number bilateral deals, a single undertaking as offered by China would show quick and significant results for Japan's economic growth.

But despite these strong rationales, Japan has been unwilling to proceed with an FTA with China. One potential area of concern for Japan is the further hollowing out of its industrial base, especially in rural areas. Igawa Kazuhiro, the head of the Kobe Research Institute of Economics and Business, politely rephrased this classic fear of being swamped by cheap Chinese manufactures, noting that Japan is not able to be a market for China's goods and so an FTA should be avoided.³⁸⁰

In particular the powerful agricultural lobby is strongly opposed, fearing a wipe-out of family farms. Subsequent to the first formal announcement at the ATP on an EAFTA with Japan and China (late 2003), the MAFF entered into the EPA/FTA fray issuing the 'Green Asia EPA' report in November (2004). Couched in terms of food security, the report called for agricultural imports to be stable, diversified and safe (*anzen anshin*).³⁸¹ It clearly, though not explicitly, targeted China - Japan's second largest supplier of food. China's growing market share in Japan has triggered calls for diversification; a goal which would be unattainable were Japan to conclude a China-FTA.³⁸² According to modelling by Urata, an FTA which included agriculture with China (and Korea) would drastically reduce Japan's grain production.³⁸³ This implies that Japan would stand to 'lose' US\$1.3 billion annually in national welfare, losses focused on rural areas with traditionally strong LDP links and which remain political relevant (although less so) even under the current DPJ regime.³⁸⁴ Intriguingly, these concerns have not prevented Japan from pursuing FTAs with Thailand and Australia, also major suppliers of Japan's food imports.

³⁷⁸ Ibid. p. 146

³⁷⁹ Guoqiang Long and Liping Zhang, "China's Approach to an Institutional Regional Arrangement," in *East Asian Economic Regionalism*, ed. Richard Baldwin, Inkyo Cheong, and Choong Yong Ahn (Dordrecht: Springer, 2005). p. 2

³⁸⁰ In fact, Igawa calls for Japan to sign an FTA with Korea in part to have a larger voice against Chinese imports. See, Kazuhiro Igawa and Bonggil Kim, "East Asian Free Trade Agreement; Strategic Aspects for Japan," in *East Asian Economic Regionalism*, ed. Richard Baldwin, Inkyo Cheong, and Choong Yong Ahn (Dordrecht: Springer, 2005). pp. 32-3

³⁸¹ Shigeki Higashi, "Tai Seijika Wo Uwamawaru Kanryō No Gaikō Nōryoku," in *FTA Seiji Keizai Gaku*, ed. Shigeki Higashi (Chiba: IDE-JETRO, 2007). p. 83

³⁸² Nobuhiro Suzuki, *FTA to Nihon No Shokuryō Nōgyō* (Tsukuba: Tsukuba Shobo, 2004).

³⁸³ Shūjiro Urata, *Nicchūkan FTA: Sono Igi to Kadai* (Tokyo: NIRA, 2008). p. 29, grain production slated to fall 49.27% in the event of a China-Japan FTA.

³⁸⁴ Nobuhiro Suzuki, *FTA to Nihon No Shokuryō Nōgyō* (Tsukuba: Tsukuba Shobō, 2004). p. 17

Moreover, even for non-LDP politicians, there are few obvious benefits and potentially major political costs in being associated with a Japan-China FTA. Japan has been rocked by a series of food-scaries which have originated from China and which have resulted in a widespread fear of Chinese imported food among the Japanese public.³⁸⁵ Whether it be frozen *gyōza*, imitation eel, or contaminated dairy products, the resultant popular outrage makes it unlikely that Japan would be able to conclude a deal with China.³⁸⁶ Tellingly, Japan's politically powerful business lobby, the Keidanren, has not issued a single policy recommendation paper for a JCFTA, although it has pressed hard for bilateral FTAs with other East Asian countries.³⁸⁷ This is in spite of the fact that most companies expect the highest return from an FTA with China.³⁸⁸ In fact, in a 2006 Keidanren position paper entitled "*Requests of the business circles for expanding commercial and economic relations between Japan and China*" the first four items listed were; early conclusion of an Japan-China-Korea investment pact, transparency of laws and regulations, protection of the intellectual property rights, and liberalization of the services sector – a bilateral FTA was not discussed.³⁸⁹

China is aware that there is no desire within Japan for an FTA with it. One important Chinese scholar noted that, "China proposed to start negotiation (on FTA), but no response from Japan [yet]. Japan is only interested to negotiate an investment treaty for Japanese companies. China will face big pressure if it starts those negotiations, but China is willing to do so. There is no political foundation in current Japanese leaders to accept a China-Japan FTA yet."³⁹⁰ Not that this has stopped China testing the waters. In October 2004, Watanabe Osamu Chairman of JETRO proposed to Zhang Yunling to organise a study on China-Japan FTA, aimed at framework for formal negotiation.³⁹¹ In February 2005, Chinese Ambassador to Japan, Wang Yi proposed that Japan and China launch negotiations

³⁸⁵ If the large scale protests which swept Korea over fears of mad cow beef from the US FTA are any indication, then Japan is likely to face popular outpouring of rage with a China-Japan FTA. Indeed, the infamous *Gyōza* scare of early 2008, which saw imports of Chinese foodstuff drop drastically (28%), and reveals the extent of these feelings.

³⁸⁶ Recall the problem that beef caused in the KORUS deal, these political factors count in negotiations.

³⁸⁷ Hidetaka Yoshimatsu, "Japan's Keidanren and Free Trade Agreements; Societal Interests and Trade Policy," *Asian Survey* 45, no. 2 (2005).

³⁸⁸ In a questionnaire survey presented to *Keidanren* members China got the highest marks as a desirable FTA partner (62), with ASEAN second (54) and India (39). Also 43.8% of companies responded favourably, of companies with overseas operations bases 68% were in China, see, Akira Kajita, "The Influence on Japanese Companies by East Asian Ftas, and an Overview of East Asian Countries' Tariff Rates," (Tokyo: JETRO, 2004).

³⁸⁹ "Daisankai Nicchū Tsūshō Taiwa Misshon Pojishon Pēpā," in <http://www.keidanren.or.jp/japanese/policy/2006/015.html> (Tokyo: Keidanren, 2006).

³⁹⁰ Author's Communication With Yunling Zhang, personal correspondence, 25 September 2008.

³⁹¹ Hidetaka Yoshimatsu, *The Political Economy of Regionalism in East Asia* (New York: Palgrave MacMillan, 2008). p.

bilaterally on a free trade agreement (without attempting to include Korea). Wang noted pointedly that 'China has taken a positive attitude on an FTA with Japan and China wants to see a positive response from Japan.'³⁹²

China's moves can be interpreted as an attempt to demonstrate China's willingness to move forward with East Asian regionalism compared with Japan. Indeed, one economist has noted that for China, "It is good to get political credit for proposing a free trade agreement with Japan and South Korea but not really having to do it."³⁹³ It is perhaps no surprise then that officials within Japan's METI have noted that the China-Japan FTA rivalry is very political.³⁹⁴ A belief publicly held by some major figures such as Asō Tarō.³⁹⁵

Japan's disinterest in an FTA was also visible when Fukuda and Wen met at the first high level economic dialogue meeting in Beijing (November 2007), free trade arrangements were discussed but again nothing was decided. Instead, the focus was on non-FTA economic cooperation on issues like climate change, energy, currency forgery and RMB appreciation.³⁹⁶ This approach of resorting to non-FTA trade agreements was continued at the May 2008, Summit of Japan and China at which agreement was reached on business environment concerns. This agreement (the action agenda) was finalised in December of that year (together with a similar document for Korea). However, the action agenda in fact represented Japan's unwillingness to progress to an FTA in prefer for less 'political' economic cooperation.

4.3.2 Trilateral: The impossibility of China revisited

Even with the addition of Korea in the trilateral process, Japan's opposition to China continues to prevent reaching an agreement. In 2002 a report entitled *Economic effects of a possible Free Trade Area among China, Japan and South Korea* emphasised "the urgent need to establish a trilateral FTA"; a call repeated one year in a follow-up report.³⁹⁷ But

³⁹² "Chinese Envoy Wang Calls for China-Japan FTA," *Kyodo News*, 3 February 2005.

³⁹³ Susan Shirk, *China: Fragile Superpower* (Oxford: Oxford University Press, 2007). p. 134, Specifically Susan Shirk believes that this strategy's target has been to put pressure on Japan's agricultural lobby.

³⁹⁴ It is also possible that China's willingness to conclude an FTA with Japan is aimed at the weakening the influence of the US, as Yong Nian Zheng of the East Asia Institute notes "as long as the Japan-China relationship is uncertain regionalization efforts will suffer. Extra regional actors may also exploit this weak link in East Asian community to intervene in regional affairs." Mark Manger, "Nihon No FTA Senryaku No Zenbō to Haikai," in *Higashi Ajia Kyōdōtai to Iu Gensō* ed. Nakakatsu Keiji (Tokyo: Nakanishiya Publishers, 2006). p. 94

³⁹⁵ Asō Tarō *Addresses the Committee on Defense and Foreign Policy*, 15 March 2007.

³⁹⁶ "Chūgoku Kyōdōbunsho Wo Ichibu Sakujo Jinmingen Kiriage Kanren Nihon No Ryōkai Naku," *Chūnichi Shinbun*, December 10 2007., This joint statement caused furore within Japan, as the Chinese side unilaterally deleted the section about RMB appreciation from their version, MOFA Minister Kōmura was scathing, and noted the influence of this act on further cooperation with China.

³⁹⁷ Mie Oba, "Regional Arrangements for Trade in Northeast Asia: Cooperation and Competition between China and

despite these calls, at the fifth Trilateral Summit (Bali, 2003) on the sidelines of the APT saw the Plus Three FTA be quietly dropped due to Japanese objections.³⁹⁸

In 2004, based on a study by think-tanks within the Plus Three countries which had reported “substantial macroeconomic effects favourable to the three countries,” to the Trilateral Summit meeting (November 27), Premier Wen proposed to his two neighbours in Northeast Asia that trilateral negotiations be started. But two days later at the Trilateral meeting of the leaders of Japan, PRC and ROK, Koizumi gave his answer – further research at the academic level.³⁹⁹ China’s impatience with Japan began to show, Premier Wen publicly replying to Koizumi that, “the need for a trilateral FTA had been pointed out in the Joint Study Group Report, and thus work must be accelerated to realize a trilateral FTA.”⁴⁰⁰ The subsequent two years saw no progress on the FTA front, with China calling off meetings with Koizumi at subsequent trilateral summits.

At the December 2008 meeting of the Plus Three countries in Fukuoka City, expectations in Northeast Asia were high that progress might be made on an FTA. Premier Wen Jiabao again proposed that negotiations on a Japan-China bilateral free trade agreement be started as soon,⁴⁰¹ but Japan’s Asō Tarō restated Japan’s desire for the resumption of the stalled bilateral FTA talks with Korea instead.⁴⁰² With Japan still unable to reach an agreement, the chances for a Plus Three FTA agreement remained dim. Unsurprisingly, the responses of business leaders and governmental officials in the ‘state of the region’ report by the PECC and ADB-OREI (2008) reveals that Northeast Asians rated the chances of a EAFTA as much less likely than their Southeast Asian neighbours.⁴⁰³ Lastly, the joint research projects which were begun in 2003 presented recommendations, and another

Japan,” in *Asia’s New Institutional Architecture*, ed. Vinod Aggarwal and Min Gyo Koo (Springer: Leipzig, 2008). pp. 104-5

³⁹⁸ Ibid. pp. 104-5

³⁹⁹ Consistently throwing the proposal back to academic (rather than official) research must be viewed as a negative position.

⁴⁰⁰ “Trilateral Meeting of the Leader’s of Japan, the People’s Republic of China and the Republic of Korea (Rok),” no. 29 November (2004), <http://www.mofa.go.jp/region/asia-paci/asean/pmv0411/summary.html>.

⁴⁰¹ “China’s Wen Proposes Early Start of Free Trade Talks with S. Korea,” *Kyodo news*, December 13 2008.

⁴⁰² “Japan Pm, South Korea President Keen on Resuming Trade Talks,” *Kyodo news*, December 13 2008. President Lee of Korea gave non-committal answer to both Japan and China, indicating his intension to play them off again each other. The Korea-Japan FTA had hit difficulties over the liberalization of agricultural and fishery produce. In addition, both Korean domestic politics (history issue) and Japan domestic politics (North Korea issue, to wit whether the Kamsung industrial park would be included or not) also factored into the longest FTA talks for Japan thus far.

⁴⁰³ 51% for NEA responders and 75% for SEA responders respectively. See “State of the Region Report; 2008-2009,” Pacific Economic Cooperation Council, <http://www.pecc.org/sotr/papers/SOTR-2008-Survey-Results.pdf> Accessed : April 2010. In response to Question 6: How would you rate the suitability of the following groups of economies for the creation of a free trade and investment area? Most also wanted a liquidity function for Asia, AMF idea (77%).

round of study was proposed for 2009.⁴⁰⁴

More recently, Japan under the DPJ has made moves toward a trilateral FTA. PM Hatoyama Yukio proposed on October 10 at the trilateral summit in (Beijing) that such an FTA be accelerated, at the same time raising the option of signing an investment pact as well.⁴⁰⁵ Just over two weeks later in Hua Hin (Thailand), Hatoyama advanced the China-Japan-Korea trilateral FTA idea with the announcement of working groups to do joint research. While this is the third time research has been commissioned, it is the first time government departments are involved. This change in policy, however, has come from the top, as METI had *not been asked* to provide any sort of policy brief as to the implications of a trilateral FTA to Hatoyama (or his Office) prior to his announcements at either of the above forums.⁴⁰⁶ Quite whether this represents a major change in policy is too early to know.

4.3.3 Plurilateral: wider not deeper (CEPEA)

With Japan opposed to a 13 party FTA, the only grouping in which Japan is willing to accept China's participation is the Japan proposed sixteen-party FTA - the CEPEA.⁴⁰⁷ But while it is true the CEPEA proposal includes China, there are at least two possible interpretations of its meaning. The first is simply that Japan wishes that China be involved; certainly the METI minister at the time Nikai Toshihiro was considered pro-China by his ministerial officials.⁴⁰⁸ The second is that Japan's proposal was aimed at scuttling China's preferred 'narrow' EAFTA among the APT members.

Of course, as Japanese scholars argue, the decision to expand membership of an EAFTA to the democracies of Australia, New Zealand and India would imply greater gains than

⁴⁰⁴ Urata Shūjiro was a participant in the CJK trilateral research. He describes the process as tiring and meaningless, every year the research group passed up its recommendation and every year the governments called for further study. Eventually the research group run out of things to study and shortly thereafter Urata left the program. He believed Japanese government did not want to hear the report. Author's Interview with Urata Shūjiro, 8 February 2010. Tokyo. Of course, there could have been a break through, one compromise solution rejected by Japan offered by a Chinese official suggested that Japan's preferred Investment pact could be bundled into an FTA, however, Japan still was not interested. See, Hidetaka Yoshimatsu, *The Political Economy of Regionalism in East Asia* (New York: Palgrave MacMillan, 2008). pp. 90-91

⁴⁰⁵ This is in spite of the fact that Chian position is that an investment pact will not be considered outside an FTA, see, Joel Ratus, "Hatayoma's FTA Strategy No Strategy at All," *Eastasiaforum.org*(2009), <http://www.eastasiaforum.org/2009/12/03/hatoyamas-fta-strategy-no-strategy-at-all/>.

⁴⁰⁶ Author's Interview with Ministry of Economy Trade and Industry Official Sekizawa Yoichi (FTA/Epa Analyst), 17 November 2009. Tokyo.

⁴⁰⁷ Author's Interview with Terada Takashi, 9 March 2010. Tokyo., Singapore and Indonesia also object to ASEAN+3 FTA for the same reason as Japan - fear of China.

⁴⁰⁸ Specifically Nikai was called *Shinchūha*. Author's Interview with Ministry of Economy Trade and Industry Official Sekizawa Yoichi (FTA/Epa Analyst), 17 November 2009. Tokyo.

from a narrower 13 party EAFTA.⁴⁰⁹ This technical truism could be extended to justify the inclusion of the US, Canada, Cuba and the whole the WTO – it is thus a useless explanation. An expansion of institutional membership is in itself likely to reduce the chances of establishment, but expanding the membership to these three particular countries is singularly damaging to the chances of CEPEA's realization. To wit, it is unlikely that the other major regional power, China would allow Japan to stack the FTA with its political allies.

And indeed, China's response suggests that Japan's decision was political. Almost immediately, the Chinese Vice-Minister of Commerce came out and strongly opposed the proposal. On the other hand, ASEAN supported the CEPEA proposal (and Australia, New Zealand and India of course supported CEPEA). For METI, this protest by the Chinese side, taken together with previous Chinese efforts to cement the 13 party FTA (such as the 2004 '10+3 FTA research project', and monies from China to the ASEAN secretariat), suggested a bid by China to take over leadership in regional trade from Japan; only adding more urgency to CEPEA.⁴¹⁰ As one senior METI official said, "China will take the lead in +3 negotiations. We should promote +6 negotiations ahead of the curve."⁴¹¹

Japan's advocacy of the CEPEA therefore is due to a sort of realist type of thinking focused on balancing against China. Indeed, realism captures the gist of Japan's policy toward regional membership in an FTA. The inclusion of Australia and India is explicable in terms of traditional external balancing (alliance building). However, realist analysis fails to explain why Australia and India were selected rather than for example Canada and/or Russia. Here constructivist variables are important in determining *which* external powers to balance with, and shared values and institutions proving to be just as important as, if not more important, than naked power alone. Additionally, constructivism also explains better than simple zero-sum thinking why it is that Japan is unable to cooperate with China. Low levels of popular trust towards China are certainly important, but so too is the fact that (after a series of food scares emanating from China), any Japanese politician advocating an FTA will be fighting an uphill battle with the voter, even as everyday Japanese would stand to benefit economically.⁴¹²

⁴⁰⁹ Masahiro Kawai, "Evolving Economic Architecture in East Asia," (Tokyo: ADB Institute Discussion Paper No. 84, 2007). p. 24

⁴¹⁰ Takashi Terada, "The Origins of Asean+6: Japan's Initiatives and the Agent-Structure Framework," in *GIARI Working Paper* (Tokyo: Waseda University, 2009). p. 12-3

⁴¹¹ Hidetaka Yoshimatsu, *The Political Economy of Regionalism in East Asia* (New York: Palgrave MacMillan, 2008). p. 154

⁴¹² Author's Interview with Urata Shūjiro, 8 February 2010. Tokyo.

4.3.4 Resources: Japan, ERIA and CEPEA leadership

Japan has also attempted to bolster its leadership through the creation and sponsoring of research into economic integration. At the East Asian Vision Group, proposed by South Korea's president Kim Dae Jung in December 1998 at the APT, Japan pushed forward many of its research institutes.

The APT process has officially recognised a number of research institutions as 'leaders' in various fields of economic integration. Japan, which has both the funding and competence to undertake such studies, has done well here. The Institute for International Monetary Affairs and Daiwa Institute dominating APT Research Group studies (See Appendix 4).

Perhaps seeking to mitigate Japan's apparent lead in terms of officially recognised 'intellectual leadership' at the Track II level, China offered to implement one of the recommendations of the East Asia Vision Group report, the setting up of the 'Network of East Asian Think tanks' (NEAT) in November 2002. This triggered further research in Japan into the East Asian community concept, and greater activism by the Japanese-sponsored Council on East Asia Community.⁴¹³ In 2005, duelling summitry by think-tanks broke out in the lead up to the East Asia Summit. In August Japan hosted the 3rd NEAT meeting entitled "Towards an East Asia Community" in Tokyo, and in October China hosted the 3rd East Asian Forum in Beijing, both of which reported finding back to the APT.⁴¹⁴

At the 2007 APT meeting in the Philippines, Japan again attempted to be the regional ideas leader with the proposal by PM Abe of a Track II research group for the East Asian Summit and ASEAN Plus Three Economic leaders, the so-called Economic Research Institute for ASEAN and East Asia (ERIA).⁴¹⁵ The ERIA was established in Jakarta, Indonesia on June 3, 2008.⁴¹⁶

⁴¹³ Former Japanese Prime Minister Nakasone became chairman in May 2004, adding a political heavy hitter to the research agenda of the CEAC.

⁴¹⁴ According to one participant, Japanese scholars seemed to be dragging down or watering down the outputs of these processes. A comparison of Memoranda 3 and 4 of the Fifth Network of East Asian Think-tanks shows the watering down in process. Eiji Yamashita, "Higashi Ajia Kyōdōtai No Kadai - FTA No Tsugi Ni Nani Wo Mezasu Beki Ka," in *30th Keio Monnet Workshop for EU studies* (Keio University: Keio, 2007).

⁴¹⁵ The idea for ERIA can be tracked back to Trade Minister Nikai Toshihiro, and further back to METI's Asia-Pacific Bureau Chief Watanabe Osamu.

⁴¹⁶ The establishment of the ERIA in Jakarta is an interesting story in its own right. With Japan footing the bill, ASEAN countries were falling over themselves in a bid to host the secretariat – aware of course that the ERIA might become a truly important institute in the future. The squabbling of ASEAN meant that Japan had to make a political choice, and eventually chose to house the ERIA in Jakarta temporarily until consensus might be reached. The Indonesian government has in true ASEAN style made this temporary housing a *fait accompli* (over the wishes of its partners in ASEAN) by issuing a MOU formalising the ERIA as an international institution (for tax purposes) and building the ERIA Annex. Author's Interview with Shiraishi Takeshi, May 20 2009. Tokyo.

It is clear however that ERIA is Japan's creature, designed at least in part to further Japan's interests in the CEPEA.⁴¹⁷ Japan initially committed 10 billion yen over ten years to the institute. Later, all three of the non-core regional members in a future FTA, India, Australia and New Zealand would each contribute symbolic sums of roughly USD one million to ERIA.⁴¹⁸ The research being conducted at ERIA is also influenced by its institutional link to the prominent Japanese research body, the Institute of Developing Economies at the Japan External Trade Organization, and has therefore picked up Japan's preference for the CEPEA.

4.4 Authority: A JASEAN Mothership?

Japan's exclusion of China in the FTAs has gone hand in hand with a strategy of trying to build a Japan-ASEAN hub. Japan is not been able to do so, but was in theory the most likely site for a trade hub at the time when these FTAs negotiations begun (see Appendix 5). Indeed, if Japan were to conclude an FTA with China it would have significant negative impacts on the economies of ASEAN.⁴¹⁹ The ASEAN manufacturing sector does not enjoy relative competitive advantage versus China, and ASEAN economies have already seen Japanese investment gravitate North. ASEAN's position in the Japanese production network would be fatally undermined if China was given preferential treatment.⁴²⁰

The idea of locking ASEAN into the Japanese production network was also reflected in the 'JASEAN' axis that Koizumi proposed, Japan and ASEAN being the core of East Asian integration with China and others being invited in.⁴²¹ For Japan, these FTAs are seen as

⁴¹⁷ Member of the Academic Board - Author's Interview with Urata Shūjiro, 8 February 2010. Tokyo.

⁴¹⁸ Japan used the ERIA (in conjuncture with IDE-JETRO) to launch three major events, culminating in PM Hatoyama giving a speech at the Tokyo ERIA symposium. In addition, ERIA received visits from former PM Fukuda (2NOV08), former METI Minister Nikai (21OCT08), Minister for Foreign Affairs Okada and Transport Minister Maehara (12MAR09) and well as Ambassadorial visits. And yet *China has yet to make any formal visits to ERIA*. Hidetoshi Nishimura, "The Progress Report of Eria," (Jakarta: Economic Research Institute for East Asia and ASEAN, 2009).

⁴¹⁹ Inkyo Cheong, "Estimation of Economic Effects of Ftas," in *East Asian Economic Regionalism*, ed. Richard Baldwin, Inkyo Cheong, and Choong Yong Ahn (Dordrecht: Springer, 2005). pp.150-3

⁴²⁰ Even competing under equal treatment for ASEAN is difficult. To escape the implications of a CJFTA, ASEAN would have to turn to capital intensive production - which would in turn require an increased, and yet more unlikely role for Japan. Kazuhiro Igawa and Bonggil Kim, "East Asian Free Trade Agreement; Strategic Aspects for Japan," in *East Asian Economic Regionalism*, ed. Richard Baldwin, Inkyo Cheong, and Choong Yong Ahn (Dordrecht: Springer, 2005). pp. 32-3

⁴²¹ Koizumi talked about the JASEAN plus two (China/Korea) but this bald-faced attempt to turn the APT, with ASEAN at its core, into a JASEAN Plus forum would have obviously placed the ASEAN states in a diplomatic alliance with Japan against China – doomed to fail. Kazuhiko Togo, "Japan and the Security Structures of Multilateralism," in *East Asian Multilateralism: Prospects for Regional Stability*, ed. Kent Calder and Francis Fukuyama (Baltimore: JHU Press, 2008).

the building blocs of a Japan-led regional trade network. As Kimura notes, "FTA's are expected to contribute to the development of international networks of production and distribution with Japanese firms as their core."⁴²² As if to highlight this the first FTA Japan signed, with Singapore, was developed to be model for future bilateral FTAs with ASEAN - and to pressure ASEAN countries to enter into FTA talks with Japan.⁴²³ Indeed, Singapore's interest in the Japan-Singapore EPA was to avoid becoming a 'spoke'⁴²⁴, by sublimating itself into (what it perceived as) the Japan-centred hub in East Asia.⁴²⁵ Maki notes that Konno Hidehiro, Director of the Trade Policy Bureau at Ministry of International Trade and Industry regarded the ROK-FTA first priority, then ASEAN and finally Singapore. This is because Singapore would never be valuable as a part of hub building strategy.⁴²⁶

Indeed, the FTA with Singapore did not provide a sufficient hub-ness 'bang' because of a lack of tariff liberalization on Japan's side. Japan's imports from Singapore under zero-tariff entry increased to 93.8% from 84.2% but that increase reflected only liberalization in industrial goods. The share of agricultural produce imported at the zero tariff rate rose from 6.6% to 6.9%, a marginal increase from a low base (agriculture represented less than 5% of Singapore exports to Japan). For other Southeast countries, for whom agriculture's share of exports to Japan was more significant (e.g. Malaysia 13%), this result promised little. In practice the effects of the Japan-Singapore FTA on the economies of Japan and Singapore were so small as to be negligible.⁴²⁷

4.4.1 Hubs, spokes and building blocks

Unsurprisingly, other ASEAN members did not clamour to join the Japan-FTA hub.⁴²⁸

⁴²² Kimura as cited by Aurelia George Mulgan, "Japan's FTA Politics and the Problem of Agricultural Trade Liberalisation" (paper presented at the Symposium on Australia and Free Trade Agreements, Australian National University, 1-2 November 2007).

⁴²³ Takashi Terada, "Constructing an 'East Asian' Concept and Growing Regional Identity: From Eaec to Asean + 3," *The Pacific Review* 16, no. 2 (2003).

⁴²⁴ Richard Baldwin, "The Spoke Trap," in *CNAEC Research Series 04-02* (Seoul: KIEP, 2004). See his discussion on anti-spoke strategy,

⁴²⁵ Ashihara Yoshihiro, "Nihon Shingapōru Epa," in *Kaisetsu: FTA/EPA Kōshō*, ed. Watanabe Yozumi (Tokyo: Nikkyōhyō, 2007). p. 49

⁴²⁶ Maki Aoki, "New Issues in Ftas," in *Working Paper No. 8* (Tokyo: IDE-JETRO - APEC Study center, 2004). p. 5

⁴²⁷ This is not to say that there were no effects; notably, a Kirin Beer factory moved back to Japan, from China, to take advantage of the EPA with Singapore. Takashi Terada, "The Making of Asia's First Bilateral FTA: Origins and Regional Implications of the Japan-Singapore Economic Partnership Agreement," *Pacific Economic Papers* 354(2006). p. 19, Japan-Singapore Economic Partnership Agreement have been estimated to increase the income of Japan by \$6.9 billion and that of Singapore by \$0.4 billion, moreover Japan is to accrue most (70%) of the gains as it will undertake most of the reforms, according Thomas Hertel, Terrie Walmsley, and Ken Itakura, "Dynamic Effects of The "New Age" Free Trade Agreement between Japan and Singapore," *Global Trade Analysis* (2001).

⁴²⁸ As discussed later, the Rules of Origin for the JSEPA was 60%RV, c.f. 40% in the AFTA and ACFTA, a new and more difficult standard.

Nogami Yoshiji, the then Vice Minister of the Ministry of Foreign Affairs, put paid to this by saying, “an [FTA] agreement with Singapore alone would not carry enough weight. We need something that will give us a bigger bang.”⁴²⁹ Within Japan, the idea for a JASEAN hub progressed, now focusing on a Japan-ASEAN FTA rather than bilaterals. In 2003 the ASEAN–Japan Research Institute Meeting called for a Japan–ASEAN FTA to be a building block for broader East Asian Free Trade arrangements, the effect of which would be the standardization of trade rules, with potential benefits to Japan of between one and two trillion yen.⁴³⁰ Interestingly, the same ambition was held by some in China. The former Chinese Vice Minister of Foreign Trade and Economic Cooperation Long Yongtu believed that China could play a leadership role with the China–ASEAN FTA by creating “very useful stepping stones to an eventual East Asian economic integration.”⁴³¹

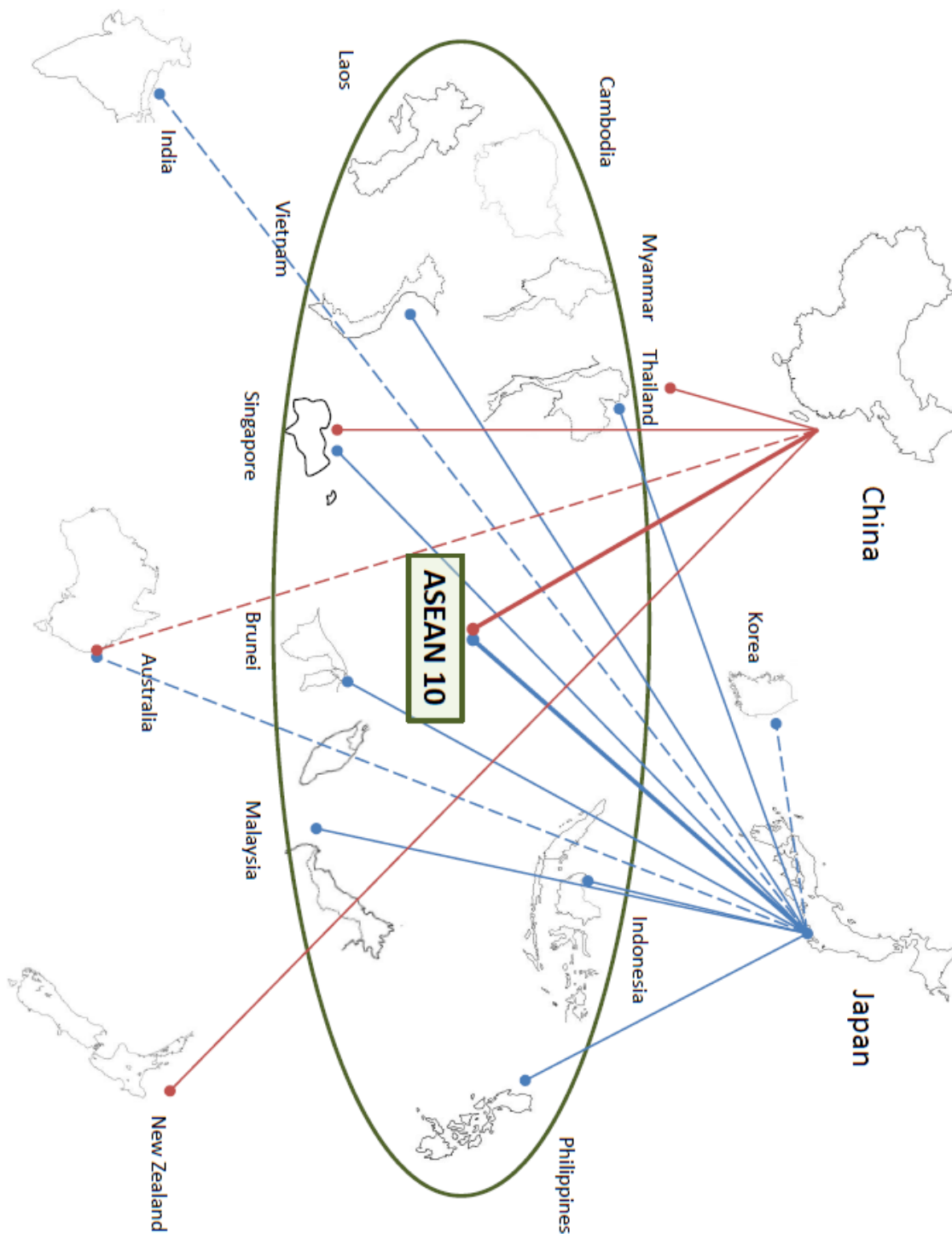
However, as highlighted earlier, Japan had not considered joining an FTA with China. By avoiding an agreement (although an offer was on the table as early as 2001) Japan has been forced to try and build a hub centred on its own economy. The result of this however has been to creation of bilaterally-networked trade regionalism (also also called the East Asian noodle bowl) with China and Japan as the competing hubs, see Figure 12 overleaf.

⁴²⁹ Straits Times 25 October 2000 in Takashi Terada, “The Making of Asia’s First Bilateral FTA: Origins and Regional Implications of the Japan-Singapore Economic Partnership Agreement,” *Pacific Economic Papers* 354(2006). p. 19

⁴³⁰ Saori Katada, Saadia Pekkanen, and Mireya Solis, “Trading Gains for Control,” *International Studies Quarterly* 51(2007). pp. 958-9

⁴³¹ Takashi Terada, “Forming an East Asian Community: A Site for Japan-China Power Struggles,” *Japanese Studies* 26, no. 1 (2006). p. 9

Figure 12 East Asian Noodle Bowl: View from Japan/China



Source: Generated by Author

Note: Dotted line means under negotiation, Full line means FTA concluded.

This section argues that the interaction of domestic and international factors has meant that this JASEAN hub has created a bilaterally-networked trade structure rather than single uniform trade area. In order to demonstrate how Japan's unwillingness to cooperate with China and its consequent efforts to build an FTA centred on its own economy have resulted in hub-and-spoke, bilaterally-networked trade regionalism it is necessary to examine each of these agreements in turn.

4.4.2 Malaysia

Unfortunately for Japan, the next FTA after Singapore signed also failed to net any regional leadership on trade matters. While Prime Minister Badawi of Malaysia was pleased with being able to take credit for the 2005 signing of the Japan-Malaysia EPA as a 'diplomatic coup' at the APT summit; speaking as ASEAN chair, he voiced concerns that "this [bilateral] approach by Japan may give rise to two classes of ASEAN members, those with full bilateral EPAs with Japan, and those without." Moreover, he noted that, in reference to Japan's bargaining position, "the negotiations are not progressing satisfactorily [for ASEAN]."⁴³² In Baldwin-ian terms, he was telling Japan that ASEAN wanted to be in the hub, not just one of the spokes.

While Japan was of course keen to spin the agreement as a "new era for the Japan-Malaysia strategic partnership,"⁴³³ the agreement was not viewed favourably in Malaysia.⁴³⁴ Indeed, there were concerns within Malaysia that the Japanese had gained more concessions from Malaysia than *vice versa*. In fact, Japan gained an additional 32% reduction in zero-tariff entry over previous rates while Malaysia gained 8%.⁴³⁵ This was because Malaysia chose to prioritize technical assistance in the car market over market liberalization in Japan. This defection by Malaysia and Japan from deeper liberalization (a benefit that all of ASEAN might expect to share in their future negotiations with Japan) towards assistance (only of use to Malaysia) weakened of the appeal of Japan as an EAFTA hub for others in ASEAN. However, the provisions still ratcheted up pressure on the

⁴³² "Japan Asked to Extend Economic Pact to All Asean Members," *Xinhua News*, 13 December 2005.

⁴³³ M Saraswathi, "M'sia-Japan Pact to Cut Tariffs for 97pct of Goods Traded," *Bernama Daily Malaysian News*, 10 December 2005.

⁴³⁴ Indeed, the bureaucrats in charge of negotiating the deal with Japan complained bitterly about the Japanese negotiation strategy – Japanese often running meetings late into the night to elicit the answer desired. Failing to take into account both that the Malay side wakes early for prayer and must drive for hours to back to their houses and families whereas the Japanese stayed in a hotel in town. For more of these details, see Isono Satoshi, "Nihon/Marēshia EPA," in *Kaisetsu: FTA/EPA Kōshō*, ed. Watanabe Yorizumi (Tokyo: Nikkyōhyō, 2007). pp. 92-3

⁴³⁵ Indeed, Malaysia agreed to abolish tariffs on 99% of its imports from Japan while Japan agreed to abolish 94% of its imports from Malaysia. Further, because Japan's tariffs were already lower than Malaysia's, duty-free goods constituted 86% of Japan's imports from Malaysia versus 67% of Malaysia's imports from Japan, Japan gaining an additional 32% over previous tariffs rates while Malaysia gained 8%, a fourfold difference. See, "Japan-Malaysia Economic Partnership: Joint Study Group Report," (2003). p. 6

member nations of ASEAN, and made exclusion from the Japan hub more costly.⁴³⁶

4.4.3 Philippines

Likewise, the negotiations with the Philippines, and the subsequent Japan-Philippines EPA, did not further Japan's objective of building a JASEAN hub. However, even the small economy of the Philippines was viewed as a part of a larger project, with Asō Tarō stating in a Diet Foreign Affairs Hearing, "by signing an FTA with Japan, the Philippines (which is a little slow economically in ASEAN) can improve its economy and I expect political relations with Japan and in this way the East Asia community can be formed."⁴³⁷ For its part, the Philippines government proposed its EPA be modelled after the Japan-Singapore agreement, hoping to attract FDI to leverage economic development and poverty reduction.⁴³⁸ Yet the Philippines was forced to sideline its important developmental interests to make way for Japan's WTO-plus agenda. Japanese delegates "repeating that an EPA should not be focussed too narrowly on tariff reductions."⁴³⁹ An agreement was only reached when the Philippines conceded to delay negotiations on the elimination of tariffs on sugar for four years in order to satisfy Japan's demands.⁴⁴⁰

After the agreements with Malaysia and Singapore, Japan's bilateral approach in concluding FTAs had created 'spokes' – and the trade diversion effects meant that for the Philippines remaining outside of an FTA with Japan had become too costly. It was after all the Philippine side which approached Japan in May 2002 – not the other way around. One of these spoke effects was the re-ordering of the Philippines' priorities; forcing the Filipino negotiation team to accept a less beneficial agreement than if they had negotiated as part of an ASEAN Free Trade Area (AFTA) bloc.⁴⁴¹ As one Philippine officer involved noted, "the costs of non-participation... [means] that the Philippines would lose around 0.04% of GDP if we do not forge an FTA with Japan while Thailand does.... hence, forging a bilateral agreement with Japan at this time is a very strategic move."⁴⁴² In other words, just to hold onto their position in the regional economy required signing up, even if the Philippines

⁴³⁶ Japan-Malaysia FTA is signed with all the usual North-North surveillance, enforcement and adjudication provisions which might be an addition turn off for the smaller ASEAN players, see Richard Baldwin, "Multilateralising Regionalism: Spaghetti Bowls as Building Blocs on the Path to Global Free Trade," in *The World Economy* (Nottingham: Blackwell, 2006). p. 1494

⁴³⁷ Diet Foreign Affairs Committee, *Asō Tarō Addresses The*, November 1 2006.

⁴³⁸ Maki Aoki, "New Issues in Ftas," in *Working Paper No. 8* (Tokyo: IDE-JETRO - APEC Study center, 2004). p. 15

⁴³⁹ "Japan-Philippines Economic Partnership Agreement-Joint Coordinating Team Report," (Manila2003).p4-5

⁴⁴⁰ Takashi Terada, "The Making of Asia's First Bilateral FTA: Origins and Regional Implications of the Japan-Singapore Economic Partnership Agreement," *Pacific Economic Papers* 354(2006). p. 24

⁴⁴¹ Yurika Suzuki, "Firipin Jiyuuka to Sangyou Ikusei No Jirenma," in *FTA No Seiji Keizai Gaku*, ed. Shigeki Higashi (Chiba: IDE-JETRO, 2007). pp.118-9

⁴⁴² Josef Yap, "Assessing the Japan-Phillipines Economic Partnership Agreement (Jpepa)," in *Philippine Inquirer* (Manila: Philippine Institute for Development Studies, 2006). p. 5

would not actually gain anything new. In contrast, failure or success meant little to the Japanese as the actual economic effects were expected to be so small as to be within the margin of error.⁴⁴³

One component of the EPA which might have won praise was the liberalization of the movement of natural persons, particularly visas for Philippine nurses and other medical staff to work in Japan. However, Japan continued to insist on a high degree of competence in both Japanese language and specialist skills, while at the same time failing to clarify those standards despite requests from the Philippine side to do so.⁴⁴⁴ Moreover, like technical assistance, concessions in this area could not be rolled over into other FTAs under negotiation, and for these reasons the Japan-Philippines EPA did not act as a stepping stone towards a larger regional trade arrangement. Indeed, from the perspective of the Philippines, the EPA delivered much less than expected.⁴⁴⁵ Moreover, the JPEPA's legitimacy was further damaged once it had been rail-roaded through the Philippine's parliament over serious constitutional concerns.⁴⁴⁶ As a result, Japan failed to gain any political credit from the EPA.

4.4.4 Indonesia

In August 2007, Japan also finally signed an FTA agreement with Indonesia, having declared the agreement concluded nearly a year earlier. This delay was due to the Indonesian side attempting to re-negotiate parts of the deal which they realized only after concluding negotiations would carry too many costs.⁴⁴⁷ As with previous negotiations,

⁴⁴³ According to the study conducted by Urata and Kiyota 2003, Japan was predicted to gain nothing of economic value, one would think therefore that focus should have shifted to political concerns, as cited in "Japan-Philippine Economic Partnership Agreement: Joint Coordinating Team Report," (2003). p. 7

⁴⁴⁴ Maki Aoki, "New Issues in Ftas," in *Working Paper No. 8* (Tokyo: IDE-JETRO - APEC Study center, 2004). p. 19, it seems likely that many of these Pilipino workers will fail the language test at the end of their terms and be sent back home. This is unlikely to be the kind of cultural exchange Japan envisaged. , Indeed the Philippine side provided the Japanese side with comparisons of qualification and distribution/success of similar plans but the Japanese would provide information about the Japan market need for medical staff for these details see, "Japan-Philippines Economic Partnership Agreement-Joint Coordinating Team Report," (Manila2003). p. 17

⁴⁴⁵ With most of the Japanese corporations in the economic zones, the gains to the everyday Pilipino was negligible. In fact, the welfare gain from the JPEPA favoured the upper and upper middle house houses, and did not contribute to poverty reduction as initially advertised by Japan. See, Lydia Yu-Jose, "Phillipines-Japan Economic Partnership: Where Is the Philippines in Japan's Plan," in *Discussion paper series* (Manila: the Philippine Insitute for Development Studies, 2004). pp. 19-20, and Taeko Yasutake, "Philippines-Japan Free Trade Agreement: Analyzing Its Potential Impact Using a Computable General Equilibrium Model," in *Discussion Paper* (Philippine Institute for Develop Studies, 2004).

⁴⁴⁶ Moreover, after disputes about processing industrial waste and foreign ownership the agreement had to be rushed past the senate to avoid awkward questions about its constitutionality (interestingly also true also of Thailand). Emir Castro, "Landmark Japan-Philippines Trade Deal: A Recap," *Business World*, January 8 2009. Protests and the general perception that the JPEPA was lopsided to favour Japan given creed by the right accorded Japanese not to transfer technology to the Philippines and the right not to hire any local Philippine staff.

⁴⁴⁷ Satō Yuri, "Indonesia," in *FTA No Seiji Keizai Gaku*, ed. Higashi Shigeki (Chiba: IDE-JETRO, 2007). pp. 173-4, Japan

Japan believed that its other FTAs/EPAs had put pressure on Indonesia to join its hub.⁴⁴⁸ From Japan's point of view the special feature of the Indonesian FTA was that energy was included. Japan had initially proposed pre-negotiated contracts for Indonesian energy resources, although this component fell through.⁴⁴⁹ Energy had featured in other FTAs as well, although rarely as prominently.⁴⁵⁰ Instead, the EPA signed contained capacity building to help (make cheaper) Indonesian energy extraction and processing for export, although Japan was not able to lock itself in as the preferred client.⁴⁵¹

4.4.5 Thailand

In November 2007, the Japan-Thai EPA went into effect, having been signed earlier in April of that year. It was clear that Thailand would be a net winner from any EPA/FTA agreed with Japan. One simulation conducted by Japanese researchers revealed that real GDP in Thailand would increase by a staggering 20.09%, this would represent an increase in national welfare of US\$23 billion in Thailand, compared to Japan's projected US\$13 billion.⁴⁵² Although the early decision (discussed later) to exclude rice from the negotiations no doubt caused upset some in Thailand, by and large the EPA was basically well received in Thailand.⁴⁵³ This is despite the fact that decision to ratify the EPA with Japan was not made by a democratically elected parliament but by the military, which had taken control in another of Thailand's too often coup-d'états. In terms of increasing Japan's hub-ness, the

was playing hard ball, proposing to negotiate the EPA as a single undertaking which would allow to use its depth of competence to take advantage of yet unlearned Indonesians, the Indonesia team believed at this time that they would 'learn by doing' and a single undertaking would limit this vital learning time. Japan is a huge player, and came with an experienced and competent team, whereas Indonesia had had no bilateral negotiation experience until that time.

⁴⁴⁸ Takashi Terada, "Constructing an 'East Asian' Concept and Growing Regional Identity: From Eaec to Asean + 3," *The Pacific Review* 16, no. 2 (2003).

⁴⁴⁹ Japan is dependent on Indonesia to provide natural gas, 28.6% in 2005 its largest supplier, coal 10.5% third largest and Oil 2.7%. Japan wanted to lock-in its access to this strategic commodity in the EPA, as its contract for gas would expire in 2010. Indonesia was however unwilling to pre-negotiate contracts for natural resources, rising prices of natural gas on the world spot market (in part no doubt due to China's growing thirst for energy) is surely the reason, although the exact series of moves that resulted in Indonesia taking this valuable chit away is unknown still. See, Yuri Satou, "Indonesia," in *FTA No Seiji Keizai Gaku*, ed. Shigeki Higashi (Chiba: IDE-JETRO, 2007). pp. 173-4

⁴⁵⁰ A similar pattern would occur in the Brunei EPA negotiations in which Japan pressed for security of supply of natural resources such as LNG and Petroleum (which together make up 100% of Brunei's exports to Japan) and had to settle for a dialogue mechanism within the EPA to resolve any problems that might arise. See Shūjiro Urata et al, *FTA Gaido Bukku 2007* (Tokyo: Jetro, 2007). p. 129

⁴⁵¹ Yuri Satou, "Indonesia," in *FTA No Seiji Keizai Gaku*, ed. Shigeki Higashi (Chiba: IDE-JETRO, 2007). pp. 177-8

⁴⁵² "Japan-Thailand Economic Partnership Agreement Task Force Report," (2003). pp. 65-6, study conducted using a Computable Generalised Equilibrium (GCE) modelling, welfare figures derived from Equivalent Variation modelling. But this number still looks too high c.f. the other FTAs signed.

⁴⁵³ Notwithstanding the issue that a military regime signed the agreement after promising not to, which dragged out time from signature to activation and further not withstanding its name as a "Thai Cooks" agreement whereby low-skilled workers would come to Japan. Questions were raised about providing JTEPA visa for "Spa service producers" as a by word for prostitution, technically illegal in Japan, as well as health workers and export of toxic waste.

JTEPA would be significant as the Thai machinery sector was highly competitive.⁴⁵⁴

4.4.6 ASEAN-Japan Comprehensive Economic Partnership (AJCEP)

These bilateral trade agreements were creating a hub-and-spoke trade network centred on Japan. However, at the same time, another hub was being developed in the China-ASEAN agreement. Japan's preference for bilateralism in FTA negotiation stood in contrast to China's decision to deal with ASEAN as a group. China's decision to negotiate with ASEAN as a group did much to allay fears and won China important political points with ASEAN as a whole.⁴⁵⁵ Japan, on the other hand, at first seemed unaware or apathetic about undermining ASEAN's precious unity.

In an attempt to facilitate trade between Japan's ASEAN 'spokes' and reinforce the JASEAN hub, Japan developed its region wide FTA proposal. In November of 2007, this ASEAN-Japan EPA agreement was concluded. The AJCEP's rationale had been made clear in a 2003 Joint Study Report, citing ASEAN's desire to increase its competitiveness, and Japan's interest in protecting and developing its manufacturing network in ASEAN, under pressure from the rise of Chinese industrial power.⁴⁵⁶

But underlying this change in approach lay political considerations towards ASEAN. As one JETRO official noted, even though signing an AJCEP (including with the CLM countries) was considered a waste of Japanese time and manpower, the AJCEP went ahead because of pressure put on the Japanese government by ASEAN countries concerned about their unity.⁴⁵⁷ Not surprising, the AJCEP would offer little new, one Vietnamese official commented that Japan's FTA proposal seemed to be a hastily-put-together affair that was 'all show' and 'little substance' and that its main purpose, not stated, was to counter the FTA proposal floated by China to ASEAN."⁴⁵⁸

Economic modelling suggested that the gains of the AJCEP would be limited for Japan.

⁴⁵⁴ One JETRO official noted in interview with author that the JTEPA was the cause of the closure of the Adelaide Honda plant in 2008, and that Japan's preferences to Thailand in car and car parts meant others in ASEAN would eventually be forced to abandon their insistence on having agriculture included in their FTAs. Author's Interview with Japan External Trade Organisation Official Sukegawa Seiya, 12 March 2009. Tokyo.

⁴⁵⁵ The fact that China had to deal with ASEAN as bloc speaks of the basic lack of trust, indeed it was this trust that China was hoping to win in ASEAN rather than market access per se.

⁴⁵⁶ "Asean-Japan Comprehensive Economic Partnership: Vision and Tasks Ahead," (Tokyo: ASEAN-Japan Research Institute Meeting, 2003). p. 2

⁴⁵⁷ Author's Interview with Japan External Trade Organisation Official Sukegawa Seiya, 12 March 2009. Tokyo.

⁴⁵⁸ Business World, February 27 2002 in Takashi Terada, "The Making of Asia's First Bilateral FTA: Origins and Regional Implications of the Japan-Singapore Economic Partnership Agreement," *Pacific Economic Papers* 354(2006). p. 25

With the bilateral FTAs already covering the major economies, adding in the smaller CLMV countries only made sense from a political perspective. The modelling suggested that by 2020, the GDP of ASEAN members countries would increase by an average of nearly 2%, while Japan's GDP would edge forward by 0.07%. In absolute number terms however the parties would be more closely balanced. The national welfare of Japan expected to increase by US\$4.59 billion to ASEAN's US\$5.59 billion from the base year of 1997.⁴⁵⁹ However, this modelling did not take into account the existence of the alternative bilateral FTA structure and that much of these economic benefits were thus already in the pipeline; in other words the limited marginal utility of AJCEP for Japan. Indeed, economically it made little sense for the major ASEAN powers either, except as a symbol of their unity.

From the point of view of building up a regional hub, Japan and ASEAN concluded a less than meaningful trade pact as a result of the basic lack of interest on both sides. Yet regional integration was the stated goal, with the AJCEP aiming to allow intra-regional trade not merely between Japan and its partner but amongst its partners as well (See Appendix 6). However, an examination of the actual structure of concessions reveals that this is rhetoric.

First, ASEAN partners of Japan are more likely to use their individual bilateral FTAs than the AJCEP for exporting to Japan. The tariff rates in ASEAN members' individual bilateral agreements are simply more generous than the subregional pact (See Table 2 overleaf). Indeed, Malaysia has not a single item which attracts a more favourable tariff rate under the AJCEP than with the bilateral.

⁴⁵⁹ "Joint Report of the Asean Japan Closer Economic Partnership Expert Group: Executive Summary," (2003). The report also states that the FTA would contribute to world peace, despite the previous notion, particularly *vis* Japan, of trade blocks being a cause of war.

Table 2 Tariff preferences comparison between AJCEP and Japan's bilateral Agreements

NOTE:
This figure is included on page 112 of the print copy of the thesis held in the University of Adelaide Library.

Source: Japan External Trade Organization

Secondly, ASEAN members of the AJCEP are more likely to use their AFTA preferences to trade amongst each other rather using AJCEP. Firstly, the AFTA provides better tariff rates with 69% of all tariff lines zeroed compared to 48% under the AJCEP. Additionally, it seems the deciding factor in usage is Rules of Origin and the AFTA's established history. The AFTA has simpler rules for establishing regional content, and the AFTA has been in existence since 1992 thus local companies are more familiar with it.⁴⁶⁰

Additionally, the AJCEP was noticeably silent about other assistance, such as liberalization of the movement of natural persons.⁴⁶¹ The effect of this silence is to create two classes within Japan's FTAs, the developed ASEAN countries which concluded a bilateral agreement receiving preferential treatment for labour mobility compared to their poorer cousins. In addition, the developed ASEAN countries received access to technical assistance to their individual economies, a facility which will not be available to the smaller countries in the AJCEP.

4.4.7 Utilization Rates

Evidence of the weakness of Japan as trade hub can be found in the low utilization rates of these FTAs. The data - the number of trading companies actually using the preferences, is still incomplete and derived mostly from company surveys. In general though, utilization rates below 50% are considered low by European and American standards.⁴⁶² All of Japan's bilateral FTAs/EPAs have utilization rates lower than 50%, according to one survey

⁴⁶⁰ Author's Interview with Japan External Trade Organisation Official Sukegawa Seiya, 12 March 2009. Tokyo.

⁴⁶¹ Joseph Purugganan, "Preliminary Comments on the Asean-Japan Comprehensive Economic Partnership," *Focus on the Global South* (2008). Trade in Textiles also harmonised the 'double jump' rule, allowing for regional content requirements to be satisfied if two processes were undertaken in the 'region.'

⁴⁶² P. Michael Gasiorek Augier and Charles Lai Tong, "The Impact of Rules of Origin on Trade Flows," *Economic Policy* 43(2005).

the usage rate for Japan-Singapore FTA was just 3.6% and the Japan-Malaysia FTA just 5.5% in 2007. Another survey put the figure at 12.5% on average, but even this larger number is viewed as depressingly small.⁴⁶³ Another survey which asked companies about the importance they placed on various FTAs saw the AJCEP placed third after AFTA, and the ASEAN-China Free Trade Area (ACFTA).⁴⁶⁴

Taken together, Japan's rejection of China and selection of ASEAN as starting point for a trade area has meant that trade regionalism in East Asia still lacks a crucial hub. A Japan-ASEAN hub, were it to share a common schedule of significant tariff reductions, might be able to function as an East Asian trade hub and form the institutional basis into which China and Korea might later be integrated. Instead, Japan's bilaterally-networked approach, which has allowed it to differentiate between its trade partners, has meant that tariff concessions in one negotiation do not spill over in following negotiations, creating a situation in which significant tariff cuts are not realized and no common regional schedule is created.

4.5 Scope: Excluding Agriculture, Including Assistance: Domestic and International Factors

Another feature of Japan's FTA network is the exclusion of agricultural goods. While Japan's decision to exclude agricultural products is made for domestic political reasons,⁴⁶⁵ Japan's determination to nevertheless press ahead with FTA negotiations is revealing.⁴⁶⁶ Indeed, in order to close the FTA deal Japan has been willing to provide assistance into to 'cover the gap' which emerged due to Japan's inability open its agricultural sector.⁴⁶⁷ I

⁴⁶³ Takahashi in Mireya Solis and Shūjiro Urata, "Japan's New Foreign Economic Policy: A Shift toward a Strategic and Activist Model," *Asian Economic Policy Review* 2(2007)., Another study JETRO revealed that only 5.1% of Japanese firms were using FTA preferences, of which 3.3% were using the AFTA. Firms looked forward to AJCEP as means of bypassing the direct shipment requirement in the JMEPA.

⁴⁶⁴ Masahiro Kawai and Ganeshan Wignaraja, "The Asian "Noodle Bowl": Is It Serious for Business?," (Tokyo: ADB, 2009). p. 15

⁴⁶⁵ Some have also suggested that were Japan to make a concession on agriculture in its FTAs with ASEAN, or Korea, or Australia then it would enter future negotiations with the US on a weaker footing. Author's Interview with Urata Shūjiro, 8 February 2010. Tokyo. , see especially Aurelia George Mulgan, "Japan's FTA Politics and the Problem of Agricultural Trade Liberalisation" (paper presented at the Symposium on Australia and Free Trade Agreements, Australian National University, 1-2 November 2007).

⁴⁶⁶ It is especially interesting as Japan does not have any *Zoku-giin*, or small interest groups of politicians, for FTAs. This point was made during the Author's Interview with Terada Takashi, 9 March 2010. Tokyo.

⁴⁶⁷ This problem emerges for Japan because as Developed member country of the WTO it is obliged (unlike China which can use the enabling clause) to conclude FTA which substantially liberalise trade – usually interpreted to mean 90% of trade. If agriculture makes up more than 10% of trade with Japan (by volume or value) then Japan usually offers to make up the difference in assistance. This is mostly about side-stepping WTO disciplines.

suggest here that competition with China has been an important factor in shifting the scope of Japan's EPAs to include economic assistance at a cost to trade regionalism.

Indeed, Japan has insisted on excluding trade in the one sector where ASEAN countries are generally more competitive - even taking pains to exclude the one or two specific produce lines which its partner would be most interested in: Goldfish and Tulips in the case of Singapore (Singapore only competitive agricultural exports), Pineapples, Plywood and Milk in the case of Malaysia, Sugar in the case of Philippines, and Rice in the case of Thailand.⁴⁶⁸ The effect of this reluctance by Japan has been to require it to grant more assistance if Japan was to successfully close the deal. In fact, the Indonesians deliberately targeted the farm sector as a negotiation strategy, pressing for liberalization on areas Indonesia itself was unsure of in order to elicit the maximum economic concessions from Japan in other areas.⁴⁶⁹

Why is Japan so keen to conclude an FTA with small economies of marginal value, especially when Japan must offer costly additional assistance in order to close the deal? The inclusion of assistance to Malaysia's domestic car manufacturers comes at an obvious cost to Japan's competitiveness in the Malay domestic car market. If protecting its agricultural sector was Japan's only goal, then simply avoiding FTAs with ASEAN would have been quite sufficient. Since these FTAs do not promise major economic returns, and some (like the Philippine EPA) are even considered as a form of 'poverty reduction' assistance by another name⁴⁷⁰, it is puzzling that Japan chooses to sign on at all - unless the wider political factors, especially the China factor, are considered.

It appears that China's move to form an FTA with ASEAN pressured Japan to respond in

⁴⁶⁸ Japan's reticence to include agricultural items can be seen in the choice of Singapore as the initial FTA partner. While it is true that Japan committed to a (modest) 14% increase in the number of zero-tariff agricultural items within the JSEPA, this was not over and above the commitments Japan had already made at the WTO. In other words Japan did not liberalise any agricultural products, keeping tariffs on more than 2,000 farm products (including tulips and live goldfish, Singapore's only competitive primary produce). Similarly, the Japan-Malaysia FTA contains some concessions from Japan on agricultural and forestry items, but excludes key Malaysian exports such as plywood, pineapples and milk products. Thailand too, despite being major producer of rice, was forced to exclude rice from its bilateral agreement. Indonesia too relented, despite the fact that getting concessions in agricultural goods was more vital to Indonesia than even Thailand. See, Takashi Terada, "The Making of Asia's First Bilateral FTA: Origins and Regional Implications of the Japan-Singapore Economic Partnership Agreement," *Pacific Economic Papers* 354(2006). p. 19, 25. Mangoes (and Mangotines) are however included in the FTA, although it is fair to say that Japan does not have a competitive advantage in these items. Plywood is Malaysia bulk item to Japan, "Japan-Malaysia Economic Partnership: Joint Study Group Report," (2003). p. 8, Maki Aoki, "New Issues in Ftas," in *Working Paper No. 8* (Tokyo: IDE-JETRO - APEC Study center, 2004). p. 21

⁴⁶⁹ Indonesia was willing to tie up the negotiations for months on this issue, aware that Japan will eventually have to close the deal and should be likely then to provide some more assistance, for the ruthless details see Satō Yuri, "Indonesia," in *FTA No Seiji Keizai Gaku*, ed. Higashi Shigeki (Chiba: IDE-JETRO, 2007). pp. 176-7

⁴⁷⁰ Author's Interview with Japan External Trade Organisation Official Sukegawa Seiya, 12 March 2009. Tokyo.

kind. For political reasons, Japan was unable to simply walk away from negotiations. The China-ASEAN FTA therefore seems to have acted as a juggernaut⁴⁷¹, forcing other players such as Japan to become involved despite their limited economic interests. In other words, if China had not moved first, Japan would not have faced much pressure to sign FTAs with ASEAN. Japan would not have then been required to provide as much economic assistance in place of tariff reductions.

While realism predicts that Japan would respond to the rise of China, the nature of that response is not described. A realist might argue that as a matter of national security it is only to be expected that Japan would protect its farming sector (in order to raise its already low self-sufficiency ratio). However, Japan's rational pursuit of its interests might just as easily take the opposite track, sacrificing the agricultural sector (a mere one percent of GDP) in order to realize much bigger gains in those sectors it is internationally competitive. Indeed, if FTAs are considered as an economic alliance, then concluding an FTA with the US and Australia which included secure supply of food would also be a possible response. In Japan's case, intervening variables on the domestic side have coloured its policy response and been responsible for a weaker form of trade regionalism.

4.6 Rules: Rules of Origin

From the outset the EAFTA project was aimed at creating a regional economic community. However, in order to become such a community, it is necessary that trade rules be common to all members. Japan's decision not to form an FTA with China first to which others might be invited has had the effect of preventing the formation of common rules.⁴⁷²

In the context of FTAs, the most important common rules are the Rules of Origin, or ROOs. The strictness of the ROOs determines how 'regional' a free trade area is.⁴⁷³ Without a

⁴⁷¹ For the Juggernaut effect on political-economic assessments to join or avoid FTAs see, Richard Baldwin, "Multilateralising Regionalism: Spaghetti Bowls as Building Blocks," *World Economy* (2006).

⁴⁷² As Grimes states, "Japanese negotiators fear Chinese hardball tactics if they are forced to enter existing Chinese arrangements. Moreover they argue that existing Chinese arrangements' ROOs, coverage of goods and services, and treatment of intellectual property, are inferior both to international standards and those of Japan's own FTAs, raising concerns that regional free trade will be highly attenuated and disadvantageous to Japan." See, William Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (New York: Cornell University Press, 2009). p. 61

⁴⁷³ Indeed GATT 1947 and GATT 1994 which were imbedded into the WTO made no mention of free trade areas or customs unions. There was agreement reached on ROOs at the Uruguay round (Annex II), but this was confined to non-preferential agreement. Indeed the work on ROOs at the WTO still seems a long way from completion, which has encouraged states to make do on an *ad hoc* basis. Basic principles of transparency and administrative standards and procedures such as judicial review and non-retrospectivity, and it is non-binding i.e. a dead-letter. See Imagawa and Vermulst, 2005 in Donald McLaren, "Rules of Origin" (paper presented at the Australia-China FTA Conference,

definition of what constitutes a regional product, all external countries would simply direct their trade via one of the FTA members in order to achieve tariff-free entry.⁴⁷⁴ With tighter ROOs in place, however, the FTA can be used to direct trade towards intra-FTA industrial linkages in preference to potentially cheaper world prices (or perhaps, the 'China price'). This means that an FTA with tight ROOs can be used to indirectly protect industries within the FTA from their rivals.⁴⁷⁵ Unsurprisingly, whichever state(s) maintains the regional FTA and thus determines its ROOs is usually the central economic power of its region, such as France and Germany for PANEURO and the US for the NAFTA ROOs systems.⁴⁷⁶

However, unlike in the Euro-zone or NAFTA, Japan has not championed a single set of ROOs. This means that the ROOs of each of Japan's FTA is, to one extent or another, unique. For example, both the Japan-Indonesia and Japan-Malaysia agreements require a higher percentage of regional Value Added (50%, rather than the base of 40%) for Export Sake or Mirin (clearly goods in competition with Japanese domestic producers) than other (non-producing) ASEAN countries. Malaysia is also held to a higher standard for automobiles (50%, and 60% for certain large, diesel motor vehicles). The Japan-Singapore agreement demands 60% regional content, except sparkling beverages (40%), before goods are considered regional and therefore tariff exempt. Even under the Umbrella Agreement, Japanese domestic politics interfered in creating a uniform system; agricultural products such as Coca beans also face differentiated ROOs for the Philippines and Thailand (50%).

Japan's FTAs also uses a complex mix of various metrics to determine regional content.⁴⁷⁷ This complexity stands in marked contrast to the AFTA and the ACFTA, which both use a simple, flat 40% regional Value Added criterion for tariff-exempt status (see Appendix 7). Importantly, these ROOs apply across all goods within the ACFTA, meaning that the ROOs

Shenzhen, 2006).

⁴⁷⁴ In this way, a Japan-Thailand FTA might see Thailand simply re-exporting Chinese manufactures to Japan rather than the FTA facilitating the growth of Thai industries. While from Thailand's point of view the re-exporting Chinese manufactures under a JTEPA would be economically beneficial, from Japan's point of view it would unacceptable. Economically, the reason is elementary – Thailand could re-export more third country goods to Japan (larger market) than Japan could to Thailand (smaller market) under a situation of no ROO in their FTA. Indeed, Auto-bike kits imported from China, assembled in Thailand and exported (attempted) to Japan under JTEPA ran into exactly this problem.

⁴⁷⁵ Kala Krishna, "Understanding Rules of Origin," *NBER Working Paper Series* 11149(2005). p. 4

⁴⁷⁶ PANEURO runs from the EU, EFTA states, Central and East European States and Mediterranean states with which there are separate agreements. Common ROOs function as a hegemonic marker of sorts, like a common currency etc.

⁴⁷⁷ In addition to the default value-added method, Japan uses were appropriate change in tariff headings on an either or basis. This is because "because the VA is preferred for some goods and CTC preferred for others, the construction of the ROO within an FTA affects the outcome, in terms of frequency used (usage rate) and the balance of trade between the two. Both sides will want the ROOs which favour their products entering the others markets." Author's Interview with Kiep Official Han Sung Kim, 3 June 2009. Tokyo.

are not functioning as non-tariff barriers to trade.⁴⁷⁸ China has been more upfront about sensitive sectors and opted to use the AFTA negative list approach, a political decision which typically smoothes negotiations and (in this case) acts as an obvious acknowledgement of ASEAN's role as a hub for economic integration in East Asia.⁴⁷⁹ Japan instead has tried to impose its own sets of rules, however inconsistently.

Another negative effect of Japan's decision to engage in a series of FTAs with inconsistent ROOs is that both Korea, and more recently, even China, have begun to follow Japan's lead. Indeed, some suggest that China's initial agreement to 40% Value Added in the ACFTA was due to the Chinese not understanding the importance of ROOs, the significance of which was only made clear with comparison to Japan's ASEAN FTAs.⁴⁸⁰ China's subsequent adjustment to the ROOs in its FTA with ASEAN can therefore be traced back to the Japanese precedent. After Japan, Korea too has signed an FTA with ASEAN. But this FTA contains even more irregular ROOs than that of Japan's, with many drawing the obvious conclusion that Korea learnt from Japan.⁴⁸¹ Adding evidence to this view that Japan is leading a default away from consistent ROOs is Korea's recent consideration of starting bilateral FTA negotiations on top of the ASEAN-Korea FTA to in order to copy Japan's success in opening ASEAN, or at least the individual members thereof.⁴⁸²

In conclusion, the effect of Japan's policy to avoid negotiating an FTA with China and rather to negotiate a series of bilateral FTAs with ASEAN and the umbrella AJCEP agreement has significantly weakened the EAFTA institutionalization process. It has created a situation in which the bilateral hub-and-spokes network centred on Japan may well hamper, rather than help, future efforts for deeper integration. This result is because by not signing a 'mother-ship' FTA with China which might both serve as a model and trigger for other FTAs in Asia, differences in the various bilateral FTAs with ASEAN, and between the AJCEP and the bilaterals, have made the creation of common Rules Of Origin all but impossible.⁴⁸³ This outcome can be explained from a realist perspective as a deficit of regional hegemony, the

⁴⁷⁸ Masahiro Kawai, "Evolving Economic Architecture in East Asia," (Tokyo: ADB Institute Discussion Paper No. 84, 2007). p. 12

⁴⁷⁹ Carsten Fink, "East Asian Preferential Trade Agreements in Services: Liberalization Content and WTO Rules," *World Trade Review* 7, no. 4 (2008).

⁴⁸⁰ Further evidence for the lack of understanding on China's side can be found in the fact that, the first six negotiations of the China-New Zealand FTA were the New Zealand team explaining the ROOs to the Chinese side. Author's Interview with Kiep Official Han Sung Kim, 3 June 2009. Tokyo.

⁴⁸¹ Masahiro Kawai and Ganeshan Wignaraja, "Asean+3 or Asean+6: Which Way Forward?," in *ADB Discussion Paper No. 77* (Tokyo: Asian Development Bank Institute, 2007). p. 35, Mireya Solis, "Japan's Competitive FTA Strategy: Commercial Opportunities Versus Political Rivalry," in *Competitive Regionalism* (Waseda University 2008).

⁴⁸² Author's Interview with Kiep Official Han Sung Kim, 3 June 2009. Tokyo.

⁴⁸³ Japan attempted to use the Japan-Singapore Partnership as the mother-ship agreement for ASEAN instead.

outcome of which is a half-way institutionalization of trade rules throughout the region.

4.7 Conclusion: Power, Identity and Domestic Politics in East Asian Trade Regionalism.

Japan's response to the rise of China has had major implications for the development of East Asian trade regionalism, and the institutions that would underpin it. Specifically, Japan's decision not to cooperate with China has prevented the formation of a hub FTA whose rules might function as a template for wider regional cooperation. Instead, Japan has selected ASEAN in place of China as a site to build up a trade hub. Negotiating with ASEAN would mean that more of the rules that Japan is interested in might be institutionalized before eventually trying to incorporate China. However, rather than negotiating with China to build up a common set of rules throughout all FTAs with ASEAN, Japan pursued a strategy which has resulted in a bilaterally-networked type of regionalism rather than a single and uniform undertaking.

Realism therefore gets it half right when describing the Sino-Japanese relationship and its impact on East Asian trade regionalism. The power transition in their bilateral relationship has encouraged competition, and prevented a cooperative form of regional hegemony crucial to the formation of uniform regional trade institutions. Japan is not interested in letting China accrue regional prestige for joint leadership of an East Asian trade regime, even though China offers the largest potential gains as FTA partner. Realism therefore predicts the triumph of concerns about relative gains in Japanese policy toward the EAFTA due to China's rise, and its corrosive effects on regional institution building.

On the other hand, mere economic power balancing alone does not sufficiently describe the details of Japan regionalist trade policy, only its direction.⁴⁸⁴ In order to understand some of the specifics of Japan's policy towards an EAFTA it is necessary to examine variables that liberals and constructivists argue are significant.

Firstly, as institutionalism suggests, these trade agreements have acquired a life of their own. Each agreement affects the outcome of others still under negotiation or not yet even conceived.⁴⁸⁵ Japan had become locked into bilateralism after the 2002 Singapore agreement, even as it was increasingly apparent that this would be inadequate from a

⁴⁸⁴ Saori Katada, Saadia Pekkanen, and Mireya Solis, "Trading Gains for Control," *International Studies Quarterly* 51(2007). p. 949

⁴⁸⁵ Another way of saying this is that negotiators attempt to craft agreements according to previous experience and previous examples, not with reference to the power or other structures which might have initiated the FTA process to begin with.

political perspective. The nature of these negotiations and the training of the Japanese negotiators also meant that Japan tended to view each agreement in isolation, without a view to its impact on future agreements and wider political significance. Yet liberalism fails to explain quite why Japan should take a bilateralist position, when the growing interdependence of the region as a whole surely called for a region-wide arrangement. This was hardly a problem of inadequate communication, but a deliberate policy choice by Japan taken due to the rise of China.

From a constructivist view-point, it is important to understand how Japan views itself relative to China to understand why an FTA is impossible despite compelling economic reasons. It is also important to note that the shared 'democratic' identity of Japan, India, Australia and New Zealand in forming the sixteen-party FTA counter-offer by Japan. Including these additional democratic powers makes it easier for Japan to 'sell' the idea of an FTA both domestically.

In conclusion, the realists are half-right. Japan is trying to balance China in its EAFTA strategy, but realist analysis mistakenly assumes a direct line of causality from external stimulus to policy response. However, in the case of Japan, the internal political landscape surrounding both trade and China has intervened to create an EAFTA strategy which addresses the rise of China only indirectly. Additionally, the bilaterally-networked outcome in Japan's foreign trade policy might have been predicted by Hegemonic Stability theory, but when actually examining the causes of this decision it is clear that domestic political factors were telling.

5 Chiang Mai Initiative

5.1 Introduction

This chapter analyses Japan's policy towards the development of regional institutions for monetary and financial cooperation in light of the rise of China. There are three main sites at which such institutionalization is progressing; Chiang-Mai Initiatives (exchange rate), the Asian Bond Market Initiative (finance), and the Asian Currency Unit (common currency). This chapter focuses on the development of the Chiang Mai Initiative (CMI), and to a lesser extent on the Asian Currency Unit (ACU) debate. The reason for focussing on the CMI is that it is the most institutionalized of the three sites outlined as well as having the most developed, if still incomplete, academic literature. Additionally, the CMI is shaping up to be a significant institution in its own right.

This chapter argues that the rise of China has triggered Japan to (belatedly) try to 'institutionalize' its role as regional leader through the provision of international public goods, in this case financial stability. However, Japan's slipping material advantages have made such institution building almost impossible without Chinese participation. The outcome of institutional development is therefore significantly influenced by power variables. However, while realist analysis identifies the major problem of insufficient hegemony within the institution, it will be shown that realist understandings alone do not sufficiently explain the institutional outcomes.

This chapter will show that Japan has been able to offset its relative loss of material power with intellectual and entrepreneurial leadership. This has permitted the CMI to institutionalize to an extent that realists would not have predicted and which permits a functional, if limited, cooperation between China and Japan on behalf of East Asia. Social constructivist favoured variables, such as the symbolic value of such cooperation and ideas about Japan's role in the East Asian economy, are also shown to be factors which have pushed forward the institutionalization of the CMI while giving rise to some unusual (from a realist perspective) effects such as debates on a common currency. This chapter's contribution to the literature is to demonstrate that, at least within the CMI, power variables are not the sole determinants of institutional development, and that even in the midst of regional power transition institutions can be formed.

Of course, extra-regional factors cannot be ignored either and are also addressed. Indeed, one important factor is the World Financial Crisis (2008-9). This factor is so important to the development of the CMI that unlike previous chapters a post-script is added for the

changes that have occurred during the crisis, and what it can tell us about Sino-Japanese cooperation and rivalry. I suggest that as of the time of writing the multilateralization of the CMI is still incomplete, remaining stove-piped and thus limited.

Financial cooperation and international relations theory

Opening a book on international financial cooperation in East Asia at random will often reveal carefully put together charts and tables about such economic esoterics as capital requirements, currency weighting and co-variance in exchange rate profiles. Intriguing as these topics may be to a pure economist, the literature on the politics behind this cooperation is not as developed. In the United States, both Jennifer Amyx and William Grimes provide the best examples of what hybrid work does exist. In Japan, Ito Takatoshi, Kawai Masahiro, and Sakakibara Eisaku among others have arguably provided the most insight into the politics of regional financial cooperation.⁴⁸⁶

As this mix of economists and political scientists shows, international financial cooperation is an issue of international political economy. While international relations theory was developed first and foremost to discuss and analyse national security, it is also applicable to government level international financial cooperation. Indeed, Grimes takes a traditional realist framework into his analysis of currency politics, and Kawai Masahiro also discusses political hegemony in his analysis of the success and failure of regionalism.⁴⁸⁷ This nexus between international political factors and economic factors indicates that the eclectic analytical approach is applicable, and potentially more so than a purely political or economic based approach.

5.2 The Asian Financial Crisis and the AMF Proposal

In the field of monetary and financial integration, Japan's first major attempt to institutionalise its regional leadership came during the Asian Financial Crisis of 1997-8. The Asian Monetary Fund (AMF) was to be Japan's flagship initiative, by using Japan's vast foreign exchange reserves to fend off currency speculation, Japan hoped to provide greater currency stability and avoid an outright financial crisis in East Asia. The AMF concept, while

⁴⁸⁶ See, for example, Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst: Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T J Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008)., William Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (New York: Cornell University Press, 2009)., Takatoshi Ito and Yung Chul Park, "Promoting Asian Basket Currency Bonds," in *Developing Asian Bond Markets* (Canberra: Australian National University, 2004); Masahiro Kawai and Haruhiko Kuroda, "Strengthening Regional Financial Cooperation in East Asia," *Pacific Economic Papers*, no. 332 (2002).

⁴⁸⁷ Masahiro Kawai, "Evolving Economic Architecture in East Asia," (Tokyo: ADB Institute Discussion Paper No. 84, 2007).

still inchoate, promised to be a regional reserve bank, in the sense that regional members could borrow its funds to bolster their individual currency interventions or to solve short-term balance of payments problems. However, the AMF concept clearly held open the door for greater Japanese influence in the region. If the AMF were ever to come into existence, it would no doubt weaken the influence of the US and the IMF. Moreover, some saw the beginning of an 'Asian EU' - with the AMF in its role as a 'regional reserve bank' evolving in an Asian Central Bank. Such grandiose dreams were not realized. Japan, rather than being hailed as regional leader, was by the time the crisis ended instead derided as the source of regional problems.⁴⁸⁸ Japan could only watch in envy as China's stock in the eyes of East Asia continued to rise.

The usual story of the Asian Financial Crisis starts with the Thai Baht. In July of 1997, the Baht, which was pegged to the US dollar, came under speculative attack by international hedge funds. The Thai government failed to fend off the attack and was forced to devalue its currency against the US dollar. This move proved to be contagious and the weakened Baht triggered a crisis in confidence in the Asian markets and led to a weakening of currencies in the region. Suddenly, the currency crisis became a financial one as short-term loans were called in. As regional currencies were already weak, many borrowers had to default. When the IMF stepped in, it was accused of both doing too little and being too late, as well as failing to take into account the region's preferences. With the US assuming a lower profile than had been expected, there was a palpable leadership vacuum.⁴⁸⁹ In this context, Japan realized that the Asian Financial Crisis was a good opportunity to further its independent leadership credentials in the region.

The key site at which Japan's response to the crisis was decided was inside the MOF. Indeed, the AMF idea was really a brainchild of the MOF, particularly the International Finance Bureau (now the International Bureau) of the MOF, which set up a group to study the plan. As this policy was discussed at the highest levels, and was worked on by the highest tier of public servant in the MOF, Director-General Haruhiko Kuroda (later vice-minister, and later still president of the ADB, see Chapter Seven) and the Vice-minister for International Affairs, the 'dynamic' Sakakibara Eisaku.⁴⁹⁰ The proposal they came up with

⁴⁸⁸ Glenn D Hook, "Japan's Role in East Asian Political Economy: From Crisis to Bloc," *Asia Business and Management* 1(2002).

⁴⁸⁹ US had just bailed out Russia (Vodka Crisis, 1996) and Mexico (Tequila Crisis, 1995). Asia expected equal treatment, it did not get it. In fact, US domestic laws prevented Clinton from extending assistance to Thailand quickly. But Asia was not persuaded and held a grudge.

⁴⁹⁰ Sakakibara Eisaku had come to the position of Vice-minister for International Affairs due to some external interference in MoF staffing by political events. He is something of a nationalist, espouses a sort of 'popular' anti-Americanism and pro-Asianism. He is considered a right-winger although his politics are too erratic to really classify. See David Kang, "Moving Beyond Bilateralism: Japan and the Asian Monetary Fund," *Pacific Economic Papers*

was for a new organization, which would provide immediate emergency liquidity relief to crisis-struck regional countries. Initially, the MOF suggested that this Asian Monetary Fund would hold US\$100 billion, of which Japan was to provide half.⁴⁹¹ Its members were to be initially drawn from the 'Friends of Thailand', a group which did not include the US.

In fact, Sakakibara badly managed the diplomacy of creating a new institution when he opened 'secret negotiations' (i.e. without informing the US). There is little doubt that Sakakibara pushed the AMF platform hard, earning the support of the crisis-struck Asian countries. But the proposal ran into difficulties with the US as Sakakibara had given the impression to Lawrence Summers (then US Deputy Secretary of the Treasury) that the AMF was to be a subset of the IMF, i.e. would not be decoupled from IMF conditionality. However, after consultations with its East Asian partners, Japan concluded that the crisis was one of liquidity, and that draconian conditions would prolong and intensify the pain. Japan was also hoping that its non-interventionist approach might pay political dividends, such as in the APEC where Early Voluntary Sectional Liberalization was under discussion.⁴⁹² When it became apparent that Japan wanted the AMF to act independent of the IMF, America moved quickly and decisively to block its formation - Larry Summers arguing to Sakakibara that if decoupled from IMF conditionality, the AMF would only increase the 'moral hazard' which the US regarded as the root cause of the crisis.⁴⁹³ It looked to the US like the AMF idea that Japan was championing was a callow attempt to gain influence in the region at a cost to the US, the regional economies and the international financial system as a whole.⁴⁹⁴

But the US was not the only great power against the AMF proposal. Much to Japan's surprise, China also opposed it, stating that it wanted no part in the development of a regional foreign exchange policy which included the RMB.⁴⁹⁵ With China against the AMF proposal, it became politically, as well as economically, impossible to proceed. Japan, or rather the MOF, was from the outset prepared to go ahead with the AMF provided China was supportive - even if the US objected. In other words, China (not the US) held the veto.

331(2002)., and for more on the personal history of Sakakibara see *Michael J Green, Japan's Reluctant Realism (New York: Palgrave, 2001)*.

⁴⁹¹ Gordon de Brouwer, "Institutions to Promote Financial Stability: Reflections on East Asia and an Asian Monetary Fund" (paper presented at the "Reinventing Bretton Woods Conference", Rome, 22-23 July 2004).

⁴⁹² C W Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?," *Review of International Political Economy* 7, no. 2 (2000). p. 246

⁴⁹³ A time-consuming long distance phone call conversation that began with 'I thought you were my friend', Summers moved quickly, passionately and directly in trying to kill the AMF see, Paul Blustein, *The Chastening* (New York: Public Affairs, 2003).

⁴⁹⁴ Edward Lincoln, *East Asia Economic Regionalism* (Washington, DC: The Brookings Institute, 2004). p. 215

⁴⁹⁵ Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). p. 249

In the opinion of some in the MOF China's objection was not an *in principle* objection but came from a lack of understanding about how the AMF might work in practice. Hu Angang, a politically influential scholar at the Chinese Academy of Science, stated at the 'the future of Asia' conference in June 2000 that support for the AMF was growing in China.⁴⁹⁶ The then premier Zhu Rongji also said that he supported an 'East Asian monetary fund' during a meeting with Mahathir in November 1999.⁴⁹⁷ But without sufficient consultation, China was not willing to commit to the plan. This was because the PRC was both less willing to risk its currency reserves on behalf of Southeast Asia without the authority of the IMF, and concerned that the AMF would institutionalize a Japanese regional hegemony.⁴⁹⁸

While the AMF plan remained technically on the books until the November APEC (1997), Japan turned to a bilateral approach to attempt to rebuild its presence in the region. The so-called New Miyazawa Initiative (named after Miyazawa Kiichi, the Finance Minister) was unveiled at the 2nd APT in October 1998, aiming to form a sort of hub-and-spokes series of bilateral economic ties centred on Japan.⁴⁹⁹ The NMI pledged US\$30 billion in assistance for crisis-struck East Asian countries, of which half would be short-term lending for currency reserve needs. The remaining were medium to long term loans at near markets rates in the form of structural adjustment program loans to the financial sector provided via the Japan Export-Import Bank (co-financed by the ADB and the World Bank).⁵⁰⁰ Additional pledges were made later in the year, including US\$3 billion in a credit account at the ADB for Asian government issued bonds.⁵⁰¹

These elements of the Initiative contained little by the way of conditionality (certainly compared to the IMF's program) and provided, both directly and through the special facility at the ADB, a total of nearly US\$21 billion.⁵⁰² At the May 15-6 APEC meeting, Miyazawa

⁴⁹⁶ Mainichi Shimbun 18 October 2000 in Shigeko Hayashi, *Japan and East Asian Monetary Regionalism: Towards a Pro-Active Leadership Role?* (London: Routledge, 2006). p. 115

⁴⁹⁷ Mainichi Shimbun 18 October 2000 in Ibid. p. 115

⁴⁹⁸ Author's Interview with Kawai Masahiro, 14 November 2008. Tokyo., Others have suggested more prosaically that China's decision not to support the AMF proposal was less to do with strategic competition with Japan and more to do with Jiang Zemin's upcoming visit to the US at which he was to negotiate accession to the WTO.

⁴⁹⁹ The proposal occurred in the context of US 'passing' Japan, President Clinton flying over Japan for a nine day tour of China, at the same time the US criticised Japan's role in the crisis while praising China.

⁵⁰⁰ Many see a link between what Japan was pursuing bilaterally and the ADB, one noted scholar writing that the "MOF used its dominant position in the ADB to move its loan agenda away from infrastructure projects and towards multilateral financial restructuring, as well as to ensure the ADB's annual Asian Development Outlook 1999 report called for the establishment of an AMF." C W Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?," *Review of International Political Economy* 7, no. 2 (2000). pp. 247-8

⁵⁰¹ Lam Peng-Er, "The Asian Financial Crisis and Its Impact on Regional Order," *The Journal of Pacific Asia* 6(2000). p. 256

⁵⁰² Pledges include Thailand (US\$1.9 billion); Malaysia (US\$ 2.2 billion); Indonesia (US\$ 2.4 billion); the Philippines (US\$ 1.6 billion); South Korea (US\$ 6 billion). Although by March 2000 only US\$5.28 had actually been disbursed.

pledged to provide another two trillion yen (equivalent to US\$16 billion) in guarantees for long term bonds issued by East Asian governments. Another notable feature of the NMI was the extension of one-way currency swaps with Malaysia and Korea, features which would return in the CMI. As one official in the Japanese Ministry of Finance explained, "the USA, Japan and China are seeking influence over the region [East Asia] ...The New Miyazawa Initiative is certainly a policy that intends to return the focus on what Japan can do in Asia".⁵⁰³

5.2.1 View from the Sino-Japanese relationship

With the failure of the AMF, Japan's hopes for regional leadership had been dashed. Japan also realized that its importance to the region had declined relative to China, both politically and economically. Politically, Japan came out of the crisis looking weak, while China emerged looking like a leader. The transfer of the mantle of leadership between China and Japan revolved around questions of who was to blame for the crisis.

Many pointed the finger at Japan. In Southeast Asia, Japan's most ardent pupil, Malaysia's Mahathir, put the case succinctly saying that Japan had 'lost the will to be head goose.'⁵⁰⁴ The failure of Japan's leaders to effect reform, particularly of the ailing banking sector, had caused Japan to remain in a recession which in turn weakened the regional economy.⁵⁰⁵ This meant that Japan was unable to provide its traditional role as an engine of growth by injecting investment. Worse still, it looked to Southeast Asia as if Japan was not interested in playing this role if it risked its own recovery. Japan was unwilling or unable to be a regional 'consumer of last resort', as efforts to lift demand in Japan failed to bear fruit. Moreover, Japan continued to block further trade liberalization efforts in the APEC, meaning that there was less opportunity for ASEAN to trade its way out of the crisis. Perhaps most damning of all was the perception that Japan had deliberately allowed its currency to depreciate against the dollar during the Crisis without a thought for the negative implications for its erstwhile partners in East Asia.⁵⁰⁶

"Miyazawa Initiative Wraps up, Providing \$21 Bil," *Asian Economic News (via Kyodo)*, March 6 2000.

⁵⁰³ Yet for all this, the NMI was criticised for using the yen provided to SEA companies to pay debts to Japanese companies and banks to solve Japan's domestic banking problems, see Nikkei Weekly, 16 November 1998 in C W Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?," *Review of International Political Economy* 7, no. 2 (2000). p. 221

⁵⁰⁴ Christopher Hughes, Hugo Dobson, and Glenn D Hook, "Japan and the East Asian Financial Crisis: Patterns, Motivations and Instrumentalisation of Japanese Regional Economic Diplomacy," *European Journal of East Asian Studies* 1, no. 2 (2002).

⁵⁰⁵ S. Javed Maswood, *Japan in Crisis* (London: Palgrave Macmillan, 2002). p. 28

⁵⁰⁶ Falling to ¥147 to the dollar. Of course, Japan does not manipulate its currency in the same way as China, but the perception still remains. C W Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?," *Review of International Political Economy* 7, no. 2 (2000). p. 232

This all compared unfavourably to the role played by China during the Crisis. Although China had devalued its currency in 1994 (by 30%), during the crisis China announced that the value of the RMB would remain pegged to the dollar, and not be devalued any further. This meant that, during to the crisis, China was not adding any additional pressure to the ASEAN states export-led development strategy – although China did not contribute significantly to any actual bail out.⁵⁰⁷ This decision by China earned it high praise in ASEAN.⁵⁰⁸ And the Chinese were not averse to publically naming Japan the culprit – Jiang Zemin and President Clinton denounced the deficient management of the yen in the bilateral US-China summit in June 1998. Rather than Japan, it was China which became viewed as the engine of growth which pulled the region out of the crisis. By the 2001 APT summit, a regional consensus had been reached; and at the ASEAN-China summit the Chairman stated that ASEAN was “deeply grateful for China’s support in efforts to recover from the recent economic crisis”, but noted somewhat formally in the ASEAN-Japan summit that “Japan...was at the forefront of international efforts to help Southeast Asia adjust to the financial shocks of 1997.”⁵⁰⁹ This challenged a view in Japan that even though the AMF idea did not manifest in a concrete institution, the levels of trust for Japan in East Asian countries rose.⁵¹⁰

Japan’s conception of itself as a regional leader had been dealt a major blow. This, despite the fact Japan had pledged nearly US\$80 billion to the Crisis recovery effort (far more than China) was particularly keenly felt in Japan’s policy circles but to little avail. Worse, the AMF proposal which Japan believed stood the best chance of helping Asia had been blocked by China. China was being praised for not doing something (currency devaluation) while Japan was criticised for something over which it had no control (yen exchange rate).

⁵⁰⁷ However, despite Chinese inferences to the contrary, the decision not to devalue the RMB is not evidence of greater Chinese commitment to regional recovery than Japan. Firstly, China was aware of the possible that it might trigger a self-destructive round of currency devaluation throughout the region, worsening China’s economic position and losing regional regard. Secondly, China was aware that the US already believed that the RMB was undervalued, and a further devaluation could create a nasty and unnecessary political standoff potentially costing China membership in the WTO. Thirdly, there were domestic political and economic reasons not to devalue revolving around being seen to defend the Hong-Kong dollar, not to mention Zhu Rongji’s personal honour. Lastly, the falling Japanese yen perversely meant that China’s debts to Japan could be more easily serviced. See Thomas Moore and Dixia Yang, “Empowered and Restrained: Chinese Foreign Policy in the Age of Economic Interdependence,” in *The Making of Chinese Foreign Policy*, ed. David Lampton (Stanford: Stanford University, 2001). pp. 215-22

⁵⁰⁸ “Press Release of the Chairman on the Asean+1 Summit Meetings between the Heads of State/Government of Asean and China, Japan and the Republic of Korea,” http://www.mofa.go.jp/region/asia-paci/asean/pmv9911/release_c.html

⁵⁰⁹ “Press Statement by the Chairman of the 7th Asean Summit and the Three Asean + 1 Summits, 6 November 2001,” <http://www.aseansec.org/5471.htm>. 2010, April

⁵¹⁰ Masahiro Kawai, “Asean Tsūka to Chūgoku No Jinmin Gen,” in *Chūgoku No Taitō to Higashi Ajia No Kinyū Shijō*, ed. Eiji Ogawa (Tokyo: Ministry of Finance Policy Research Deptment., 2006). p. 32

Moreover, Japan felt that China was partially to blame for displacing ASEAN in traditional markets.⁵¹¹

But the real meaning of the failure of the AMF idea was that Japan was unable to go it alone. It needed either the US or China in order to lead by a cooperative hegemony. With Japan's regional leadership under question, and unable to cooperate with China in the building up appropriate institutions, it is no surprise that Japan tried to go it alone under the Miyazawa initiatives. But to succeed, in other words to get to the CMI, Japan would need China.

5.3 Formation: Chiang-Mai Initiatives

The Chiang Mai Initiative (CMI) was announced in May 2000 at the ASEAN Plus Three Finance Ministers Meeting. Taking its name from the Thai city in which it was proposed, the CMI is essentially the successor to the failed AMF. Indeed, Kuroda has since argued that the AMF could be most swiftly realized by the expansion of swap agreements and an effective surveillance mechanism – i.e. the CMI.⁵¹² However, to avoid upsetting the US, the Japanese Ministry of Finance took great pains to conceptually 'de-link' the two.⁵¹³ The CMI saddles the gap between the AMF and New Miyazawa Initiatives, being somewhat less than a 'fully' institutionalised financial body and yet more than merely an *ad hoc* bilateral currency swap. Nevertheless, the CMI is trending towards greater and greater levels of institutionalization. The logical end point, or one of the logical end points, of this institutionalization is the de facto, if somewhat delayed, realization of the AMF concept.

5.3.1 What is the CMI?

The essence of the CMI is a series of Bilateral Swaps Agreements (BSAs) between Japan, China, Korea and the ASEAN 5 economies (Indonesia, Malaysia, Philippines, Singapore, Thailand). Swaps allow member countries struck by a currency crisis to borrow a set amount of their counterpart's foreign exchange reserves for ninety days (renewable for up to 2 years). In exchange, the crisis affected country would transfer to the lender an

⁵¹¹ Of course, Japan was felt to be partially responsible as major Japanese companies were shifting to China from Southeast Asia, of course this was just business hardly orchestrated by the Japanese government which would probably just have preferred that ASEAN remain as competitive as China.

⁵¹² Moreover, Kuroda makes clear the AMF is in Japan's interest, over the middle term. Kuroda is also reported to have said to Malaysia's Mahathir that he "would not give up the AMF" had suggested that Japan has expertise with surveillance, as original participant in G5 and G7 financial ministers meetings. Indeed Kuroda was a junior official involved in the 1986-7 G7 multilateral surveillance meeting (and was not that impressed). This might explain his interest in such matters at the ADB. See Shigeko Hayashi, *Japan and East Asian Monetary Regionalism: Towards a Pro-Active Leadership Role?* (London: Routledge, 2006). p. 114

⁵¹³ In the face of the World Financial Crisis, this link is again being made by MOF officials and Japanese academics.

equivalent amount of its local currency. At the end of the swap period borrowings would be returned plus interest (at the IMF drawing rate). The effect (in theory) of such mechanisms is to allow a country to pay off its short-term dollar-denominated debts without undermining the strength of its local currency (with effects on inflation and interest). In other words, to solve the problem faced during the Asian Financial Crisis.

The CMI was initially established with contributions totalling the equivalent of US\$40 billion (approx.). This was doubled to US\$80 billion (approx.) at the Hyderabad Meeting of 2005, and, as of 2008, was slated to be extended to nearly US\$120 billion.⁵¹⁴ However, calculating the total of the CMI is academic; no country can in fact draw the total.⁵¹⁵

In light of their collective experiences in the mid nineties, many in East Asia became aware that providing liquidity in a financial crisis, while ostensibly an economic function, is in fact inherently political. Bailing out an economy in crisis is not free, and whoever accepts this burden can claim not just a 'leadership role' but may also link their assistance to concessions in other areas. Precisely due to these fears of political interference in their domestic economics, the CMI was premised on the prevention of a future crisis. Somewhat like the ARF (discussed later), the success of the CMI is 'proved' by the absence of crises.

5.3.2 Japan's interests

The CMI should not be understood as merely a technical solution, there is more than mere functionalism at play. Indeed, Japan is quite able to fend off currency speculation in a crisis on its own. Rather, Japan's interests in the CMI lie in gaining the acceptance of ASEAN states for Japanese regional leadership. In part this is a hedge against unwanted US influence by the Japanese, but regional actors also emphasize Japan's concerns about the rise of China and the inevitable loss of influence that this entails.⁵¹⁶

Specifically, Japan is hoping to gain acceptance of a Japanese role in protecting the financial stability of Asian states. Firstly, an acknowledgement of Japan's continuing important role, indeed vital role, in the economic order of East Asia. Secondly, Japan expects some additional political leverage, in particular during a crisis, for its views and policy preferences. Lastly, there are some economic advantages stemming from an increased covariance in yen and regional countries' currencies and, of course, from the

⁵¹⁴ "Asean, Regional Partners Likely to Increase Crisis Funds," *BBC Monitoring Asia Pacific*, December 15 2008.

⁵¹⁵ Prior to multilateralization, each country could only draw from the set of BSAs which it has signed. BSAs that other members of ASEAN might have signed can not be drawn on (even though they are counted in the total sum "available" to CMI). Hyoung-kyu Chey, "The Political Economy of East Asian Financial Cooperation: The Chiang Mai Initiative," (Seoul: Institute for Monetary & Economic Research, Bank of Korea, 2007). p. 18

⁵¹⁶ *Ibid.*

possibility of averting a crisis.⁵¹⁷

Japan's interest in regional leadership rose after the Asian Financial Crisis. It is no accident therefore that some of the elements of the New Miyazawa Initiative grew out of the AMF concept, and can now be found within the CMI. As such, Japan can claim its role as the intellectual leader of the CMI even if its material leadership had slipped.⁵¹⁸

5.3.3 The China factor in Japan's approach to the CMI.

There is precious little information available in the public arena about the events which led up to the CMI's announcement in 2000, participants in those negotiations staying silent thus far.⁵¹⁹ China's earlier opposition to the AMF had softened significantly by the time of the first 1999 ASEAN Plus Three Finance Minister's Meeting (APT-FMM). The APT itself having only been established 1997 was initially preoccupied with crisis and keen for further coordination in the financial arena. In this context it was decided to make regular a meeting of the region's financial ministers. Since the finance ministers were already scheduled to meet at the ADB's Annual General Meeting, it was decided to regularize the APT-FMM meeting there. In only its second meeting, China reversed its position and agreed to support the creation of an institution for East Asian financial cooperation at the APT-FMM.

China's reasons for reversing its position of regional financial cooperation are not directly relevant, save what it can tell us Japan's ability to persuade and lead. China's cooperation appears to be premised more on political concerns about its image in the region than strict economic utility. ASEAN had been very interested in the AMF facility and was disappointed when it fell through. While most fingered United States' opposition as to blame, China's role in downing the AMF was not forgotten in Japan. In 1999, as ASEAN decided to extend the ASA to its five small members (more a symbol of unity than an effective measure) and increase the size of the agreement to US\$1 billion, Japan proposed that it, together perhaps with other Northeast Asian countries, might link into the ASA. With Japan (and possibly Korea) in agreement with ASEAN, China was left with no option but to join what would become the CMI.⁵²⁰ In other words, Chinese participation based on perceptions of

⁵¹⁷ It is also true that the CMI can be considered as a relatively cheap option for leadership in the sense that Japan has stockpiled an unnecessary surplus of foreign exchange reserves, and attempting to turn these reserves into political capital is better than simply sitting on them – assuming of course that the money is returned after a crisis. "Intra-Regional Exchange Rate Stability and Prevention of Financial Crisis in East Asia," (Tokyo: Institute for International Monetary Affairs, 2006).

⁵¹⁸ NMI provided short term financial support to Malaysia and Korea, model for BSAs in CMI. In fact, the same funds rolled over in the case of Korea.

⁵¹⁹ Author's Interview with Yung Chul Park, 1 June 2009. Seoul., Prof. Park was involved in the initial negotiations of the CMI in 2000 but the Author had difficulty eliciting information about it.

⁵²⁰ If China came out against the CMI it would lose political influence in ASEAN, which was keen for the fund to be set

the political cost of exclusion rather than an actual interest in providing leadership.

5.4 Membership

The membership of the CMI is instructive as to the effects of the Japan-China bilateral relationship on regional institution building. Within the CMI, this has created two overlapping groups centred on China and Japan. Japan and China, as the bankrollers of the CMI, have acted as hubs for the various BSAs. The CMI as a regional institution composed of Bilateral Swap Agreements is clearly a form of bilateral networked regionalism, see Figure 13 overleaf. Its network structure is evidence that neither Japan nor China is interested in giving up the freedom to choose their partners and their level of commitment.

While the CMI process itself is based on the ASEAN Plus Three Finance Minister's Meeting, the membership of the two groups is not the same. In fact, of the ten ASEAN nations only five are CMI members. Those excluded in the initial phase were Brunei, Cambodia, Laos, Myanmar and Vietnam, aka the CLMV countries plus Brunei. Moreover, Singapore has concluded a BSA only with Japan and not with China or Korea.

The exclusion of the CLMV countries (and Brunei) from the CMI is due mostly to their small economies. Japan was unwilling to extend currency protection to these smaller ASEAN powers – it just was not worth it economically. In fact, Japan's FTAs and BSAs share a similar membership; with the exception of Brunei, which concluded a bilateral FTA for the export of energy resources, these countries were not signatories to a bilateral FTA with Japan.⁵²¹ Moreover, individual members had differing levels of access to funds; to wit, there are different 'levels' of membership. Of course, in the IMF too, there are different levels of access to funding, but this is predicated on different levels of commitment (measured in SDRs). However, in the CMI, any given country's access to the total is dependent on how important the Big Three (Japan, China and Korea – but in particular Japan) feel that country is. As there is no objective measure as to how this is derived, strategic as well as economic factors can and do enter this calculation.

up. See, Tadahiro Asami, "Chiang Mai Initiative as the Foundation of Financial Stability in East Asia," (Tokyo: IIMA, 2005). pp. 9-10

⁵²¹ Interestingly, China is more involved in the CLMV countries. Most intriguingly is the decision to allow RMB usage in CLMV in December 2008, relaxing tight controls of the currency and baby step towards internationalization. See, Tetsuji Murase, "China Makes a Step Forward Towards a Rmb Currency Area," *CEAC Commentary*, April 22 2009.

Figure 13 Membership Structure of the CMI

NOTE:
This figure is included on page 131 of the print copy of
the thesis held in the University of Adelaide Library.

Source: Bank of Japan, www.boj.or.jp/en/type/release/adhoc09/data/un0904a.pdf

Access: April 2010

Access can also differ in terms of scale, symmetry, denomination and conditionality. In terms of scale, Korea could call in equivalent of US\$23.5 billion (or roughly 25% of the total CMI), while Malaysia could call in a total of US\$4 billion (4.4%), half that of the Philippines at US\$10 (11%). Why the Philippines should require more than Malaysia when their trade volumes differ greatly, and why Korea can make do with twice that allotted to the Philippines, is not readily explicable in economic terms.⁵²²

In terms of symmetry, some of the bilateral swaps were one-way only, i.e. there was no obligation for the recipient to provide its foreign reserves in the event that the lender suffers a currency crisis, for example the Japan-Malaysia BSA. Other BSAs were two ways, but the commitments are asymmetrical, such as the BSA between Japan and the Philippines in which Japan committed \$6 billion, while the Philippines committed a symbolic \$0.5 billion in return). While at least one other BSA oscillated between symmetrical and asymmetrical depending upon domestic political circumstance, such as Japan-Thailand.⁵²³ In general however, most BSAs in the CMI were two-way and symmetrical, such as Korea-Malaysia (\$1.5 billion each way). Additionally, the CMI also included in its 'total' the ASEAN Swap Agreement (ASA) of perhaps US\$2 billion which is only accessible ASEAN members. Thus the total is not 'pooled' but rather is kept stove-piped – with no one member actually able to access the whole pool. Moreover, there are some questions about how the total is calculated. One researcher noted that if you factor out the 'double-counting' in some of the agreements and the symbolic pledges by developing countries to either China or Japan, then the total amount is perhaps a quarter less than commonly reported.⁵²⁴ Of this total, Japan was source for roughly 50% of the BSAs by value, China and Korea 20% each and Southeast Asia 10%.⁵²⁵

5.4.1 Diffusion in membership

Lastly, even as the CMI's institutionalization progressed, both Japan and China began defaulting from the arrangement to provide BSAs to key powers in the region. Korea in particular has been a beneficiary of competition to provide financial stability between Japan and China. On 12 December 2008, the Plus Three countries met trilaterally for first time in Fukuoka.⁵²⁶ At this meeting, the Japanese central bank announced an increase in the size

⁵²² Although the inclusion of Japan->Malaysia BSA pledged in the NMI (and since maintained) worth 2.5b somewhat lessens the discrepancy. China BSA with Malaysia expired in 2005, and therefore perhaps ought not to be counted.

⁵²³ William Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (New York: Cornell University Press, 2009). pp. 82-4

⁵²⁴ C Randall Henning, "The Future of the Chiang Mai Initiative: An Asian Monetary Fund?," *Peterson Institute for International Economics, Policy Brief* PB09-5(2009). p. 2, It will be a cold day in hell when the Philippine pledge of US\$500 million is called on by Japan to rescue its currency. Thus, in 2005 the CMI of 80b should be regarded as 50-60b.

⁵²⁵ April 2009 numbers, there were some minor fluctuations over time but Japan was always the biggest bankroller.

⁵²⁶ The historic summit was brought on by the sub-prime crisis, and interestingly featured a call for ADB capital injection

of the Japan-Korea BSA, taking it from US\$3b to US\$20b denominated in local currency. At the same time, Korea and China signed a BSA valued at US\$28b (also in local currency), earning China a formal thank-you at the next APT.⁵²⁷ Both of these new BSAs to Korea came on top of prior agreements and both fall outside the conditions (such as the IMF link) of the CMI.⁵²⁸ Likewise, on May 3 2009 on the sidelines of the Bali APT meeting, Japan pledged a further US\$60 billion to ASEAN outside of the CMI facility, and additionally offered to insure US\$5 billion worth of yen denominated sovereign bonds.⁵²⁹

Outside of the CMI and ASEAN, Japan has also courted India, albeit only half-heartedly. Initial interest and basic agreement was reached in the middle of 2007; they at last settled on an amount over a year later (January 2008), US\$6b (3b each way). However, it was not until June of 2008 that Japan reached a final agreement with the Indian authorities, and even then Japan insisted on keeping a 20% link to the IMF as per the CMI specifications.⁵³⁰ In fact, Japan cloned the conditionality of the CMI for India's BSA.⁵³¹ Officials in the Bank of Japan suggest that this may be part of a move to shift the CMI from an APT-linked institution to one under the umbrella of the EAS.⁵³² Given the long lead time into this agreement with India, there is some suggestion that the news that China had also extended a non-CMI linked BSA to Malaysia worth 13.5b (local currency) in January 2009 triggered Japan final agreement.⁵³³ This indicates Japan somewhat limited trust towards India, but also Japan's interest in bringing India (and perhaps Australia and New Zealand under the rubric of EAS) into the CMI framework.⁵³⁴ Thus, outside of the network of BSAs within the CMI framework, Japan has been willing to build up its own separate bilateral network.

(GCI) from the three, see "Asian Giants Agree Economic Plan ", *BBC News Online*, 13 December 2008.

⁵²⁷ Asami Tadahiro, "Chiang Mai Initiative as the Foundation of Financial Stability in East Asia," (Tokyo: IIMA, 2005). p. 9

⁵²⁸ Bank of Korea and the US Treasury had also signed a BSA worth US\$30 billion, the role of the US as a factor in prompting China and Japan to act must not be discounted.

⁵²⁹ "Japan to Provide up to 60 Billion Dollars in Crisis Fund," *Earth Times*, May 3 2009.

⁵³⁰ "Signing of the Bilateral Swap Arrangement between Japan and India June 30, 2008," <http://www.boj.or.jp/en/type/release/adhoc/ind0806a.htm>18FEB2010

⁵³¹ Author's Confidential Interview with Ministry of Finance Official, 16 March 2010. Tokyo.

⁵³² Author's Confidential Interview with Bank of Japan Officials, 16 March 2010. Tokyo.

⁵³³ It should be noted that the US is also involved in this game, reaching a BSA worth 30b between Central Bank of Korea and the US Fed. See, C Randall Henning, "The Future of the Chiang Mai Initiative: An Asian Monetary Fund?," *Peterson Institute for International Economics, Policy Brief PB09-5(2009)*. p. 2

⁵³⁴ In fact Australia has some interest in joining a body like the CMI. In 2001 the Australians proposed and coordinated working group in the Manila Framework calling for a "region financing facility" be set up within its ambit. Of course, this would have involved the US, for more details see Pradumna Rana, "Monetary and Financial Cooperation in East Asia: The Chiang Mai Initiatives and Beyond," in *ERD Working Paper* (Manila: Asian Development Bank, 2002). p. 6. nor does it seem that the ASEAN members of the CMI would much object to further cost sharing with Australia; see Asami Tadahiro, "Chiang Mai Initiative as the Foundation of Financial Stability in East Asia," (Tokyo: IIMA, 2005). Report prepared for the ASEAN Economic Ministers, p. 17.

Japan and China's interest in protecting each other's financial stability is moot. These two powers hold the bulk of the world's foreign exchange reserves, and thus are capable of managing their currencies independently. Interestingly, the two sides reached an agreement between their central banks (which step-sides the IMF link in CMI) in 2002. However despite the growth of the CMI since, this agreement has (unusually, and perhaps uniquely, of BSAs within the CMI membership) not be not been extended, increased or modified in any way since activation, reflecting its symbolic rather than functional purposes.

This outcome of bilateral networks for financial cooperation both within and outside of a common framework can be explained with reference to realism. Both Japan and China have jealously protected their freedoms in choosing whom to protect and the extent of that protection. Japan and China have not reached some objectively assessable criteria in choosing their partners, but rather maximized their discretion. Indeed, Japan and China have failed to coordinate with each other and have been willing to undercut the CMI by offering increasingly generous terms to key partners like Korea, suggesting a competition for influence has broken out.

5.5 Scope: Common Currency Redux

The CMI is not chartered at this stage, so discussion about the scope of this institution is premature. What can be noted is that while the CMI is expected to play just one role, i.e. the provision of liquidity in a time of crisis, there is some hope that once established it will develop further. In particular, Kawai Masahiro has noted that the CMI, once fully institutionalised, can be the basis for other financial and monetary cooperation such regional bond market development and a regional currency.⁵³⁵ Thus far however, this idea for a common currency has remained a plan and is far away from becoming reality. Nevertheless, the Asian Currency Unit (ACU) concept is relevant to understanding Japan's response to the rise of China and its possible future trajectory.

Japan' Interests in the ACU

Within Japan, the ACU has attracted several high profile supporters. Not merely academically-minded ex-bureaucrats such as Sakakibara Eisaku, but also former Prime Ministers such Nakasone Yasuhiro.⁵³⁶ More recently, the current PM Hatoyama Yukio has

⁵³⁵ Masahiro Kawai, "Evolving Economic Architecture in East Asia," (Tokyo: ADB Institute Discussion Paper No. 84, 2007). p. 28

⁵³⁶ Nakasone Yasuhiro, "Kyōtsū Tsūka Ga Hiraku Nihon to Ajia No Mirai," *Chūō kōron*, April 2009. The former prime minister (1982-7) heads the world peace research institute and the council for East Asia community. One might question the extent to which Nakasone understands what he is proposing, while no doubt very bright he is not an economist.

supported the ACU idea.⁵³⁷ Both Nakasone (as head of Council on East Asia Community) and Hatoyama support the ACU not out of a judgement of its economic utility but as a symbol of the indivisibility of Asia. Indeed, as Mundell notes the common European currency is predicated more on feelings of 'never again' than any economic analysis.⁵³⁸

From a Japanese perspective, apart from demonstrating unequivocally Japan's 'one-ness' with Asia, a common currency for Asia would of necessity entail a greater role for the yen in the region. Indeed, Japan's interest in furthering the use of its currency in the region is hardly recent. Ignoring unfavourable historical parallels, Japanese academics begun calling for a new role for the yen since the early nineties.⁵³⁹ These proposals, for what became known as the 'yen bloc', were based on the belief that Japan's informal trade network in East and Southeast Asia ought to be 'formalised' by the adoption of the yen as regional currency for settling trade and other accounts.⁵⁴⁰ Due to East Asia's (including Japan and her companies⁵⁴¹) reliance on the dollar⁵⁴², the idea of providing a sort of financial regional leadership in the 'yen bloc' was never adopted as government policy.⁵⁴³

⁵³⁷ Yukio Hatoyama, "Watashi No Seiji Tetsugaku," *Voice*, August 10th 2009.

⁵³⁸ "The case for European money is... tied up with the case for integration. Since the case for integration rests on social, political, military, cultural and intellectual grounds our arguments...based on economic grounds alone...[are] the tip of the iceberg." See, Mundell 1973b in Ronald McKinnon, "Euroland and East Asia in a Dollar Based International Monetary System: Revisited" in *Money, Capital Mobility and Trade*, ed. Guillermo Calvo, Rudi Dornbusch, and Maurice Ostfeld (Cambridge, Massachusetts: MIT Press, 2004). p. 428

⁵³⁹ Most notable among these is Kojima Kiyoshi's Multiple Key Currency of USD, yen, and Deutsche Mark. Interestingly in 2009, China's Central Bank Governor Zheng proposed something similar to the Multiple Key Currency but with Euro in place of Deutsche Mark and RMB in place of yen. See, Kiyoshi Kojima, "A Multiple Key Currency Gold Exchange Standard," *Journals of Asian Economics* 1(1990).

⁵⁴⁰ C H Kwan, *Yen Block* (Brookings Institute, 2001)., Jeffrey Frankel, "Is Japan Creating a Yen Block in East Asian and the Pacific," in *Working Paper 4050* (Cambridge: National Bureau of Economic Research, 1995). p. 1

⁵⁴¹ "According to the survey research conducted by Keizai Dōyūkai (Japan Association of Corporate Executives) in 1999, 73.7% of 76 Japanese companies (both manufacturing and services) would support increased use of yen instead of US dollars for their international business transactions. Despite of such hope, 70 to 80% of the responses from the very same companies see the increased use of the yen either very difficult or impossible" in Saori Katada, "From Supporter to Challenger? Japan's Currency Leadership in Dollar-Dominated East Asia," *Review of International Political Economy* 15, no. 3 (2008). p. 405, 409

⁵⁴² R Taggart Murphy, "From a Supporter to a Challenger? Japan's Currency Leadership in Dollar-Dominated East Asia at the Brink of Financial Collapse." 2009, 3 March The cause of this under representation of the yen in the region is ultimately attributable to the dominance of the dollar, but Japan's long standing capital account surplus has also made it difficult to accumulate yen. Another contributing factor is the experience of Southeast Asian countries, particularly of Malaysia, which found themselves painfully short yen after the Plaza Accords of 1985. For ideological reasons Malaysia diversified its debts into yen away from dollars in the early 1980s. However, even though Japan was major trade partner of Malaysia, since much of Japanese trade was denominated in USD Malaysia found itself short yen after the Plaza Accords caused the rapid appreciation of the yen.

⁵⁴³ Yen likely did not account for more than 15% of total reserves in Southeast Asia. Even though the yen made up nearly 30% of the value of the IMF's SDR 1999, Japan was shocked during the crisis when it realized that yen made up only 5% of Thailand's reserves. While Japanese business also preferred to use dollars, non-resident holding of Japanese Government bonds 10% of total, c.f. US treasury bonds. See Murase 1999 in Glenn D Hook, "Japan's Role in

After the Asian Financial Crisis, the yen bloc concept was again advanced under title of 'internationalization of the yen.' Major domestic reforms of Japan's financial sector were pushed through aimed at making Tokyo a world-class financial capital⁵⁴⁴ after the collapse in the early 1990s.⁵⁴⁵ Internationalization of the yen, as an official Japanese policy objective, was emphasised by the statements of the Minister of Finance at the Vancouver APEC in 1998, and subsequently by Prime Minister Obuchi himself in January of 1999.⁵⁴⁶ As a policy however, internationalization of the yen has clearly failed (see Appendix 8)

Japan and China compete in the ACU idea

In 2002, at the Asia-Europe Meeting (ASEM) in July, Finance Minister Shiokawa Masajūrō, citing the experience of Europe, called for a single Asian currency – an idea linked to yen internationalization.⁵⁴⁷ Contrary to the policy advice of the IMF, Japan began to champion an intermediate currency regime called the 'G3 Currency Basket for Asian economies'. This basket was to be artificially constructed of US dollars, Japanese yen and the euro, but the weight of each component was not formally discussed.⁵⁴⁸ Japan also aggressively pursued the idea in international organizations, such as the ADB.⁵⁴⁹ Indeed, the ACU has been seen by many as an attempt to ensure a privileged place for the yen in a region where the RMB

East Asian Political Economy: From Crisis to Bloc," *Asia Business and Management* 1(2002). p. 31

⁵⁴⁴ A sort of 'City of London' model for Tokyo, but greater exposure of the yen was seen as *sine quo non* if Japan was to become a major exporter of financial services. The MOF put it thus, "It is urgently required to enhance the functioning of the Japanese financial market to prevent its possible hollowing out. In doing so, the status of the yen as an international currency would be strengthened." in "Internationalisation of the Yen: Essential Issues Overlooked," *Pacific Economic Papers* 307 (2000). pp. 7-8

⁵⁴⁵ The rise and fall of Tokyo is neatly explained in Youssef Cassis, *Capitals of Capital* (Cambridge University Press: Cambridge, 2006). p. 269, interesting is the role that the UK and the US had in the Basel accords which wiped out Japanese bankers.

⁵⁴⁶ Glenn D Hook, "Japan's Role in East Asian Political Economy: From Crisis to Bloc," *Asia Business and Management* 1(2002). p. 29, PM Obuchi sought to place the yen in the same league as the Euro and the USD as a key international currency,

⁵⁴⁷ to be supported by an Asian Central Bank by 2030 à la AMF perhaps according to initial research conducted at Kōbe. See Edward Lincoln, *East Asia Economic Regionalism* (Washington, DC: The Brookings Institute, 2004). p. 225, The Kobe research project report called for a basket of currencies, but was not specific.

⁵⁴⁸ In particular, Korean and Thai economists were supportive, an intriguing manifestation of the optimum currency area between Japan and Korea/Thailand.

⁵⁴⁹ The paper called for the ACU to function as a unit of account, invoicing and as reserve currency, and to be freely converted into other currencies, and to be served by an Asian Reserve Bank, broadly in line Shiokawa's proposal to ASEM. See, Ramgopal Agarwala, "Regional Cooperation in Asia: Long Term Progress, Recent Retrogression and the Way Forward," in *Economics and Research Department Working Paper Series no. 28* (Manila: Asian Development Bank, 2002). However, this idea was similar also to Eichengreen's parallel currency idea, in that it was not to displace national currencies. That implies a questionable value, as there are better means of hedging risk. According to Agarwala, his work was not commissioned by any government (such as Japan) but came from within the ADB itself. It seems clear that Kuroda's or Kawai's hand was in this. Author's Communication with Ramgopal Agarwala, personal correspondence, 19 June 2009.

is increasingly likely to be the currency of choice.⁵⁵⁰ The perception within Japan is that the ACU is also due to fear of Chinese influence, and not (as some in the US regard it) an attempt to improve relations with China.⁵⁵¹

In fact, Japanese officials took up the currency basket idea directly with Chinese monetary authorities in late 2004 or early 2005. Their aim was to persuade Chinese monetary authorities to move away from the straight dollar peg towards a basket containing yen.⁵⁵² As Vatikiotis notes, "Japan is in a hurry to cement its role as a pivot of these financial mechanisms before China becomes too dominant—and perhaps before the yen is overshadowed by the RMB."⁵⁵³ This fear of being consumed by China, including financially, is clearly growing at a popular level.⁵⁵⁴ Although many in the MOF do not feel such anxiety, the internationalization of the RMB is perceived even at the Ministry potential damage to Japan's interests.⁵⁵⁵

In February of 2006, ADB's President Kuroda announced that the ACU would be unveiled at the upcoming Finance Minister's meeting in April.⁵⁵⁶ The data for the ACU would go up on the ADB website, including details about its current strength and the relative weights of the currencies which composed it.⁵⁵⁷ However, the ACU data did not get posted as announced, nor has it been posted since. The reason was to do with relative weights of the currencies, in particular the weights of the yen and RMB.

Deciding the relative weights of the currencies in the ACU was always going to be politically difficult.⁵⁵⁸ The proposal which the Asian Development Bank's Office for Regional Economic

⁵⁵⁰ Jo Johnson, "Ft.Com Site: ADB Chief Explains Currency Unit Plan," *FT.com*, May 5 2006.

⁵⁵¹ Author's Interview with Katsu Etsuko, 18th January 2010. Tokyo.

⁵⁵² The Japanese MOF sent a memo to the Chinese Ministry of Finance providing an analysis of the merits of various regimes for China, but the proposal was unsurprisingly ignored. See, William Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (New York: Cornell University Press, 2009). pp. 138-9

⁵⁵³ Vatikiotis in Jeremy Clift, "The Quiet Integrationist," *Finance and Development*, March 2006.

⁵⁵⁴ Asakawa Natsuki, *En Ga Gen Ni Nomikomareru Hi* (Tokyo: Jigyōnohi Publishers, 2008).

⁵⁵⁵ Author's Interview with Katsu Etsuko, 18th January 2010. Tokyo. Katsu is a member of the MOF's *Kanzei Gaikoku Kawase to Shingikai* Tariff and Exchange Rate Consulting Group.

⁵⁵⁶ Kuroda is hardly a neutral party, in 2002 together with Kawai he called for a revaluation of the RMB, and accused China of exporting deflation to the world via over-capacity. Haruhiko Kuroda and Masahiro Kawai, "Time for a Switch to Global Reflation , ,," *Financial Times*, December 1 2002.

⁵⁵⁷ "ADB to Launch Asian Currency Unit in April," *Jiji Press English News Service*, Feb 21 2006.

⁵⁵⁸ If a particular country's weight is large in the ACU basket, then its movements against outside currencies, such as the dollar, will have a greater influence on the ACU's value. This means that exchange rate adjustments required to reduce divergence from ACU is less for large weighted currencies than for small countries. In other words, the cost of adjustment is born by lower weighted entities. Thus, 'there is an incentive for every economy to act like a large country...essentially a country with the largest currency weight can exercise the leadership role under the ACU-based exchange rate regime' see, Masahiro Kawai, "An Asian Currency Unit for Regional Exchange Rate Policy Coordination,"

Integration put forward focussed on three economic elements, size of economy defined by GDP (at market exchange rate), plus intra-regional trade, plus capital control variable (international debt security by residence of transactions) simply averaged, to arrive at technical weights for the currencies. Using this method, the exact weights arrived at was yen at 36.9% and RMB at 19.51%. However, these technical weights were seen by China as unacceptable. The RMB was weighted too low in their estimation. What China sought was “politically agreed averages” as in the case of Europe, which would imply a rebalance in favour of the RMB.⁵⁵⁹ As Giovanni Capannelli, an involved participant and senior economist at ADB-OREI notes, "It seems like there are many more sensitivities than we thought with regard to the definition of weights."⁵⁶⁰

China's objection at the ADB research level carried over to that year's formal meeting of the APT-FMM, at which the Chinese insisted that the resolution read “potential utilities of regional currency baskets”, rather than a stronger call for the need for the ACU. Some involved believed that this reflected a desire to rein in the ADB's efforts rather than moving ahead with monetary cooperation.⁵⁶¹ Another reason for this objection was the lack of effort by Japan to involve China in the APT based ACU research the previous year – no doubt stirring up suspicions.⁵⁶² Only after the ACU proposal was reduced to an index for academic and research purposes (rendered meaningless) did China come around to supporting it.⁵⁶³

At the same time, the ACU idea was proving divisive among other ADB board members. President Kuroda's promotion of it was viewed darkly by the United States. Not only did it smack of a Japanese scheme to ease out the dollar in the region, but as far as the US was (and still is) concerned, the ADB, as regional development bank, should not be engaged in these kinds of monetary matters.⁵⁶⁴ In addition, India also opposed on the basis that an

in *Fostering Monetary and Financial Cooperation in East Asia*, ed. Barry Eichengreen (New York: World Scientific, 2009). p. 107.

⁵⁵⁹ ———, "An Asian Currency Unit for Regional Exchange Rate Policy Coordination," *unpublished*, for *Eichengreen chapter* (2008). . pp.18-9, The graph which shows this was subsequently cut out of the Eichengreen chapter cited above.

⁵⁶⁰ Victor Mallet, "Launch of Asian Currency Unit Held up by Political Bickering," *Financial Times*, May 27 2006.

⁵⁶¹ Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst: Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T J Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008). p. 136

⁵⁶² "The Chinese did not participate in the ASEAN Plus Three research group in 2005-6, and it was in this forum that the Japanese presented a Japanese Ministry of Finance-supported proposal for the creation of the an ACU (called AMU in the paper)." See *Ibid.* in footnotes p. 135

⁵⁶³ Even here this reflects not cooperation with Japan at a lowest of low levels, but probably a shot over the bow at the US. See, Richard McGregor, "China and Japan Back 'Asia Currency Unit'," *Financial Times*, 30 Aug 2006.

⁵⁶⁴ Informal conversation with Curtis, ADB board member

Asian Currency Unit should include India, rather than be an exclusively East Asian affair.⁵⁶⁵ In the face of such difficulties at the ADB, the ACU project was transferred to the APT for further study but the ACU remains on the ADB's agenda. In May, 2009 General Manager Rajet Nag said, "one of our long-standing issues on the table is establishing an Asian Currency Unit."⁵⁶⁶

Japan has continued using its position at the ADB to push the ACU idea despite opposition from both the US and China.⁵⁶⁷ However, while China's rise no doubt is a factor in pushing Japan to consider institutionalizing the yen in a regional currency, other factors are also important. First of all, one must consider that the Japanese MOF is itself no longer interested in the ACU. After 2002-3, interest and discussion within the MOF has apparently shifted away from ACU.⁵⁶⁸ Research into the ACU is therefore funded by and pursued by non-governmental agents, whether backed by the ADB, the MOF linked Research Institute of Economy, Trade and Industry or private academics. Even Sakakibara Eisaku, who ought to be committed to the successful realization of a common currency, suggests that the project will take many decades.⁵⁶⁹ In 2010, with Japan's official interest at quite low levels, it appears as if the ACU – while coloured by realist factors – is mostly a socially constructed phenomenon.⁵⁷⁰ The common currency goal is predicated not so much on balancing against China, or even on growing levels of interdependence between Japan and East Asia (as exchange rate volatility demonstrates), but on a regionalist dream of integration, peace and prosperity. Those arguing that Japan *should* champion a common Asian currency bring in issues of peace, stability (and even war memory and guilt) in addition to stressing the economic factors they see as important.⁵⁷¹

⁵⁶⁵ William Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (New York: Cornell University Press, 2009). p. 144

⁵⁶⁶ "ADB Says Regional Currency Still under Discussion," *Agence France-Presse*, 3 May 2009.

⁵⁶⁷ Indeed, China's Central Bank Chairman's Zheng support for the SDR could be interpreted as a means to nix a regional common currency.

⁵⁶⁸ Author's Interview with Kawai Masahiro, 14 November 2008. Tokyo.

⁵⁶⁹ Eisuke Sakakibara, "Market Driven Integration in East Asia," (Asian Development Bank Institute 2009).

⁵⁷⁰ Author's Interview with R Taggart Murphy, 1 April 2009. Tokyo.

⁵⁷¹ Masahiro Kawai, "An Asian Currency Unit for Regional Exchange Rate Policy Coordination," *unpublished, for Eichengreen chapter* (2008).

5.6 Authority

Sino-Japan political relations have also affected the authority of the CMI itself. Both Japan and China would like the ability to veto the activation of the BSAs but neither is willing to pay the political cost of doing so alone. The solution thus far has been to import authority from the IMF by conditioning activation of the CMI on an IMF stand-by agreement. However, a fraction of the CMI can be tapped without an IMF agreement, and here institutional authority again comes into play between Japan and China to *compel* them to loan into a crisis.

How the CMI non-linked portion would work in practice remains unclear. Funds under the CMI are controlled by a so-called 'two key' system. This system means that in order for the CMI to be activated, a crisis-struck country must make a request and the second parties must grant the request. This system does not compel the creditors to provide funds at all, and in effect allows the creditors to opt-out of any rescue. Thus, while swap lines must be activated simultaneously and proportionally (i.e. the borrower could not preference certain lenders) by choosing not to sign a BSA with a country (or by opting out, or not renewing) this could in practice be defeated.⁵⁷²

Compared to the European Monetary System, this lack of authority to compel creditors to make loans in a crisis is particularly noticeable.⁵⁷³ In addition to the incorrect assumption that the unlinked portion of the BSA would be automatically approved, there is also a belief that these funds would be made available without any additional conditions. Yet there is no guarantee of this. Indeed, many of the BSAs already contain some performance criteria as conditions for disbursement. Handing over money without conditions is a fool's game and all of the Northeast Asian countries (the real money behind the CMI) are rightly concerned about moral hazard, i.e. the risk of becoming a long term charity for smaller Asian countries. For this reason the BSAs are charged at or above market rates of interest; this functions as a built in disincentive to use the CMI for anything other than short term currency intervention.⁵⁷⁴

⁵⁷² Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst: Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T J Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008). p. 122

⁵⁷³ The Bundesbank would intervene only when a member's currency moved towards the edges of an accepted, predetermined band of value versus the other currencies. Decision was the technical rather than political in nature, at least in theory. Of course, the position of the Deutsche-mark as the strongest currency did allow Germany more influence, a bone of contention would no doubt be replayed in Asia were the yen allowed to play a similar role in the CMI, see Chapter 5 of C Randall Henning, *East Asian Financial Co-Operation*, vol. 68 (Washington: Peterson Institute for International Economics, 2002). p. 55

⁵⁷⁴ Usually funds provided are charged at London Inter Bank Offered Rate (LIBOR) plus 150 basis points for initial

5.6.1 Conditionality

In the case of Japan, initially the conditionality was simply a requirement for the recipient country to maintain a certain, fixed amount of foreign exchange reserves. However, Japan has since (during the 2005-7 re-negotiations of all the BSAs) sought to convert this fixed sum into a variable sum of three to four months' worth of imports. This conditionality might present difficulties if Japan attempts to multi-lateralize the CMI in the future, and may have to be abandoned unless others adopt the same rule.⁵⁷⁵

China too has imposed some additional conditionality onto its BSAs. While it is generally known that the amounts disbursed under the BSAs are charged interest at market rates, what this means varies from agreement to agreement. In principle the premiums are kept secret to avoid stigmatising individual economies, but it is now known that China charges the highest rates for access to its reserves committed under the CMI. Consequently, certain Southeast Asian governments (Malaysia and Thailand) have allowed their BSAs with China to 'lapse' in 2005. This demonstrates Japan's greater willingness and capability to commit the resources to lead in Asia in this field. However, despite China's quiet but effective move to reduce its exposure in the CMI economically, China has been publicly positive about the process out of fear of losing political leadership.⁵⁷⁶ Ideally, both Japan and China should have a common policy on access conditionality and ought not to be gaming each other for a free ride in a realist fashion.

5.6.2 Surveillance Mechanism

Another area of contention has been over plans for the CMI to acquire a role in regional economic surveillance.⁵⁷⁷ On the sidelines of the ADB AGM in May 2001 (Honolulu), the APT-FMM agreed to study a policy dialogue/review mechanism. It was no coincidence that Japan was to co-chair this study group (with Malaysia). When the report from the study group was returned in November (2001), it became clear that the Japanese Ministry of

withdrawal, going up 50 basis points (to a max of 300) for every two renewals after that. With up to two years to repay the CMI could in theory be used also for middle term balance of payments financing, which was unlikely. See William Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (New York: Cornell University Press, 2009). p. 82

⁵⁷⁵ In 2009, other did adopt this rule in the multilateralization process. The possibility for stigmatism if the conditionality was public and states could compare their nation's treatment with others means this information is hard to come by. Author's Confidential Interview with Bank of Japan Officials, 16 March 2010. Tokyo.

⁵⁷⁶ Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst: Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T J Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008). pp. 122-3

⁵⁷⁷ Actually, the first move towards a regional surveillance mechanism came not from the APT-FMM but from an ADB sponsored study.

Finance (which had prepared the report) was unwilling to accept a monitoring and surveillance mechanism outside of their control. Japan's demand for de facto control was not acceptable to China, and the result was an agreement to limit policy review to the deputy minister level.⁵⁷⁸ However, such an informal process would not be able to provide the level and quality of surveillance that Japan desired. In fact, Japan has conditioned softening the CMI's link to the IMF on an improved surveillance policy and the increased (presumably Japanese) institutional capacity to control CMI activities.⁵⁷⁹ Yet China remained adamantly opposed to any independent regional surveillance capacity.⁵⁸⁰

The outcome of Japanese demands for greater surveillance was the creation of the Economic Review and Policy Dialogue (ERPD) at the APT Deputy Finance Ministers Meeting in April of 2002 (Yangon). The ERPD meets twice a year; once in April at the APT-FMM (Deputy Minister level), and once in November in a closed session hosted by a Northeast Asian country. Reviews at the Deputy level are more technical and include the region's central bankers plus other experts as needed. Ministerial level meetings are closed to all but the ministers themselves, plus the ASEAN Secretary General and (interestingly) the President of the ADB.⁵⁸¹ A side effect of the deepening of regional surveillance at the APT-FMM has been to edge out US influence in regional financial matters by causing the dissolution of the Manila Framework.⁵⁸²

The role of the ERPD as a regional surveillance mechanism was reinforced at the Istanbul meeting of the APT-FMM in May 2005. It was agreed that in order to strengthen cooperation, it was necessary to integrate the ERPD into the CMI. Following the decision to double the amount available under the CMI, all swap agreements were revised to include a requirement linking their activation to the ERPD. The Hyderabad meeting of 2006 saw the formal agreement that the ERPD, rather than individual states, would judge the worthiness of an applicant to the CMI (although the opt-out option remained in place). However, if the ERPD was actually used to in this manner to judge, approve, provide policy adjustment

⁵⁷⁸ Yung Chul Park, "Beyond the Chiang Mai Initiative: Prospects for Regional Financial and Monetary Integration in East Asia," (Korea University, 2004). p. 9, 52

⁵⁷⁹ C Randall Henning, "The Future of the Chiang Mai Initiative: An Asian Monetary Fund?," *Peterson Institute for International Economics, Policy Brief* PB09-5(2009). p. 6

⁵⁸⁰ Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst: Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T J Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008). pp. 126-7

⁵⁸¹ Tetsuji Murase, "Economic Surveillance in East Asia and Prospective Issues," *Kyoto Economics Review* 76, no. 1 (2007). p. 72, the time allotted to the ERPD on the agenda is 40 minutes.

⁵⁸² The Manila Framework was set up during of the crisis (1997) to improve monitoring and access to the IMF and included the US, Australia and New Zealand in its membership. After the establishment of the ERPD in 2002, the Manila Framework voted itself less frequent meetings in 2003 and then dissolved itself promptly in 2004.

recommendations or conditions, and to provide due diligence (review of policy response) for the provision of liquidity in crisis instead of the IMF, it will become very political indeed.⁵⁸³ As of 2008, the ERPD in fact set no rules as to the disclosure requirements, allowing each state a wide band of discretion in order to avoid conflict. But unfortunately, the upshot of this lack of standardization is that comparison of national conditions has become impossible.⁵⁸⁴

The cause of this lack of standardization is likely the unwillingness of China to open its books to external scrutiny (an unwillingness which allows other nations off the hook as well).⁵⁸⁵ Part of this is due to the fact that China is unwilling to submit to any type of stringent surveillance, such as the IMF Article IV consultations, presumably for fear of being criticised over its currency policy.⁵⁸⁶ Japan and China too have previously had disputes over the RMB exchange rate and exchange rate cooperation. Most notably, the high level strategic bilateral economic talks in 2007 were dealt a serious blow when China unilaterally edited its version of the formally agreed statement to remove references about the future convertibility of the RMB.⁵⁸⁷

Indeed, one of Japan's interests in strengthening the ERPD is surely to gain a better picture of what is happening in China's economy. Some suggest that the real value of the surveillance to its members is this function - an opportunity to discuss developments within China.⁵⁸⁸ But without China's cooperation, Japan has struggled to build the ERPD as an independent surveillance mechanism within the CMI - an important step in de-linking the CMI from the IMF.

China's decision to prioritize its flexibility over the regional (and indeed global) public good that submitting to surveillance would entail is predictable by realism. So too is Japan's inability to compel China to accept surveillance due to the shifting balance of power.

⁵⁸³ Tetsuji Murase, "Economic Surveillance in East Asia and Prospective Issues," *Kyoto Economics Review* 76, no. 1 (2007). p. 74

⁵⁸⁴ CMI used IMF staff papers initially. Peter Kenen and Ellen Meade, *Regional Monetary Integration* (Cambridge: Cambridge University Press, 2008). pp. 157-8, compare this to the OECD where each government confronts peer analysis of its policies and must respond.

⁵⁸⁵ Author's Interview with Etsuko Katsu, 18th January 2010. Tokyo., although ASEAN members are mostly doing IMF surveillance these days, it is possible China alone is resisting.

⁵⁸⁶ Michael Mussa, "IMF Surveillance over China's Exchange Rate Policy," in *Conference on China's Exchange Rate Policy* (Peterson Institute for International Economics, 2007).

⁵⁸⁷ "Chūgoku Kyōdōbunsho Wo Ichibu Sakujo Jinmingen Kiriage Kanren Nihon No Ryōkai Naku," *Chūnichī Shinbun*, December 10 2007.

⁵⁸⁸ Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst: Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T J Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008). p. 125

However, discounting all good from the process is to miss something important. That China is unwilling to cooperate on surveillance is a communication of sorts about the risks inside the Chinese economy and its banking system in particular. Thus, China's decision not to participate is in this case at least not chiefly aimed at preventing Japanese leadership, but a reflection of its domestic economic circumstances. Moreover, like in the CBMs process discussed later, China's disclosure is improving (although not yet at level of actionable information), and the ERPD is still clearly valued by its participants. While the outcome, the lack of institutionalization, is due to a lack of cooperation between China and Japan, it is not at all apparent that this is due to a realist competition but rather the current, if now negotiated, limits of China's economic institutions.

5.6.3 Rules: IMF Linkage

One of the more significant rules of the CMI process is the limitation of access to funds without the IMF being involved. Initially, only up to 10% of the total amount available would be released without a standby agreement from the IMF to the country involved. This limit was raised to 20% in 2005. This link to the IMF is in fact a peculiar feature to the CMI, neither its parallels in the Americas or Europe contain such a rule.⁵⁸⁹ This linkage rule is a thus a shared interest of both China and Japan, but for different reasons. Recalling the lessons learnt by the Japanese MOF during the crisis, one would not expect the Japanese side to be interested in such a link. However, after the failed the AMF proposal, any move towards an IMF independent monetary institution in Asia is likely to be viewed by the US as a threat. For the Chinese, the linkage limits Japan's leadership ability (if the US does not lead, then it will be likely be Japan). The real advantage for both China and Japan in linking the CMI disbursement to the IMF is that it frees them from the responsibility of having to pay the political costs of saying 'no' to ASEAN; they would both rather lay the blame elsewhere.⁵⁹⁰

Other events seem to bear out this analysis. There is some indication that China pressed for a full 100 percent linkage to the IMF for the CMI in the initial phase, despite the fact that

⁵⁸⁹ Those parallels being NAFA and EMS see, C Randall Henning, *East Asian Financial Co-Operation*, vol. 68 (Washington: Peterson Institute for International Economics, 2002), p. 62

⁵⁹⁰ In fact, these unlinked loans to prop up a currency might be exactly the signal to currency markets to sell triggering another destabilising round of capital flight. See, Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst; Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T J Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008); William Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (New York: Cornell University Press, 2009), p. 85, and Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst; Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T J Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008), p. 124. This does not include 2.5b free of such IMF link pledge to the Philippines by Japan under the NMI, or the tiny amounts available to it under the ASEAN Swap Agreement.

Chinese officials remained critical of IMF. When the 2005 APT FMM in Istanbul agreed to increase the unlinked proportion of the CMI to 20%, the ASEAN members (and Korea) preferred to completely abolish the link, or, if that were impossible, for the limit to be raised to 50%.⁵⁹¹ China did not take a formal position in these negotiations and it fell to Japan to take the unpopular position to support linkage.⁵⁹²

As one researcher points out, "The largest potential lenders, Japan and China, understandably wanted some assurance that their funds would not be used in the futile defence of failed economic policy [when they insisted on the IMF conditionality for the CMI]."⁵⁹³ The May 2001 Guidelines announced a review by finance ministers every three years, but at the 2004 review (an explicit opportunity to revisit the AMF idea) the joint statement merely affirmed, "agreement to undertake further review" rather than pledge to remove the peg.⁵⁹⁴

Japanese and Chinese insistence on an IMF-link is reflective of a level of cooperation between Japan and China. But this is limited to cooperation on rules to prevent membership from accessing the CMI to prop-up politically popular but failed economic policy, hardly the kind of leadership necessary to build a regional alternative to the US-led IMF financial system. To an extent this demonstrates that rivalry in other spheres of the CMI do not prevent cooperation on shared interests as per liberal institutional prescriptions, but only in so far as neither cede pride of place regionally to its rival as per the realist logic.

5.7 Resources

The capacity of the CMI to successfully meet the challenge of a(nother) regional financial crisis has, at least on paper, grown substantially since inception. However, this growth of the CMI is a reflection of the leadership struggle between Japan and China, rather a sign of a growing commitment to solve regional problems in a co-ordinated manner. Coordination would lessen the need for larger sums to be committed to the CMI. The CMI began in 2000 with a total of US\$40b (or equivalent). By 2009 it had trebled to US\$120 billion approximately. It is generally considered that US\$120 billion is necessary to actually avert a crisis; the IMF agreements during the Asian Financial crisis ran from between US\$20-60

⁵⁹¹ Author's Interview with Yung Chul Park, 1 June 2009. Seoul.

⁵⁹² Jennifer Amyx, "A Regional Bond Market for East Asia? The Evolving Political Dynamics of Regional Financial Cooperation," in *Pacific Economic Papers No. 342* (Canberra: Australia-Japan Research Centre, 2004). p. 91

⁵⁹³ Stephen Grenville, "Australia, East Asia and the Current Financial Crisis," in *Analysis* (Sydney: Lowy Institute, 2008).

⁵⁹⁴ Jennifer Amyx, "A Regional Bond Market for East Asia? The Evolving Political Dynamics of Regional Financial Cooperation," in *Pacific Economic Papers No. 342* (Canberra: Australia-Japan Research Centre, 2004). p. 7

billion.⁵⁹⁵

The ability of the CMI to deliver additional foreign exchange reserves in an immediate and effective manner is further complicated by the use of local currency (yen or RMB rather than USD) in some of the agreements involving either Japan or China; the Japan-China BSA is all in local currency. In addition, growing as it did out of the New Miyazawa Initiative; a portion (6 of the US\$21 billion equivalent) in the Japan-Korea BSA is local currency.⁵⁹⁶ China's insistence on using local currency in several of its BSAs is interesting. If China were to attempt to deliver on its \$1 billion pledge to the Philippines, the RMB provided under the CMI would need to be immediately converted into dollars by the People's Bank of China itself as the currency is non-convertible in international markets. It seems therefore the Chinese commitment in local currency is more political posturing than any attempt to increase the effectiveness of the CMI.⁵⁹⁷

5.7.1 Resources: USD, Yen or RMB?

Indeed, without a regional currency to back it up, the CMI must use one or a number of other currencies. But how is the balance between these currencies, particularly the USD, yen and RMB, to be struck? While it may be economically rational to set the proportions of the various currencies in the CMI to their actual usage rates in the region's trade and finance (which would see the USD dominate), it is clear that the agreement is to be based principally on political concerns.⁵⁹⁸ This is because every player has an interest in maximising the role of their currency in the CMI.⁵⁹⁹ Certainly for Japan, which initially proposed that the yen count for half of the AMF, anything less was going to look like backing down. However, if Japan were to contribute half, this would mean that China's RMB would be in second place – and China demanded at least equality with Japan as a

⁵⁹⁵ Asami Tadahiro, "Chiang Mai Initiative as the Foundation of Financial Stability in East Asia," (Tokyo: IIMA, 2005). p. 12

⁵⁹⁶ BOJ is contracting party for the NEA BSAs in Yen, while the MOF is the contracting party for SEA BSAs in dollars.

⁵⁹⁷ In fact, there is an in principle commitment to shift the BSAs to entirely local currencies in the future, which carries Japanese fingerprints. For China, one minor advantage of issuing in local currency for China is that damage from a mismatch is limited if they are forced to devalue their currency.

⁵⁹⁸ China uses the term, "politically agreed averages" as per the Euro. See, Masahiro Kawai, "An Asian Currency Unit for Regional Exchange Rate Policy Coordination," *unpublished, for Eichengreen chapter* (2008).

⁵⁹⁹ See Point B in Eric Girardin, "Regional Monetary Units for East Asia; Lessons from Europe," in *ADB Discussion papers 116* (Tokyo, 2008). While this has yet to be confirmed as a reason to my satisfaction, when country A provides country B with a BSA denominated in local currencies, country A assumes country B's exchange rate risk. Moreover, as country B is now holding country A's currency, it is easier for country B to resolve its debts to country A (whenever in trade or finance). In fact, country B now has an incentive to depend on country A in trade and finance because of this. Swapping currency causes integration, the weaker partner B integrating into the larger partner A by using A's currency. Especially for the RMB, which is inconvertible, the smaller economy (Korea say) is virtually forced to use the RMB to buy Chinese goods and services.

matter of national pride. Conversely, Japan was hoping to lock-in its leadership in the provision of regional public goods.⁶⁰⁰ (also a matter of pride) by having its currency hold the largest share in the CMI precisely due to concerns about China's rise.⁶⁰¹

Of course, some doubt that Japan will be able to actually provide yen to its CMI partners in event of a crisis. One Singaporean official noted that, as Japan had not yet put any mechanism in place, Japan might be forced to buy yen on the open market with its USD reserves, defeating the purpose of using local currency.⁶⁰² On the flip side, Korea's interest in a yen deal is marginal; Korea is likely use the yen to buy USD in any case. It does not matter to Korea if the resources are received in yen or in dollars. Rather, the benefit is Japan's - both symbolically and in terms of monetary influence. For the same reason, China's BSA with Korea is also denominated in RMB.⁶⁰³ This interest of both Japan and China in the symbolic value of pledging local currency, despite its limitations and complications, suggests that they are indeed competing for pride of place in the CMI.

5.7.2 Institutional Capacity: Secretariat?

If the CMI is to function as intended then it will need to acquire a secretariat to control and manage loans rather than a network of BSAs. This need had been informally acknowledged by the APT minister themselves prior to the May 2007 APT FMM in Kyoto at which a formal call was made for the so-called Chiang Mai Initiative Multilateralization (CMIM). However, the agreement which resulted was not for multilateralization in the sense of institution building, but rather an agreement (in principle) to create "a self-managed reserve pooling arrangement governed by a single contractual agreement."⁶⁰⁴ The purpose of this 'single agreement' is to actually avoid the need for an institutionalised secretariat to manage the funds. Instead, this agreement aimed to clarify circumstances in which CMI funds would be released even while maintaining the status quo of creditors managing their portion of the CMI within their own national foreign exchanges reserves (no paid-in portion but rather a promissory note).

⁶⁰⁰ Japan (and China) only has access to \$1 for every \$2 it puts in, it is clearly therefore the "providers", all other members ration is 1 or above and are thus recipients, see Appendix 9.

⁶⁰¹ Saori Katada and Mireya Solis, "Under Pressure: Japan's Institutional Response to Regional Uncertainty," in *Northeast Asia: Ripe for Integration*, ed. Ramgopal Agarwala (Berlin: Springer, 2009). p. 140

⁶⁰² The official addressing MOF Yosano begun by saying "are you sure you have thought about this?", see Yasuhiko Ota, "Genei No Ajia Tsūka Kōbō," *Nihon Keizai Shimbun*, May 10th 2009.

⁶⁰³ A Korean intervention with yen can hardly be blamed on Japan after all. For China, since the RMB can not be turned into USD on the open market, Korea is forced to trust and depend on the Chinese central bank. The other option is to use those RMB to purchase Chinese goods and services and take some pressure indirectly off the Won, but hardly flexible. Interview with negotiator of the CMIM, Author's Interview with Yoon Deok Rong, at Kiep 3th June 2009. Seoul.

⁶⁰⁴ Masahiro Kawai, "Evolving Economic Architecture in East Asia," (Tokyo: ADB Institute Discussion Paper No. 84, 2007). p. 15

In reality the options for the creation of a secretariat are limited. The default option is for the ASEAN Secretariat to handle the CMI. This option, while neatly side-stepping Sino-Japanese tensions is unlikely for two reasons; firstly, the money is coming from Northeast Asian countries, and secondly, the costs for ASEAN of running the CMI secretariat are high enough to cause political tensions (as not all of ASEAN are members of the CMI).⁶⁰⁵ Another option is for the ADB to become the home for the future secretariat. While this seems less likely, as the US and other Western powers would object (on the grounds that a development bank should not play host to a mini-IMF, and especially should not be using ADB money to do so). Additionally, China continues to be sceptical about the neutrality of the ADB, suspecting it of a pro-Japan bias (see Chapter Seven). Yet another option is for the CMI to form *de novo* its secretariat, however this 'solution' would run into the usual problems of where to house it. The logical place to establish the secretariat might be Japan, after all the idea was Japanese and Japan is footing at least half of the bill but Chinese opposition prevents this.⁶⁰⁶ In fact, a decision on where to place the CMI secretariat was due in December 2008, but no conclusion was reached at that time.⁶⁰⁷ A solution only reached in April 2010, with the decision to house the secretariat in Singapore – a site that avoids both China and Japan.⁶⁰⁸

In institutionalising the role of their respective currencies and in reaching a decision on where to place the secretariat, China and Japan have been unable to cooperate with each other neither willing to cede pride of place. In both instances, Japan's reasons for attempting to institutionalise Japanese influence in the CMI were due to its fears about the implications of the rise of China. Unsurprisingly, China is unwilling to see Japanese influence become locked-in for precisely this reason of mutual distrust. Thus, both the reason for Japan's actions in seeking to institutionalize its influence and the inability of Japan to achieve this goal, are in conformity with the realist prescriptions of Power Transition and Hegemonic Stability theory.

⁶⁰⁵ In fact, multilateralization might well weaken the rationale for ASEAN countries who viewed the CMI as a borrowing facility with no up-front costs. If multilateralised, these ASEAN might actually be required to help each other in crisis, rather than get handouts from the NEA countries see Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst: Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T J Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008). pp. 126-7

⁶⁰⁶ The link between institutionalization and Sino-Japanese relations is clear in the mind of one member of the Tariff and Exchange Rate consulting group, stating that "we will need a secretariat if surveillance is to go ahead, but with China and Japan in opposition it is impossible to agree where to put it." Author's Interview with Etsuko Katsu, 18th January 2010. Tokyo.

⁶⁰⁷ Author's Interview with Jayant Menon, 4th December 2008. Tokyo.

⁶⁰⁸ Also side-stepping Thailand which had been tipped for the secretariat but whose domestic political instability called into question its ability to successfully host it. Indeed, Thailand nearly did not sign the CMIM document.

5.8 Conclusion: Power, Efficiency and Identity in East Asia's Financial Regionalism.

Japan's response to the rise of China in the arena of financial regionalism is hard to capture using any one international relations theory. While the need to go ahead with the provision of international public goods such as financial stability must necessarily be explained with reference to interdependence, in tracing actual institutional outcomes, realism's relevance cannot be discounted.

China's initial veto of the AMF rendered Japan's preferred means for its financial leadership impossible. China's continued insistence on formal equality with Japan (on pain of spoiling further institutionalization) has made it impossible for Japan to lock-in its influence. Instead, Japan launched a series of bilateral swaps with regional member countries, and coordinated to one extent or another with China on scale and conditionality through the CMI. Both China and Japan have also begun to offer a number of BSAs outside of the CMI process in an attempt to more directly purchase influence in the region, clearly with one eye on each other. The outcome of this rivalry is predictable and its deleterious effects are visible in the membership, authority and resources of the CMI. In particular, the bilaterally-networked structure of the CMI stovepipes members' access to funds, and has even introduced the possibility that the institution will fail to deliver in the face of a crisis. Realist conceptions such as power transition and hegemonic stability are therefore fundamental to understanding how the rivalry of Japan and China has impacted on the development of the CMI. But while realism describes the problems of the institution adequately, realists would not likely have predicted that this institution would even have come into being.

Liberalism on the other hand is able to explain why the rivalry between Japan and China has not been fatal to regional financial cooperation. While Japan has been unable to hegemonically establish its preferred institution (the AMF) due to its lack of a material power edge, its entrepreneurial and intellectual leadership have prevailed. Specifically, Japan responded to a perceived demand for a regional public good (financial stability) chiefly by ASEAN and Korea by offering a solution acceptable to both the demanders and suppliers (including China and the US, via the IMF). Starting modestly, the CMI has slowly expanded in size and prestige - even if access remains stove-piped in a network of BSAs. Similarly, the CMI process has also had spill-over type effects on the ERPD surveillance mechanism.

Yet both realist and liberal thinkers would also be puzzled by Japan's apparent interest in a

common regional currency. This is because the idea of a common regional currency is more important to the region's identity politics than either its actual chances of realization or its probable limited economic utility would suggest. Indeed, the Chiang Mai Initiatives serve as more of a symbolic reference of how far Asia has come together, despite the fact it has never been activated. The CMI is in part a response to the West ('the other' in Asia's still nascent but growing regional identity formation) for the perceived wrongs committed during the Asian Financial crisis. For Japan too, the CMI is evidence of its continued relevance to Asia, both as a leader and as a part of the 'solution'. Recalling the damage to Japan's national self-confidence in the aftermath of the crisis, especially in light of China's growing presence and prestige, the CMI was important to Japan for reasons more to do with restoring national identity than actual economic benefits or hard-nosed calculus of national interest.

In conclusion, the realists are half-right. Japan is trying to balance China in its approach towards the CMI and regional financial cooperation. Certainly the laboured first years of the CMI's existence until 2008 or early 2009, being built up as an *ad hoc* bilateral network with dubious actual utility, can be explained with realism. Thus the realist hypothesis about the link between a lack of a regional hegemon and the inability of regionalism to progress beyond the bilaterally-networked stage seems to capture the initial phase most accurately. But realist analysis over-emphasizes the role of zero sum material power considerations as a motivating force for state action in the financial arena. Blocking China was not the critical interest in Japan's initial offer of the AMF, rather Japan's interests lay with preserving Japan's influence in the face of unwanted US interference. Scope therefore always existed for China and Japan to cooperate, and although Japan is still unable to accept China officially participating as co-equal 'number one', Japan has been willing to see China in a position of influence within the institution.

5.9 Postscript: the World Financial Crisis and CMI Multilateralization.

Of course, regional institutional development hardly occurs in a vacuum and is a moving target.⁶⁰⁹ The outbreak of the World Financial Crisis in 2009 has done more to accelerate the CMIM process than the improving Sino-Japanese political relationship over the same period. While an agreement had been reached in May 4 of 2008 that 80% of the total CMI would come from China, Japan and Korea – negotiation among these three were dead-locked for reasons outlined above.⁶¹⁰

⁶⁰⁹ Multilateralization is scheduled for 24 March 2010, and this thesis ought to be submitted some weeks later. The arguments made here may well be dealt a lethal blow.

⁶¹⁰ Put simply, China wanted to be equal to Japan, while Korea wanted to be equal to China. Author's Interview with

However, in wake of the World Financial Crisis, Korea finally accepted a quota of 16% of the total, or 24b, at the Pattaya conference in April 2009.⁶¹¹ Even still, Japan and China were unable to resolve their differences at that time and could not agree how to split the remaining 64%.⁶¹² The cause of the disagreement is China's insistence that the remaining be split equally, refusing to accept a lower weight than that of Japan.⁶¹³ A month later a compromise was worked out whereby Japan and China contribute 38.4b each (32%). However China's share included 4.2b from Hong Kong (3.5%), which was specially (and suddenly) added to membership of the CMI. This allowed China to claim co-equality with Japan and Japan to claim the largest individual contribution (with varying understandings about whether Hong Kong *is* China for the purposes of the CMI or ought to be treated separately).⁶¹⁴ This is the first time that China has been accorded an equal weight to Japan in an international body.⁶¹⁵

That multilateralization has gone ahead at all is a reflection of the common perceived need for a regional facility in the face of the World Financial Crisis. However, if these proportions get rolled over in voting weight (even allowing for a portion to be equally distributed as is the regional norm) then it is less likely that the CMI will be able to be activated. Assuming that the ASEAN vote to give themselves access to the fund (a safe bet based on their interests and behaviour thus far), then the support of either Japan or China in addition to that of Korea is necessary to have a majority. In fact, under the voting system in place at the CMIM, neither China nor Japan can block CMIM's activation.⁶¹⁶

The way this negotiation process was set up tended to encourage competition between Japan and China. Since the CMIM's total contribution is limited, in fact limited to the Northeast Asian three, the contributions game started to look zero-sum; any increase in contribution from say, the Japanese side must be linked to a corresponding decrease in China or Korea. Secondly, the CMI is in fact about regional leadership. This means that

Former MOF Official, November 2008. Tokyo.

⁶¹¹ Author's Interview with Yoon Deok Rong, at Kiep 3th June 2009. Seoul. 'Korea learnt that Japan and China are competing (at APTFMM) and Korea in the middle. To resolve the problems between the big two players we [Korea] argued for more bureaucratic process, lower level meetings and technical to build consensus and personal relationships as well. By agreeing to 16% Korea was also able to take itself out from between the middle of China and Japan, and let them work it out themselves'

⁶¹² D Arul Rajoo, "Asean Summit Likely in Third Week of June," *Bernama*, 27 April 2009.

⁶¹³ Interview with former MOF official, and corroboration in Wichit Chaitrong, "Japan and China Vie to Be Top Contributor to Regional Fund," *the Nation*, April 10 2009. In fact the ASEAN countries resolved their individual contributions fairly early on, the delay in announcement due probably due to not wanting to "shame" NEA countries?

⁶¹⁴ "Asean, China, Japan, Skorea Finalise Crisis Pact," *AFP*, 3 May 2009.

⁶¹⁵ China has half of Japan's voting power in the IMF (3% c.f. 6% approx) and the ADB (6% c.f. 12% approx.).

⁶¹⁶ Author's Confidential Interview with Bank of Japan Officials, 16 March 2010. Tokyo.

China has every incentive not to allow Japan to cement its position as leader even as Japan attempts to position itself as such, a conflict not merely of national interests but also of status perceptions. Thirdly, there are clearly doubts in the minds of the Chinese that Japan would use the institution in a purely apolitical, functional manner. Money speaks, and by maintaining co-equal share with Japan, China can ensure that its voice will be equally loud. In fact, given that there is already a basic consensus that the CMI should be institutionalised on the principle of weighted voting, i.e. wielding votes equal to contribution, it is only natural that China and Japan would compete.⁶¹⁷ Lastly, the political decision about how much weight to attribute to each of the currencies can be used, and is likely to be used, in any future financial cooperation in the East Asia – i.e. winning this game is crucial to winning future games.

Moreover, even this new multilateralized framework is still stove-piped, as no one country is able to access the entire amount (see Appendix 9). Indeed, the total amounts accessible remain insufficient for individual countries to fend off financial crises without also going to the IMF, even assuming that the IMF condition is abolished in time. The CMIM is thus still a supplement to the IMF rather than an independent facility; this seems to be the preferred outcome for Japan.

⁶¹⁷ C Randall Henning, "The Future of the Chiang Mai Initiative: An Asian Monetary Fund?," *Peterson Institute for International Economics, Policy Brief PB09-5(2009)*. p. 6

6 ASEAN Regional Forum

6.1 Introduction

The ASEAN Regional Forum (ARF) is the only multilateral setting in which Japan and China can discuss regional security issues.⁶¹⁸ It is no accident that China and Japan have both chosen to join the ARF; the organization was formed by ASEAN precisely to engage these giants. Japan too was interested in the ARF to help manage its strategic options in the face of a rising China. This chapter argues that the rise of China has been a key factor in Japan's policy and activities in the ARF. The rise of China not only initially pushed Japan into multilateral institution building as a part of its national strategy, but is now responsible for Japan's virtual abandonment of the ARF and pursuit of other bilateral and mini-lateral security networks.

This chapter also argues that realism is half right, predicting the outcome reasonably well. China's rise has destabilized the ARF and caused Japan to reappraise its institutional strategy towards China. But such an argument simplifies how this process has occurred, in other words the link between the bilateral and the multilateral. It is here that social constructivist understandings are most useful. China's rising national power, and consequent influence in the ARF, need not provoke any policy response from Japan depending on how it is used and how Japan perceives it (i.e. the meaning attributed to power). From Japan's point of view, China's rise in power has not, however, been matched by a rising commitment to either a Confidence Building Measures (CBMs) regime or even a general commitment to allowing and equipping the ARF to discuss CBMs. Socialization is therefore at work, but it is the socialization of Japan into a realist-type regional order under China. It is no surprise then that Japan has started to defect from the ARF. This is not simply due to a reversing power balance (which as in previous chapters led to an institutionalization strategy) but also because of an increasing distrust of China's future power. Tracing the link between the effects of the Sino-Japanese bilateral relationship and the institutional outcome is this chapter's contribution to the literature.

6.1.1 The ARF as an institution in the IR literature

The ASEAN Regional Forum has attracted a fair amount of academic interest. Whether or not ASEAN is an important grouping has been written about exhaustively, and the lines

⁶¹⁸ One other setting would of course be the UN Security Council, but Japan-China bilateral disputes are unlikely to be raised in such a high-profile setting, it is made even more unlikely by China's status as a veto-holding permanent member of the UNSC. We will not discuss the UNSC as it is a global organization, not regional, and thus moves to different dynamics.

drawn between the realists and the constructivists remain.⁶¹⁹ This is due in part to its status as an indigenous response to the region's security challenges, and the complete lack of other multilateral security institutions. And yet for all this interest, there has remained a question of just how significant the ARF is an institution – will it evaporate in the heat of a serious bilateral dispute between the major powers? Richard Stubbs and Sarah Eaton pose the question in terms of power, asking simply, "is ASEAN powerful?"⁶²⁰ Unfortunately their conclusion, that it depends on how you define power, only raises more questions than it answers.

Neo-realist and realist thinkers have tended to discount the ARF as force in the international relations of the region. This is due in part to a belief that the only 'real' actors on the international stage are states. Thus there is a disinclination to see the effects of institutions/norms on shaping state interest.⁶²¹ Also important is the central role that ASEAN plays within the ARF. Many realists see ASEAN as a collection of weak states, and thus incapable of building regional order. Realists thus describe the 'ASEAN way' as a phantom that does not assist with foreign policy coordination.⁶²² Ralf Emmers argues that the balance of power in Asia goes much further in explaining state behaviour than fuzzy ideas of norms. He suggests that ARF was formed principally to balance against rising Chinese power, a common interest of ASEAN, not to mention Japan and the US.⁶²³

However, Emmers notes that, rather than aiming to strike the *military* balance, as is the traditional realist understanding of the purpose of security multilateralism (c.f. North Atlantic Treaty Organization), it was hoped that ARF could achieve a *political* balance. Foreign

⁶¹⁹ Kai He, "Does Asean Matter? International Relations Theories, Institutional Realism and Asean," *Asian Security* 2, no. 3 (2006); Ralf Emmers, "The Influence of the Balance of Power Factor within the Asean Region Forum," *Contemporary South East Asia* 23, no. 2 (2001); Dominik Heller, "The Relevance of the Asean Regional Forum (ARF) for Regional Security in the Asian Pacific," *Contemporary South East Asia* 27, no. 1 (2005); Tsuyoshi Kawasaki, "Neither Skepticism nor Romanticism: The Asean Regional Forum as a Solution for the Asia-Pacific Assurance Game," *The Pacific Review* 19, no. 2 (2006); Tobias Nikchalke, "Insights from Asean's Foreign Policy Cooperation: The Asean Way, a Real Spirit or a Phantom?," *Contemporary South East Asia* (2000); Richard Stubbs and Sarah Eaton, "Is Asean Powerful? Neo-Realist Versus Constructivist Approaches to Power in Southeast Asia," *The Pacific Review* 19, no. 2 (2006).

⁶²⁰ Richard Stubbs and Sarah Eaton, "Is Asean Powerful? Neo-Realist Versus Constructivist Approaches to Power in Southeast Asia," *The Pacific Review* 19, no. 2 (2006). A fuller discussion can be found in William Tow, "Alternative Security Models: Implications for Asean," in *Broadening Asia's Security Discourse and Agenda: Political, Social and Environmental Perspectives*, ed. Ramesh Chandra Chandra Thakur and Edward Newman (Tokyo: United Nations University Press, 2004).

⁶²¹ Robert Keohane and Kenneth Waltz, "Correspondence: The Neo-Realist and His Critic," *International Security* 25, no. 3 (2000).

⁶²² Tobias Nikchalke, "Insights from Asean's Foreign Policy Cooperation: The Asean Way, a Real Spirit or a Phantom?," *Contemporary South East Asia* (2000). p. 91

⁶²³ Ralf Emmers, "The Influence of the Balance of Power Factor within the Asean Region Forum," *Contemporary South East Asia* 23, no. 2 (2001).

policy makers in the region also seem to support Emmers view, Former Thai Foreign Minister Surin Pitsuwan, (ASEAN's secretary- general) characterized the association in a recent interview as "a fulcrum of power plays in the region."⁶²⁴ Another scholar, Yuen Foong Khong, has described the ARF as a "mechanism for defusing the conflictual by-products of power balancing practices" in Asia.⁶²⁵ Thus the ARF was premised on that belief that "hegemonic disposition can be restrained through political and institutional means and without the use of war."⁶²⁶ Indeed, He Kai has even coined the term institutional balancing to describe this strategy, which sits in between realist and liberal understandings.⁶²⁷

Constructivists, on the other hand, are most willing to entertain the prospect that a political solution can be found to Asia's security problems. The constructivists would point out that the ARF is not trying to be a Western-style collective security institution. Specifically, the constructivists, noting that 'anarchy is what states make of it', suggest that the ARF is self-consciously trying to change the assumptions underpinning the region's international relations; its goal is 'community-building', aiming towards security *with*, rather than *against*, others member states.

The goals of ARF, according to First Statement of the Chairman includes "to work towards the strengthening and enhancement of political and security cooperation within the region, as a means of ensuring lasting peace, stability and prosperity for the region and its peoples."⁶²⁸ These goals are, even to pro-ASEAN scholars like Amitav Acharya, "vague"⁶²⁹ and difficult to concretely operationalize - certainly when compared to the Helsinki Final Act of the Conference on Security and Cooperation in Europe (CSCE).⁶³⁰ In spite of its problems, constructivists still believe in the worth of the ARF as an institution capable of boosting the region's security though its informal approach. For example, Caballero-Anthony notes that the networks developed at the ARF create, "social capital, a stock of

⁶²⁴ Schlotthus, "Asean-China Relations Take Shape," *Taipei Times*, Nov 19 2007.

⁶²⁵ Yuen Foong Khong in Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). p. 420

⁶²⁶ Ralf Emmers, "The Influence of the Balance of Power Factor within the Asean Region Forum," *Contemporary South East Asia* 23, no. 2 (2001). p. 275

⁶²⁷ Kai He, "Institutional Balancing and International Relations Theory: Economic Interdependence and Balance of Power in Southeast Asia," *European Journal of International Relations* 14(2008).

⁶²⁸ "Chairman's Statement of the First Asean Regional Forum," <http://www.aseanregionalforum.org/PublicLibrary/ARFChairmansStatementsandReports/ChairmansStatementofthe1stMeetingoftheASE/tabid/201/Default.aspx>

⁶²⁹ Amitav Acharya, *Regionalism and Multilateralism : Essays on Cooperative Security in the Asia-Pacific* (Singapore: Eastern Universities Press, 2003). p. 190

⁶³⁰ Damp Sukontasap, "The Asean Regional Forum: An Asia Pacific Model for Multilateral Security Cooperation," in *Perspectives of Regional Security Cooperation in Asia Pacific: Learning from Europe or Developing Indigenous Models*, ed. J Krause and Frank Umbach, *Arbeitspapiere Zur Internationalen Politik* (Bonn: Europa Union Verlag, 1998). p. 140

trust, familiarity, ease and comfort, which could become crucial assets at critical moments.”⁶³¹ Dosch also sees such personal relationships among elites in the region as a factor in stabilizing Southeast Asia.⁶³² Whether or not this ‘social capital’ is viable means of achieving security is contested, realists would tend to regard these beliefs as naïve at best, and dangerously idealistic at worst.⁶³³

Related to Dosch’s view is Kawasaki’s analysis, which suggests that the ARF solves a particular problem in the region, an ‘assurance game’. The assumptions underpinning the assurance game are fundamentally different from the hard zero-sum analysis of the realist school. Rather than the high stakes ‘prisoners’ dilemma’ game, the best result in an assurance game can only be achieved by mutual cooperation.⁶³⁴ As Kawasaki notes, “Japan... took...[a] leading role in erecting the ARF in hopes of inducing...[mutual cooperation aimed at] sustaining the status quo among the major powers.”⁶³⁵ The objective of the assurance game is thus fundamentally conservative, to protect the status quo. ASEAN states aim to maintain this balance by reassuring each other of their benign intent with symbolic displays and informational exchange. The ARF internationalizes this assurance game by inviting others, especially key powers such as China, to lower their weapons and reduce defence spending and opacity in the interests of preserving their prosperity and economic development.

As Xu notes, the reason this approach can work is because of the low goal set, the ARF aims for a stable order (or not-war), “because Asia’s main concern was with economic development and not security” as had been the case in Europe.⁶³⁶ The biggest ‘security’ threat ASEAN states face is a withdrawal of the US presence in Asia, which may destabilize the system. As Leifer notes, “For ASEAN, a constructive regional order would ideally be

⁶³¹ Mely Caballero-Anthony, "Partnership for Peace in Asia: Asean, the ARF, and the United Nations," *Contemporary South East Asia* 24(2002).

⁶³² Jorn Dosch, Remy Davison, and Michael Conners, *The New Global Politics of the Asia-Pacific* (London: Routledge, 2004). p. 78, Indeed, ARF has been useful in this regard by putting US Foreign Minister Warren Christopher together with the PRC’s Foreign Minister Qian Qichen at the 2nd ARF in 1995 at the height of the Taiwan Straits crisis.

⁶³³ Of course, the extent and import of this “social capital” is questionable when in 2005, the ‘big players’ US, Japan and China did not send ministerial level representatives. See, "Major Players Skip Asean Forum," *Thai News Service*, 29 July 2005.

⁶³⁴ Assurance Game is therefore one of the ‘Stag Hunt’ variety of games, where not even betraying a cooperative partner will yield a better result for the rational player. There is overlap between this view from the constructivists side and Charles Glaser’s ‘contingent realism’, see Charles Glaser, "Realists as Optimists: Co-Operation as Self-Help," *International Security* 19, no. 3 (1994-5).

⁶³⁵ Tsuyoshi Kawasaki, "Neither Skepticism nor Romanticism: The Asean Regional Forum as a Solution for the Asia-Pacific Assurance Game," *The Pacific Review* 19, no. 2 (2006). p. 233

⁶³⁶ Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). p. 419

based on the balancing military engagement of the United States. This would allow Japan to continue its limited security policy which in turn would be critical in encouraging China to conduct its regional relations according to those norms that had served the general interests of the ASEAN states so well.”⁶³⁷

From a realist perspective, however, this conception of the ARF’s goals implies that the relevance of the ARF to Japan was in question even from the outset. The ARF, as a conservative grouping, was not interested in seeing a new leader and regional order emerge. Indeed, it can be argued that it was actively out to prevent such an occurrence in the form of China’s hegemonic potential. Nor was ASEAN much interested in seeing Japan take on a ‘new’ leadership role in the area of security, except as a means of balancing out Chinese influence. Thus, the ARF was hardly going to act as a force multiplier for Japan’s foreign policy preferences towards China, a fact Japan would only wake up to after the ARF was well and truly established and China had taken its place at the table.

6.2 The Formation of ARF: the China Factor and Japan’s Interests

This section provides a brief history of the formation of the ARF. In particular, it will discuss Japan’s interests in a regional multilateral security institution at the end of the Cold War and the role that Japan played in the formation of the ARF. It will argue that the rise of China was central in Japan’s decision to promote multilateral security institutions.

6.2.1 The Nakayama Proposal: the role of Japan in forming the ARF

During a Diet address on January 25 1991, Minister of Foreign Affairs Nakayama Tarō, after giving the usual platitudes about the inappropriateness of modelling East Asian security cooperation on the CSCE, advocated “strengthen[ing] dialogue and cooperative relations on a sub-regional basis” and noted ASEAN would be the most logical place to situate such an organ.⁶³⁸ Indeed, the need for such an organization had also been realized by ASEAN. The ASEAN Institute of Strategic and International Studies (ASEAN-ISIS), in 1990 considered whether or not to broaden the scope of the ASEAN Post-Ministerial Conference (ASEAN-PMC) to include a security role. Japan played a role in these discussions at the ASEAN-ISIS, with Satō Yukio from the Foreign Ministry’s Information and Analysis Division attending as a guest speaker and observer.⁶³⁹ Sato stated at this meeting that Japan was

⁶³⁷ Leifer in Ralf Emmers, "The Influence of the Balance of Power Factor within the Asean Region Forum," *Contemporary South East Asia* 23, no. 2 (2001).

⁶³⁸ Paul Midford, "Japan's Leadership Role in East Asian Security Multilateralism: The Nakayama Proposal and the Logic of Reassurance," *The Pacific Review* 13, no. 3 (2000). p. 374

⁶³⁹ Yukio Satō’s role however in the formation of ARF is questioned by Jusuf Wanadi, the chairmen of CSIS Indonesia who thought the direction of influence was uni-directional, that Satō “was influenced but did not influence the ideas of

interested in playing a larger and more active role in Asia-Pacific security and politics, and that this required a multilateral security framework to reassure Japan's neighbours of its benign intentions.

However, Satō's ideas for an ARF did not mesh with those of ASEAN. As opposed to ASEAN, Japan was open to APEC as a site for security cooperation and wished to limit the membership to ASEAN-PMC members (i.e. to exclude the socialist countries, such as China).⁶⁴⁰ Sato, who was intimately involved in the process, suggests that "the [Nakayama] proposal reflected Tokyo's intention that Japan and ASEAN together form the *core coalition* for regional consensus building on security multilateralism. The combined diplomatic weight of ASEAN and Japan could largely ensure the realization of any forum they crafted."⁶⁴¹

The results of this Track II meeting was then handed up to the ASEAN Ministerial Meeting in 1991 in Kuala Lumpur; however there was no consensus and the idea was not developed further.⁶⁴² In the PMC that followed, Japan's Foreign Minister Nakayama officially proposed, in what was to become known as the Nakayama proposal, that the PMC be formally mandated to address regional security issues. Nakayama argued that formalizing the PMC meetings would institute a "process of political discussions designed to improve the sense of security among [Asian countries]."⁶⁴³ Although his proposal received only a lukewarm response, the 1992 PMC meeting in Manila included political and security issues for the first time. Building on this momentum, in a January 1993 speech in Bangkok, Prime Minister Miyazawa Kiichi called upon the region to "develop a long-term vision regarding the future order of peace and security For this, various ideas should be thrashed out through political and security dialogue... Japan will actively take part in such discussions." Indeed, Japanese political interest in regional multilateralism was high, with support for such a mechanism appearing in the Prime Minister's advisory groups, in reports from *Bōei Mondai Kondankai*.⁶⁴⁴

The Nakayama proposal opposed including either the Soviets or China in a future grouping. Nakayama wanted to restrict the dialogue to "the friendly countries...us."⁶⁴⁵ China was a low priority. While some MOFA officials have suggested that the China Desk wanted to

formation of the ARF." Although Satō believes that Japan's interest and activism was instrumental in convincing the US to support the ARF idea. Ibid. p. 380

⁶⁴⁰ Ibid. p. 381

⁶⁴¹ (emphasis added) Ibid. p. 378

⁶⁴² Ibid. the idea to extend the PMC was received positively by Singapore, but Indonesia and Malaysia were reluctant.

⁶⁴³ Ibid.

⁶⁴⁴ See Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005). p. 489

⁶⁴⁵ MOFA Bluebook 1991 p. 470 in Paul Midford, "Japan's Leadership Role in East Asian Security Multilateralism: The Nakayama Proposal and the Logic of Reassurance," *The Pacific Review* 13, no. 3 (2000).

include China, Chinese membership was seen as inseparable from Russia and the Soviet Desk (*Sorenka*) was against including Russia. It appears that the reason for the sudden appearance of the Nakayama proposal was to pre-empt others, including ASEAN,⁶⁴⁶ and to head off the chances of China and the Soviets getting membership in any security organization to be formed.⁶⁴⁷ Thus Japan's China policy was subordinated to its Russia policy, which in turn depended on US strategy.⁶⁴⁸ Japan lost an early opportunity to engage China in the emerging security grouping. For China, which participated as an observer in the PMC for the first time in 1991, and thus saw firsthand Nakayama propose a future group which might exclude it, the incentive to become included (via ASEAN support) only increased.

In the end, the Nakayama proposal fell far short of being the instrument by which a regional security group would be formed. Nevertheless, ASEAN states were quietly pleased with Nakayama's speech as it had "broken the ice" on the subject.⁶⁴⁹ There are several reasons for this failure. Nakayama's lack of prior consultation before submitting the proposal was clearly very significant.⁶⁵⁰ Secondly, some also suggest that the Nakayama proposal came as suddenly as it did because Japan saw a chance to prove that it was still diplomatically dynamic after the 1991 Gulf War fiasco.⁶⁵¹ Of course, Japan's reputational problem related to wartime history also interfered with its attempt to design an institution for security reassurance.⁶⁵²

The emergence of China as factor motivating Japanese security multilateralism

Yet in 1992, just one year after the Nakayama proposal, the situation changed radically. The collapse of the Soviet Union in December 1991 and the subsequent concern in both Japan and ASEAN that the US might withdraw from Asia pushed the issue of a security

⁶⁴⁶ Akiko Fukushima, "The Asean Regional Forum," in *The Regional Organizations of the Asia-Pacific*, ed. Michael Wesley (New York: Palgrave Macmillan, 2003). ASEAN members wanted to expand membership of the future security organization beyond the ASEAN-PMC to include China, Russia, and DPRK. This did not mesh with Nakayama's idea of limiting membership to ASEAN-PMC. ASEAN also worried about the PMC becoming a 'security only' grouping.

⁶⁴⁷ Paul Midford, "Japan's Leadership Role in East Asian Security Multilateralism: The Nakayama Proposal and the Logic of Reassurance," *The Pacific Review* 13, no. 3 (2000). p. 384

⁶⁴⁸ Ibid.384, At that time the US was opposed a multilateral forum with included 'non-like minded' states, Japan welcoming them into a security grouping would have undermined the US position.

⁶⁴⁹ Satoh in Ibid. p. 382, an ASEAN ISIS Scholar noted that "opinions of ASEAN researchers have passed through the Japanese Foreign Ministers mouth and onto the government level"

⁶⁵⁰ Another unsubstantiated explanation was that the memoranda surfaced too soon in the official setting, i.e. an accident.

⁶⁵¹ Paul Midford, "Japan's Leadership Role in East Asian Security Multilateralism: The Nakayama Proposal and the Logic of Reassurance," *The Pacific Review* 13, no. 3 (2000).

⁶⁵² Ibid. p. 386

dialogue to the foreground.⁶⁵³ At the 4th ASEAN Heads of Government meeting in 1992 in Singapore it was decided that, "ASEAN should intensify its external dialogues in political and security matters by using the ASEAN PMC" - a significant change from the previous year, and essentially embracing Japan's position. For ASEAN, successfully engaging China had become their chief security concern; especially in light of worsening territorial disputes with China in the South China Sea.

For Japan, the falling away of the Soviet threat and the possibility of an American retrenchment meant that, like ASEAN, Japan needed a way to engage with China. Whereas before Japan had tried to exclude China from regional security institutions, now it became imperative to have China involved. Japan came to support the ASEAN position for the inclusion of China in a regional security institution for much the same reasons as ASEAN itself.⁶⁵⁴ In August 1994, the ASEAN Regional Forum (ARF), Asia's first institution created solely to address security concerns, held its inaugural meeting.⁶⁵⁵ Although Japan was certainly not the sole force behind the ARF's creation, Tokyo's support for ARF had been critical, and behind Japan's interests lay concerns with China's rise.⁶⁵⁶

6.3 The ARF: Japan's Expectations

This section will examine the expectation of Japan first going into the ARF. We have already established that Japan's interests lay with enhancing its role in the region and managing China. But did Japan truly expect to achieve this? Certainly during the 1990s there was some domestic division in Japan on regional security multilateralism. Idealists believed that the ARF might form a security community, although they contested over whether an open model or more conservative 'Asians only' grouping was best.⁶⁵⁷ Realists viewed the ARF as simply one more tool to use in playing the balance of power game with China, although they worried more about the role of the US.⁶⁵⁸ In the middle, the MOFA merely hoped for the fostering of trust and communication through institutionalized transparency, a sort of limited community for information sharing.⁶⁵⁹

⁶⁵³ The US had announced in November of 1991 that it would close bases in the Philippines and protests were causing concern about the sustainability of Okinawa bases.

⁶⁵⁴ Peng Er Lam, "Japan and the Spratlys Dispute: Aspirations and Limitations," *Asian Survey* 36, no. 10 (1996).

⁶⁵⁵ Cautious organizers planned to limit the meeting to just three hours, which meant each Foreign Minister would have only five or ten minutes to say what is on his mind, including dialogue and questions.

⁶⁵⁶ Christopher Johnstone, "Paradigms Lost: Japan's Asia Policy in a Time of Growing Chinese Power," *Contemporary South East Asia* 21(1999).

⁶⁵⁷ Nobuo Okawara and Peter J Katzenstein, "Japan and Asia-Pacific Security: Regionalization, Entrenched Bilateralism and Incipient Multilateralism," *The Pacific Review* 14, no. 2 (2001), p. 177

⁶⁵⁸ Ibid. p. 177

⁶⁵⁹ Ibid. p. 178

6.3.1 A site for Japanese security leadership?

What the ARF represented for Japan was an opportunity to shake off some of the negative war time legacy and re-engage with its neighbours on matters of security. Japan was, however, aware that in order to achieve security leadership it would need to reassure its neighbours. As Yuzawa notes;

The idea of promoting multilateral security dialogue attracted MOFA officials, as it was expected that multilateral dialogue would function as a means to reassure other Asian countries by not only allowing them to express concerns about Japan's security policy and intentions more openly than in bilateral dialogues in which most Asian neighbours would be hesitant to air such concerns because of their dependence on Japan's ODA, but also providing Japan with an opportunity to respond to their concerns.⁶⁶⁰

MOFA was aware that unilateral moves by Japan to expand its military powers would be viewed with suspicion in ASEAN and might trigger a security dilemma with China.⁶⁶¹ Moreover, externally granted legitimacy would help Japan to reform those domestic institutions which had militated against Japan acquiring a larger role in the region's strategic affairs. Thus the ARF looked like the first real opportunity for Japan to re-join Asia as defined geographically rather than ideologically.

Yet realists in Japan believed this so-called 'self-targeting strategy' of the MOFA would be self-defeating. To their mind, using the ARF to explain the alliance and 'reassure' was not only irrelevant, but potentially dangerous.⁶⁶² For them, the purpose of the ARF should be more properly confined to traditional security cooperation, such as promoting transparency measures. The difference was in discretion. The realists suggested that non-discriminatory application of principles reached would undermine Japan's interests. In particular, practicing diffuse reciprocity with China was seen as dangerously unwise, and instead Japan should argue for conditional reciprocation.⁶⁶³ These realists, mostly in the Japan's then Defence Agency argued that Japan's involvement in the ARF process could weaken the value of the US alliance.⁶⁶⁴ Of course, the ARF as a security community was from the

⁶⁶⁰ Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005). p. 465

⁶⁶¹ Thomas J. Christensen, "China, the U.S.-Japan Alliance, and the Security Dilemma in East Asia," *International Security* v23, no. i4 (1999).

⁶⁶² Tsuyoshi Kawasaki, "Between Realism and Idealism in Japanese Security Policy: The Case of the Asean Regional Forum," *Pacific Review* 10, no. 4 (1997). p. 483

⁶⁶³ Ibid. I would suggest that the realist school is here out of touch with the realities of Chinese politics, China is more interested in hiding its self-perceived weakness than understanding better the superiority of the Japanese defence forces.

⁶⁶⁴ Taku Ishikawa, "Alliances in Security Communities: Theoretical Perspective on Compatibility," in *An Alliance for Engagement: Building Cooperation in Security Relations with China*, ed. Benjamin Self and Jeffery Thompson (New

outset designed to be an alternative to the US-led/Japan-supported security order in the region.⁶⁶⁵

6.3.2 Japan's view on involving China

Nishihara, a leading realist thinker in Japan, noted that "Japan could use the ARF to 'discourage through regular contacts, a potential adversary [i.e. China] from becoming an actual adversary (*kenzaiteki tekisei koku*) and show the benefits of being a potential adversary or becoming a friendly state."⁶⁶⁶ The rightwing Japan Strategy Research Centre (*Nihon Senryaku Kenkyū Senta*) directly points out that Japan's goal in the ARF is "to check the excessive influence of China" in traditional balance of power thinking. For Japanese realists, the ARF is only viable as long as China is a potential adversary only – and not an actual one; although where the line is drawn is a subject of debate.

For Japan the logical target of the ARF was China. One Japanese MOFA Official noted that, "keeping China in any regional multilateral forums, such as APEC or the ARF, is the common interests of all Asia Pacific countries, including Japan."⁶⁶⁷ Another official, Kōno Masaharu, noted later that "by using the ARF as a venue within which to criticize certain policies of certain countries, Japan can exercise wider options."⁶⁶⁸ Indeed, the ARF did allow Japan more opportunities for dialogue with China, such as via the Foreign Ministers informal breakfasts.⁶⁶⁹ Japan therefore was hoping that the ARF would provide additional pressure on China to provide greater military transparency and to reduce the likelihood of Chinese military build up. For China's interests in joining the ARF see Appendix 10.

6.4 Membership

Membership is a defining feature of a regional institution as who is in and who is out is a politically charged question. More than this, the membership of regional institutions becomes a benchmark for who is in 'the region', and who is beyond it. However, in this

York: The Henry L Stimson Center, 2002).

⁶⁶⁵ Amitav Acharya, *Regionalism and Multilateralism : Essays on Cooperative Security in the Asia-Pacific* (Singapore: Eastern Universities Press, 2003). Indeed quite the debate has started over whether ARF ought to be considered a security community or not. For the negative voice see Nicholas Khoo, "Deconstructing the Asean Security Community: A Review Essay," *International Relations of the Asia-Pacific* 4(2004). For a response see, Sorpong Peou, "Merit in Security Community Studies," *International Relations of the Asia-Pacific* 5, no. 2 (2005).

⁶⁶⁶ Nishihara in Tsuyoshi Kawasaki, "Between Realism and Idealism in Japanese Security Policy: The Case of the Asean Regional Forum," *Pacific Review* 10, no. 4 (1997). p. 488

⁶⁶⁷ Takeshi Yuzawa, *Japan's Security Policy and the Asean Regional Forum* (London: Routledge, 2007). p. 57

⁶⁶⁸ Ibid. p. 58

⁶⁶⁹ "Japan, China, S. Korea to Hold Trilateral Talks in Brunei," *Kyodo News*, 17 July 2002.. This was apparently instigated by China.

regard the ARF Regional Forum is a little unusual, containing some 27 countries drawn from every continent save Africa and Antarctica. Membership of the ARF consists of the ten sub-regional ASEAN states (Brunei, Cambodia, Indonesia, Malaysia, Singapore, the Philippines, Laos, Myanmar, Thailand, Vietnam) plus Australia, Bangladesh, Canada, the People's Republic of China, the European Union, India, Japan, North Korea, South Korea, Mongolia, New Zealand, Pakistan, Papua New Guinea, Russia, Timor-Leste, United States and Sri Lanka. This broad membership is due to ASEAN's acknowledgement that certain non-East Asian powers are crucial for regional security and stability. Membership is therefore not determined principally by geographic scope but rather politics, more specifically whether an applicant satisfies the four criteria set out in the Guidelines for Participation.⁶⁷⁰

This section will address issues of membership in the ARF between China and Japan. It will argue that China's rising power has pushed Japan to take a particular (expansive) line on membership issues.

6.4.1 Taiwanese (lack of) Membership

Taiwanese membership in any international institution faces obvious complications. Recalling that the loss of Taiwanese sovereignty was responsible for the unravelling of Asia's first regional attempt at security cooperation, the Asian and Pacific Council, one might expect that questions over how, if at all, Taiwan should participate in the ARF might be the best yardstick for determining ARF's relevance to regional security. Indeed, Taiwan's lack of membership is *prima facie* at odds with the ARF's mission of encouraging dialogue over the region's security concerns. Moreover, because Taiwan is a claimant in the territorial disputes over the Spratly Islands, resolution of other security issues depends in part on Taiwan's participation in the solution, undermining China's efforts at reassurance.⁶⁷¹

Given Japan's deep trade links to Taiwan and previous support for Taiwanese involvement in regional security organization, Japan was interested in having Taiwan participate.⁶⁷² But ASEAN was not explicit about whether only sovereign countries could be members (an

⁶⁷⁰ 1) New members must subscribe to and work cooperatively toward achieving the ARF key goals as stated in the ARF Concept Paper annexed to the chairman's statement 1 August 1995, 2) Applicants must directly affect the peace and security of the region, 3) ARF will expand carefully and cautiously, 4) Participation should be decided by consultation among all ARF participants.

⁶⁷¹ "By keeping the Taiwan question hidden from regional scrutiny, China defeats its own purpose of reassuring its neighbors about its peaceful intentions. When treated like a dark secret, the Taiwan issue raises suspicion about the possibility of military conflict across the Taiwan Strait" argues Susan Shirk. Shirk 1994 in Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). p. 459

⁶⁷² A fact that can be further attested to by the run of non-official security dialogues that Japan has hosted with Taiwanese participation.

inter-national institution) or whether it was a dialogue process more akin to APEC, which had successfully included Taiwan as a member (even if awkwardly labelled). As noted in the Guidelines for Participation, ASEAN states were willing to include those 'which directly affect the peace and security of the region', thus Taiwan was a potential member.

The decision on Taiwan might have gone either way. However, in July 1996, the ASEAN Regional Forum agreed to restrict membership to sovereign states (i.e. not Taiwan), with officials further noting that future membership would be decided by consensus - effectively preventing future Taiwanese participation.⁶⁷³ This was due to China making clear that its membership was dependent on Taiwan's exclusion. Since the purpose of the ARF for ASEAN was as a vehicle to engage China, Japan was forced to cut Taiwan loose.

6.4.2 Indian Membership (1996)

Many in Japan believe that India, a vibrant democracy of over one billion and a growing economic and military power, may assist Japan in balancing against China.⁶⁷⁴ But India was not a member of the ARF from the beginning. As Ganganath Jha notes, India's omission at the outset of the enterprise is especially strange when one considers who was in fact included.⁶⁷⁵ No doubt, India's initial exclusion was based on both international and Indian domestic factors. In 1994, India still not fully persuaded of the merits of security multilateralism based in large part on the continuing dispute with Pakistan over Kashmir.⁶⁷⁶ Therefore, India did not pursue membership in the ARF with particular vigour. At the same time, others were unsure of the merits of bringing India in.

Initially, Japan and China agreed that India ought not to be included. Japan was even willing to side with China in arguing against Indian participation in the ARF, over the wishes of ASEAN.⁶⁷⁷ More than Japan's limited interest in India generally, the reasons for Japan's

⁶⁷³ Consensus granted China an effective veto. Even before the ARF was formed, Taiwan requested in July 1992 (through the Philippine foreign secretary Raul Manglapus) to become a dialogue partner of ASEAN; a request that was indefinitely put off while China has also made it clear that its participation in the ARF is contingent on Taiwan being refused membership. See, "Asean Regional Forum Restricts Future Members," *Agence France-Presse*, July 23 1996., *Strait Times* August 17 1992 in Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). p. 459

⁶⁷⁴ Indeed, one might posit a link between Japan's support of India's admission at the same time as Myanmar, as Myanmar is a site of contest between India and China.

⁶⁷⁵ Ganganath Jha, "India Shut out of Asean Regional Forum," *Jakarta Post*, 31 January 1995.

⁶⁷⁶ If India was to join the ARF, then Pakistan would eventually join too, and inevitably the issue of Kashmir would be raised – an issue that India was not interested in discussing. It seems likely that it was this issue which precluded India being invited to ARF in the first place. See, Baladas Ghoshai in "Academic Says Se Asia Will Benefit If India Joins ARF," *Bangkok Post*, 2 April 1995.

⁶⁷⁷ Certainly it was the Indian perception that "American and Japanese opposition has forced ASEAN not to invite India to the meeting of this regional forum." "All-India Radio Commentary Views Scope for Asean Regional Forum

rejection of Indian membership were due to a fear that the institutional focus would drift away from East Asia to South Asia. As Japan's real security interests were in East Asia, and specifically in engaging China, Indian participation was perceived as detrimental to Japan. China's opposition on the other hand was based on a belief that Indian participation in the ARF would dilute Chinese influence in ASEAN.⁶⁷⁸ Thus, Japan and China agreed that India ought *not* to be included initially, but for different reasons.

However, after the establishment of the ARF, Japan's priorities started to change. The 1995 Mischief Reef incident (more later) demonstrated that China was willing to undermine the ARF, and Japan came to support ASEAN's position in favour of India, for the same balance of power-type considerations as ASEAN.⁶⁷⁹

6.4.3 North Korean Membership (2000)

North Korea became a member of the ARF in 2000, despite vigorous Japanese objection. Japan objections were due to a perception that North Korean membership would be a boon for Chinese influence in the ARF. In fact, China's representative was the first to speak out in favour of North Korea being admitted at the 2000 ARF-SOM in Thailand 18 May.⁶⁸⁰ But by including the North Korean regime, and by implication the issue of nuclear proliferation on the Korean peninsula, the ARF risked not only failure, but progress on other issues. As China was ambivalent about the ARF's CBM agenda this mattered little to China, (in fact having North Korea take a hard line would, perversely, help China play the role of good regional citizen).⁶⁸¹ It was precisely these concerns which Japan singled out in May 2000; Kono Yohei noting that Japan would not support North Korean inclusion unless its fears about weakening institutional consensus were addressed.⁶⁸²

In understanding Japan's position towards membership in the ARF it is important to appreciate both realist and social constructivist factors. While realists would have accurately predicted the outcome, that Japan would favour the inclusion the like-minded, democratic powers of Taiwan and India and be opposed to the inclusion of North Korea for the same reasons, the actually timing and rationale of this position is due more to

Membership," *BBC Monitoring Service: Asia-Pacific*, 19 April 1996.

⁶⁷⁸ In denying India membership, the Chinese Foreign Minister Qian Qichen noted that 'India is an Asian, not an ASEAN, power.' This is a remarkably short sighted view of India's role in Southeast Asia, both historically and even in the present. Sunanda Datta-Ray, "Expedient to Include India in the Asian Fold," *Straits Times*, 19 April 1995.

⁶⁷⁹ Ralf Emmers, "The Influence of the Balance of Power Factor within the Asean Region Forum," *Contemporary South East Asia* 23, no. 2 (2001). p. 280

⁶⁸⁰ "Asean Regional Forum," *Bangkok Post*, 19 May 2000.

⁶⁸¹ China benefitted from North Korea's first ASO Defence White Paper at the ARF, which criticised the role of the US-Japan alliance.

⁶⁸² "Japan Undecided on N. Korea's ARF Bid, Kono Says," *Kyodo News*, May 12 2000.

constructivist factors. Put simply, Japan has become socialized to realism by China's obstructive attitude. At the outset, if North Korea had shown interest in joining the ARF, it is unlikely Japan would have opposed vehemently, if at all. Likewise, initially Japan favoured engagement with China even if that meant excluding natural balancers like Taiwan and India.

6.5 Scope

Scope refers to what the institution is 'authorized' to discuss, and can be defined in various ways. In the case of the ARF, its scope is defined both geographically and thematically. According to the first chairman's statement, ARF's scope involves "the comprehensive concept of security, including its economic and social aspects, as it pertains to the Asia-Pacific."⁶⁸³ The scope of the ARF has been, since its inception, one of the more hotly debated elements of the institution. Japan has sought to use the ARF to examine/test the nature of Chinese rising power to determine its potential future aggressiveness, but increasingly it has been China which steers the organization's agenda. Consequently, the ARF has focused on issues of less pressing concern for Japan. Indeed, the ARF's broadly defined scope means that some 'hard' issues are avoided. The scope shift in the ARF can also be seen in the number of meeting that the ARF sponsors. As Acharya notes, the Track I component alone has grown from one meeting in 1994, to nine in 1998, to fourteen in 2000, to nineteen in 2007.⁶⁸⁴ However, more meetings do not necessarily equal greater productivity.

6.5.1 South China Sea

One area in which Japan has attempted to have the ARF involved is in the resolution of the South China Sea territorial dispute. For Japan, examining how China acts in the South China Sea is an important litmus test both for how China will use its strength in the future and whether Japanese security activism will be positively viewed by regional peers.⁶⁸⁵

Prior to the establishment of the ARF it had been impossible for ASEAN countries to resist encroachment by China into the disputed region. Beijing had simply not felt constrained by the individual ASEAN countries and was able to use unilateral measures to further its claims; a precedent that worried Japan. Both ASEAN and Tokyo were disturbed when in February 1992 Beijing passed its 'Law of the People's Republic of China on the Territorial

⁶⁸³ "Chairman's Statement of the First Asean Regional Forum," <http://www.aseanregionalforum.org/PublicLibrary/ARFChairmansStatementsandReports/ChairmansStatementofthe1stMeetingoftheASE/tabid/201/Default.aspx>, 7(2) p. 3

⁶⁸⁴ Amitav Acharya, *Constructing a Security Community in Southeast Asia* (London: Routledge, 2009). p. 2

⁶⁸⁵ Peng Er Lam, "Japan and the Spratlys Dispute: Aspirations and Limitations," *Asian Survey* 36, no. 10 (1996). p. 996

Waters and continuous Area', signalling China's willingness to use force in resolving its maritime territorial disputes. Indeed, at the first ARF meeting, China's Minister of Foreign Affairs Qian noted, "China does not...have a single soldier stationed on foreign soil, nor does it have a military base abroad" had the paradoxical effect of reaffirming China's hard-line on Spratly issue, indirectly attacking the US-alliance and bringing ASEAN and Tokyo closer together.⁶⁸⁶

Japan is a natural player in the South China Sea dispute, as the area is important to Japan both economically and strategically. This fact was highlighted during the War years when Japan first occupied (1918), then annexed (1939) the Spratly islands, before finally being forced to surrender all rights to islands under the San Francisco Treaty (1951).⁶⁸⁷ Moreover, the South China Sea issue has the potential to complicate Sino-Japanese relations. Chinese possession of the South China Sea would be a minus for Japan's energy security, potentially allowing China to (in the future) interdict oil coming from the Persian Gulf. In addition, in the mind of the Japanese the South China Sea and Spratly Island dispute became linked to the Senkaku dispute. This is due in no small part to China, as the 1992 Territorial Waters law linked the Spratlys, Senkaku/Diaoyutai, and other disputed islands in a single Chinese claim.⁶⁸⁸

By 1995 however Japan had begun to realize that a more active policy was necessary. Triggered in part by China's recent nuclear test, Japan used the Second ARF to push the South China Sea issue and apply political pressure to China.⁶⁸⁹ Foreign Minister Kōno reiterated at the beginning of this meeting Tokyo's desire for safety of navigation and a peaceful solution to the Spratlys dispute. And to indicate Japan's growing interest in the area Kono, as co-chair of the ISG on CBMs also took the opportunity to propose Tokyo as a venue for the intersession group to begin its work, with the South China Sea clearly targeted.⁶⁹⁰

China did not respond favourably to these signs of growing Japanese interest, attempting

⁶⁸⁶ Amitav Acharya, *Regionalism and Multilateralism : Essays on Cooperative Security in the Asia-Pacific* (Singapore: Eastern Universities Press, 2003). p. 193

⁶⁸⁷ Peng Er Lam, "Japan and the Spratlys Dispute: Aspirations and Limitations," *Asian Survey* 36, no. 10 (1996). p. 997-8

⁶⁸⁸ In 1992, Japan still wished to de-link the disputes, and protested only against the inclusion of the Senkaku islands, not taking a stronger line with the ASEAN states. Other reasons for Japan's lack of interest in supporting Vietnam's bid prior to its membership in ASEAN is that originally Japan did not care whether China seized islands from South Vietnam in 1974, and 1988 because the Cold War put China and Japan together and Vietnam and Soviet together over the Occupation of Cambodia Ibid. p. 1000

⁶⁸⁹ Ibid. p. 1001

⁶⁹⁰ Ibid. p. 1006

to freeze Japan out of the decision making process. One way China sought to do this was through blocking Japan's membership in the groupings which discussed the South China Sea, however informally. For example, in 1995 Japan, with the assent of ASEAN, joined the annual Indonesian-initiated Workshops on the South China Sea Conflict.⁶⁹¹ However, China deliberately absented itself and denounced participation of non-claimant states like Japan - thereby sabotaging that year's Workshop and preventing Japanese inclusion in the future.⁶⁹²

Despite the fact that the Workshop was nearly cancelled for lack of financial support, China has remained staunchly against it receiving funding from both outside of the region or from Japan. Indeed, China refuses to discuss this issue with Japan in any setting as it rejects absolutely the interests of non-claimant countries.⁶⁹³

Japan sometimes had reason to believe that the ARF would help to bring China around to its way of seeing things. In 1997 at the informal meeting of the 'Plus three' heads of government, Japan, China and Korea were able to agree to a review of territorial issues and even drafted an agreement to refrain from provocative acts and to construct to those ends guidelines of behaviour. Despite this, an agreement could not be reached due chiefly to the opposition of China to the establishment of a formal device on acceptable behaviour in the disputed region.⁶⁹⁴

China's resistance to any expansion of the ARF's authority in the South China Sea has been systematic. Indeed, *The Code of Conduct in the South China Sea*, which was prepared by both China and ASEAN at the 1999 Senior Officials Meeting (Manila), is not an ARF document *per se*. Moreover, the Chinese and ASEAN versions differ; ASEAN's version of the Code emphasizes the suspension of further occupation of islets, a point that Beijing's version lacks. Moreover, Beijing interprets the Code as limited to the islands in dispute, rather than the South China Sea as a whole.⁶⁹⁵ Thus the final document is weakened both in its geographic scope and in its commitments to not erect new structures.⁶⁹⁶ China's rejection of the initiative led one media commentator to declare, "China has taken control of

⁶⁹¹ Ibid. p. 1007, ironically land locked Laos is a member, on the nod from China while Japan, a regional power with clear interests in the dispute has been blocked. China was clearly concerned protecting its advantage in the Workshop.

⁶⁹² Ibid. p. 1007

⁶⁹³ Reinhard Drifte, "Japan's Energy Policy in Asia: Cooperation, Competition, Territorial Disputes," *The Centre for Energy, Petroleum and Mineral Law and Policy Journal* 11, no. 3 (2002).

⁶⁹⁴ Bandō Satoshi, *Ajia Kyōdō Tai to Nihon* (Tokyo 2006). pp. 33-34

⁶⁹⁵ Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). p. 469

⁶⁹⁶ Emmers in Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005).

the agenda and other delegates, including...Japan, were forced to go along with Beijing.”⁶⁹⁷

To summarize, discussion on the South China Sea has moved slowly; the chief reason for which is China’s reticence to discuss ‘solutions’ rather than the problem. Japan has been bundled along with this. Japan has been unable to gain access to the various working groups which discuss this issue due to Chinese opposition. It is also watching China increase its presence in the disputed area even as ASEAN states become less and less capable of resisting incursion. As Lam Peng Er noted, “the Spratlys dispute serves as a test of whether or not Japan’s recent emphasis on multilateral forums to promote stability is viable.”⁶⁹⁸ Since Japan has been unable to increase its influence in Southeast Asia via the ARF and has been limited by China to giving only declaratory support for a peaceful resolution, it is unsurprising that Japan would become more pessimistic of the ARF.⁶⁹⁹

6.5.2 East China Sea

Even if one accepts the argument that the ARF had been a catalyst for the *Code of Conduct* in the South China Sea, the ARF has not looked to the related dispute in the East China Sea. It is here where China and Japan both vie for possession of a group of islands, called in Japanese *Senkaku* and *Diaoyutai* in Chinese. These islands, which lie about 200 nautical miles West of Naha, Okinawa, are a chain of eight islands which Japan has claimed since 1895 after they were charted and it was established (to Japan’s satisfaction) they were not Chinese. They were generally thought of as ‘insignificant’ until 1969 when UN geologists reported that oil and natural gas reserves might be found around them.⁷⁰⁰ In 1970 China formally announced its claim, arguing that the islands were first charted by Chinese vessels in 1534. These strong differences of opinion of ownership prompted Deng Xiaoping to announce in 1978 that the issue ought to be shelved and the issue went quiet until the mid-1990s.

The first sign that the issue might be re-opened was China’s adoption in 1992 of the so-called Law on Territorial Waters, which not only laid claim to the “Nansha” (the South China Sea) but in the same breath also claimed the Senkaku islands. This sparked criticism from Japan at the highest levels, with the Prime Minister and Foreign Minister both protesting.⁷⁰¹

⁶⁹⁷ Amitav Acharya, *Regionalism and Multilateralism : Essays on Cooperative Security in the Asia-Pacific* (Singapore: Eastern Universities Press, 2003). p. 193

⁶⁹⁸ Peng Er Lam, "Japan and the Spratlys Dispute: Aspirations and Limitations," *Asian Survey* 36, no. 10 (1996). p. 1001

⁶⁹⁹ Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005).

⁷⁰⁰ Mark J Valencia, "Ways Forward East China Sea Dispute," *Pacnet Newsletter*, September 6 2006., Indeed under the currently (1982) UN Laws of the Sea, it is unlikely that Japan can claim 200nm from the islands even if they fall to Japan, so they are almost certainly ‘insignificant’.

⁷⁰¹ Linus Hagstrom, "Relational Power for Foreign Policy Analysis: Issues in Japan's China Policy," *European Journal of International Relations* 11, no. 3 (2005). p. 127

The situation only worsened during the nineties. In 1995, (the same year that China pushed into the Philippines and claimed Mischief Reef), Chinese vessels were spotted exploring for oil around the Senkaku islands. China worsened the situation by claiming its activities were legal as the area was 'Chinese territory', at least as understood by China's interpretation of its own law. Furthermore, Chinese officials noted that China's military could be used to protect China's claim to Senkaku, sparking fears of an armed standoff.⁷⁰²

This is exactly the sort of problem in which the ARF might prove its worth as a regional security institution, yet the ARF has not volunteered itself. This is due, at least in part, to its narrowly defined interests in Southeast Asian security and a disinterest in spreading itself too thinly in the region. Moreover, there is a real possibility that ASEAN would then have to make the politically painful decision to support one party's claim over another's, a situation ASEAN powers would like to avoid – such a decision might split ASEAN. The most effective, cost free way the ARF might contribute to this dispute would be to set up an Eminent Persons group to discuss the issue in a neutral setting, yet even this has not occurred.⁷⁰³ Indeed, Japan has not even attempted to raise the issue at the ARF, nor, as far as is known, has Japan raised this prospect with either ASEAN or the US.⁷⁰⁴ While Chinese reticence would be understandable, Japan has perhaps squandered an opportunity to lead in regional security by putting this issue on the table at the ARF, even if it is eventually resolved either bilaterally or at the global level.

6.5.3 US-Japan Alliance

As Friedman notes, Tokyo's chief disappointment in the ARF is that China keeps talking about the US-alliance as part of the security 'problem.'⁷⁰⁵ Japan's earlier liberal strategy of 'self-targeting', aiming to reassure the region of the utility of the US-Japan alliance by talking through any uncertain issues, has perhaps invited this. But unfortunately for Japan, China is taking advantage of this openness to further its claims of regional leadership vis-à-vis the US-Japan led regional order.

Of course, China's expression of its concerns is not merely grandstanding. China's positive

⁷⁰² Susan Shirk, *Chinese Views on Asia Pacific Regional Security Cooperation*, Analysis V5 I5 (United States: The national bureau of Asian Research, 1994).

⁷⁰³ Mark J Valencia, "Ways Forward East China Sea Dispute," *Pacnet Newsletter*, September 6 2006.

⁷⁰⁴ Author's Interview with Yuzawa Takeshi, 28 September 2009. Tokyo. He notes, Japan seems to be fishing for a political solution, rather than one mediated by outside bodies. This underlines Japanese lack of confidence about its claim.

⁷⁰⁵ Edward Friedman, "The Fragility of China's Regional Cooperation," in *Regional Cooperation and Its Enemies in Northeast Asia: The Impact of Domestic Forces*, ed. Edward Friedman and Sung Chul Kim (London: Routledge, 2006). pp. 125-6

assessment of the US-Japan alliance has been consistently weakening.⁷⁰⁶ Ironically, China had been one of the greatest supporters of the US-Japan alliance during the Cold War (especially through the 1970s), when China believed that a resurgent Japan might upset the status-quo.⁷⁰⁷ However, China has seen how the alliance has been used to accelerate, rather than arrest, Japan remilitarization. The ARF has provided China with the ideal site to air such concerns, as China believes that it can criticize the US-alliance under the rubric of seeking reassurance without cost. One such example is at the eighth ARF meeting in 2001 at which Chinese Foreign Minister Tang Jiaxuan praised the ARF as “the most important venue in the Asia pacific region for the discussion of regional security issues” before proceeding to his attack against the US-Japan alliance.⁷⁰⁸ This comes at cost to the ARF. Yuzawa recounts an exchange at the ARF in which disagreement of the wording of Chairman’s statement regarding the role of the alliance delayed a meeting several hours.⁷⁰⁹

Of particular concern to China is the movement toward Theatre Missile Defence (TMD) that Japan is undertaking in conjunction with the United States.⁷¹⁰ China is particularly sensitive because its comparatively small stock of strategic weapons could be knocked out by such a system if it ever went online, rendering its nuclear capacity obsolete. Director-general of the Arms Control and Disarmament Department of the Chinese Foreign Ministry Sha Zukang stated in 2001 that, “we [China] just hope that the existing mutual deterrence...can be preserved.”⁷¹¹ China only has a limited stock of nuclear weapons capable of threatening US assets in the Asian region (chiefly in Japan), the largest of which is the roughly 20

⁷⁰⁶ Kenneth Pyle, *Japan Rising* (New York: Public Affairs, 2007). p. 321

⁷⁰⁷ China initially worried that the ARF would form anti-China alliance; while the US worried it would undermine its alliances. Both have stopped worrying because the ARF does nothing. Evelyn Goh and Amitav Acharya, "The ARF and Security Regionalism," in *Advancing East Asian Regionalism*, ed. Melissa G Curley and Nicholas Thomas (New York: Routledge, 2007). p. 106

⁷⁰⁸ Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). pp. 446-7

⁷⁰⁹ Exact wording as follows: “Due to discord between Chinese, US and Japanese representatives over ASEAN’s proposal to include language in the Chairman’s statement stating that the ‘US-Japan alliance plays a constructive role in maintaining regional peace and stability and is the foundation upon which regional multilateral mechanism are established’, the meeting was delayed several hours.” Takeshi Yuzawa, *Japan’s Security Policy and the Asean Regional Forum* (London: Routledge, 2007). p. 117

⁷¹⁰ One reason is China, which does not view North Korea as a threat to its security in the same way as Japan. China can not accept that Japan might desire TMD capacity to protect it from North Korea, and neither can Japan accept that China might legitimately feel threatened by the “defensive” TMD. This tension has meant that US-Japan bilateral cooperation on TMD undermines the ARF, and Japan is increasingly faced with having to choose between the two exclusive security strategies. See, Nobuo Okawara and Peter J Katzenstein, "Japan and Asia-Pacific Security: Regionalization, Entrenched Bilateralism and Incipient Multilateralism," *The Pacific Review* 14, no. 2 (2001). p. 182, Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005). p. 485, also see Ralf Emmers, "The Influence of the Balance of Power Factor within the Asean Region Forum," *Contemporary South East Asia* 23, no. 2 (2001).

⁷¹¹ "Envoy Warns Us over Missile Defence Issue.," *Xinhua News Agency*, 15 March 2001.

Dongfeng-5 Inter-Continental Ballistic Missiles (ICBMs) which were first built in the 1960s. Christensen notes that TMD has an 'offensive' character in China's eyes due to the Taiwan factor.⁷¹² Ambassador Sha has gone on record saying that TMD would weaken regional security, not strengthen it, and likened it to "drinking poison to quench thirst." Taiwan and TMD are clearly linked in China's eyes, Sha protesting in the 1999 ARF that TMD might "give the separatist forces on the island a false sense of security, which may induce them into a reckless path."⁷¹³

This link in the minds of the Chinese, not unreasonably, between the US, Japan and Taiwan (especially in light of the enhanced emphasis on TMD) is best seen in *China's National Defence in 2000* which notes;

The United States is further strengthening its military presence and bilateral military alliances in the region, advocating the development of the TMD system and planning to deploy it in East Asia. Japan has passed a bill relating to measures in the event of a situation in the area [emphasis mine] surrounding Japan. All this goes against the tide of the times.⁷¹⁴

It should be clear, by the obfuscating language alone, that the 'event of a situation in the area' is Taiwanese *de jure* independence. China has many times attempted to pin down what exactly the area surrounding Japan might be, but without gaining a 'satisfactory' answer.⁷¹⁵ This ambiguity in the Guidelines makes a security dilemma with China more likely, and raising it in the ARF is thus reasonable for China but still embarrassing for Japan.⁷¹⁶

Indeed, a cursory examination of the US-Japan-Australia relationship with India, especially in light of India's potential access to nuclear materials from the US under the Nuclear Deal between President Bush and India's PM Manmohan Singh, gives a certain amount of credence to China's concerns about a US-led 'containment alliance' built on strategic

⁷¹² Thomas J. Christensen, "China, the U.S.-Japan Alliance, and the Security Dilemma in East Asia," *International Security* v23, no. i4 (1999).

⁷¹³ Chinese Delegation to ASEAN Regional Forum Inter-Sessional Support Group Meeting, March 3-5, 1999 in Brad Roberts, "China and Ballistic Missile Defense: 1955 to 2002 and Beyond (Ida Paper P-3826)," (Virginia: Institute for Defense Analysis, 2003). p. 27, presumably the sense of security is "false" because the PRC will crush the island in spite of TMD if independence is declared.

⁷¹⁴ "China's National Defense in 2000," ed. State Council Information Office (Beijing2000). Section I. While the rhetoric has since been toned down, China basic postures remains the same, see "China's National Defense in 2008," ed. State Council Information Office (Beijing2009).p. 6

⁷¹⁵ Takeshi Yuzawa, *Japan's Security Policy and the Asean Regional Forum* (London: Routledge, 2007). p. 119

⁷¹⁶ Takehiko Yamamoto, "Regionalisation of Security Communities," in *Japanese Responses to Globalization: Politics, Security, Economics, Business*, ed. Glenn D Hook and Harukiyo Hasegawa (New York: Palgrave Macmillan, 2006). p.

weapons and TMD.⁷¹⁷ Beijing's strong reaction against such an occurrence has meant that discussions about a 'democratic quad' have been limited to deputy minister level on the sidelines of the ASEAN Regional Forum.⁷¹⁸

China's desperation to avoid such a TMD-based coalition forming is visible its appeal to Russia, ignored by then Russian President Putin, to protest TMD.⁷¹⁹ China has even tried asking Japan to convince the US to ratify the Comprehensive Test Ban Treaty, which would imply stopping the TMD project.⁷²⁰ Indeed, Theatre Missile Defence is often picked up by Chinese officials as a concern at ARF meetings. Again, Chinese Foreign Minister Tang Jiaxuan has stated in the ARF that, "insistence on developing a missile defence program will upset the global strategic equilibrium, undermine regional peace and stability."⁷²¹

Ironically, the fallout from the TMD project has contaminated the ARF's planned Confidence Building Measures. As Japan has defaulted from ARF to US-led TMD, China and some ASEAN countries have responded by limiting their military transparency, increasing levels of uncertainty in the region.⁷²² However ASEAN does not want to put itself in the middle of the disagreement between China and the US-Japan axis. ASEAN watered down their statement from "expressing concern" about TMD to "expressing hope" that the two would solve it by themselves. One official added that both the US and China "will be pleased because ASEAN did not take sides", a sensible policy but one which reflects the basic inability of ASEAN, and by extension the ARF, to resolve this dispute.⁷²³

With regards to scope, Japan's preference to include the South China Sea issue and the US-Japan alliance as legitimate areas of discussion has not yielded a positive outcome. Not only has Japanese influence in the South China Sea been blocked by China, but the legitimacy of the alliance has come under question. Putting aside the issue of whether China's protests have weakened regional states acceptance of the US-Japan alliance as an appropriate or necessary means of gaining regional security, it is apparent that

⁷¹⁷ Brad Roberts, "China and Ballistic Missile Defense: 1955 to 2002 and Beyond (Ida Paper P-3826)," (Virginia: Institute for Defense Analysis, 2003). pp. 25-6

⁷¹⁸ Michael J Green, "Alliance Maintenance," *Diplomat*, Sept/Oct 2007. p. 53

⁷¹⁹ Putin was convinced by the US that TMD did not diminish the Russian nuclear capability, and thus did not support China's position in the ARF, see, "Asean Steers Clear of Missile Defense Row," *Agence France-Presse*, 20 July 2001.

⁷²⁰ Sergei Mingazhev, "China Asks Japan to Convince Us to Ratify Ctb," *ITAR Tass* 2000.

⁷²¹ Dario Agnote, "Corrected: China Says Us Missile Shield Will Undermine Peace," *Kyodo News*, 25 July 2001.

⁷²² "Japan's Growing Security Dilemma," *The Nation*, 11 June 2001., for a more detailed discussion see, Christopher Hughes, "Japan's Military Modernisation: A Quiet Japan-China Arms Race and Global Power Projection," *Asia Pacific Review* 16, no. 1 (2009).

⁷²³ Surin Pitsuwan at the AMM July 2000, notes that ASEAN thinks that TMD might negatively effect the ARF, and security generally by worsening the relationship among major powers. "Asean Steers Clear of Missile Defense Row," *Agence France-Presse*, 20 July 2001.

discussion and communication has not satisfied China. Indeed, if communication has achieved anything it is to further convince the Japanese that they are distrusted by China.

6.6 Authority: Seeking Reciprocity, Finding None.

The ARF, as an offshoot of the ASEAN process, is by design devoid of institutional authority as it is typically understood. Rather the ARF has explicitly labelled itself as a 'process' that is aimed at changing the 'structure' in which state behaviour occurs, rather than attempting coercion directly. One of the ways in which it has tried to do this is through the creation of a Confidence Building Measures regime. In the context of the rise of China, a CBM regime is aimed at creating expectations of peaceful change and mutual reassurance (rather than mutual deterrence). Certainly Japan expected the ARF to facilitate China's integration into a CBM regime of a reasonable authority.

From Japan's point of view, the construction of such a regime would greatly benefit Japan's security situation, and would form the necessary ground work for acceptance of China's rise. Firstly, with increased openness and transparency from China, Japan would be less reliant on the US alliance. Moreover, Japan would be better able to contain calls for constitutional reform and 'normalization' of the military apparatus from Japan's right-wing – potentially heading off a security dilemma. In essence, a China deeply engaged in an ARF-led CBM regime would not be seen a challenge to the status quo by Japan. Indeed, as Fukuda notes a CBM regime is essentially a communication about satisfaction with the status quo.⁷²⁴ Lastly, Japan might even benefit from the CBM regime in reassuring its neighbours and especially Southeast Asia and escape the trap of history. This section will examine the effect of the rise of China on the creation of such a regime and Japan's approach to it.

Confidence Building Measures: Institutional elements.

It is necessary to discuss the definitions of Confidence Building Measures. As the term 'Confidence Building Measures' was initially coined in the West, it comes with certain Cold War era 'baggage.' The ARF has attempted to side step any expectation or precedents from the Western experience by declaring the ARF a *sui generis* organization, meaning that it is institutionally 'all of its own' and will define for itself what exactly its means by 'Confidence Building Measures.' However, there are certain basic problems that a CBM regime, however it is defined, will aim to overcome whether in the East or the West.

⁷²⁴ Tamotsu Fukuda, "Managing the Security Dilemma in East Asia: The Potential and Performance of Confidence Building Measures," in *Strategic and Defense Studies Centre* (Canberra2002). p. 38

Johan Holst, one of the leading scholars of CBM theory and practice has noted the universal applicability of CBMs as a tool to achieve common security, stating that: "CBM constitute building blocks which could provide operation substance to the notion of common security."⁷²⁵ Holst notes there are 'two types' of CBMs; Type I, designed to "inhibit the political exploitation of military force", and the more demanding Type II, designed to "reduce the danger of surprise attack."⁷²⁶ The ARF has so far focused on Type I, being chiefly concerned with superpower intervention in their internal affairs. The means by which CBMs are to do so, Holst summarizes, is by increasing the *predictability* of each state's military operations and thereby build a pattern of 'normal' military interaction against which a change to an aggressive posture would be more easily spotted. CBMs are seen therefore as a boost to mutual national surveillance of military preparations and "serve the goal, therefore, of political *demonstration* of good will and common interest."⁷²⁷ Moreover, since CBMs are a negotiated tool, usually through multilateral channels, they are less likely to reflect power imbalances in a bilateral relationship, meaning that large powers can assure their neighbours on the basis of formal equality.⁷²⁸

Of course, if CBMs really worked as advertised then war would be a thing of the past. Holst notes that CBM can actually destabilize a relationship build on deterrence, as uncertainty in the outcome of a war maintains a cold peace.⁷²⁹ Yet this is merely a reflection of more fundamental problem with CBMs, namely it assumes that those states which enter a CBM regime have benign intent, and merely lack a *modus vivendi*. Yet, where states are dissatisfied, or are revisionist, they might still enter such a regime so as to *appear* to be non-threatening while building up their strength.⁷³⁰ These general problems with CBMs are in play in the ARF, especially for those hoping to use the ARF to manage the rise of China.

Most international relations scholarship characterizes the ARF as a whole in terms of a CBMs regime aimed mostly at China. Heller argues that the "ARF can be seen as a litmus test: once a member acts aggressively the breach of the code of conduct of the ARF is a

⁷²⁵ John Holst, "Confidence Building Measures: A Conceptual Framework," *Survival* 25, no. 1 (1983). p. 5

⁷²⁶ *Ibid.*

⁷²⁷ *Ibid.*, see also Charles Glaser, "Realists as Optimists: Co-Operation as Self-Help," *International Security* 19, no. 3 (1994-5). for discussions of costly signals.

⁷²⁸ An example of this is the Soviet Union claiming that it would only provide notification of its military movements if they came within 250km of a Western power, essentially claiming an exclusive *droit de regard*, this was soon dropped in negotiations.

⁷²⁹ John Holst, "Confidence Building Measures: A Conceptual Framework," *Survival* 25, no. 1 (1983)., this dovetails with Lemke's observation that regional states in power parity are likely to enjoy cold peace if an external great power will interfere (such as CBM regime).

⁷³⁰ Tamotsu Fukuda, "Managing the Security Dilemma in East Asia: The Potential and Performance of Confidence Building Measures," in *Strategic and Defense Studies Centre* (Canberra2002).

clear warning signal for the remaining actors.”⁷³¹ This idea of the ARF as trip-wire justifies the view that China’s participation in the ARF is itself a multilateral CBM act.⁷³² The question of course is whether the ‘ASEAN way’ is just the most recent manifestation of the ‘Spirit of Locarno’, which brought a revisionist Germany back into the fold before it had accepted and internalized the legitimate security concerns of its peers. Does China’s preference for multilateralized security mechanisms reflect a cynical belief in their inability to prevent the US or Japan from furthering their interests, even at a cost to order and potentially the peace? Put another way, does China want to put ASEAN at the centre of the institution, cynically aware that ASEAN can do no harm to its interests even if regional security is not advanced.⁷³³

6.6.1 Confidence Building Measures: the Concept Paper 1995

When Japan’s Nakayama first proposed that a regional security institution be formed, CBMs were not explicitly mentioned. The reasons for this omission were both tactical and semantic. CBMs were conceived as a tool for bringing adversaries together – and Japan was uninterested in labelling others or being labelled an adversary. Additionally, CBMs were first designed to deal with the Soviet Union, which Japan wanted to exclude from the body. Indeed, Japan’s concept paper at the first ARF Senior Officials Meetings (SOM) noted that the CBMs were forged in the paradigm of the East-West confrontation in Europe and thus were not applicable to modern Asia. Nakayama talked instead about Mutual Reassurance Dialogue (*otagai ni anshinkan wo takameru koto wo mokuteki to suru seiji taiwa*).⁷³⁴ This term was used by the Japanese as an attempt to essentially repackage the substance of CBMs for Chinese consumption.⁷³⁵ While Japan was interested in CBMs in the future, it settled on this term as a compromise as such a dialogue would not require ‘true’ transparency measures (instead focused on declarative statements of intent). At the same time Japan pushed the ARF towards agreeing on a “process for CBMs creation” rather than immediately on their actual creation.

⁷³¹ Dominik Heller, "The Relevance of the Asean Regional Forum (ARF) for Regional Security in the Asian Pacific," *Contemporary South East Asia* 27, no. 1 (2005). p. 135. This author really doubts the signal would be that clear.

⁷³² Swaine and Johnston in Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). p. 439

⁷³³ The option of having China lead the ARF is out of the question, China realizing that if it takes over directing the process will have negative consequence (legitimacy deficit). Evelyn Goh and Amitav Acharya, "The ARF and Security Regionalism," in *Advancing East Asian Regionalism*, ed. Melissa G Curley and Nicholas Thomas (New York: Routledge, 2007). p. 101

⁷³⁴ Paul Midford, "Japan's Leadership Role in East Asian Security Multilateralism: The Nakayama Proposal and the Logic of Reassurance," *The Pacific Review* 13, no. 3 (2000). p. 383

⁷³⁵ Takeshi Yuzawa, *Japan's Security Policy and the Asean Regional Forum* (London: Routledge, 2007). p. 65

Initially China and Japan shared a common position towards CBMs, both wishing to proceed cautiously, acknowledging that a sudden movement on the issue would be counterproductive to their own interests.⁷³⁶ Indeed, Japan's proposals for modest but concrete steps towards a CBM regime functioned as a bridge between the 'Western' proposals of Australia/Canada which favoured strong, formal CBMs and 'Eastern' proposals from some ASEAN countries and China which wanted a declarative, informal approach.⁷³⁷ Japan's proposals struck a middle ground, urging publication of Defence White Papers and participation in the UN Register of Conventional Arms although only on a voluntarily basis.

At only the second meeting (1995), the ARF agreed on a *Concept Paper* which had been prepared by the ASEAN-SOM in 1994. The *Concept Paper* laid-out the evolutionary approach of the ARF over three stage; 1) promotion of Confidence-Building Measures, 2) Development of preventive diplomacy, and 3) elaboration of approaches to conflict. This was welcomed by Japan as it meshed with their expectation for the organization.⁷³⁸ But China was still hesitant about the role of the ARF. In order to overcome Chinese uncertainty, an Inter-Sessional Group (ISG) was established to examine CBMs – although even here the Chinese were hesitant, insisting that the ISG's mandate be reviewed annually.⁷³⁹ Thus assuaged, Beijing did not disrupt the consensus on the chairman's statement in the 1995 ARF, which had called for states to end nuclear testing at the behest of Japan. China did however ignore the consensus, and conduct an additional nuclear test in June 1996, much to Japan's dismay.⁷⁴⁰

Lastly, both within Japan and ASEAN there was support for the ARF eventually taking a role in conflict resolution, a task that might require the use of force. And in fact, point three of the *Concept Paper* was initially to read simply "conflict resolution".⁷⁴¹ However, the Chinese objected to conflict resolution being a part of the ARF's mandate, even in the future, and the term was dropped.⁷⁴² Ironically, China's support for a multi-polar world order does not extend to allowing the ARF to become an independent 'mini-UN', mainly due to

⁷³⁶ A cynic might suggest that Japan's interest being not to frighten China away at the outset, and China's being not to have any CBMs.

⁷³⁷ Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005).

⁷³⁸ *Ibid.* p. 471

⁷³⁹ Much to the annoyance of Japan, the ISG was not set up as a meeting but rather as a "group", with little or no authority to decide anything other than recommendations. The Chinese Assistant Foreign Minister Wang Yingfan saying "the ARF is a venue for dialogue and exchange of views. It is not a negotiating body or a body for arbitration at the second ARF-SOM, so chairman deleted references to mechanism as it sounded to legalistic for China. Yuzawa, *Japan's Security Policy and the Asean Regional Forum* (London: Routledge, 2007). p. 70-71

⁷⁴⁰ *Ibid.* p. 110

⁷⁴¹ Envisioning an eventual role for the ARF in commanding regional peace keeping missions – with the Cambodian experience presumably in mind.

⁷⁴² Siti Rahil Dollah, "China against Asean Plan for ARF," *Kyodo Newswire*, 20 May 1995.

the Taiwan factor. A perception emerged that, “[The Chinese] are concerned that if the ARF process moves to the second stage of preventive diplomacy it will open a Pandora's Box that could induce superpower intervention.”⁷⁴³ Of course, the US was at the top of China's mind. But Chinese objections also blocked Japanese coordination with ASEAN on security matters. These would be the first of many failures of the ARF to serve Japanese interests in building better relations with ASEAN or fostering greater trust in China.

6.6.2 Preventive Diplomacy is Prevented: 1996-1999

With stage three “conflict resolution” out of the question, at least for the interim, Japan focused on trying to get China to embrace Preventive Diplomacy (PD) at the ARF, again with little success. During the first Conference on Preventive Diplomacy (Singapore), a whole session was given over to the Chinese view. It is clear from the Co-chair's summary that China's view was at odds with most of the other conference members.⁷⁴⁴ Japan chose to wilfully ignore this signal from China, and in the subsequent ARF SOM in Malaysia (1997) Japanese officials proposed a Working Group on PD – an offer which was flatly rejected by China. Instead, China went on the diplomatic offensive by proposing that China Chair at the next ISG-CBM in Beijing. One high ranking official at ARF noted that with this offer, “China wants to control the progress in the ARF's Inter-Sessional Group.”⁷⁴⁵ Indeed, the 1997 ISG-CBMs was in many ways a non-event, the summary of the discussions being the shortest ever (in its admittedly short history). However, the 1997 ISG-CBMs in Beijing did seem to put enough moral pressure on China that in 1998 another Defence White Paper was produced.⁷⁴⁶

In fact, China's activism in the ISG-CBMs has been due in part to its realization that CBMs might be used to help China achieve its ‘offensive-type’ security interests.⁷⁴⁷ For instance, in the 1999 ISG-CBM meeting, China presented five new CBM proposals. One was a proposal for a CBM to cover the ‘use of force against civilian ships or fishermen’, and was

⁷⁴³ “Japan's Growing Security Dilemma,” *The Nation*, 11 June 2001.

⁷⁴⁴ All managed to agree that consensus was important in the practice of PD. Essentially an agreement that agreement was needed if PD was to progress, which is both obvious and useless.

⁷⁴⁵ But he also said “it could also be a domestic manoeuvre of the Chinese Foreign ministry in targeting the PLA to become a little bit more moderate in the international arena”, see “China's Motives in Wanting ARF Post Questioned,” *BusinessWorld*, 17 May 1996.

⁷⁴⁶ A fact which is generally credited at least in part to the ARF process. Nobuo Okawara and Peter J Katzenstein, “Japan and Asia-Pacific Security: Regionalization, Entrenched Bilateralism and Incipient Multilateralism,” *The Pacific Review* 14, no. 2 (2001). 179 and Rosemary Foot, “China in the Asean Regional Forum: Organisational Processes and Domestic Modes of Thought,” *Asian Survey* 38, no. 5 (1998). p. 430, even the 1998 Defence Whitepaper is not so revealing when it comes to ‘defence expenditure’, noting that most money was spent on ‘normal activities’, whatever they ought to be.

⁷⁴⁷ By offensive I mean here, China's interest in getting another to act/not act, rather than a defensive interest in preventing another from influencing China's decisions.

clearly aimed at reversing some recent setbacks China had suffered over its maritime territorial claims with Japan and the Philippines.⁷⁴⁸ The Chinese CBM proposal was just an attempt to deflect similar ‘strong’ responses in the future, and in the end China subsequently withdrew the proposal after facing coordinated ASEAN-Japan diplomacy (a list of Japanese and Chinese sponsored CBMs is provided in Appendix 11). Likewise, at the at the Ninth ARF meeting in 2001, when Foreign Minister Kawaguchi called for other ARF countries to hold more talks on PD, it was China who opposed.⁷⁴⁹ These objections from China came despite progress with Russia on similar types of cooperation in Central Asia.⁷⁵⁰ The result of instability in the ARF was an agreement to keep discussion in the ISG-CBMs at “an overlapping area between the first stage of CBMs and the second stage of PD”⁷⁵¹, instead of tackling the hard issues in PD directly.

6.6.3 Rules: Voluntary Briefings and the ASO: developments since 2000

One of the CBMs that Japan has been most eager to push in the ARF (and most eager for China to adopt) is the presentation of a Defence White Paper with a reasonable level of military transparency. It is worth noting that the Chinese had not produced a Defence White Paper until November of 1995, and even then the document, although a step in right direction, was below average. Thus, at the 1996 Tokyo ISG-CBMs, Japan pushed for the creation of minimum standards of quality in Defence White Papers, however the idea was blocked.⁷⁵² A year later in 1997, Japan hosted a workshop on ‘transparency on armaments’ to seek to expand the UN Register of Conventional Arms to include reporting on military holdings and procurement from domestic sources. At a subsequent ministerial-level meeting, then Minister for Foreign Affairs Ikeda called for the same, but again the idea was not developed because of Chinese resistance.⁷⁵³

Where Japan has had more success with China is in the voluntary briefings. This item on the agenda of the ISG-CBMs allows member countries to explain some element of their country’s defence policy. This item appears to have grown out of a previous agenda item, the ‘exchange of view’, and has been officially on the agenda since 2000. The voluntary briefing is more formal and more transparent, as the actual details of who spoke on what

⁷⁴⁸ In April 1997, Chinese fishing boats were ordered out of the Scarborough reefs by Philippine forces. Similarly, in the East China Sea in 1997-8, the Japanese coast guard and Chinese civilian vessels (protestors) had clashed, a collision even causing one boat to sink.

⁷⁴⁹ Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005). p. 474

⁷⁵⁰ China’s five power agreement 1996 in central Asia, which includes Russia, contains so-called mutual security clauses, which are probably the closer thing to CSCE type CBMs in Asia. See, Alastair Iain Johnston, *Social States: China in International Institutions, 1980-2000* (Princeton: Princeton University Press, 2008). p. 171

⁷⁵¹ "Chairman’s Statement, the Fourth Asean Regional Forum," Subang Jaya, Malaysia, July 27, 1997,"

⁷⁵² Takeshi Yuzawa, *Japan's Security Policy and the Asean Regional Forum* (London: Routledge, 2007). p. 73

⁷⁵³ Ibid. p. 78

are recorded and made available to public inquiry. Japan, which had embraced the self-targeting strategy, has given nine voluntary briefings at the ISG, or on average one per year until 2009. Among the topics Japan has discussed are its 1997 Defence Guidelines, its Anti-terror laws, its bilateral talks with North Korea, its contribution to Operation Enduring Freedom in Iraq and the upgrading of the Japan Defence Agency to ministerial level in 2007. China has availed itself of this opportunity five times (or roughly half as often). China's briefings include once in 2002 to discuss its new Defence White Paper, and twice in 2003/2004 to discuss the results of six party talks with North Korea, and twice in 2008 to discuss cooperation with Russia and the SCO (see Appendix 12).⁷⁵⁴

Another area of marginal success for Japan has been the formalization of the Annual Security Outlook (ASO). This document, compiled by the ARF, is arguably one of the more significant CBMs developed thus far. The ASO contains Defence White Papers or their equivalent from each of the ARF countries.⁷⁵⁵ Although a voluntary mechanism, the ASO at least provides a yardstick by which to measure dissatisfaction.⁷⁵⁶ Although originally envisioned as a collection of Defence White Papers, one problem with the ASO is that by virtue of removing both an editor (the ARF Chair) and clear specifications like those Japan had proposed, the ASO has not become sufficiently rigorous to be significant for regional security.

Recently, the ASO contains less and less reporting of each country's military and more opinion and assessment about the regional security environment. While Japan has contributed every year, China has been more ambivalent and has 'skipped' a few years.⁷⁵⁷ Moreover, a comparison of Japan's and China's submissions to the ASO gives some indication as to how seriously each side takes the process. In 2007, Japan listed specifically how much money it would spend on anti-terrorist measures and their nature, discussed its Peace Building operations in Sri Lanka and how much it would spend there, and frankly assessed the ARF's progress, noting the good points and committing itself to

⁷⁵⁴ "Co-Chairs' Summary Report of the Meeting of the Asean Regional Forum Inter-Sessional Support Group on Confidence Building Measures, Yangon, Myanmar, 11-14 April 2004", <http://www.aseanregionalforum.org/PublicLibrary/ARFChairmansStatementsandReports/CoChairsSummaryReportoftheMeetingoftheAS/tabid/70/Default.aspx>, and, "Co-Chairs' Summary Report of the Meeting of the Asean Regional Forum Inter-Sessional Support Group on Confidence Building Measures in Vientiane, Lao Pdr, 26-28 March 2003", <http://www.aseanregionalforum.org/PublicLibrary/ARFChairmansStatementsandReports/ReportoftheCoChairoftheARFIn tersessional/tabid/86/Default.aspx>

⁷⁵⁵ The ASO had been an idea developed down at Track II, which worked its way up through the ISG (CBM) were it was kept confidential, to being finally formally recognized at the Ninth ARF Meeting as a CBM for boosting transparency in 2001.

⁷⁵⁶ Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005).

⁷⁵⁷ Dominik Heller, "The Relevance of the Asean Regional Forum (ARF) for Regional Security in the Asian Pacific," *Contemporary South East Asia* 27, no. 1 (2005). p. 133

'expected' improvements. China on the other hand studiously avoided discussing its defence policy or budget. Indeed, according to the 2007 ASO, China believes that its greatest contribution to regional peace is its growth rate of 10.7%: an economic answer to a political question. China's contribution is therefore hollow, more a reading list of agreements already reached and declarations of its peacefulness than any real attempt to engage with its peers.

Even in 2009, the ARF was still struggling to define a standardized format for the ASO. Although able to reach agreement at the ISG level of the need to include in ASO submissions national defence budget information, the level of detail is not yet agreed – moreover even if the ASO standardization is agreed at the ISG, it still has to clear the SOM and, of course, ultimately the Ministers.⁷⁵⁸

6.6.4 Non-traditional security

One of the side effects of this lack of progress in the 'hard' area of CBMs is the emergence of non-traditional security (NTS) cooperation as an item on the ARF's agenda, which was initially formally focused on traditional military cooperation.⁷⁵⁹ Without the NTS agenda, the ARF would have almost no work to do. Some therefore describe the NTS agenda as a fight for the ARF's institutional survival.⁷⁶⁰ In part to compensate for its negative stance on CBMs proper, it is China which is most in favour of having the ARF become focused on NTS.⁷⁶¹ Japanese officials on the other hand perceive the flourishing of NTS related so-called 'CBMs' as running contrary to Japanese interest in promoting military focused

⁷⁵⁸ "Asean Regional Forum Inter-Sessional Support Group on Confidence Building Measures and Preventive Diplomacy Co Chair's Summary Report," (Seoul, Korea: ARF, 2009). Article 36 reads, "The ARF Unit briefed on the progress on the ARF Preventive Diplomacy Work Plan. The ARF Unit noted that the 15th ARF directed Senior Officials to study the recommendations of the "Joint Study on Best Practices and Lessons Learned in Preventive Diplomacy" (PD study). In view of this, ARF Unit had studied the recommendations of the PD study and prepared a table (Annex 14 of the document) listing out the key recommendations of the PD study that would be relevant in the ARF context. The ARF Unit proposed that delegations consider this table and provide written comments by 30 April 2009. The ARF Unit would then revise the table and the revised table of relevant PD recommendations would be submitted to the ARF-SOM in May 2009 for consideration. The Meeting agreed with the ARF Unit's proposal and noted that using the table of key recommendations of the PD study as a basis, the ARF-SOM could consider recommending to the Ministers at the 16th ARF that a Work Plan on Preventive Diplomacy be developed. *If the Ministers endorsed this recommendation, proper work could begin on a PD Work Plan.*"

⁷⁵⁹ "Chairman's Statement, the Fifth Meeting of the Asean Regional Forum Manila, 27 July 1998", <http://www.aseanregionalforum.org/PublicLibrary/ARFChairmansStatementsandReports/ChairmansStatementofthe5thMeetingoftheASE/tabid/180/Default.aspx>, Point 7, "the Ministers noted that the ARF had maintained its approach to security concerns in a comprehensive manner. They welcomed the fact that while the focus of the ARF was on core military and defence-related issues, the ARF also addressed non-military issues." The focus was thus initially on the military, or traditional security elements.

⁷⁶⁰ Author's Interview with Yuzawa Takeshi, 28 September 2009. Tokyo. Yuzawa is a researcher at the JIIA.

⁷⁶¹ And no accident that this shift towards NTS occurred after Beijing hosted 1997 ISG CBMs. Takeshi Yuzawa, *Japan's Security Policy and the Asean Regional Forum* (London: Routledge, 2007). p. 80

CBMs.⁷⁶²

Some Japanese scholars such as Morimoto Satoshi (a frequent Track II participant) have noted that even the NTS elements of the ARF, such as disaster relief, do in fact provide some military utility to Japan. Japanese self-defence forces deployed alongside Chinese PLA in regional disaster relief operations would still have an opportunity to observe manoeuvres, weapons and equipment. One such example is the “civilian led, military supported” Voluntary Demonstration of Response on disaster relief in 2009. Although these activities are labelled a CBM by the ARF, Japan does not accept this label.⁷⁶³ This is because the information thus gained is of an informal nature, and hardly represents a costly signal of Chinese trust in future regional peace. In fact, Japan is highly frustrated with China’s cynical ploy to prevent the CBMs agenda gaining momentum. In fact, as of 2009, there are currently no talks at the ARF aimed at military transparency.⁷⁶⁴

Japan has consistently attempted to push forward the CBMs agenda at the ARF. It is no secret that Japan’s target for such a CBMs regime is China, indeed Japan has singled out China in its ASO Security review nearly every year as being a growing power which needs to embrace transparency and CBMs. Japan’s liberal strategy, premised on the indivisibility of security, has however failed in face of China’s lack of reciprocity. Japan has learnt that China is not interested in any real military transparency boosting CBMs, and is only willing to accept declarative or NTS-type CBMs. While this is valuable information, it is hardly the position that Japanese hoped or expected that the ARF would be in after 16 years. Indeed, as it becomes apparent to Japan that China’s basic position is unchanged and unlikely to change. Japan’s commitment to an engagement strategy is therefore weakening and other strategies are becoming favoured.

6.7 Resources: Institutional Weakness

As noted earlier, the ARF is light on common institutional elements. Indeed, the ARF was founded without its own secretariat, source of funds or staffers – or phone line. Instead, ARF’s resources were tied to ASEAN, which provided what facilities it deemed necessary for the ARF to succeed. This section will examine the moves towards providing the ARF with its own institutional resources. One area of particular interest has been the ARF’s subcontracting of research staffers to the so-called Track II diplomacy, such as the Council

⁷⁶² ———, “Japan’s Changing Conception of the ARF,” *The Pacific Review* 18, no. 4 (2005). p. 472

⁷⁶³ Author’s Interview with Yuzawa Takeshi, 28 September 2009. Tokyo. This view of NTS as CBM is also supported by Morimoto at Takushoku University, a Track II participant and media personality.

⁷⁶⁴ Ibid.

for Security Cooperation in the Asia Pacific.

6.7.1 ARF reform: Chair

The need for the ARF to become more institutionalized was noted early in the ARF's history. The Japan-sponsored Working Grouping on Preventive Diplomacy (1997) noted that the role of the ARF chair needed to be considered as a mechanism for preventive diplomacy, although various views were put forward about what the Chair's competences should be. The idea for the Chair's role to be enhanced was further developed at the ISG-CBMs 1999-2000 in Singapore (Japan co-chaired). At the 2000 meeting, Japan developed concrete proposals for PD; the concept paper outlined seven main roles for the ARF chair.⁷⁶⁵

Japan's paper also contained the idea of helping to 'support' the ARF chair by enabling the Chair to draw on all/any of the ARF member countries' resources, rather than being limited to just ASEAN. Japan perhaps hoped that increased non-ASEAN influence would help jump start reform of the ARF as a whole.⁷⁶⁶ Of course, this upset Japan's ASEAN neighbours, some countries criticizing Japan for drafting a paper without first having ASEAN's approval.⁷⁶⁷ But in fact, Japan's focus was on China. Japan made vigorous efforts to reassure China, with MOFA officials informally visiting Beijing to discuss the draft working paper in the interlude between the 1999 meeting and the 2000 meeting. Indeed, based on these exchanges Japan voluntarily redrafted its paper on the Enhanced Role of the Chair several times in Tokyo before presenting a 'final' version at the eighth ARF-SOM (Hanoi 2001).

Despite Japan's efforts, the result was less than hoped for. Japan's proposal for the ARF Chair to be able to call an emergency meeting without prior notification was thwarted. Instead, emergency meetings called by the Chair would have to have the "prior consent of directly involved states and the consensus of all the ARF members."⁷⁶⁸ Furthermore the Chairman's ability to make an addition to the Statement without consensus was removed, in part due to Chinese objections.⁷⁶⁹ As a result Japan felt disappointed, and the ARF itself

⁷⁶⁵ 1/ provide early warning by taking up and drawing attention to potential regional disputes and conflicts that may have a negative impact on regional stability, 2/ convening a emergency meeting, 3/ issuing statements at chairs discretion (without the consent of ARF members), 4/ facilitating discussion on norms building in the ARF, 5/ enhancing liaison with external parties, such as international organizations and track two forums, 6/ promoting confidence building among ARF members by facilitating information exchange and dialogue, 7/ fostering cooperation between ARF members by facilitating discussion on potential areas of cooperation.

⁷⁶⁶ Takeshi Yuzawa, *Japan's Security Policy and the Asean Regional Forum* (London: Routledge, 2007). p. 98

⁷⁶⁷ Ibid. p. 98

⁷⁶⁸ ———, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005). p. 473

⁷⁶⁹ Ibid. p. 473

acknowledged that the reforms had not moved the ARF forward institutionally.⁷⁷⁰ Japan had hoped that closer coordination with China would help Japan to push ASEAN towards opening up the ARF, but in the final analysis China was unwilling to cooperate with Japan to further institutionalize the Forum.

6.7.2 ARF reform: ARF Secretariat functions

Japan has also called for the creation of a permanent ARF secretariat to coordinate the ARF's activities and, in the event of an incident, to be able to call for talks. The secretariat debate is therefore linked closely to the discussion about the enhanced role of the Chair - Japan making this link formal at the 2003 Phnom Penh ministerial meeting.⁷⁷¹ At the 2004 Ministerial meeting, Foreign Minister Kawaguchi again presented a position paper stating that the ARF should hold more substantive sessions with a stronger role for the Chair and Secretariat; in fact, at the preceding 2004 ISG-CBMs Japan presented a paper entitled "Reconsidering the ARF Functioning for the Coming Decade."⁷⁷² Towards the middle of that year there was a compromise solution reached; the ASEAN-SOM agreed to set up an ARF Unit within the ASEAN secretariat, in order to provide the ARF with basic secretarial support.⁷⁷³

Japan's understandable attempts to increase its influence via deepening the ARF's institutionalization have been thwarted. No surprise then that even in 2009, there are still two groups struggling over the definition of the vision statement; Japan in one group preferring an action plan rather than statements of principle, China preferring the opposite.⁷⁷⁴

6.8 Diffusion: Mutual Defection

China's rise in the ARF has challenged Japan's belief that its security needs can be provided through multilateral dialogue. Japan's objective from the first was to create an overlapping system of bilateral and multilateral security guarantees. Ministry of Foreign

⁷⁷⁰ ———, *Japan's Security Policy and the Asean Regional Forum* (London: Routledge, 2007). p. 102

⁷⁷¹ Yoriko Kawaguchi proposed to establish a permanent secretariat in the ARF, which would have ASEAN and non-ASEAN ARF nationals as staffers. Ibid. p. 103

⁷⁷² "Japan Wants Asean Regional Forum to Have Conflict Prevention Role," *Kyodo News*, 27 June 2004.

⁷⁷³ Text reads, "ASEAN established the ARF Unit at the ASEAN Secretariat on 26 June 2004. Based on its Terms of Reference, the ARF Unit's role and functions are as follows: (1) to support the enhance role of the ARF Chair, including interaction with other regional and international organizations, defence officials dialogue and Track II organizations; (2) to function as depository of ARF documents/papers; (3) to manage database/registry; and (4) to provide secretarial works and administrative support, including serving as the ARF's institutional memory."

⁷⁷⁴ Article 35 of the CBM-ISG 2009 notes that "Asean Regional Forum Inter-Sessional Support Group on Confidence Building Measures and Preventive Diplomacy Co Chair's Summary Report," (Seoul, Korea: ARF, 2009).

Affairs officials had begun with the expectation that the multilateral approach would work next to the alliance, and assumed that both were necessary.⁷⁷⁵ Yanai Shunji (director-general of Foreign Policy Bureau in MOFA) argued in 1995 that Japan's national and regional security policy was being shaped by the mutual co-existence of a bilateral and multilateral security networks. Japan believed the two approaches would complement each other.⁷⁷⁶

But as a consequence of the growing disillusionment with the ARF due to an inability to find *modus operandi* for cooperation with China, Japan has turned its attention towards building up bilateral and mini-lateral security networks outside of the ARF and China. This diffusion away from the ARF toward closed, invite-only groups is qualitatively different to the diffusion reciprocity that the ARF had hoped to engender in its members. Rather than mutual security, Japan's closed-shop discussion with Australia and India (in addition to deepening alliance relations with the US) poses the risk of feeding into the Northeast Asian security dilemma as Japan seeks to improve its own security situation vis-à-vis China.

Of course, Japan hardly led the diffusion away from the ARF, although its defection to minilateralism will no doubt accelerate the trend. Japan's defaulting is simply because others, but most importantly China, are not reciprocating to the level that Japan had expected. Moreover, China was already beginning to advocate a different security grouping which might undercut the ARF, the most important being the Shanghai Cooperation Organization (SCO) which China established with Russia and Central Asian states in 2000.

But even within the ARF, Beijing has sought to create sub-groups which limit or exclude outside players. To this end China has sponsored the creation of the ARF Security Policy Conference.⁷⁷⁷ Japan and China's differing opinions on the future of the ARF were reflected as Japan and China both presented differing working papers about the future of the ARF in 2007 at this conference.⁷⁷⁸

In comparison to China's subtle moves, the Japanese shift away from the ARF towards

⁷⁷⁵ Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005). p. 470

⁷⁷⁶ Few would go so far as to suggest that the ARF was to replace the Alliance, a supplementary-only role. Ralf Emmers, "The Influence of the Balance of Power Factor within the Asean Region Forum," *Contemporary South East Asia* 23, no. 2 (2001).

⁷⁷⁷ One effect of the ASPC is to reduce the significance of the Shang-ri La Dialogue, a process China had previously snubbed by not sending a representative and which includes the UK and other "colonial" powers, but China's attempts to lead within (or without) the ARF are still vague, as damaging the legitimacy of the ARF does not further China's interests as being seen as a peaceful-riser. see Michael Vatikiotis, "Military Alliances -- a Diplomatic Offensive in Southeast Asia and the Pacific," *Far Eastern Economic Review*, 5 August 2004.

⁷⁷⁸ "Chairman's Summary Report, 4th Asean Regional Forum Security Policy Conference," (Manila: ARF, 2007).

bilateralism and minilateralism is more direct. In March of 2007, Japan and Australia issued a Joint Declaration on Security – scheduled to be upgraded with a Cross Service Agreement in 2010. This was first time that Japan signed such an agreement with a country other than with the US, and represented an historic shift in Japan’s strategic thinking. While then Prime Minister, Abe, attempted to obfuscate the true intent of the agreement, it became clear that the unspoken target was indeed China.⁷⁷⁹ By linking the security declaration to fundamental human rights, Japan was deliberating excluding China from similar arrangements in the future.⁷⁸⁰

Likewise, Japan’s security cooperation with India, which had begun in 2001 with the establishment of a Security Dialogue, experienced a sudden lift in intensity from 2005. Beginning with greater exchange of high level officials, such as Japan’s Chief of Staff, and the Chiefs of the Army, Navy and Airforce visiting India in 2005-6, the negotiations for a deeper security relationship were begun in 2006 by then Foreign Minister Aso. These arrangements were later formalized under the “Joint Declaration on Security Cooperation between Japan and India.” Like the agreement with Australia, this declaration began by noting common values⁷⁸¹, and promised greater bilateral cooperation in the region, including the ARF.⁷⁸² These agreements were also the basis for trilateral naval exercises with India and the US in April 2007, and quadrilateral exercises including Australia in September of the same year.

At the same time, as a part of this diffusion away from the ARF, Japan is committing fewer diplomatic resources to the ARF. Japan’s ARF policy is mostly under the control of the MOFA’s National Security Policy Division which handles regional and multilateral security activities. In the early 2000s, the Division had eight staff, two of which were on ARF duty.⁷⁸³ However as of 2009, this number has been reduced to just one, while the North America bureau (which handles the alliance) reportedly has 15 staff.⁷⁸⁴ It is clear the Japan’s emphasis on the ARF, low to begin with, has fallen to what might be regarded as purely

⁷⁷⁹ Apparently when Abe first raised the quadrilateral agreement with US President Bush Jr. China featured prominently in his discussion of the need for a strategic/military aspect, C. Rice’s intervention stopped this idea from being developed further, Author’s Interview with Shiraishi Takeshi, May 20 2009. Tokyo.

⁷⁸⁰ Aurelia George Mulgan, "Breaking the Mould: Japan's Subtle Shift from Exclusive Bilateralism to Modest Minilateralism," *Contemporary South East Asia* 30, no. 1 (2008). p. 64

⁷⁸¹ Text reads as follows, “that Japan-India relations are rooted in their similar perceptions of the evolving environment in the region and the world at large [and] Recognizing their common commitment to democracy, open society, human rights and the rule of law”. Similar text is not possible in a Japan-China declaration.

⁷⁸² In 2000, Indian Minister of Defence, George Fernandes said that “India and Japan, as members of the ARF, will inevitably assume greater responsibilities to ensure peace and stability.” See, Sujit Chatterjee, "India, Japan to Assume Greater Responsibilities for Peace," *Press Trust of India*, 13 January 2000.

⁷⁸³ Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005). p. 482

⁷⁸⁴ Author’s Interview with Yuzawa Takeshi, 28 September 2009. Tokyo.

symbolic levels.

Taken together, the emergence of India and Australia as security partners demonstrates that Japanese security has broadened from a simple reliance on the US and a hope that the ARF might deliver a 'security with' CBMs based solution. By building up bilaterally a wider security network, Japan hopes to better manage its strategic environment, in particular China.

6.9 Conclusion: Power, Distrust and East Asia's Nascent Security Regionalism.

In conclusion, Japan's response to the rise of China has impacted on the region's security order and institutions in significant ways. It was chiefly due to concerns about China and a desire to engage with China that Japan first proposed that a regional security institution be formed. But in the face of an obstructive China, Japan's strategy has come unstuck. Japan has responded by adopting a two-pronged response; firstly, elevating the importance of bilateral and mini-lateral security networks with US, Australia and India, and secondly, by continuing to press for a CBMs regime at the ARF.

Realism captures the first part of this dynamic accurately, and is therefore mostly right about the corrosive effects of a weak Sino-Japanese bilateral relationship on the ARF. From realist theory, this is merely the natural outcome of the fact that as an institution the ARF suffers from the lack of a hegemonic stabiliser. At the outset, Japan considered ASEAN as sufficiently competent, and itself as sufficiently 'weighty', that some progress might be made in bringing China in to the ARF. However, China's growing power has allowed it to effectively seize control of the institution, and to guide it down pathways which do not limit China's freedom of action and (therefore) do not help secure Japan's position in the region. Instead of consolidating its position, Japan has had to follow China's lead as the ARF's agenda becomes increasingly cluttered with items of limited interest to Japan. Japan's anxiety about its future has thus prompted it to look outside of the ARF for its security, resulting in the decision to deepen its political, strategic and military ties to the US, Australia and India as a form of external balancing.

Yet realism does not explain very well why Japan should, even now, continue its efforts within the ARF to promote CBMs. Japan has attempted to lead by example, regularly producing high quality Defence White Papers for the Asian Security Outlook. Japan has availed itself frequently of the voluntary briefing facility at the ISG-CBMs, twice as often as China, (despite the fact that Japan has not even half as many serious security problems

with its neighbours as China). Japan has allowed the pace of CBMs to be slowed down, even to the point of stalling and has been willing to play along with the NTS agenda, all in the hope that the ARF might one day “develop into an organization that contributes effectively for the security of the region.”⁷⁸⁵ Part of the reason for this apparent patience is that the ARF has become a diplomatic set-piece. Even while not functioning as initially intended, the Forum continues to have an institutional life all its own. Notwithstanding Condoleezza Rice’s ‘boycott’ in 2005, the ARF continues to be regarded as a useful site where Foreign Ministers might meet annually – even if they carefully control with whom they will interact. This perception is shared also by Japan, which is loath to see its single possibility for a useful regional security institution wither on the vine. Thus, institutional effects such as sunk cost and path dependence are important in explaining Japan’s persistence with the ARF, in spite of the institutional weaknesses caused in large part by China’s spoiling tactics.

In harmonizing these two views about the ARF, social constructivism is needed. This is because the ARF is an institution designed to socialize states. In fact, Japan initially hoped that the ARF might socialize China into accepting some of Japan’s security interests as its own, especially CBMs and military transparency. Socialization is not simply one way though. In understanding Japan’s shift away from the ARF and towards building up alternative bilateral/minilateral security networks, it is necessary to appreciate that Japan has also been socialized by the ARF. Increased communication and contact with China since 1994 has not led to greater trust and confidence – quite the opposite. This explains why Japan, which started out positive about the ARF, has become increasingly pessimistic about its utility. What is emerging instead is a more realist orientation to security based on the lesson that China is playing a sort of zero-sum game in regional security. With cooperation with China unable to deliver, Japan has chosen to expand its security networks as a limited form of realist type balancing.

⁷⁸⁵ "Gaikō Seisho," (Tokyo: Ministry of Foreign Affairs (Japan), 2004).

7 Asian Development Bank

7.1 Introduction

This chapter examines Japan's response to a rising China in the context of the Asian Development Bank (ADB). The ADB is an interesting case for several reasons. Firstly, in a region where institutionalization is still relatively weak, the ADB is by any measure densely institutionalised. Founded in 1966, the ADB is one of the older organizations in the region – and one of a handful which have survived the Cold War period.

More importantly, the balance of power within the institution makes the ADB a good choice as a case study. This is because Japan enjoys within the ADB a lion's share of the formal voting power. This, in addition to other informal benefits, allows Japan a high level of influence over the Bank and its activities. The ADB is therefore invaluable as a site where Japan's response to China is comparatively easy to detect and measure. In addition, the ADB itself is relatively transparent compared to other institutions in East Asia.⁷⁸⁶

This chapter argues that the rise of China has played an important role in how Japan defines and executes its preferences within the Bank. Specifically, Japan is attempting to use the ADB as vehicle to increase its presence and influence in Asia and has become willing to bet the Bank's reputation on the success of a regionalist strategy. This chapter will argue that the institutional effects of this policy are corrosive. However, these effects are not yet a level which significantly impedes the Bank in pursuing its business, the hidden costs are being paid by the poorest member countries. This outcome is in line with realist thinking and the relevance of material power to creating and sustaining international institutions.

In characterizing the Japanese response and its institutional outcomes, this chapter will argue that the realists are however only half-right. Firstly, China's rise within the ADB has not in fact come as a challenge to Japan. Indeed, China's formal influence relative to Japan has actually slipped since accession. The institutional features of the Bank itself are at play as an intervening variable, and realism's posited direct link between power and institutional outcome is therefore highly questionable. Indeed, the Bank's management of loans to China is also reflective of a negotiated outcome between China and Japan and no doubt played a role in depoliticizing the ending of Japan's bilateral ODA. These institutional

⁷⁸⁶ The author would like to thank Mr Paul S. Mamonong, the Public Information & Disclosure Coordination Asst., for answering his many questions, and taking the effort to declassify, and pass along the minutes of the ADB Board Meetings.

effects of ADB are testimony to the importance of liberal ideas.

Likewise, this chapter will show that social constructivists' arguments about the causal nature of ideas such as regional identity are crucial in understanding the ADB's push toward a regional development strategy. While Japan's support for the regionalist strategy can be understood as motivated by concerns about its influence in Asia due to the rise of China, this is to miss out the important role of ideas about power and identity. Indeed, Japan and China have both cooperated and competed in the formation of the regionalist development strategy at the ADB. Moreover, the personality of the ADB's President, and his ideas about regionalism, proves to be a surprisingly important factor.

7.1.1 ADB as a regional institution

Examining the interaction of state interests in international institutions is hardly novel. There is a vast literature available on the politics involved in multilateral forums, and the ADB has not been immune to this sort of analysis. However, the ADB has not attracted nearly as much academic scrutiny as that received by the World Bank, or European Bank for Reconstruction and Development.⁷⁸⁷ In solving the development problems of the region, the ADB uses economic assessment and estimation tools which are often assumed to be divorced from the political concerns of the donors. Research on the ADB has therefore tended to focus on practical issues, such as how successful are its activities in promoting development or reducing poverty.

One of reasons for the existence of a multilateral organization like the Bank to dispense development loans rather than states doing so bilaterally is to produce credible signals for private capital markets. As Rodrik argues, this is a role only a multilateral organization can undertake by virtue of its (seeming) independence from state-level political consideration.⁷⁸⁸ Yet the ADB is not divorced from the interests of its donors, indeed from the donors' perspective there is little reason to give to such an organization without some kind of a return. For the states which are its donor members (such as Japan), the great appeal of the ADB is that it provides greater control than the World Bank over its loan activities in the region. This control reduces the credibility of its signalling role but its nature as a multilateral permits the ADB to present itself as mostly (if not completely) impartial. This apparent impartiality among donor members as a collective increases the legitimacy of its activities and allows the ADB to loan to countries which might otherwise refuse

⁷⁸⁷ Part of this is due to the image the ADB projects as a technocratic organization, while the EBRD was always seen in more political light. See for example, Robert Wade, "Japan, the World Bank, and the Art of Paradigm Maintenance," *New Left Review*, no. 217 (1996).

⁷⁸⁸ Rodrik in Christopher Kilby, "Donor Influence in Multilateral Development Banks: The Case of the Asian Development Bank," *Review of International Organizations* 1, no. 2 (2006).

assistance due to concerns about sovereignty (a right defended more vigorously in Asia than in the West). On closer examination therefore we can see that state interests play a major role in the Bank's activities and thus political analysis is appropriate. This is not immediately apparent however, and this fact also explains the lack of political analysis of the ADB.

Where political analysis of the Bank has been done, it has tended to focus on the role of the United States. This is not surprising, a great of research goes on in the US and naturally enough research would be concerned with American involvement. While Japan has attracted less attention than the US, there is some good research done on Japan's role. Dennis Yasutomo has written the only book, albeit now dated, on the subject of Japan and the ADB.⁷⁸⁹ Significant too is Wan Ming's study looking at Japan's role in the ADB, but as it was published before the Asian Financial Crisis it does not address the changes in both Japanese interests and Bank structure.⁷⁹⁰ Wan's study also does not address the causes behind Japanese policy preference shift, but rather describes the activities of Japan in the Bank. Since we will examine Japan's response to China and implications for the Bank, why Japan acts and the effects of its actions on the Bank are as important as what Japan does.

The effects of Japanese action on the Bank are addressed to some extent in work done on institutional change in the Asian Development Bank. The best of this literature on institutional change at the ADB, of admittedly very few works which address the issue, is Michael Wesley's book chapter.⁷⁹¹ However, while he admirably describes the changes that have occurred over the Bank's history, the focus is not on Japan. As a general rule scholarship on the ADB has not addressed specific causes of institutional change. In short, despite the fact that Japan is generally acknowledged to be a central figure in the Bank, the motivations of Japan in the restructuring of the Bank and reordering of loans activities has not been comprehensively addressed. This chapter will contribute to the academic literature by addressing these points.

⁷⁸⁹ Dennis T Yasutomo, *Japan and the Asian Development Bank* (New York: Praeger, 1983)., and more recently but thinly ———, "Japan's Multilateral Assistance Leadership: Momentum or Malaise?," in *Facing Asia: Japan's Role in the Political and Economic Dynamism of Regional Cooperation*, ed. Verena Blechinger and Jochen Legewie (Monograph of the German Institute for Japanese Studies, 2000).

⁷⁹⁰ Ming Wan, "Japan and the Asian Development Bank," *Pacific Affairs* 68, no. 4 (1995).

⁷⁹¹ Michael Wesley, ed. *The Regional Organizations of the Asia-Pacific* (New York: Palgrave Macmillan, 2003).

7.2 Formation

Before launching into an investigation of the changes within the ADB due to Japan's response to China, an introduction to the Bank itself is in order. In particular, how and why the ADB came to be and Japan's role in its inception needs to be explained. As noted previously, global multilateral development institutions such as the World Bank or even the United Nations Development Program could easily have performed the role of the ADB. In the early 1960s, the United States did not support the proposal for a regional multilateral development bank for Asia. The interest in such an institution sprung instead from regional players – particularly Japan. This section first examine why Japan was interested in an Asian Development Bank, and examine its activism in its formation. This section will examine how the Bank was then used to serve Japanese interests and how Japan was able to influence, directly and indirectly, the Bank's activities. It is important to understand both the 'initial' level of Japan's control of the institution prior to China's accession and to appreciate the important role that the ADB has played in Japanese aid diplomacy and rebuilding of Japanese image in the region.

7.2.1 Japan's Interests in the ADB

While a consensus more or less existed within Japan during the 1960s about the political and economic utility of an ADB, there was some uncertainty about which of these interests should have priority.⁷⁹² Politically, the ADB promised national prestige and a chance to rebuild relations with Asia, particularly in Southeast Asia. This was hugely appealing to the GOJ, which during this time was keen to assuage the suspicions of its peers in the international community. The interest of prestige was championed by the MOFA, which was aware of the strategic dimension to aid. During the Cold War, membership in the ADB would allow access to development funds but entailed support for the US regional security role.⁷⁹³ The MITI was also aware that the ADB could further Japanese economic interests both directly, through procurement contracts for development, and indirectly, through the trade facilitation effects of partner countries economic development. Additionally, the ADB's assistance to Southeast Asia was expected to help Japan secure access to raw materials. Moreover, the ADB, like bilateral ODA, would allow Japan to recycle its trade surpluses and

⁷⁹² David Arase discusses these competing interests of prestige and practicality in terms of *kokueki* and *tsukiai*, see his introduction in David Arase, ed. *Japan's Foreign Aid: Old Continuities and New Directions* (London: Routledge, 2005).

⁷⁹³ This is evident in the membership, China only joined once it began moving away from the Soviet Union, which observed but never joined. Post-communist Russia is looking to join, but has not entered due to opposition from the US. Vietnam's stock was suspended during the conflict, and was a point of contention when it resumed a place in 1993. For more on the political nature of ADB support see, Anthony Rowley, "The Politics of Who Gets What," *Far Eastern Economic review*, May 7 1992.

help to lower tensions with its neighbours over trade imbalances.⁷⁹⁴ Japan, having decided that an ADB would be in its interests, put its diplomatic energies into the ADB's institution-building, for details see Appendix 13.⁷⁹⁵

7.2.2 Japan's advantage in the formal rules

Japan's activism in the formation of the Bank provided it with an opportunity to help shape the rules which govern its operations. This influence is evident in the Charter establishing the Asian Development Bank, agreed upon in 1966. Voting weight within the ADB is derived in part from shares purchased (80%), while a proportion (20%) is equally divided among the membership. The equal distribution of 20% of the voting weight was designed to give the Developing Member Countries (DMCs), i.e. the borrowing countries which would not be able to purchase a large number of shares, a voice in the decision making of the Bank and increase the legitimacy of the Bank's activities.⁷⁹⁶ This was an outcome which Japan had not favoured but which also cost little.

But the real, if quiet, victory for Japan was in ensuring that 60% of stock was reserved for regional members, ostensibly to maintain the Bank's so-called 'Asian character.' This stipulation in effect meant that it would be easier for regional donor members to control loan allocation than non-regional members. Japan, being the dominant regional donor benefitted from the clause the most; other regional states simply could not purchase shares on par with Japan. While this so-called 'Asian character' of the nascent ADB initially dissuaded America from contributing funds, the US eventually decided to match Japan as events heated up on the Indochina peninsula over the late 1960s and the Cold War waxed hot.⁷⁹⁷

In order to counter perceived Japanese influence, America and the other Western powers were keen to have the non-regional members well represented at the Board of Directors.⁷⁹⁸ Japan would have preferred a lower number, as it would have cemented its influence

⁷⁹⁴ David Arase, ed. *Japan's Foreign Aid: Old Continuities and New Directions* (London: Routledge, 2005). p. 13

⁷⁹⁵ With Japan buying into the scheme, more prospective shareholders were found, the Bank was finally capitalized with \$1 billion on the 22nd August 1966 when the governments subscribing two thirds of the authorized capital ratified the agreement. For more details of the diplomacy behind the creation of the ADB.

⁷⁹⁶ Article 33(1) of "Agreement Establishing the Asian Development Bank," (1966), <http://www.adb.org/Documents/Reports/Charter/default.asp>, There was certainly a precedent as the African Development Bank (established 1964) had 50% of its voting weight distributed in this way. The greater the equal distribution to members, the more autonomy the DMCs would enjoy, however as Krasner has pointed out there seems to be an inverse correlation between autonomy and access to funds. See, Stephen Krasner, "Power Structures and Regional Development Banks," *International Organisation* 35, no. 2 (1981).

⁷⁹⁷ Ming Wan, "Japan and the Asian Development Bank," *Pacific Affairs* 68, no. 4 (1995). p. 2

⁷⁹⁸ In the end 20% was agreed to, "there was an informal bargain that the donors would accept 20% basic votes if the Asians agreed to a 30 percent share of the board seats for the non-regionals." See, Dick Wilson, *A Bank for Half the World* (Asian Development Bank, 1987). p. 26

relative to the other regional countries. This result increased the influence of regional DMCs, while giving the non-regional states good access to the board of directors and weakened the Japanese position vis-à-vis both other groups.⁷⁹⁹ Still this was not a particularly significant weakening, as Japan would enter the ADB a co-equal largest shareholder with the US, holding little over 20% of the total voting power.⁸⁰⁰ Japan was therefore well positioned in the ADB at the outset.

7.2.3 Japan's further advantages in the informal rules

In order to make the nascent Bank more useful to it, Japan consciously set about institutionalizing its influence in the Bank. Japan was able to do so by securing key positions in the Bank for its nationals – most notably the President. In order to maintain an 'Asian character', Japan was able to have written into the Charter that the President ought to be from a regional member country.⁸⁰¹ Moreover, as the president would likely come from a donor country (*a quid pro quo* for the monies put in), Japan's status as both a donor and regional member made it the only real choice for President.

At the same time, Japan was able to institutionalize – or embed – its own national preferences indirectly by having its nationals (usually from the Ministry of Finance) staff key posts within the ADB. This was achieved informally and almost by accident, as the first President Watanabe Takeshi appointed only those whom he personally knew. Watanabe's first appointment was Fujioka Masao to the important administrative post of Budget and Personnel matters.⁸⁰² Fujioka's ambit involved the hiring of future staff, and unsurprisingly therefore, of the first ten professional staff hired, half were Japanese.⁸⁰³ This effectively established a shadow rule which remains to the present, whereby Japanese staffed certain key posts – such as Budget, Personnel, and later, Strategy. While Japan did not get everything it wanted, by the time the ADB came into existence its vaunted Asian character already had a 'Japanese' face.

⁷⁹⁹ Ibid. pp. 26-27

⁸⁰⁰ The effects of countries with smaller shares to form voting blocs are significant. Small donors, including the Europeans which are unable to select a director, effectively have a reduced voting power due the structure of the board. Strand in Christopher Kilby, "Donor Influence in Multilateral Development Banks: The Case of the Asian Development Bank," *Review of International Organizations* 1, no. 2 (2006). p. 176 and Dick Wilson, *A Bank for Half the World* (Asian Development Bank, 1987). p. 22

⁸⁰¹ Article 34 of the "Agreement Establishing the Asian Development Bank," (1966), <http://www.adb.org/Documents/Reports/Charter/default.asp>. which states that "the president be a national of a regional country."

⁸⁰² Fujioka would in turn be ADB President from 1981-86.

⁸⁰³ Dick Wilson, *A Bank for Half the World* (Asian Development Bank, 1987). p. 34, and Michael Wesley, ed. *The Regional Organizations of the Asia-Pacific* (New York: Palgrave Macmillan, 2003). p. 27

7.3 Membership: Japan and the Accession of China

Membership in the Asian Development Bank has expanded quite significantly since formation. There were 31 founding members in 1966, however by late 2008 the Bank consisted of 67 members. Not for nothing was the ADB's official history entitled "A Bank for Half the World."⁸⁰⁴ The reason for this expansion is two-fold. Firstly, the end of the Cold War has seen European countries joining the ADB as non-regional members as their interest in Asian development has grown. Secondly, regional membership is also up, driven by the emergence of Central Asian and Oceanic countries. This section however will focus on the accession of China and Japan's policy towards it. It will argue that realism explains Japan's interest in involving China, but that intuitionism plays a key role in explaining Taiwan's continued participation in the ADB.

7.3.1 Japanese Interests in China's accession

Chinese membership in the ADB was perceived as an opportunity by Japan to further its interests both in trade and security. Like the US, Japan was interested in splitting China from the Soviets, and economic development assistance appealed as a tool to achieve this.⁸⁰⁵ While Japan had pursued informal bilateral diplomacy with China before the 1972 normalization of relations, the ADB represented a formal multilateral path of engaging with the Chinese. Most importantly for Japan, it would allow China to 'practice' international conference diplomacy in a 'safe' environment, and would hopefully be a pathway to further diplomacy in the future.

For Japan, the ADB was thus seen as a tool to socialise China into the world system. Japan aimed to support the 'opening' and reform movement and to prevent a return to autarky in China. The reforms in China began in 1978, and the Ohira administration put in a place an ODA program in 1979 to support the modernization effort in China – the yen loans component first paying out in 1980. Additionally, Japan hoped to shore up the Deng reforms through its ODA and PRC membership in the ADB.⁸⁰⁶ However, then Prime Minister Suzuki Zenkō backed away publicly from an outright political justification of Japan's aid policy in China.⁸⁰⁷

Japan also expected to receive economic benefits from Chinese membership in the ADB. Directly, Japan could expect that China's development needs would be met by Japanese

⁸⁰⁴ Dick Wilson, *A Bank for Half the World* (Asian Development Bank, 1987).

⁸⁰⁵ Yong Deng, "Chinese Relations with Japan: Implications for Asia-Pacific Regionalism," *Pacific Affairs* 70, no. 3 (1997).

⁸⁰⁶ For Japanese aid's role in the Deng reforms see, Tsukasa Takamine, *Japan's Development Aid to China: The Long-Running Foreign Policy of Engagement* (London: Routledge, 2006). p. 50

⁸⁰⁷ Dennis T Yasutomo, *The New Multilateralism in Japan's Foreign Policy* (New York: St. Martin's Press, 1995). p. 9

suppliers. Some rather cynically observed that “Japan has no hesitation about letting China in, since more construction capital for China may produce more contracts for Japanese traders and industrialists.”⁸⁰⁸ Indirectly, Japan was expecting that the Chinese market would develop to be highly with compatible the Japanese market. At this time Akamatsu Kaname’s ‘flying goose’ model held sway in the minds of many Japanese. According to this model, China too could pull itself out of backwardness and into modernity as the newest ‘goose’ in Japan’s flock. Additionally, Japan was interested in China for coal and other unrefined or natural products, which a low tier goose could provide. And while China would require assistance (thus the ADB), in order to efficiently and stably provide such goods, Japan could expect to benefit from China’s economic development.⁸⁰⁹ For China’s interests in joining the ADB see Appendix 14.

7.3.2 Taiwan or China? Japanese preferences and ADB politics over membership

However, the accession of China carried with it one significant hurdle - Taiwan. China’s accession to multilateral bodies such as the UN had in the past entailed Taiwanese expulsion. But this time Taiwan refused to back down. Japan was torn. Japan had economic and political interests in both Taiwan and China, and was reluctant to sacrifice either. Moreover Taiwan flattered Japan with its positive take on Japan’s role in the region and cutting Taiwan loose would have cost Japanese business interests dearly. However, if China did not join the ADB, Japan feared the organization might lose relevance and in the long term cease to exist.⁸¹⁰ Similarly, if Taiwan was expelled the damage to the ADB would be extensive. Whereas China was a new and unknown quantity, Taiwan was a founding member of the ADB.

For reasons relating to the rules contained within the Charter, it was difficult for China to press home its case about Taiwanese expulsion. According to the Charter, a member might be expelled only if it defaults on loan repayments. By 1971, not only was Taiwan no longer borrowing, it was paying its loans ahead of schedule and was held up as a model.⁸¹¹ While China had been encouraged to join by the non-political nature of the ADB, this same technocratic nature meant that political demands for ‘One China’ carried less weight in the organization. Moreover, the balance of power within the organization was still against China. The US was not going to chose to support the PRC over Taiwan, and made clear that its

⁸⁰⁸ "The Economist Has Reported on the Reaction of Japan and the US to China's Request That Taiwan Be Ousted from the Asian Development Bank (ADB) before It Will Join.," *The Economist*, 27 February 1983.

⁸⁰⁹ Stuart Harris and Greg Austin, *Japan and Greater China: Political Economy and Military Power in the Asian Century* (London: Hurst and Company, 2001). p. 157

⁸¹⁰ The ADB could only lend to its regional member countries, as China was not a member it could not access ADB development assistance. As China was home to a great number of the regional poor, the ADB could never fulfil its mandate as long as China did not join – if the ADB was to be relevant it needed Chinese membership.

⁸¹¹ Michael Wesley, ed. *The Regional Organizations of the Asia-Pacific* (New York: Palgrave Macmillan,2003). p. 25

support for the ADB (and its money) might be withdrawn if Taiwan were to be expelled. Likewise, demands to remove a “successful, contributing regional member” in to order to include a poor and backward China was never going to win over the other DMCs.

It was Japan which played the central role in negotiating a compromise that would allow the Republic of China to stay on even as the PRC joined. Through the discussions surrounding China accession and Taiwanese membership, Japan was able to communicate its position into ADB policy by the ‘back door’ of its national staff, importantly via the President. President Fujioka had previously sought the advice of Japan’s MOFA.⁸¹² Moreover, Fujioka also talked with the MOF about the Taiwan issue to gauge Tokyo’s feelings on the plan.⁸¹³ And it was Fujioka, together with the US and Japanese representatives, who put together the deal; to keep on the Republic of China but under the name ‘Taipei, China’ and to allow the accession of the PRC.⁸¹⁴

The accession of China had significant implications for the running of the Bank. In 1986, the Board of Governors had not agreed on how China should be represented at the Board of Directors, and thus the PRC initially participated as an observer only.⁸¹⁵ In 1987, China formally became the 47th member of the ADB, and its third largest stockholder.⁸¹⁶ ‘Taipei, China’ was able to keep control of its stock, despite the name change, but became a smaller stockholder with only 1.394% of the total voting power. China had joined the ADB and Taiwan was permitted to stay on.⁸¹⁷ This outcome satisfied Japan’s interests. While realism explains Japan’s interests in seeking to include China in the ADB, institutionalism explains how Japan was able to influence the outcome on the question of Taiwan.

7.4 Scope: Regional Strategy

One of the areas in which the ADB has changed most has been in terms of the type of activities it undertakes, i.e. its scope. One reason for this has been the changing needs of Asia. The ADB’s traditional role in providing loans for large national works projects is not as relevant in a region with an enviably high saving rate. Instead, the ADB has moved towards

⁸¹² Dick Wilson, *A Bank for Half the World* (Asian Development Bank, 1987). p. 271

⁸¹³ Ming Wan, "Japan and the Asian Development Bank," *Pacific Affairs* 68, no. 4 (1995). p. 8

⁸¹⁴ All except Taiwan, which was highly unhappy with the name change, and even as late as 1996 once it had become fait accompli offered more money to the ADB if it could be changed. See "Taiwan Tells ADB a Name Change Could Result in More Funds," *Taiwan Economic News*, 1 May 1996.

⁸¹⁵ "The Asian Development Bank's Annual Meeting of Bank Governors Has Not Resolved the Question of Representation for Its Newest Member, China.," 1986.

⁸¹⁶ It became 114, 000 capital stock valued at US\$1.3 billion, becoming the 3rd largest stockholder with 6.153% of the voting power, marginally ahead of India.

⁸¹⁷ "Annual Report of the Asian Development Bank," (Manila: Asian Development Bank). (1987)

providing expertise, targeted projects and, more controversially, regional vision. This section will focus on the last of these, regional vision. The ADB's growing emphasis on regional development through integration is an agenda with greater international political significance than traditional aid operations. This section will show the Japanese role in the expansion of ADB scope and discuss Japan's motivation in the leadership game with China. Rather than just a response to changing power realities, this section will argue that social constructivism is most relevant in understanding the institutional outcomes of Japan's response to China in the ADB.

7.4.1 The Regional Cooperation and Integration strategy

While the historical trend towards greater wealth in Asia was always going to challenge the ADB's core business and necessitate either the provision of different international goods or going out of business, the ADB did not necessarily have to adopt a strategy based on leveraging Asian regional integration for economic development.⁸¹⁸ In fact, the ADB's initial move away from its traditional role as the bank-roller of large national projects was towards poverty reduction. Mirroring moves within the World Bank, President Satō (1993-1999) in fact re-emphasised a close national focus, and brought the ADB to local and 'micro' issues like village sanitation.

However, the Asian Financial Crisis caused the ADB to revise its approach. Not only did the Crisis threaten to wipe out nearly forty years of development progress, but as the ADB admits internally, the ADB was also effectively sidelined from decision making. The ADB was unable to provide this international leadership itself, nor did it voice regional concerns to the IMF when the decisions were being made. As one internal report notes, "the ADB was not able to utilize its special regional knowledge and regional sensitivities to help its member countries, and instead largely followed the lead of <the IMF>."⁸¹⁹ Japan too had suffered heavy criticism during the crisis, and in order to demonstrate Japan's continued relevance to the region, then Finance Minister, Miyazawa channelled short term assistance through the ADB.

To put the ADB back on the map, President Chino Tadao (1999-2004) approved the Poverty Reduction Strategy and put in place a Long-Term Strategic Framework. Both strategies included regional cooperation as a way to leverage development, yet little was

⁸¹⁸ The goal for development banks is in fact to go out of business because one's clients are too wealthy to need you anymore. Of course there are still many poor countries in Asia, but at least from the point of view of Japan, for whom East Asian development was the priority, the ADB's success implies a possible reduced interest of Japan in the ADB.

⁸¹⁹ Ramgopal Agarwala, "Regional Cooperation in Asia: Long Term Progress, Recent Retrogression and the Way Forward," in *Economics and Research Department Working Paper Series no. 28* (Manila: Asian Development Bank, 2002). p. 31

specifically done to foster regionalism, rather social and environment issues continued to dominate.⁸²⁰ The ADB also institutionally evolved by setting up within its walls the Regional Economic Monitoring Unit (REMU), which was mandated by a request from ASEAN leaders. Initially the REMU was set up to provide early warning of financial crises, and it was soon expanded to manage ongoing components of the New Miyazawa Initiative. However, this role really only saw Japan and the ADB providing a series of bilateral short-term loans and support to regional countries, and did not represent a truly regionalist push.

Only in the term of the subsequent President of the ADB, Kuroda Haruhiko (2004-present) did regional cooperation assume pride of place. In fact, in his first speech, the newly installed President stressed the ADB's role in regional economic integration, saying;

ADB must also assume an even more proactive role as catalyst, as well as coordinator, for regional cooperation and integration - a special and unique mission of a regional development bank. ADB must continue to support financial cooperation agreements in the region, such as the Chiang Mai Initiative and the Asian Bond Markets Initiative. In coming years, ADB should also work toward advancing regional economic integration as a Knowledge Leader.⁸²¹

This focus on regional development as opposed to a national focus has real effects both institutionally and in the disbursement of funds. The regional approach was further institutionalised at the operations level, with the country strategy program and regional cooperation strategy programs required to mesh and the creation in 2007 of the Regional Cooperation and Integration (RCI) Fund. These institutional adjustments to the regional departments have had a major impact on the ADB at the operations level.⁸²² Indeed, the ADB has effectively hived off money into the RCI Fund that only be accessed for regional type projects.⁸²³

7.4.2 Office of Regional Economic Integration (OREI)

In order to further his vision for regional development through cooperation, Kuroda worked towards establishing a new department to oversee regional economic integration. The

⁸²⁰ Author's Interview with Giovanni Capannelli, 14 September 2009. Tokyo-Manila., ADB President Chino was personally disinterested in regionalism, and rather external events (the financial crisis) pushed the ADB in this direction.

⁸²¹ "Statement by Haruhiko Kuroda: Development Challenges for the Asia and Pacific Region and the Role of the Asian Development Bank," Feb. 1, 2005. While it is uncertain if Kuroda is using the term Knowledge Leader to mean the same thing as the then Foreign Minister Asō, it is clear that Kuroda has brought with him the domestic Japanese political jargon to the ADB .

⁸²² Author's Confidential Interview with ADB Official, November 2008. Tokyo., if the RCI remained an aspirational goal then this would be fine, but with institutionalization at the operations level the RCI has had lots of effects on how and to what the ADB lends, as the official put it operations is "where it matters, this is where there is money, lots of money".

⁸²³ "Minutes of the Meeting of the Board of Directors of the Asian Development Bank Held at 10:00 A.M. On 27 June 2007," (Manila: ADB, 2007)., the US opposed this development.

Office of Regional Economic Integration (OREI) was founded on 1 April 2005 – taking only a few months to come into existence, an unusually short time for organizational change. Kuroda also appointed fellow-national Kawai Masahiro to the Head of OREI⁸²⁴, both men had been active in Japan on issues of regional integration and had a good personal relationship.⁸²⁵ OREI took over the activities of the REMU, such as continuing to support the ASEAN Surveillances Process. However, compared with REMU which was formed at the request of the ASEAN Finance Ministers, in spite of its sweeping responsibilities the OREI was not similarly ministerially mandated.

Organizationally, the OREI is set up within the office of the President. And whereas the REMU had been somewhat removed from the ADB, OREI is very much at heart of the 'new' ADB. In addition to picking up the five professional staffers of REMU, OREI has acquired a further dozen or so professional staff (20). However, most of these new personnel at OREI were not trained 'regional' economists or specialists but have been transferred from other unrelated parts of the ADB.⁸²⁶ Quite apart from causing some strained relations within the organization, this personnel reshuffle has run the risk of weakening the ADB's core competence.⁸²⁷

In July of 2006, little more than a year after Kuroda took office, the ADB approved a Regional Cooperation and Integration strategy. This strategy sought to further Asia's economic development by building up regional cross-border infrastructure to support trade and investment.⁸²⁸ In particular, the OREI was mandated to take "the primary responsibility for pillars 2 and 3" of the RCI strategy, i.e. trade and investment, and monetary and financial cooperation – neither of which are traditional development issues.⁸²⁹ More significantly, the ADB decided to earmark 30 percent of its loans for projects under the regional cooperation and integration category in its "Strategy 2020" Report.⁸³⁰ It was perhaps for this reason that the ADB was found to be "spread too thin" by an independent

⁸²⁴ Harking back to the past when Japanese presidents of the ADB would parachute in their colleagues from the MOF in order to achieve certain goals.

⁸²⁵ Kuroda had first worked with Kawai over reforming the financial system in the mid-nineties and was so impressed with Kawai's competence that Kuroda brought Kawai into the MOF, and then to the ADB. In fact the OREI concept appears to have originated with Kawai, even though the execution lay with Kuroda.

⁸²⁶ "Regional Cooperation and Integration Strategy," (Manila: Asian Development Bank, 2006). p17, initially there was just one full time staffer working on pillar 2 (trade and investment), but growing.

⁸²⁷ This is certainly the feeling of some of the staff at the ADB. Others more pointedly remark that if intra-ADB governance is poor then the projects suffer and that ought to be a priority.

⁸²⁸ "ADB Adopts Regional Cooperation and Integration Strategy," 2006.

⁸²⁹ "Regional Cooperation and Intergration Strategy," (Asian Development Bank, 2006). See, Article 29.

⁸³⁰ "Strategy 2020: The Long Term Strategic Framework of the Asian Development Bank 2008-2020," (Manila: Asian Development Bank, 2008). Art. 54(iv), p21, interesting this strategy report was penned by Sakai, another Japanese at the Bank and also a proponent of regionalism.

review.⁸³¹

Moving the ADB away from its traditional role of a primary financier of development, a task which it seemed increasingly unsuited for,⁸³² Kuroda argued that the ADB added value by providing a regional vision. What this implicitly meant was supporting and building up the regional production network which had been centred on Japan. Naturally, leveraging this production network naturally lined up with Japan's interests. Indeed, Kawai commented that, "We [Kuroda and I] ...knew that Japan's relative importance was declining... whereas other countries, in particular China, were growing very fast...the only way for Japan to survive would be to strengthen its economy with other economies in Asia. So this RCI would also good opportunity for Japan."⁸³³ It is important to note that the MOF did not give any order to Kuroda (or Kawai) to pursue a regional agenda; rather, those two carried with them perceptions and beliefs which had been built up during their time at the Ministry. In fact, Kuroda's swift decision to develop a regional strategy after becoming President apparently was not taken in consultation with the ADB professional staff. Some of these veterans were unconvinced about Kuroda's direction.⁸³⁴

Japan was pleased this new direction. At the 2005 Annual Meeting of the ADB, Tanigaki Sadakazu, then Minister of Finance, addressed a special session of the Governors entitled "A road map for Asia's economic cooperation and integration." Tanigaki outlined Japanese support for the new approach that Kuroda was taking and expressed his hopes that OREI would be further strengthened as site for economic surveillance and policy dialogue.⁸³⁵ Indeed, Japan championed the RCI from the outset, immediately recognising the ADB's mandate to promote regional economic integration.⁸³⁶ Official Japanese support for Kuroda and the RCI has continued. Tanigaki spent nearly a tenth of his speech at the next year's (2006) Annual Meeting praising Kuroda's leadership and the RCI.⁸³⁷ In 2008, then Finance Minister Nukaga, Fukushiro also spoke about the RCI, calling for the "ADB to continue its leading role in regional cooperation and regional integration."⁸³⁸ Interestingly Nukaga

⁸³¹ "ADB Deemed Effective but Could Do Better," November 14 2006.

⁸³² Even in 1996, the ADB was fast approaching irrelevance as a source of funds for development projects, see "Help Yourself: The Asian Development Bank," *The Economist* v339, no. n7964 (1996).

⁸³³ Author's Interview with Kawai Masahiro, 14 November 2008. Tokyo.

⁸³⁴ Author's Confidential Interview with ADB Official, November 2008. Tokyo., especially in the South Asia were it is not at all obvious that India, Pakistan and Bangladesh would be interested in cross border infrastructure build operations as "they hate each other."

⁸³⁵ "Speech by Sadakazu Tanigaki - Minister of Finance of Japan", (paper presented at the ADB Annual Meeting, Istanbul, 3 May 2005).

⁸³⁶ Ibid.

⁸³⁷ "Speech by Sadakazu Tanigaki - Minister of Finance of Japan", (paper presented at the ADB Annual Meeting, Hyderabad, 4-6 May 2006).

⁸³⁸ "Speech by Fukushiro Nukaga - Minister of Finance of Japan", (paper presented at the ADB Annual Meeting, Madrid,

singled out the East West Corridor Project, an ADB project which skirts around China (discussed later).

Intriguingly, China has also publicly supported the RCI. At the 2005 AGM, China's Finance Minister Jin Rengqing spent a good paragraph defending the ADB's mandate in the area of regional cooperation, and praising regional effort in the Greater Mekong Subregion (GMS) and with the Central Asian Regional Economic Cooperation (CAREC).⁸³⁹ As one ADB official noted, China's support for the regional strategy comes from the belief that regional operations on its periphery will benefit China.⁸⁴⁰ Firstly, these projects benefit China economically by facilitating trade between China and its neighbours. Also, because China's allotted access to loans for purely national development is sufficiently large, China is under less pressure to use regional allotments as a supplement for strictly national development.⁸⁴¹ Secondly, China feels that the RCI has political benefits as well, not only putting China at the centre of the region's economic development but building better informal policy networks between China and its neighbours. Ultimately however, it was Japanese persistence in the face of US opposition which won over the Board, with China playing a negligibly small role in this formal decision making.⁸⁴²

7.4.3 ADB's role in Japan's push for an Asian Currency Unit

Japan's push towards regionalism in the ADB has taken the Bank into some unusual territory, such as the creation of a regional currency. In 2002, the Asian Development Bank Economics and Research Department (ADB-ERD) produced a working paper calling for the ADB to promote an ACU (Asian Currency Unit) formed along the essentially same lines as a paper that Kuroda and Kawai had published earlier at the MOF.⁸⁴³ In 2004, Kuroda had

5-6 May 2006).

⁸³⁹ "Speech by Jin Rengqing - Minister of Finance of China", (paper presented at the ADB Annual Meeting, Istanbul, 3 May 2005).

⁸⁴⁰ Author's Interview with Asian Development Bank Beijing Regional Office Vice-Director Jeffery Liang, 31 July 2009. Beijing.

⁸⁴¹ Hemamala Hettige, "Asian Development Bank's Regional Cooperation and the People's Republic of China," (Manila: Asian Development Bank, 2007). Already the Country Strategy for China stipulates that 12% of projects ought to be in regional cooperation.

⁸⁴² Author's Confidential Interview with ADB Official, November 2008. Tokyo.

⁸⁴³ The paper called for the ACU to function as a unit of account, invoicing and as reserve currency, and to be freely converted into other currencies, and to be served by an Asian Reserve Bank, broadly in line with Shiokawa's proposal to ASEM. See, Ramgopal Agarwala, "Regional Cooperation in Asia: Long Term Progress, Recent Retrogression and the Way Forward," in *Economics and Research Department Working Paper Series no. 28* (Manila: Asian Development Bank, 2002). However, this idea was similar also to Eichengreen's parallel currency idea, in that it was not to displace national currencies. That implies a questionable value, as there are better means of hedging risk. This work was not commissioned by any government (such as Japan) but came from within the ADB itself. Although it seems clear that Kuroda's or Kawai's hand was in this. Author's Communication with Ramgopal Agarwala, personal correspondence, 19 June 2009.

given a speech to the ADB's Board of Governors about the merits of the ACU as an academic.⁸⁴⁴ Unsurprisingly therefore, Kuroda was quick to endorse the ACU project from the bully pulpit of the ADB's presidency, explaining how he expected the ACU would come into existence.⁸⁴⁵ After Kuroda's accession, the ADB almost immediately commenced research about the utility of an ACU. Shortly thereafter, the ADB also became involved in the APT research group examining the same topic.

In February 2006, President Kuroda announced that the ACU would be unveiled at the upcoming Finance Minister's meeting in April. Data for the ACU would go up on the ADB website, including details about its current strength and composition. While Kuroda had made clear that the ACU was to be composed of a basket of the APT currencies, the actual weights had not yet been made public.⁸⁴⁶ In the event, the ACU was not posted as announced, nor has it been announced since. The reason was to do with weights of the currencies, in particular the weights of the yen and RMB.

Deciding the relative weights of the currencies in the ACU was always going to be difficult. In this case the Office of Regional Economic Integration under Kawai undertook a study to look at the issue of the ACU. Using a technical method, the exact weights arrived at was yen at 36.9% and RMB at 19.51%.⁸⁴⁷ However, these technical weights were seen by China as unacceptable, as the RMB was weighted too low versus the yen in their estimation. As such, the research group was told by Chinese representatives not to go ahead and unilaterally post this ACU on the webpage. As the Senior Economist at OREI, Giovanni Capannelli said, "It seems like there are many more sensitivities than we thought with regard to the definition of weights."⁸⁴⁸

At the same time, the ACU idea was proving divisive among the ADB board members. President Kuroda's promotion of an ACU was viewed darkly by the United States. Not only did it smack of a Japanese scheme to ease out the dollar in the region, but as far as the US is concerned the ADB, as regional development bank, should not be engaged in these kinds of monetary matters.⁸⁴⁹ In addition, India also opposed on the basis that an Asian

⁸⁴⁴ In addition to being an academic, Kuroda was well placed to influence policy as he was also a special advisor to the Cabinet on Economic affairs.

⁸⁴⁵ Jo Johnson, "Ft.Com Site: ADB Chief Explains Currency Unit Plan," *FT.com*, May 5 2006.

⁸⁴⁶ "ADB to Launch Asian Currency Unit in April," *Jiji Press English News Service*, Feb 21 2006.

⁸⁴⁷ The proposal which the ADB-OREI put forward focussed on three economic elements, size of economy defined by GDP (at market exchange rate), plus intra-regional trade, plus capital control variable (international debt security by residence of transactions (IDS)) simply averaged, to arrive at technical weights for the currencies.

⁸⁴⁸ Victor Mallet, "Launch of Asian Currency Unit Held up by Political Bickering," *Financial Times*, May 27 2006.

⁸⁴⁹ Author's Confidential Interview with a High Level Official at the ADB, December 2008. Tokyo.

Currency Unit should include India, rather than be an exclusively East Asian affair.⁸⁵⁰ Facing such difficulties in the ADB, the ACU project was transferred back to the APT for further study.⁸⁵¹ However, the ACU still remains on the ADB's agenda. In May, 2009 General Manager Rajet Nag said at the "One of our long-standing issues on the table is establishing an Asian Currency Unit."⁸⁵²

There is little doubt that this move towards a regionalist agenda at the ADB is being driven by Japan. However, there are two reasons why this ought not to be considered a response to China, at least not in a realist manner. Firstly, Japan is interested in seeing its influence being extended via a regionalist push at the ADB, but from a zero sum perspective it is the US rather than China which stands to lose from this. Not surprisingly, it is the US which is most opposed to the RCI at the Board.⁸⁵³ China and Japan have apparently worked (and voted) together against the US in pushing the RCI through and China too expects to benefit from the regional strategy.⁸⁵⁴ Secondly, it is unclear how far Japan actually wished to take the regional strategy, and how much due to the surprisingly determined person of President Kuroda.⁸⁵⁵ Kuroda, together with Kawai, are responsible for re-engineering the ADB along lines of thought developed in the Japanese Ministry of Finance after the Asian Financial Crisis. Kuroda's ideas, even if they correlate closely with Japanese policy-makers' and imply a concern about China's rise, are not GOJ policy and are devoid of the meaning of a

⁸⁵⁰ William Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (New York: Cornell University Press, 2009). p. 144

⁸⁵¹ Kawai's group had come up with various compromise proposals to ameliorate the feelings of being excluded among non-APT members, such as proposing multiple regional baskets one each for CAREC, Oceania, etc. Author's Interview with Kawai Masahiro, 14 November 2008. Tokyo.

⁸⁵² "Asean+3 Backs Currency Fund as ADB Meets," *Jakarta Globe*, May 4 2009.

⁸⁵³ The US is one of the few countries willing to be on record as opposing a proposal at the Board of Directors, for its own reasons the US has consistently voiced its opposition to regionalist approaches. The US opposed the creation of the Regional Cooperation and Integration Fund on the 22 March, 2007. However, US opposition can also look mean-spirited, such as the opposition in November 2005 to a Communicable Disease Control Project for the Mekong. "Minutes of the Meeting of the Board of Directors of the Asian Development Bank Held at 10:00 A.M. On 27 June 2007," (Manila: ADB, 2007). And, "Minutes of the Meeting of the Board of Directors of the Asian Development Bank Held at 10:00 A.M. On 28 November 2005," (Manila: ADB, 2005).

⁸⁵⁴ Firstly by linking other regional economies into China, the regional strategy implicitly supports China's claim as a 'peace riser' and net good for the region. Secondly, and more cynically, even if China were not to gain much in economic terms, smiling on a strategy in the ADB over which the US and Japan are opposed is a way to further increase China's influence. China is able to do this because the ADB's strategy for China is now premised on both national and regional development (called in house the two pronged approach). China's national envelop at the ADB (its quota) is between one to one and half billion dollars, which means that unlike smaller countries China the ADB's regional strategy has not forced a rethink in development strategy at home. Instead, China can earn kudos by using its OCR allotment in conjunction with regional funds in order to attract assistance for itself and its neighbours. Author's Interview with Asian Development Bank Beijing Regional Office Vice-Director Jeffery Liang, 31 July 2009. Beijing., Liang is deputy director of the ADB's Beijing regional office.

⁸⁵⁵ Indeed, the MOF is apparently surprised and more than a little concerned with what their former vice-minister is doing with the ADB. Author's Informal Discussion with Peter Drysdale, November 2009. Tokyo.

balancing strategy (or any strategy) on behalf of Japan at the ADB. To the extent that Kuroda's personality is a factor, it is a reflection of the importance of social constructivist variables in international politics.

7.5 Resources: Japan's Policy Towards ADB operations in China

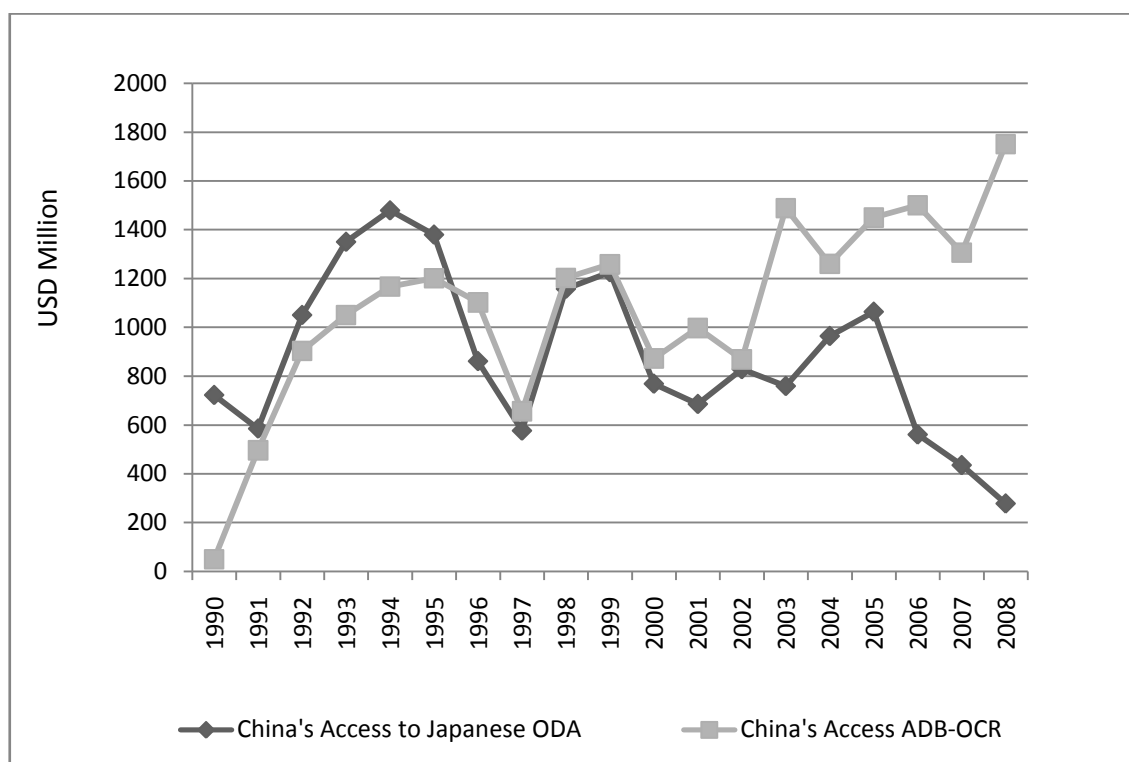
Compared to scope, Japan and China have competed more vigorously over distribution of the ADB resources. In the area of ADB development loans to China from the Ordinary Capital Reserve (OCR), Japan has sought to bring the ADB practices in line with its own national objectives – a process which China has had to agree to. In the area of Technical Assistance (TA), Japan has attempted to do the same. However, China has found ways to still access TA via the RCI, and is starting to contribute resources of its own in order to shape ADB operations.

At the same time, the continuing significance of the ADB to China's overall development is in question. ADB loans representing merely 0.15% of total fixed assets investment to the Chinese economy.⁸⁵⁶ China's economic rise means that it is now able to finance more and more of its own development, and hence the ADB's primary tool - development loans - is now increasingly irrelevant to China's overall economic development.⁸⁵⁷ However, this does not reflect any desire by China to 'graduate' from the ADB's assistance. Quite the opposite in fact, China's access to the ADB's OCR loans has increased even as Japan ODA dries up, see Figure 14 below. Another way of interpreting this graph is that Japan has allowed this greater access by China to the OCR to offset its declining bilateral flows.

⁸⁵⁶ "China Factsheet 2007," Asian Development Bank, http://www.adb.org/Documents/Fact_Sheets/PRC.pdf. 2007, July

⁸⁵⁷ China is also increasingly funding development projects in other countries, a fact which ought to raise questions about the amount of funds and priority the PRC ought to attract.

Figure 14 Comparison of Japanese ODA and ADB loans to China



Source: OECD-DAC and the ADB Annual Report, various years.

7.5.1 ADB OCR and Japanese ODA in China

When China joined the ADB in 1986, its largest source of ODA was Japan. This was mirrored by the fact that Japan's largest ODA destination was China.⁸⁵⁸ Unsurprisingly, China's access to the ADB's OCR expanded quickly; doubling annually until 1989. The Tiananmen Square crisis triggered a suspension of Japanese ODA and at the same time steep cuts in the ADB's activities. At the 1990 New Delhi meeting of the ADB, both Japan and the US agreed to continue to block the resumption of ADB activities in China.⁸⁵⁹ But Japan was interested in a swift return to normal operations, and then Finance Minister (later Prime Minister) Hashimoto Ryūtarō pushed for an early resumption of multilateral aid, especially through the ADB.⁸⁶⁰ Japan's bilateral ODA to China resumed in 1992, before that of the Western countries. Shortly thereafter, the ADB declared that it too would recommence its activities. In 1992 China received nearly half a billion from the ADB's OCR coffers, and over next several years attracted one billion annually – wiping out any losses

⁸⁵⁸ Frank B Tipton and Huilin Xiao, "Chapter 4: China," in *Japanese Official Development Assistance in the Asian Region*, ed. Leslie Williams (Sydney: University of Sydney Press, 2006). p. 133

⁸⁵⁹ "A Fund of Questions (Asian Development Bank)," *The Economist*, May 5 1990., this meant that no new loans were agreed to that year but the previous agreed to pipeline was not suspended.

⁸⁶⁰ Akitoshi Miyashita, *Limits to Power* (Lanham: Lexington Books, 2003). P72, Part of this also was Japanese business interest, as the Keidanren told PM Kaifu that long suspension of yen loans would hurt Japanese economic relations with PRC.

due to the earlier suspension.

However, the Tiananmen Square incident had affected Japanese ODA policy. In 1992, Japan produced an ODA Charter which, although it contained escape clauses, would allow Japan to invoke sanctions in the future under a wider range of conditions. While at the ADB, Japan's concerns were also reflected in the Medium Term Strategic Framework of 1994, which highlighted environmental and social loaning (committing itself to increasing loans to these sectors from 30% to 40%).⁸⁶¹

While there was a high correlation between Japanese bilateral ODA and ADB activities in the early period, differences grew during the nineties. In 1995, Chinese nuclear testing caused another suspension of Japanese ODA, based on the provisions of the aforementioned Charter. Popular support for ODA to China started to fall, and according to one poll 90% of Japanese felt that suspension was either appropriate or too lenient.⁸⁶² While in the end, only a symbolic amount of US\$75m was suspended, the Lop Nor nuclear weapons test crisis in 1995 shocked Japan into the realization that aid diplomacy would not be effective.⁸⁶³ This crisis, together with ongoing tensions across the Taiwan Strait, the South China Sea and the East China sea (disputes over the Senkaku islands would cause another suspension in 2000) pushed Japan to reconsider how aid was given. Japanese bilateral ODA began to shift to environmental and social sectors away from heavy industry linked projects like in the transport and energy sectors, as Figure 15 overleaf shows.

⁸⁶¹ Ming Wan, "Japan and the Asian Development Bank," *Pacific Affairs* 68, no. 4 (1995).

⁸⁶² Saori Katada, "Why Did Japan Suspend Foreign Aid to China? Japan's Foreign Aid Decision-Making and Sources of Aid Sanction," *Social Science Journal of Japan* 4, no. 1 (2001).

⁸⁶³ After completing the nuclear test series China announced unilaterally in 1996 that they would join the Comprehensive Test Ban Treaty. Michael J Green, *Japan's Reluctant Realism* (New York: Palgrave, 2001). pp. 80-1

Figure 15 Japan ODA to China by Sector

NOTE:
This figure is included on page 208 of the print copy of
the thesis held in the University of Adelaide Library.

Source: Japan Bank for International Cooperation

7.5.2 ADB's OCR sectoral adjustments and Japanese ODA

These moves were reflected in the ADB. But even as Japan was reconsidering how to manage its bilateral aid, China's appetite for ADB's development loans continued to expand. China's borrowing more than doubling from almost \$600 million in 1997 to \$1500 million in 2008. In relative terms, China's percentage share of OCR loans has also increased; going from under 10% to around 25% of total OCR lending. Thus China is both receiving both more compared to previously and more compared to others. This would suggest that China had become a top priority for the ADB.

The ADB OCR operations reflect these trends in Japan's ODA to China. In particular, ADB loans to the social sector rose over the 1990s and remained high into the 2000s. However, in 2003, ADB lending from the OCR to the social sector in China abruptly ended. This was due to protest from the PRC, which was unhappy with loans for poverty reduction to the social sector attracting the higher OCR rates (compared to the concessional rates at either Asian Development Fund (ADF) or other grants) – to the Chinese, that money could be better used elsewhere.⁸⁶⁴ This can be seen in China's Country Partnership Strategy (CPS).

⁸⁶⁴ "People's Republic of China Country Strategy and Program 2004-6," (Manila: Asian Development Bank, 2003).: (Item 74, p27) and "People's Republic of China Country Strategy and Program Update 2006-8," (Manila: Asian Development Bank, 2005).: (Item C5, p. 1), Renqing Jin, "Address by the People's Republic of China Governor of the Asian Development Bank" (paper presented at the Asian Development Bank Annual Meeting, Jeju, Korea, 15-17 May

The CPS is a document in which the ADB make clear its intentions for each country, much as the Medium Term Strategy does in general. In the PRC's 2006-8 CPS, 'social infrastructure' appears as a loan receiving sector – attracting nearly 15% of the total and expanding to over 20% by 2008.⁸⁶⁵

The 'social infrastructure' sector allays Japanese concerns that the ADB is propping up China's military modernization, and focuses on economic development in rural areas by covering such diverse activities as water supply, waste material treatment, rural transport and communication. It also suited the Japanese business community, which was feeling the squeeze from Chinese producers.⁸⁶⁶ Certainly, China's interest continues to be in engaging the ADB to assist infrastructure development, under whatever category, for as long as possible. At the 2007 Board of Governors meeting, the Chinese Minister of Finance called on the ADB to retain its focus on infrastructure development, and to reduce borrowing costs for social sector development.⁸⁶⁷ There have also been meetings at the highest level, with the Chinese Premier Wen Jiabao meeting with ADB President Kuroda in January of 2007, at which time Wen emphasised China's continued interest in the ADB playing a role in his country's development.⁸⁶⁸

What we can see therefore in the ADB's loans activities to China is a re-negotiation of the development agenda. While China under Deng had realized the necessity of addressing regional inequality, it only became a part of the Chinese development strategy in the ADB after the 11th five year plan in 2006-2010. However, the Japanese decision to shift the geographical focus of their ODA towards the central provinces was not based on China's preferences but rather due to Japan's domestic political considerations driven by growing threat assessment of China's rise – especially in the military field.⁸⁶⁹ Thus the ADB's move towards focusing on the Western provinces is driven by both China and Japan. The introduction of the 'social infrastructure' sector can be seen as the ADB's attempt to realize this common interest in the two parties. The ADB was therefore instrumental in getting the

2004).

⁸⁶⁵ "People's Republic of China Country Strategy and Program Update 2006-8," (Manila: Asian Development Bank, 2005)., "People's Republic of China Country Strategy and Program Update 2007-8," (Manila: Asian Development Bank, 2006).

⁸⁶⁶ By 1999 China was insisting that it provide the majority (70%) of the contracts for its development, this competition for contracts limited further Japanese business interests in ODA. See, Stuart Harris and Greg Austin, *Japan and Greater China: Political Economy and Military Power in the Asian Century* (London: Hurst and Company, 2001). p. 159

⁸⁶⁷ Renqing Jin, "Address by the People's Republic of China Governor of the Asian Development Bank" (paper presented at the Asian Development Bank Annual Meeting, Kyoto, Japan, 6-7 May 2007).

⁸⁶⁸ "China Factsheet 2007," Asian Development Bank, http://www.adb.org/Documents/Fact_Sheets/PRC.pdf.2007, July

⁸⁶⁹ Reinhard Drifte, "The Ending of Japan's ODA Loan Programme to China - All's Well That Ends Well?," *Asia Pacific Review* 13, no. 1 (2006).

two sides reach a common understanding. This institutional effect that the ADB can provide in this area is important for the health of the China-Japan relationship into the future.

7.5.3 ADB's OCR geographical and Japanese ODA

The ADB has couched its new country strategy for the PRC in terms of the Chinese government's 11th five year plan and the so-called 'five-balances' development strategy espoused therein.⁸⁷⁰ One of these balances that China has identified as needing to be struck is between the East coast and central provinces. China has also promoted to Japan (and others) the Western provinces as an area requiring assistance.⁸⁷¹ Yet, according to one ADB official, China's real preference was for continued support for industrial development in the East, and ADB had to apply pressure to influence the strategic priorities of the Chinese side towards favouring sectors and areas that ADB was willing to be active in.⁸⁷²

Japan is more than happy to see the central provinces receive a larger share of assistance, as China's East coast is threatening to hollow out Japanese manufacturing – at least in Japanese popular perception. This perception has precipitated a rise in Japanese dissatisfaction about its bilateral ODA to China; indeed Japan's committed bilateral ODA to China has been falling steadily since 2000. Due to concerns over the possible use of ODA to subsidise military development, Japan has, since the mid-nineties, shifted its focus towards poverty reduction; the projects were aimed squarely at the same Western and central provinces which China now highlights as needing assistance. Reinhard Drifte points out that the PRC was not developed to the point where Japan could 'graduate' China from the yen loans scheme, even under Japan's own definitions.⁸⁷³ Thus, the decision to wind down the ODA to China, and to shift its focus to central provinces, was not based on 'pure' humanitarian concerns, but taken for political reasons.

⁸⁷⁰ "China Factsheet 2007," Asian Development Bank, http://www.adb.org/Documents/Fact_Sheets/PRC.pdf. 2007, July

⁸⁷¹ "Speech by Xiang Huaicheng, Governor of the PRC", (paper presented at the ADB Board of Governors Meeting, Hawaii, 2001).

⁸⁷² Author's Interview with Asian Development Bank Beijing Regional Office Vice-Director Jeffery Liang, 31 July 2009. Beijing.

⁸⁷³ ———, "The Ending of Japan's ODA Loan Programme to China - All's Well That Ends Well?," *Asia Pacific Review* 13, no. 1 (2006).

7.5.4 ADB loans to China and India and Japanese ODA

While China's share of ADB loans appears to be increasing through to 2005, there are indications that the ADB is shifting its focus. Indeed, the CPS Update for the PRC (2006-8) is increasingly starting to resemble Japan's preferences in its ODA commitments.

The CSPU has programmed total loan assistance of \$4.5 billion for 2006–2008 (excluding subregional projects), amounting to annual average lending of about \$1.5 billion. Of this, 47.6% is for transport projects, 20.0% for agriculture and natural resource projects, 14.8% for social infrastructure projects, 12.0% for energy sector projects, and 5.6% for multisectoral projects. About 85% of these projects will be located in the central and Western provinces.⁸⁷⁴

In terms of absolute amounts this program will see China stabilize at about US\$1.5 billion, arresting its upward movement. While this is not the same as an absolute decline (although that might depend on disbursements each year) as was seen in the bilateral setting growth in disbursements is dropping off. More interestingly perhaps, there is a movement away from transport sectors towards the agriculture sector – i.e. direct support for industrialization is being withheld, instead 'other' concerns are on display in the ADB's lending to China. Together with the move away from the Eastern provinces towards Central and West provinces, this CSP ties in with the ADB and GOJ's decreasing support for industrial development.

Of particular interest is the comparison with India, which is tipped to become the largest recipient of Japanese ODA. The ADB started to tip in favour of loaning to India in place of China in 2009, with India to overtake China as the largest recipient of OCR loans in 2009, see Figure 16. At the same time India is likely to have overtaken China as the largest recipient of ODA from Japan also in 2009, see Figure 17. Indian access to ADB loans over the same period (2006-8), is projected to increase according to its CPS update – “from \$2.25 billion in 2006 to \$2.45 billion in 2007 to \$2.65 billion in 2008.”⁸⁷⁵ Moreover India does not have the same restriction on its development assistance “...with infrastructure projects (transport, urban, and energy) accounting for nearly 77% of the 3-year pipeline...The relative size of infrastructure (transport, urban, and energy) projects in the ADB's assistance program was increased from 69% of the 2005– 2007 pipeline as proposed in the 2004”.⁸⁷⁶ This indicates that Japan is moving to balance its interests in China with its wider strategic needs.⁸⁷⁷

⁸⁷⁴ Article 23 of "People's Republic of China Country Strategy and Program Update 2006-8," (Manila: Asian Development Bank, 2005).

⁸⁷⁵ "India Country Strategy and Program Update 2006-8," (Manila: Asian Development Bank, 2005). Art. 39

⁸⁷⁶ Ibid. Art. 10

⁸⁷⁷ Purnendra Jain, "Westward Ho! Japan Eyes India Strategically " *Japanese Studies* 28, no. 1 (2008).

Figure 16 Japan's ODA to China and India

NOTE:
This figure is included on page 212 of the print copy of
the thesis held in the University of Adelaide Library.

Source: OECD-DAC

Figure 17 China and India's Access to the Ordinary Capital Reserves (OCR)

NOTE:
This figure is included on page 212 of the print copy of
the thesis held in the University of Adelaide Library.

Source: ADB Annual Report, various years.

Taken together the shift in the focus of the ADB is not described entirely by realism. As the ADB's relevance to China falls, the ADB focus on the West of China will in fact help the Chinese Communist Party authorities to demonstrate that they have not forgotten their rural roots. At the same time, it ameliorates suspicions in Japan about Japanese aid inadvertently subsidizing Chinese militarization.

7.6 Diffusion: the ADB Special Funds

In addition to the OCR, the ADB also manages a series of special funds. The first of these, the 1968 Agricultural Special Fund, was a means to further Japanese interests and influence in the ADB.⁸⁷⁸ This section will examine two special funds, the Japan Special Fund (JSF) and the China Special Fund for Regional Cooperation (CSF). The creation of these special funds reflects a move away from true multilateralism in the policy of both Japan and China towards the ADB in an attempt to purchase greater influence. Indeed, the ADB has stated that it is willing to draw additional resources from larger economies (this means China and Japan) in order to pursue its regionalist agenda.⁸⁷⁹ This section will argue that the emergence of these two special funds and the 'innovation'⁸⁸⁰ of bilateral loaning from China and Japan reflects a competition between Japan and China for influence in/through the ADB which will be ultimately damaging for the institution. This section will also show that these bilateral loans, which might be considered the start of network type of regionalism within the development agenda, are not yet a level that threatens to derail the ADB.

⁸⁷⁸ Japan set up an Agricultural Special Fund (ASF) in 1968, and contributed US\$100 million to its coffers. The AGF was highly criticised by western powers in the ADB, who felt that the stringent conditionality attached to accessing the AGF undermined its purpose. Ming Wan, "Japan and the Asian Development Bank," *Pacific Affairs* 68, no. 4 (1995), p. 4

⁸⁷⁹ "Regional Cooperation and Intergration Strategy," (Asian Development Bank, 2006). Article 94. "Additional financial resources will also be required. Two types of financial resources are needed to implement the strategy effectively. First, with regard to the lending component of the strategy, for the immediate future, it is proposed to use existing OCR and ADF resources within available headroom and to catalyze additional public funding (particularly from larger economies)."

⁸⁸⁰ The funding for regional projects is sourced not from the countries' national quota (or "envelop" as it called), but rather from a regional "allowance". Indeed, the ADB admits that these nations would not use their own national allowance to buy in regional development goals. See, "Medium Term Strategy II (2006-8)," (Manila: Asian Development Bank, 2006). Article 39 reads, "the rationale for RCI is premised on significant externalities, benefits that transcend national borders. This requires innovative funding arrangement because the distribution of benefits and costs among the partner countries is not always balanced. In the absence of an honest broker/facilitator, individual countries would not bear the cost of providing public goods from which the benefits would primarily flow to other countries."

7.6.1 The Japan Special Fund (JSF)

Throughout the 1980s Japan was trying to increase its influence in the ADB. The most direct route was to push for a Special Capital Increase, which would allow Japan to break parity with the US (which was undergoing budget restrictions) and give Japan the formal leadership it felt it deserved. Part of the Japanese argument for the Special Capital Increase was that Japan's contributions to the ADB's concessionary arm (the ADF) ought to be reflected in its voting weight – a move countered by the US.⁸⁸¹ While Japan and the US contributed equally to the OCR, Japan's contribution to other elements of the ADB far outstripped that of the US. In 1987, Japan's contribution to the ADF was US\$2 billion while the US contributed nothing.

The alternate view by which influence could be gained is through additional financial contributions to voluntary special funds. By 2007, Japan had contributed US\$9.86 billion to the various voluntary funds (around a third of the total special funds).⁸⁸² Moreover, in any individual year, Japan gave more than half of the total contribution to these voluntary Funds (far outstripping the US).⁸⁸³ Japan had also become involved in co-financing for the same reasons. Co-financing allows the ADB to supplement its loans with private and state finance. In 1999, US\$3.2b of ADB loans came with a further \$3b in co-financing, over half of which came from Japanese sources; predominately the Japan Bank for International Cooperation.⁸⁸⁴

Japan wished to 'harmonise' its voting shares by including these contributions. Japan started to send English-speaking 'young turks' to the ADB and pushed harder for Japanese interests at the Board meetings.⁸⁸⁵ The new assertiveness was based on Japan's growing economic dominance in region, which it wished to funnel into the ADB.⁸⁸⁶ This included expanding their contribution to the ADB's concessional and grant aid through the creation of the Japan Special Fund for Poverty Reduction at the ADB. The time taken from proposal to Board authorization to first grant was less than one year.⁸⁸⁷ China's access to the JSF

⁸⁸¹ Rowley in Michael Wesley, ed. *The Regional Organizations of the Asia-Pacific* (New York: Palgrave Macmillan, 2003), p. 31, see also the Agricultural Special Fund that Japan attempted to set as an example of influence through contribution.

⁸⁸² "Japan's Role in the ADB," Asian Development Bank, <http://www.adb.org/JRO/>, 2007, July

⁸⁸³ Ming Wan, "Japan and the Asian Development Bank," *Pacific Affairs* 68, no. 4 (1995).

⁸⁸⁴ Edward Lincoln, *East Asia Economic Regionalism* (Washington, DC: The Brookings Institute, 2004). Indeed, Japan contributes roughly US\$1.5 billion through co-financing every year, p. 120

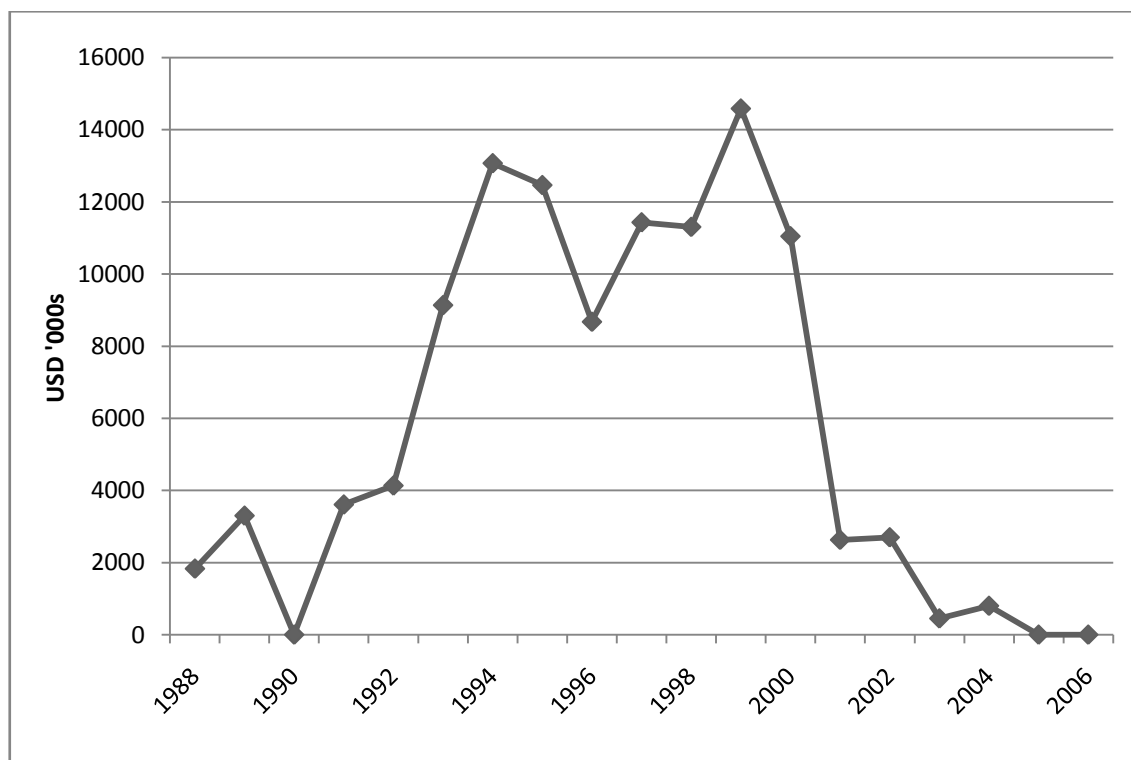
⁸⁸⁵ Ming Wan, "Japan and the Asian Development Bank," *Pacific Affairs* 68, no. 4 (1995), p. 8

⁸⁸⁶ Linked to trade issues, as "In a speech to [the ADB Board] ... Bank of Japan Governor Satoshi Sumita said his country wants to recycle up to \$30 billion in trade surplus funds. One way is by increasing its stock in the [ADB]." "Japan, U.S. Clash at Bank Meeting," *St. Louis Post-dispatch*, 1 May 1988.

⁸⁸⁷ Indeed, as we will see later Japanese proposals to re-rig the ADB have a habit of being rapidly approved and implemented.

was immediate, China receiving \$1.831 million in grant technical assistance in 1988. The amount disbursed to China nearly doubled to \$3.3 million the following year, see Figure 18 below. As a part of Japan's wider ODA diplomacy China's access to the JSF was always dependent on Japan. As such, China's access to the JSF therefore varied depending on Japan's policy at that time – rather than being a part of the ADB's institutional ambit.

Figure 18 China's Access to the Japan Special Fund



Source: Asian Development Bank Annual Report, various years. Compiled by the Author.

For Japan, the JSF represented a path to regional influence. Japan was able to borrow the institutional legitimacy of the ADB even though under its charter Japan would have the authority to turn down any application to the JSF. Japan could therefore pick and choose projects outside of a true multilateral selection process. In fact, the ADB became increasingly dependent of the JSF for funding grant projects, with almost half of grants approved being JSF rather than the generic Technical Assistance Special Fund. The Technical Assistance Special Fund is the generic pool and is more truly 'multilateral' as Japan does not have a formal veto, but its relevance is declining as the JSF is increasingly tapped for projects mainly in East Asia.

7.6.2 The China Special Fund for Regional Cooperation

Recently, China too has begun to contribute to the ADB, sending a powerful signal that China has become interested in the ADB. In 2005, it committed \$30 million to the ADF - the first time a Developing Member Country had done so. This allowed China to sit with the

major donor countries and shape policy at levels previously barred to them.⁸⁸⁸ In the same year, China also contributed US\$20 million to set up its own special fund in the ADB - the 'People's Republic of China Regional Cooperation and Poverty Reduction Fund.'⁸⁸⁹ At the same time, China has stepped up its bilateral aid program, which threatens to undermine the ADB (See Appendix 15).

This special fund is used by China to extend its influence over the region. One project, the 'Capacity Building for Designing, Negotiating, and Implementing Free Trade Agreements in Selected Asian Developing Member Countries', financed by the China Special Fund in October 2006, is aimed at training officials in Southeast Asian countries in FTA negotiations. Conveniently for China, FTA negotiations were underway between it and its Southeast Asian neighbours while this TA was in effect. And while training officials whilst negotiating with them on a bilateral basis would look sinister, China is able to add legitimacy by using the multilateral ADB channel.⁸⁹⁰

China has also become skilled in tapping the RCI Fund (discussed in scope) usually in combination with the China Special Fund to direct the ADB towards financing regional projects that benefit China. One example of this is the "Facilitating sustainable, environmental-friendly regional power trading in the GMS" project, co-financed by Region Cooperation and Integration Fund and the PRC Special Fund. The purpose of this cooperative US\$2 million dollar project is "developing the hydropower plants for exporting power to Yunan province or other potential hydropower sources for inclusion in the power trade."⁸⁹¹ This project clearly benefits China both politically and economically, and is a mark of China's growing skill in using the regionalist agenda to nudge the ADB into areas China is interested in.⁸⁹²

The Mekong subregion has also seen the most obvious case of Sino-Japanese rivalry in the ADB's funding for the North-South and East-West economic corridors project. Japan has been supporting the East-West corridor, a road which connects Eastern coastal Vietnam to the West coast of Myanmar and is expected to improve Japanese market

⁸⁸⁸ In 2008 China again contributed \$35 million to the ADF.

⁸⁸⁹ To be used initially within a four year window, for details see "Board Paper: People's Republic of China Regional Cooperation and Poverty Reduction Fund," (Manila: Asian Development Bank, 2005). See Article 19.

⁸⁹⁰ One ADB official relates the sorry story of Laos official trained under a China sponsored TA grant whom then felt obliged to use that training (in order to justify it) although he/she was deeply ambivalent about the developmental effectiveness for Laos. The project was however of clear benefit to China and as such it appears the TA is affecting preferences in these admittedly small countries. Author's Confidential Interview with ADB Official, November 2008. Tokyo.

⁸⁹¹ "Indicative Rolling Regional Cooperation Operations Business Plan," (Manila: ADB, 2007). p. 8, 22.

⁸⁹² As an added bonus for China, the project is (via the RCIF link) effectively subsidized by Japan.

access to the GMS. Financing for the East-West corridor has come from Japanese bilateral ODA sources (the Japan Bank for International Cooperation and Japan International Cooperation Agency) together with the Japan Special Fund at the ADB. At the same time, China has promoted the North-South corridor, providing the funds and workers to complete a road from Kunming in South China through Thailand and Myanmar to Singapore.⁸⁹³ In addition to the considerable investment that the ADB has made to the various countries of the GMS sub-region in the pursuit of this project, China also used its Special Fund within the ADB to guide certain sections of the larger project.⁸⁹⁴ But despite the fact that the East-West and North-South Corridor projects literally intersected, there was little policy coordination between China and Japan.⁸⁹⁵

The emergence of the China Special Fund, and the ADB's innovation of using these 'multilateral appearing/bilateral provided' funds for regional projects is a major institutional change and a reflection of China's rise. Japan's response of cutting the JSF funding to China and limiting coordination even as Japan steps up its involvement in the GMS is reflective of a realist logic.⁸⁹⁶ For the ADB as an institution, this outcome bodes poorly. By permitting these bilaterally funded projects to carry the ADB name, the institution risks its reputation.⁸⁹⁷ An international institution's *raison d'être* lies in promoting cooperation, and allowing China and Japan to go their separate ways within the institution is reflective of weakness. From a realist perspective this weakness is due to a lack of a regional hegemony. That said, the amounts in the JSF and its Chinese equivalent are still small compared to the ADB's overall profile. But more than simply a lack of power concentration, this outcome is due to the institutional history of the ADB. Ironically, it was Japan which first defaulted from the ADB by establishing the JSF in 1998 to boost its influence versus the US, a precedent which subsequently allowed the PRC to create its own fund to boost its influence versus Japan.

⁸⁹³ Hisane Masaki, "Japan Vies with China for Dominance in Indochina and Asean," *Asia Times*, May 22 2007.

⁸⁹⁴ "Technical Assistance Greater Mekong Subregion: Development Study of the North South Economic Corridor (Cofinanced by the PRC Poverty Reduction and Regional Cooperation Fund)," (Manila: ADB, 2006).

⁸⁹⁵ Masafumi Iida, "Japan-China Relations in East Asia: Rivals or Partners?," in *Nids Joint Research Series No.3 China's Shift: Global Strategy of the Rising Power* ed. Masafumi IIDA (Tokyo: National Institute for Defence Studies, 2006). P135, seeking to rectify this on April 2008 the first Japan-China Policy Dialogue on the Mekong region was held.

⁸⁹⁶ Going as far as to have 2009 declared the year of Mekong-Japan friendship.

⁸⁹⁷ Author's Confidential Interview with ADB Official, November 2008. Tokyo.

7.7 Rules

This next section addresses changes in the ADB's rules. I will show that China, despite slipping in formal voting weight, has increased its informal influence. Japan has accepted this subtle, informal shift in institutional power and is not feeling threatened by China in the ADB, or at least not enough to act on.

7.7.1 Voting Weight

The first area to be examined is voting weight. When the ADB was founded in 1966, Japan held 17.12% of total voting weight, and the PRC was not represented. Japan's share fell to 12.5% after the PRC joined in 1986. Upon accession, China received 114,000 shares valued at US\$1.3 billion and thus garnered 6.1% of the voting share, or roughly half of Japan's share. This allowed China to appoint its own director, giving it an immediate say of the day to day operation of the Bank. Not all were happy with this outcome and there were some fears that small countries would lose out on representation to China.⁸⁹⁸

Some twenty years later, in 2006, China's voting power had fallen to 5.4% despite its rising economic power. Inversely, Japan, despite its economic malaise, has been able to marginally increase its stock share to 12.8%.⁸⁹⁹ This has meant that despite China's rising power (especially relative to Japan) this story is played in reverse inside the ADB. China's actual voting power in the ADB had fallen 15% vis-à-vis Japan, albeit from an admittedly low base.⁹⁰⁰ Nevertheless, China has retained its position as the third largest holder of shares after Japan and the United States, with India coming a close fourth.⁹⁰¹

In May 2009, there was an additional General Capital Increase to help the ADB fund its response to the World Financial Crisis. While it was possible that voting weight might again be adjusted, this has not occurred.⁹⁰² Neither China nor Japan have sought to increase their voting weight to formally take greater control of the Bank. This is in part because there are more cost effective informal means to achieve the same result.

⁸⁹⁸ Indeed, the Board was increased in size to 12 to countervail these fears, see Michael Wesley, ed. *The Regional Organizations of the Asia-Pacific* (New York: Palgrave Macmillan, 2003). p. 26

⁸⁹⁹ However, this should not be interpreted as Japan trying to crowd out China. Rather, Japan was aiming to break parity with the US with the Capital Increase of 1994. Ibid. p. 25, and "Annual Report of the Asian Development Bank," (Manila: Asian Development Bank). (various years)

⁹⁰⁰ Interestingly, this trend is also reflected in other multilateral organizations, such as the IMF.

⁹⁰¹ China and India are able to maintain such large subscriptions because they need only pay in 4% of their total pledge. The rest is raised on the open market with the states promising to step-in in case of default.

⁹⁰² "Annual Report of the Asian Development Bank," (Manila: Asian Development Bank). (2009)

7.7.2 Informal Influence

Both Japan and China have sought to increase their influence informally. China, in particular, has gained a greater voice in decision making by making a donation to the ADF, allowing it to sit in on meetings with the major donors. China's Establishment of a Regional Cooperation Special Fund (discussed in resources) has also allowed it to also shape the direction of the ADB, in a similar (if lesser) manner to the Japan Special Fund.

China has also benefited from being moved into essentially its own department. The March 2005 realignment of regional departments means PRC now shares 71 staffers with Mongolia - yet Mongolia borrows only a fraction of what China does (for example, in 2005 Mongolia received 0.01% of total ADB loans and TA, compared to China's 25%). The head of ADB's Regional Office in China, Jeffery Liang, noted that China and Mongolia sharing a department was a little unusual as it appear not to be based on any particular technocratic or regional logic.⁹⁰³

The establishment of the Beijing Regional Office has also been quite useful to China. This Office was established to help with the day to day administration of the ADB operations in China and facilitate better people-to-people linkages. The Office has also allowed the Chinese government side (usually the Finance Ministry) to become involved in the earlier 'design stage' of China's country strategy.⁹⁰⁴ It is evident that China can, and intends to, use this office to gain control over development assistance allocation decision-making process within the ADB.⁹⁰⁵ Likewise, in 2008 Japan established its own representative in Tokyo to better coordinate its policy to the ADB. Japan's new regional office was established across the hall from the ADBI on the eighth floor of the *Kasumigaseki* building near the Ministry of Finance.

In addition to being a source of national pride, having one's citizens well placed in multilateral institutions is a possible (third) source of influence, or at least prestige. This is generally denied by the institutions themselves due to legal (and largely theoretical) imperatives. However, both officials working in the ADB and the academics involved with the Bank all believe that nationality is not somehow 'left at the door.'⁹⁰⁶ One scholar who has examined the ADB at length has noted how Japan has gained influence though the

⁹⁰³ Unlike other groupings such as CAREC, Author's Interview with Asian Development Bank Beijing Regional Office Vice-Director Jeffery Liang, 31 July 2009. Beijing.

⁹⁰⁴ The ADB admin budget pays for the RO. But a portion of that is paid by PRC. Ibid.

⁹⁰⁵ Zweig in Guang Zhang, "The Determinants of Foreign Aid Allocation across China," *Asian Survey* 44, no. 5 (2004), p709

⁹⁰⁶ Observation based on discussions with ADB officials and experts.

shadow posting of its Ministry of Finance (MOF) officials to the Bank.⁹⁰⁷ Considering that these officials know that they will return to the MOF, they are unlikely to advocate any policy which radically challenges dogma in their home institutions.

It is also apparent that some ADB staffers continue to identify with their home nation even after beginning work at the ADB. One MOF official at the ADB (director) stated commented on this link stating, "I did not consider the ADB appointment as any kind of great honour. I considered it as my fourth division director (*kachō*) in the International Finance Bureau's Manila branch."⁹⁰⁸ According the 2007 Annual Report, Japanese nationals held 119 (14%) of a total of 856 professional positions, while Chinese nationals number 52 (6%).⁹⁰⁹

Data from previous years is not yet available but there are indications that the number of positions held by Chinese nationals is increasing. Part of this is due to the Chinese Ministry of Finance pushing its nationals forward.⁹¹⁰ Most prominent is China's former vice-minister for Finance (and former Ministry of Finance official), Jin Liqun, who was appointed to the position of Vice-President in 2003. However, Japan still retains key positions in management. The President continues to be a Japanese national in deference to tradition and Japan also holds its virtually hereditary positions in budget/personnel, strategy, and treasury.⁹¹¹

One former Japanese official at the ADB noted that that the Chinese are pushing for more 'earmarked' professional posts for their nationals, and that sometimes horse trading Japanese over a post occurs.⁹¹² There is some evidence too that India is becoming more vocal, demanding at the 2006 Board of Governors a Vice-President position, but settling for

⁹⁰⁷ Ming Wan, "Japan and the Asian Development Bank," *Pacific Affairs* 68, no. 4 (1995).

⁹⁰⁸ Dennis T Yasutomo, *The New Multilateralism in Japan's Foreign Policy* (New York: St. Martin's Press, 1995). p. 85

⁹⁰⁹ Slight increase in 2008, 125 of professional staff are Japanese (14.3%) of a total of 875. see, "Annual Report of the Asian Development Bank," (Manila: Asian Development Bank). 2007,

⁹¹⁰ "China's New Spring Role," *South China Morning Post*, 8 May 2002. This is also true at the global level in the World Bank. China has also benefited from the 2005 realignment, which placed it in the East Asia department, whose borrowing members are itself and Mongolia.

⁹¹¹ Japanese officials are moved around the key position (musical chairs). For example, in 2003, after the reorganization, Iwasaki became the South Asia director. Previous he had worked in REMU, the precursor to OREI. In 2004, Shibuichi (former Bangladesh director) moved to the PRC directorship while Japan maintained the South Asia director (Iwasaki retiring, Senga (from Strategy) ingoing. Then (Japanese) Kondo became the India director. And OREI directorship went to Masahiro Kawai before he became Dean of ADBI (vice-presidential position). Over this time budget and personnel, and treasury have remained in Japanese hands. One official noted that exceptional people are not criticised for their nationality. However, he notes that Japan has sent across from the MOF some unexceptional people, which have caused problems. He singled out the former Human Resource manager who came from Hokkaido's Tax office for a holiday in the pacific - apparently totally disinterested in doing real work. Interviewee requested name be withheld! Author's Interview with Former Mof Official, November 2008. Tokyo.

⁹¹² Ibid.

a Canadian Indian (Rajat Nag) as the Managing Director. There are fears that China will also demand the same or similar treatment.

7.7.3 The Asian Development Bank Institute (ADBI)

Another area where the Japan has sought informal influence over the agenda is in the establishment of the Asian Development Bank Institute (ADBI). Proposed by Japan in 1995, the ADBI was established only in 1998.⁹¹³ It is funded through the ADBI Special Fund, in turn a grant from the Government of Japan.⁹¹⁴ Despite its source of funding, its Tokyo location and the current Dean's nationality – the ADBI is presented as 'not Japanese'. However, the purpose of the ADBI is clearly to boost Japan's leadership credentials.

Japan benefits in an informal manner by drawing to Tokyo DMC officials for training and research seminars. Recently, the ADBI has been making efforts to attract Chinese officials. Apart from these networks, the ADBI's research platform has acted as means for Japan to express its policy preferences and potentially impact on policy decisions throughout the region.⁹¹⁵ One example of this influence on regional policy is the Emerging Asian Regionalism Report (2008) which was funded and directed by the ADBI.⁹¹⁶ Interestingly, one participant has stated that the conclusion was already decided at the initial meeting.⁹¹⁷ The ADBI has reportedly picked up the research agenda of other Japanese research institutes, in particular the MOF affiliated Research Institute of Economy, Trade and Industry.⁹¹⁸

Taken together though, Japan's influence both formal and informal over the ADB has hardly been significantly eroded by China's rise. Indeed, the incongruous *fall* of China's formal control relative to Japan has put hard limits on the effectiveness of China's growing informal

⁹¹³ Given this timing, it is likely that Japan was trying to increase its influence in response to the US rather than China at the outset.

⁹¹⁴ Setup cost US\$15, annually \$10 million, this is relatively cheap compared with other Japanese development activities. See, "Annual Report of the Asian Development Bank," (Manila: Asian Development Bank). (various years)

⁹¹⁵ For examples see, Masahiro Kawai, "Towards an Exchange Rate Regime in East Asia," in *ADBI Discussion Paper* (Tokyo: ADBI, 2007). as research which dovetails with the MOF plan for Yen role, and ADBI (Asian Development Bank Institute) Workshop for Asian Think Tanks in June 2007 which increases Japan profile as a 'knowledge leader', a priority set out by Tarō Asō in December of 2005.

⁹¹⁶ It conveniently found that regionalism was good and that it, itself was good because "research institutes such as ADBI ought to play a role in fostering regionalism." See, "Emerging Asian Regionalism," (Manila: Asian Development Bank, 2008). pp. 269-270

⁹¹⁷ Author's Informal Discussion with Peter Drysdale, November 2009. Tokyo. Also, Author's Informal Interview with an Adbi Official (b), June 2009. Tokyo. Some are puzzled why report was not "in-house", and questioned the ADBI institutional competence in comparison other major international research bodies.

⁹¹⁸ Author's Informal Interview with an ADBI Official (a), November 2008. Tokyo., "working with Research Institute of Economy, Trade and Industry meant that the ADBI acquired that institutions policy agenda for research – you can see it in the Ageing project. What does that have to do with development?"

influence. In fact, China is not interested in challenging Japan for leadership in the ADB. China's chief interest remains extracting resources from the Bank rather than contributing more in a bid to lead it. Because China both lacks the means and the intent to challenge for leadership, Japan has not felt any need to respond actively. Rather, China has shown itself willing to obey the rules of the ADB, rules which favour Japan, in order to gain the benefits of membership.

7.8 Conclusion: Power, Institutions and Regionalism.

Japan's response to the rise of China in the ADB has been mixed, and no one theory of international relations quite does justice to its complexity. The most significant development in recent years at the Bank has been the emergence of the RCI strategy and its associated emphasis on regional cooperation. For Japan, the RCI represents a means of increasing its presence and influence in Asia, an interest which has only grown as China's influence and aid diplomacy expands. Unsurprisingly, Japan has been anxious about coordinating with China at a strategic level, even though both powers are deeply involved and vocally supportive of the RCI.

While realism might not have predicted competition over regionalism, it is correct in identifying competition in the relationship between Japan and China at the ADB. Indeed, as Japan's primary interest in the PRC's participation was based on a realist, political calculus, it should be no surprise that political factors would colour its assessment of the role of China today. Japan's growing concern about Chinese national power, in particular the rapid pace of militarization, has driven a reassessment of Japan's aid diplomacy. Here, the ADB has served as a foil to Japan's ODA policy in China. As China's access to Japanese ODA declined over the late 1990s and 2000s, so ADB's policy towards China has also shifted. While the net amount has remained constant, or even grown, in recent years, the geographical and sectoral distribution has changed to be in line with Japanese preferences (away from areas with potential military links). This political use of the ADB is even clearer in the Japan Special Fund, which would be switched off and on depending on Chinese behaviour – and which is now seemingly permanently in the off position.

Likewise, the emergence of the China Special Fund, in part modelled and a response to the Japan Special Fund, reflects the rise of China as a challenge to Japan. Indeed, the use of the China Special Fund and Japan Special Fund to funnel Technical Assistance into regional projects, especially in light of the lack of policy coordination between the two, suggests a competition for influence in the GMS in particular. With Japan and China both willing to undermine the Bank's reputation and authority in a struggle for influence, realists

would suggest that the institution will suffer. This outcome is very much in line with realist thinking and the relevance of material power to creating and sustaining international institutions. The increased use of bilateral funds to guide the ADB's operations into countries/areas in which Japan or China has an interest also suggests that the ADB is at risk. While the institution is unlikely to devolve wholly into a network, some network-like effects are occurring.

Yet this line of thinking over-states the role and significance of balance of power type factors in determining actual institutional outcomes. In examining the rules of the ADB, it is apparent that the institutional features of the Bank itself are at play as an intervening variable in determining institutional outcomes of the rise of China. China's rising power in the region and versus Japan was *not* matched by a comparable rise in formal influence at the ADB – China's voting weight even slipping slightly. Japan's position of privilege in the Bank has therefore been effectively locked-in despite rising Chinese influence within the region. The ADB has also functioned to depoliticize the ending of Japan's bilateral aid to China. As seen in the resources section, the ADB was able to find a reasonable compromise solution between China and Japan on the levels and sorts of access China might receive by emphasizing less political sensitive sectors, thus reaffirming the relevance and value of the ADB to both countries.

While Japan's support for the regionalist strategy can be understood as motivated by concerns about its influence in Asia under threat from the rise of China, this is to miss out the important role that East Asia's nascent regional identity plays in shaping the institutional outcomes. While both the Japan and China Special Funds are clearly manifestations of national self interest, their focus on regional cooperation is hardly accidental. To wit, Sino-Japanese competition for influence need not have taken the form of funding for regional cooperation but could have equally occurred on country-by-country basis. In explaining this outcome it is necessary to appreciate the desire of some in Asia, but particularly in Japan, to be more independent of American power after the 1997 financial crisis. And indeed, the personality of the ADB President, and his ideas about regionalism, proves to be a surprisingly important factor in explaining the move towards a regionalist strategy at the ADB. The constructivists' favoured intellectual framework of the 'us-them' dichotomy is therefore not dividing Japan from China in the ADB so much as 'Asia' from 'the West'.

Under this constructivist ideational framework both Japan and China perceive that they might displace the US to increase their own influence in the region. The most potent example of this was the spectacle of China and Japan calling together for a greater role for the ADB in the face of the Global Financial Crisis. Japan and China have therefore

cooperated with each other in promoting the ADB as a site of East Asian regionalism. Japan and China have vocally supported at annual meetings regionalist activities promoted by the ADB⁹¹⁹ – over the protests from the United States (and other extra-regional) members.⁹²⁰

In conclusion, despite the seemingly technocratic arena of economic development, the realists are half-right. Japan and China are competing for influence in East Asia, and the ADB is not except as a field of play. However, it is incorrect to conclude simply that this competition has resulted in damage to the ADB as an institution. Rather, as per liberal understandings, the ADB has been strong enough institutionally to resolve some issues related to aid in the Sino-Japanese relationship. Thus, contrary to realist expectations, the direction of causality goes from the ADB to the bilateral relationship as well. Part of this might be explained as the ADB having effectively *slowed* the speed of power transition between Japan and China in the ADB allowing greater levels of cooperation. But in fact there is something more fundamental at work. It is clear that there is a growing demand for regional common goods, and the beginnings of shared vision of the (East) Asian future. These ideational forces are pulling the ADB towards playing a bigger role in regionalism, regardless of the actual merit of such plans. China's rise has not prompted Japan to defect from the institution, and the bilaterally-networked regionalism effects on institutional development seen in previous case studies are thus not on display to the same extent in the ADB. In short, Japan's response to the rise of China in the ADB cannot be totally explained by a form of realism as significant cooperation exists parallel to a level of competition.

⁹¹⁹ Sadakazu Tanigaki, "Address by Japan's Governor of the Asian Development Bank" (paper presented at the Asian Development Bank Annual Meeting, Hyderabad, India, 4-6 May 2006). Also see, Anthony Rowley, "ADB Divided over Future Direction," *Business Times Singapore*, 8 May 2006.

⁹²⁰ It is perhaps no surprise that the US has voiced its concern over 'mission creep' in the ADB, as an alignment of interests between China and Japan about a more exclusive regionalism would only undermine the US's influence. Rick Carew, "Friction over Adb's Role --- East Asian Members Use Lender to Foster Financial Integration," *Wall Street Journal*, May 8 2006.

8 Conclusion

This dissertation set out to establish why East Asian regional institutions proliferated even under the conditions of a Sino-Japanese rivalry. In particular, it examined the effects of the rise of China on Japan's regional policy and its outcomes. It adopted an eclectic approach to test each of the main international relations theories against the story of Sino-Japanese relations within the studied regional institutions of East Asia.

This thesis has shown that no one international relations theory was able to satisfactorily capture the complexities of Japan's policy towards East Asian regionalism. Specifically, it demonstrated that no one theory could satisfactorily explain how Japan's response to the rise of China would impact on the development of East Asian regional institutions. Instead, this thesis confirmed the importance and utility of Analytical Eclecticism as an approach. It demonstrated the importance and utility of the eclectic approach by empirically examining the institutional changes within four case studies, and tracing the link to Japanese policy and the rise of China. As realism was only ever half-right in explaining actual institutional outcomes, it was important and necessary to bring in variables favoured by other international relations theories. This eclectic approach was more sensitive to the unique characteristics of each case and was able to explain why Japan's response to the rise of China was responsible for different institutional outcomes across the case studies.

This thesis also found that across all the case studies, the weakness of the Sino-Japanese relationship was a crucial explanatory variable in understanding the development of East Asian regional institutions. Japan's attempts to lock-in its influence by institutionalizing rules that favour it have sometimes succeeded and sometimes failed but in either case the motivation was generally to be found in Japanese anxieties about China. While this dynamic has no doubt pushed forward regional institutions, it is also responsible, at least in part, for a certain kind of institutionalization built up from a network of bilateral relations.

The Case Studies

The link between the rise of China, Japan's response and the emergence of a bilaterally-networked regionalism was first explained in Chapter Four. This thesis demonstrated that Japan's attempts at leadership in the field of trade regionalism were linked closely to China's rise; whether directly as a response to Chinese proposals to ASEAN or indirectly due to a perceived need to protect the Japanese manufacturing network from becoming overly dependent on China. In either case, Japan's decisions can be seen as following a form of realist logic. The effects of a regional power transition explain why the institutions of

regional trade have remained weak; Japan avoiding an FTA with China and instead championing the sixteen-party EAFTA.

Nevertheless, factors other than those favoured by realism are necessary to explain some important idiosyncrasies of Japan's FTA policy. Firstly, Japan's unique set of domestic political conditions, such as the role of the agricultural lobby and big business, have impacted on Japan's FTA strategy and subsequently on the wider EAFTA agenda. Moreover, this thesis has found *qua* liberalism that these trade agreements acquire a life of their own. This locked-in expectations and created a certain level of path dependency which limited the effects of simple power factors and explained why Japan's policy might favour the creation of a bilaterally-network trade regionalism. Secondly, while Japan may be more afraid of relative losses than absolute gains arising from an FTA deal with China, this has less to do with rising power *per se* than with perceptions of that power as explained by social constructivism. Even as China grows to become Japan's largest export market, this shift is hardly translating into a deeper shared identity. Instead, popular polling shows the Japanese are more negative towards China than ever, and in the context of a trade deal, worried about the safety of Chinese produced goods. Such a perception gap limits Japan's ability to cooperate with China in the furtherance of regional free trade, and creates an image (self-fulfilling) of competition between Japan and China.

Chapter Five discussed financial regionalism. Here we found that Japan's attempts at leadership are able to be linked to the rise of China and the emergence of bilaterally-networked regionalism. While Japan no doubt aims to increase its influence in the region by leading with financial cooperation, Japan did not aim at displacing China's still modest role in this arena. The outcome of negotiations with China at the Chiang Mai Initiatives is broadly in keeping with realist expectations. Yet the stalling of an agreement over contributions to CMI is reflective of the problem of a zero-sum type negotiation when the question of regional leadership and hierarchy remains unsettled. As predicted by realism, the CMI is a story of China dragging down Japanese efforts to institutionalize Japan's position and influence in the region and the inability of these two to cooperate leading to a bilaterally-networked solution for regional financial cooperation.

But this picture is incomplete. The fact that China and Japan were able to sit down with their neighbours and create even this modest network of bilateral swaps is evidence of the causative nature of deepening regional interdependence in a manner described by liberals. While this interdependence does not extend to China and Japan, as each is amply able to fight off a speculative attack on their respective currencies, both Japan and China share an interest in trying to head off such events in the future, or at least to be better positioned to

negotiate with the IMF on behalf of Asia about the conditions of a bail-out. From a constructivist point of view, the parallel story of internationalization of the yen, the RMB and a future regional common currency captures the dynamics of an emerging regional identity. From both these perspectives, the CMI should be explained with reference to growing interdependence in East Asia and the emergence of regional (rather than national) 'us/them' dichotomy. The CMI, while limited by factors identified by realism, is in fact being driven more by factors identified by liberalism and social constructivism.

As discussed in Chapter Six, the ASEAN Regional Forum, this thesis has established that Japanese efforts to create a Confidence Building Measures regime at the ARF can be linked to China's rise. Japan has repeatedly called for greater transparency from China in its military spending, and has proposed at the ARF a series of CBMs which aim to limit the freedom of China's military. However, Japan has been unable to progress the preventive diplomacy and conflict resolution agenda at the ARF over Chinese objections. At the same time, China has used the ARF to call into question Japan's role in regional security by criticizing the US alliance and blocking Japanese participation in sub-groups, such as those focussed on the South China Sea. Thus, China's rise in the region had allowed it to seize control of the institution.

Yet power variables alone are insufficient in explaining Japan's policy towards regional security. Japan's initial policy towards the ARF was best described by liberalism, with its emphasis on self-targeting and mutual (and assumed reciprocal) reassurance. The causes for this change are best explained by social constructivism with its emphasis on learning and identity. Specifically, this thesis has shown that Japan's interactions with China in the ARF have taught Japan that cooperation with China on regional security is not possible. The upshot of this disappointment has been the weakening of Japanese commitment to the ARF, and Japan's attempts to build-up new security networks (both bilaterally and mini-laterally) to manage China.

Chapter Seven examined the Asian Development Bank. Here we found that the rise of China has influenced the manner in which Japan uses the ADB, and that bilaterally-networked regionalism was evident at the ADB, albeit only mildly. As per realist expectations, China's rise has caused Japan to funnel development assistance away from sensitive sectors in China via its influence at the ADB and encouraged Japan to target other regions and sectors. Realists would also identify the emergence of the China Special Fund and competition in the GMS sub-region via the Regional Cooperation and Integration strategy as a challenge to the ADB itself.

However, it was also found that realism overstates the impact of a changing balance of power on institutional outcomes by suggesting an uninterrupted, direct line from power to institutional development. China's rise has not led to the degeneration of the ADB itself or undermined Japan's influence at the ADB. This is because, as liberals suggest, the institution itself plays a role as an intervening variable. China's growing influence in the ADB has instead been limited to the informal sphere and the PRC's formal voting weight actually falling relative to Japan. Thus Japan's position of leadership in the Bank has effectively been locked-in, and the bilateral power transition has not been played out in the ADB.

Additionally, explaining the emergence of the ADB's Regional Cooperation and Integration agenda requires bringing in variables that the constructivists identify as important. Since the Asian Financial Crisis, and now with the onset of the World Financial Crisis, Japan and China have sought to extend their influence in and through the ADB as a foil to US power. President Kuroda's personal experience and ideas aside, the fact that China and Japan lined up side by side to support a greater role and more money for the ADB over US objections suggests that, in the ADB at least, the identity boundary is cutting through the Pacific Ocean rather than the Sea of Japan. This development has meant that as opposed to realist expectations to the contrary, the ADB has only increased in relevance to both Japan and China (and regionalism as a whole) even as their bilateral relationship has suffered.

Discussion of Results

Throughout all the regional institutions examined, one trend has emerged. Whether in trade, finance, security or development, East Asian regionalism is characterized by 'bilateral networks.' This networked outcome is more flexible than European or American-type regionalism, allowing for any dyad to calibrate their commitments as they please without reference to a regional standard. It is precisely the lack of common agreed rules which allows, and perhaps encourages, this form of cooperation. But as long as agreement on common rules for East Asia remains unforthcoming, this bilaterally-networked regionalism will not lead into more formal and deeper cooperation.

If these bilateral networks can be collapsed in a larger, harmonized regional structure (as appears to be the case in the CMI) then the significance of this finding is that it confirms liberal understanding about how international institutions can be developed from the ground up rather than hegemonically imposed from above. If, on the other hand, the bilateral networks are incapable of progressing to truer multilateralism (such as in the ARF and potentially the

EAFTA), then the realist case for power and institutional development in East Asia is made. What is clear however is that progress from bilaterally-networked regionalism to a regionalism based on harmonized rules and expectations will be driven by different factors depending on the area of cooperation. Thus in the relatively low politics area of economic development, the ADB has least displayed such bilaterally-networked effects even though it faces the same pressures from the Sino-Japanese relationship as the other cases studied. In addition to the theoretical conclusion, this conclusion about the manner of institutionalization in East Asia forms another contribution to the international relations literature.

Additionally, over the course of the research some other generalizations about the nature of East Asian institution building were discovered. Firstly, even as Japan proposes a regional agenda with an eye to China, China responds with its own initiatives. This feedback process ensures that Japan's policy is always in a state of change. One effect of this is that Japanese policy is more 'rushed' than need be, either in the preliminary stage or during implementation. Japan has therefore had to revisit and revise its position several times in each of the institutions studied and has therefore missed opportunities for further integration. The costs of this are not borne by Japan alone but also by the region as a whole.

Secondly, while institution creep is hardly a phenomenon unique to Asia, the institutions studied do share a similar kind of creep. With China and Japan gridlocked, institutions have had to defend their relevance in new areas where success is more likely, even if not entirely consistent with the institutions' original official mandate. This has created a form of institution creep which leads not towards 'deeper' cooperation, as spillover-type thinking might suggest, but towards 'wider' cooperation and the creation of new, symbolic appendages of limited use in helping to resolve the major regional problems; including the Sino-Japanese relationship itself.

Finally, the suggestion that Japan and China's competition for influence in the provision of public goods is a net benefit for East Asia can be shown to be wrong. In the field of trade, East Asia has had to settle with a networked arrangement which is not only difficult to use, but frequently simply not worth it economically. In the field of finance, the CMI has not only remained unactivated as of yet, but continues to define its success by remaining inactive. Likewise, tensions between Japan and China over the role of the US in the ARF have only exacerbated the major problems already facing efforts at creating a CBMs regime there. While at the ADB, regionalist projects (while helpful) are not the kind of help that poorest of the poor need.

These above findings imply some significant challenges to the current theoretical understanding about East Asian regionalism. The first of these is the potency of the link between the Sino-Japan bilateral relationship and multilateral relations. Whilst many have observed that a weak Sino-Japanese relationship was either unhelpful or detrimental for the development of East Asian regional institutions in a commonsense manner, this thesis has empirically established the effect that the Sino-Japanese relationship has. In particular, Japan's response to a rising China was seen as a key explanatory variable in causing East Asian regional institutions to develop in a bilaterally-networked manner. Thus, this dissertation has contributed to the literature by explaining the mechanisms by which bilateral relationships on the one hand effects regional institutions on the other.

9 Appendices

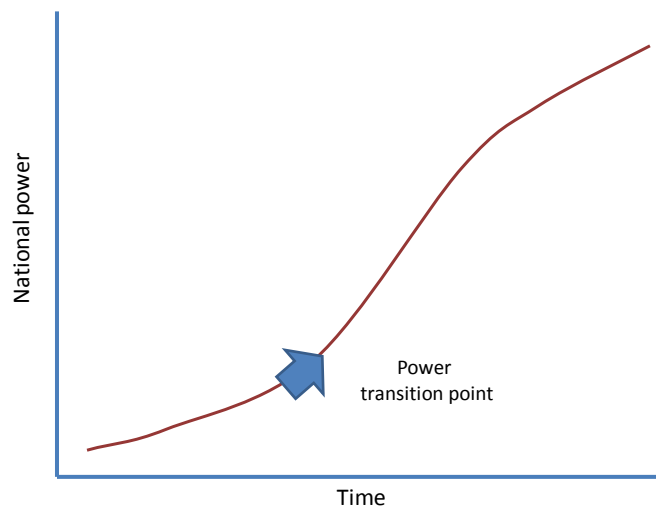
Appendix 1 List of Interviews by Affiliation

Academics	
Informal Discussion with Peter Drysdale, ANU	November 2009.
Interview with Etsuko Katsu, Meiji Uni	18th January 2010.
Interview with R Taggart Murphy, Tsukuba Uni	1th April 2009.
Interview with Shiraishi Takeshi. Cabinet Research Office	May 20 2009.
Interview with Terada Takashi. Waseda Uni	9 March 2010.
Interview with Urata Shujiro, Waseda Uni	8th February 2010.
Interview with Yung Chul Park, Korea University,	1st June 2009
Think-tank staffers and other researchers	
Interview with Kim Han Sung, Korea Institute for International Economic Policy	3rd June 2009
Interview with Yoon Deok Rong, Korea Institute for International Economic Policy	4th June 2009.
Interview with Yuzawa Takeshi, Japan Institute for International Affairs	28 September 2009.
Interview with Sukegawa Seiya, Japan External Trade Organization Official	12th March, and 12 th December 2009.
Government of Japan, Ministry Officials (and former/affiliated)	
Interview with Former Ministry of Finance Official.	November 2008.
Confidential Interview with Ministry of Finance Official.	16 March 2010.

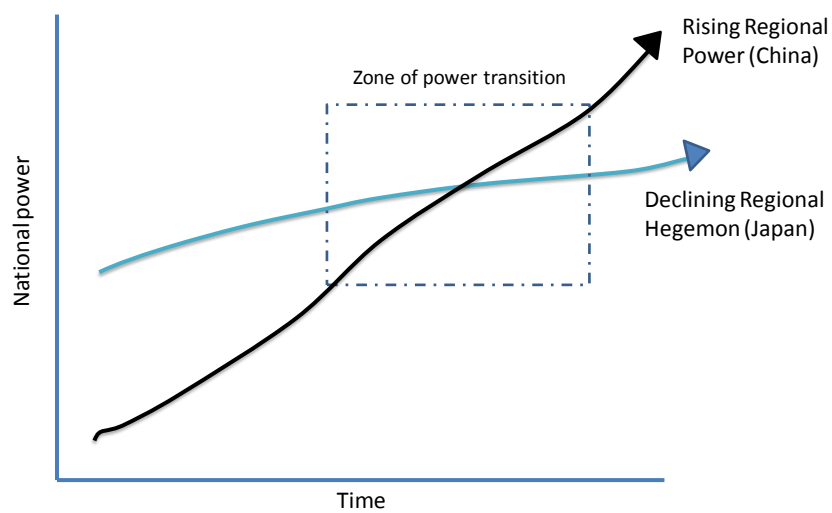
Interview with, Sekizawa Yōichi, FTA/EPA Analyst at Ministry for Economy, Trade and Industry	17th November 2009.
Interview with Ministry of Foreign Affairs Official	5 February 2010.
Confidential Interview with Bank of Japan Officials.	16 March 2010.
Asian Development Bank/ADB	
Confidential Interview with ADB Official.	November 2008.
Confidential Interview with a High Level Official at the ADB.	December 2008.
Informal Interview with an ADB Official (2).	June 2009.
Informal Interview with an ADB Official.	November 2008.
Interview with Giovanni Capannelli, Office of Regional Economic Integration	14 September 2009.
Interview with Jayant Menon, Office of Regional Economic Integration	4th December 2008.
Interview with Jeffery Liang, Vice Director Beijing Regional Office	31 July 2009.
Interview with Kawai Masahiro, Dean of the ADB	14 November 2008.

Appendix 2 Graphic representation of Power Transitions Theory

National Power Transition



International Power Transition



Source: Generated by Author

Appendix 3 The significance of the Japanese Agricultural lobby to FTA negotiations

At the 2003 meeting of the ASEAN–Japan Comprehensive Economic Partnership (AJCEP) Expert Group, which consisted of senior officials from Japan and ASEAN in charge of their respective economic affairs, ASEAN emphasized repeatedly the absolute necessity of the inclusion of agriculture in trade liberalization reached within an FTA.⁹²¹ However, going into the negotiations with Thailand there were storm clouds on the horizon. Thailand is a very competitive producer of rice (in fact it is the world's largest exporter of rice), the most politicized sector of the Japanese economy. More than that, Thailand was the most vocal in demands for agricultural liberalization during the 2003 preparatory meeting.⁹²²

For the first time, there was potential in these dealings for Japan's FTA/EPA project to be derailed by failing to reach an agreement. It is likely that Japan would be unable to conclude an FTA with Thailand if rice were not excluded from the talks.⁹²³ "Indeed, only a few years earlier, the JMAFF (sending a 'kill-team' delegation larger than that the JMOFA and JMETI) scuttled the WTO talks in Cancun over agricultural matters, it did not seem likely that JMAFF would concede then to Thailand.⁹²⁴ This play was in fact signalled by the JMAFF which took charge of negotiations over agriculture with Thailand, while METI took charge of manufacture.⁹²⁵

⁹²¹ Takashi Terada, "The Making of Asia's First Bilateral FTA: Origins and Regional Implications of the Japan-Singapore Economic Partnership Agreement," *Pacific Economic Papers* 354(2006). 23, citing interview with METI official, Singapore 25 March 2002

⁹²² Maki Aoki, "New Issues in Ftas," in *Working Paper No. 8* (Tokyo: IDE-JETRO - APEC Study center, 2004).p. 21

⁹²³ Takashi Terada, "The Making of Asia's First Bilateral FTA: Origins and Regional Implications of the Japan-Singapore Economic Partnership Agreement," *Pacific Economic Papers* 354(2006). p.24

⁹²⁴ Lydia Yu-Jose, "Phillipines-Japan Economic Partnership: Where Is the Phillipines in Japan's Plan," in *Discussion paper series* (Manila: the Philippine Insitute for Development Studies, 2004). p.19

⁹²⁵ Yōichi Sekizawa, "Japan's FTA Policy: Analysis of the Policy Process," in *Tokyo University Institute of Social Science* (Tokyo: Tokyo University, 2008). pp. 81-2

Appendix 4 List of ASEAN+3 Research Group Studies**NOTE:**

This appendix is included on pages 235-236 of the print copy of the thesis held in the University of Adelaide Library.

Source: Japan External Trade Organization

Appendix 5 Richard Baldwin's calculations for Hub-ness in East Asia**NOTE:**

This appendix is included on page 237 of the print copy of the thesis held in the University of Adelaide Library.

Source: Personal notes of Richard Baldwin

Note: JKCFTA is most likely to trigger the creation of a hub, it does not yet exist.

Appendix 6 Comparison of Trade with/out AJCEP**NOTE:**

This appendix is included on page 238 of the print copy of the thesis held in the University of Adelaide Library.

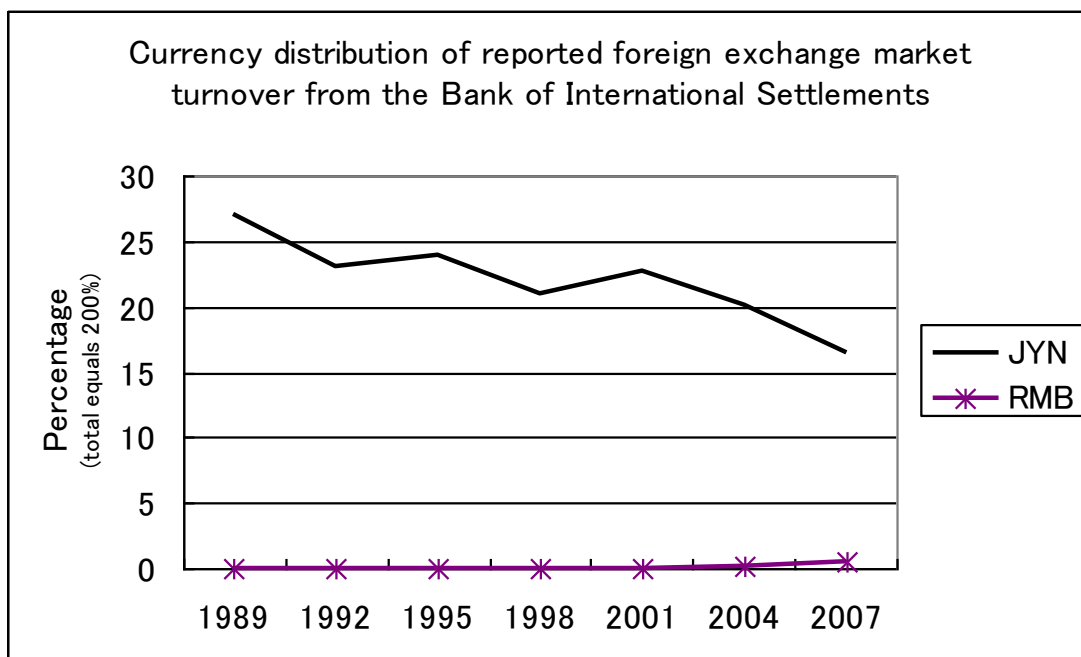
Source: Japan External Trade Organization

Appendix 7 Comparison of Rules of Origin in JACEP and CAFTA

ROO	Japan-ASEAN	China-ASEAN
CC	736	2
CC or RVC	123	
CC+ECTC	175	
CC+ECTC or RVC	3	
CC+ECTC+RVC	41	
CC+RM	348	
CC+RM or TECH	44	
CH	121	40
CH or RVC	3041	
CH+ECTC	32	
CH+ECTC or RVC	13	
CH+ECTC+RM	81	
CH+ECTC+RM or TECH	200	
CS	8	6
CS or RVC	33	
RVC	220	4752
WO	3	
TECH	0	424
Other	2	
Total	5224	5224

Notes: CC – Change in Chapter, CH – Change in Heading, CS - Change in Subheading, RVC - Regional Value Content, TECH – Technical Process, ECTC – Exception to CTC, WO – Wholly Owned, RM – Regional Value Content Minimum

Source: Personal notes of Kim Han Sung, shared with Author.

Appendix 8 Usage of Yen and the RMB in International financial market(s)

Source: Bank of International Settlements, compiled by Author

Appendix 9 Access and Contribution to the CMIM**NOTE:**

This appendix is included on page 241 of the print copy of the thesis held in the University of Adelaide Library.

Source: Japanese Ministry of Finance,
http://www.mof.go.jp/english/if/091228press_release.pdf, **Accessed:** 20/2/2010

Appendix 10 China's interests in the ARF

China's decision to join the ARF reflects a fundamental change in China's perception of the region and its role in it. Indeed, as late as the early 1990s, the terms of 'multilateralism' and 'regionalism' were almost unknown to China's international relations scholars, let alone to its policy makers and officials.⁹²⁶ As Hempton Jones notes, China was initially fearful of joining the ARF for two reasons.⁹²⁷ Firstly, China believed that China would not be able to leverage its relative strength as easily in a multilateral setting. Certainly within the Chinese MOFA, there was an acknowledgement that China could potentially make itself a target, as Xu has discovered "in general the [Chinese] MOFA officials observe that multilateral setting make China feel pressured for China is usually everyone's target."⁹²⁸ And secondly, China's core, 'internal' interests in Taiwan would be exposed.

What then was China's interest in joining the ARF? Some have suggested a realist motivation for relative gain, in other words that China was hoping to undermine the US hub-and-spokes regional security structure.⁹²⁹ Part of the strategy would naturally entail trying to loosen the 'tight' alliance between the US and Japan, a concern even Japan had noted in the early days of the ARF. Indeed, China's New Security Concept includes so-called 'democratization' of international relations, and an emphasis on discarding 'old' alliance politics. Also noted are the similarities between the NSC and the ASEAN way.⁹³⁰

But most see China engagement with the ARF not as an attempt to undermine the US-led order, but in order to avoid becoming a target for containment. In other words to reassure its neighbours, and indeed the world, that China will be a responsible power. Indeed, many believed that the PRC hoped to throw off the last vestiges of international isolation it had suffered after 1989 by joining the ARF.⁹³¹ In this view, China is playing a social constructive game aimed at trying to shape regional perceptions about its nature and capabilities – rather than a realist game aimed at joining with the weak powers to balance against the US

⁹²⁶ Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). p.404

⁹²⁷ Justin Hempton-Jones, "The Evolution of China's Engagement with International Governmental Organisations," *Asian Survey* 45, no. 5 (2005). p. 719

⁹²⁸ Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). p.439

⁹²⁹ Justin Hempton-Jones, "The Evolution of China's Engagement with International Governmental Organisations," *Asian Survey* 45, no. 5 (2005). p. 719

⁹³⁰ Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003).

⁹³¹ Dominik Heller, "The Relevance of the Asean Regional Forum (ARF) for Regional Security in the Asian Pacific," *Contemporary South East Asia* 27, no. 1 (2005).

while bidding its time and amassing power. The reasons are simple enough; the US is not perceived as a threat in the region, whereas China is. In this context power balancing behaviour is unnecessary and possibly dangerous. China has received a boost from ASEAN, which has traditionally avoided public discussion in favour of a behind closed doors approach.⁹³² From ASEAN's point of view, it is dangerous to talk about the 'China Threat' because it might lead to a self-fulfilling prophesy, which suits China's interests well.

Another factor in China's warming to the ARF was American attempts to turn APEC into a security forum. At the Osaka APEC in November 1995, US secretary of Defence Perry had proposed that APEC be a site of security consultation but China had opposed due to Taiwanese membership in the APEC. Thus it is likely that, as Takagi argues, 'to pre-empt further development of the idea by reinforcing the effectiveness of the ARF must have been one of the calculations behind China decision [to be more positive about joining the ARF].'⁹³³ In fact, upon joining China also placed at the outset fairly clear limits about what it was prepared to be engaged about. When China first agreed to the establishment of the ARF at the ASEAN FMM in 1993, Foreign Minister Qian Qichen said "it [the ARF] should not make a decision nor take common action on a certain country, a certain region, a certain question", indicating that the price for China's participation was the avoidance of Taiwan issue.⁹³⁴ More promising however was the potential for the ARF to resolve South China Sea dispute. On the eve of the [first] ARF, a Chinese MOFA spokesman noted that it was unavoidable for the Nansha/Spratly issues to be on the agenda, even though China still preferred a bilateral approach.⁹³⁵

Indeed, it seems fairly clear then that China did not join the ARF with the intention of engaging with Japan. China's interests lay with protecting its claim on Taiwan, managing relations with the US and with Southeast Asian countries. Thus there was a perception gap between Japan desire to engage with China, and China lack of interest in engaging with Japan from the outset.

⁹³² Acharya in Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). "Identifying a country publicly as your adversary goes against the grain of Asian Strategic culture." p. 425

⁹³³ Ibid. p. 442

⁹³⁴ Takeshi Yuzawa, "Japan's Changing Conception of the ARF," *The Pacific Review* 18, no. 4 (2005). 468, of course it stands to reason that given the widened geographical scope of the US alliance, Japan would wish Taiwan to be discussed at the ARF.

⁹³⁵ Xin Xu, "China and East Asia: Reshaping Power and Identity in the Post Cold War Era" (Phd thesis, Cornell University, 2003). p. 436

Appendix 11 Japanese and Chinese sponsored CBMs at the ARF 1998-2005**NOTE:**

This appendix is included on page 244 of the print copy of the thesis held in the University of Adelaide Library.

Source: www.aseansec.org/ARF/cbmdb.pdf Accessed: April 2010

Note: ARF discontinued reporting CBMS by sponsor in 2005, the Author has been unable to secure access.

Appendix 12 Voluntary Briefs at the CBMs-ISG

Year	Japan	China
2000	<i>Unknown</i>	<i>Unknown</i>
2001	New anti-terror laws	None
2002	Cooperation with US/UK	Defence White paper
2003	None	Six Party Talks outcome
2004	Non-proliferation	Six Party Talks outcome
2005	Various, unspecified	None
2006	11 th Tokyo Defence forum, People Building for Peace	None
2007	On upgrading the Defence agency to the Ministry of Defence	None
2008	12 th Tokyo Defence Forum, Pacific Shield 2007	Peace Mission 2007 (SCO), China-India-Russia Foreign Minister Summit
2009	None	None
Tot.	9	5

Source: Chairman's statement of the ARF's ISG-CBMs, compiled by Author

Appendix 13 Japan's diplomacy and the formation of the ADB

Japan played a critical role in the formation of the ADB, without Japanese support and activism it is unlikely the ADB would have ever been formed. The idea of a multilateral development bank was not new in Asia. Proposals had been made at various forums for an organization capable of bridging the credit worthiness gap in Asia and facilitating the development of the region. In Japan too, the idea for a development bank had been floated privately by an economic journalist and researcher Ohashi Kaoru. In 1962, momentum started gaining in Japan as Ohashi put together a group to discuss the plan, a group which included Watanabe Takeshi – a Ministry of Finance (MOF) official who would become president of the Asian Development Bank. While American support for the plan did not seem immediately forthcoming, the energy with which Asian countries (particularly Sri Lanka and Thailand) embraced the plan was sufficient to put a regional development bank onto the agenda in the UN sponsored Economic Commission for Asia and Far East (ECAFE). After passing through an expert group in August-September of 1963, the plan was passed up to the first full-blown Ministerial conference for Asian Economic Cooperation which accepted, in principle, the need for a regional development bank.⁹³⁶

These moves in Asia and ECAFE (the multilateral forum in which the action happened) reflected an understanding in the region that development was reliant on external assistance. The idea of an Asian Development Bank, followed in the footsteps of such organizations as the African Development Bank and the Inter-American Development Bank, which had been founded later was already heading towards loaning its first \$1billion.⁹³⁷ While India and Pakistan could look to Britain (and through Britain to easy access to the World Bank's soft loans) and China might to a lesser extent look to Russia, Asia were seemingly without 'natural' powerful friends. For the Asian country members of ECAFE, the proposal for ADB was appealing, as it would hopefully provide a better conduit for foreign aid to reach Asia. However, as eager as the Asian countries were for concessionary loans in the early 60s, there was no desire for having it controlled by either Japan or America. While acknowledging that these players would want political influence in exchange for contributions, regional states hoped to find a middle path between these great powers.⁹³⁸ At this stage there was no Chinese presence *per se*.

⁹³⁶ Dick Wilson, *A Bank for Half the World* (Asian Development Bank, 1987). p. 4

⁹³⁷ *Ibid.*

⁹³⁸ The ADB came into existence in 1966, about the same time as ASEAN was formed. The strategy of ASEAN states to attempt to avoid entanglement in either Japan or US, can now be seen in ASEAN's approach to China too. For more about the impetus to regional organization see Mark Beeson, "Asean Plus Three and the Rise of Reactionary Regionalism," *Contemporary South East Asia* 25, no. 2 (2003).

Japan in the meantime was working in the background to get the ADB formed.⁹³⁹ In his capacity as an expert, Watanabe advised the Expert Group on what elements the Government of Japan (GOJ) would like to see in any ADB proposal, elements which the Ohashi group had already discussed in depth. But he did so as an expert and *not* as a representative of Japan. This approach was taken as Watanabe did not want to reveal to the Expert Group that Japan already had ideas for an ADB as this might put offside those in Asia already suspicious of Tokyo's growing economic power.

Appendix 14 Chinese interests in joining the ADB

China signalled its intention to join the ADB in 1983. However it would not be until 1986 that it would take a place at the table. China was still highly suspicious of international organizations and anxious about preserving its sovereignty and freedom of action. Chinese commentators tended to view regional cooperation of any stripe, including the ADB, as part of "capitalistic" US and Japanese strategy to dominate developing countries.⁹⁴⁰ And yet China was painfully aware of how desperately it needed development assistance, and thus how necessary joining the international community was.

From China's point of view the ADB was 'different' from other international organizations. While multilateralism was a new approach as far as China was concerned, ADB allowed China to accept aid that it might not of. Furthermore, the ADB's non-political nature facilitated China joining, as it could practice multilateral diplomacy without the potential of causing itself catastrophic damage in the international arena. Put simply, if China was willing to join the UN Security Council, then it may as well join the ADB. There is also some evidence that Japan's strategy of socialising China into the international system through economic means, including Japan's vaulted 'aid diplomacy', had worked.

By 1985, after Nakasone had approved the second yen loan package, worth nearly US\$2.5 billion, and, as bilateral trade with Japan expanded rapidly to exceed US\$10billion, China

⁹³⁹ Japan preferred the background for a variety of reasons, certainly among them was being continuing suspicions in the region about Japan based on its wartime legacy. Japan needed to work quietly but efficiently. Takeshi Watanabe was able to do just that, possessing both MOF and international experience. When the expert group re-assembled in Bangkok on 20th October 1964, Watanabe was in attendance and had gathered support back in Japan for proposals which might arise from the meeting. Despite attending as 'an expert', with no official capacity to represent Japan, he had already sounded out the political leadership of Japan about an ADB developed along the lines of the Ohashi plan. In exchange, Prime Minister Ikeda had told Watanabe that the Government of Japan would support any reasonable proposal which came out of the Expert Group. See, Dick Wilson, *A Bank for Half the World* (Asian Development Bank, 1987). p. 11

⁹⁴⁰ See Wu Jixian in Yong Deng, "Chinese Relations with Japan: Implications for Asia-Pacific Regionalism," *Pacific Affairs* 70, no. 3 (1997). p. 376

began to see the benefits associated with multilateral economic cooperation.⁹⁴¹ However, from the outset China treated joining the ADB with a calculated lack of interest. China never did tip its hand about *why* it wished to join the ADB. Then President of ADB, Fujioka (1981-89) commented that it was not clear even to him what China wanted from membership in the bank, as China had never indicated that it was interested in development loans to him.⁹⁴² China was of course still suspicious therefore, and playing 'hard to get' in the interests of getting a better deal, true *realpolitick* style.

Appendix 15 Rise of China's bilateral aid and impact on the ADB

At the same time the ADB has become increasingly challenged by China's growing bilateral aid activities. In this light, China's aid diplomacy has become more significant. Indeed, the mere fact that China, an ostensibly developing country, has an aid program at all has raised eyebrows. Opinions about China's aid vary widely, attracting either criticism or praise depending on who you listen to. Most observers agree that China's interest in giving aid is political, whether in its own region or in Africa where China's activities have ruffled feathers at the G8 – fears in part arising from China's historical use of aid in the early cold war years.⁹⁴³ Certainly, China is interested in using aid to generate a positive perception of itself in the region, as well as to win points in the diplomatic game with Taiwan. While remaining agnostic about what China's intentions may be, this section will suggest that China's rising aid profile does undermine the ADB as is perceived a threat to Japan's interests.

Indeed, we need to understand the increased supply of aid with low or zero conditionality being provided by China has had real effects on the way the business of aid is being carried out in the region.⁹⁴⁴ Secondly, Chinese aid is highly politically and strategically motivated.⁹⁴⁵ While no aid is given entirely free of self-interest, protecting the national

⁹⁴¹ Ibid.

⁹⁴² "The president of Asian Development Bank has seen China's entry as one of the bank's major achievements in the last three years" (1986).

⁹⁴³ For more on China's early aid diplomacy and its "rather blatant efforts to buy political influence" see, Peter Poole, "Communist China's Aid Diplomacy," *Asian Survey* 6, no. 11 (1966).

⁹⁴⁴ Even the World Bank is not immune, with Chinese willingness to build a dam in Laos pushing the World Bank to approve the project despite its concerns over its environmental impact.

⁹⁴⁵ In Cambodia, Chinese aid has been linked to access to oil. China has helped finance a deep port in Sihanoukville which would allow an overland route for oil coming from the Gulf. Additionally, China has received permission to explore Cambodia's own oil reserves. Jane Perlez, "China Competes with West in Aid to Its Neighbours," *The New York Times* 2006. See also, Joshua Kurlantzick, "China's Charm Offensive in Southeast Asia," *Current History* 105(2006). for more on the energy security factors driving this strategy.

While in the Pacific islands, China has been using aid diplomacy to swing a diplomatic coup over the recognition of Taiwan through the oddity of cricket stadium construction, but with a short term goal only in mind undermining the utility of the development assistance. This short sightedness has meant instability, such as China also got a satellite tracking

interest plays a dominant role in Chinese aid diplomacy ahead of factors like the actual success of the development assistance.⁹⁴⁶ Indeed, China often ties its development assistance to its own businesses, even providing the labour for many these projects.⁹⁴⁷ Moreover, due to this political nature it is difficult to get good and accurate statistics on China's aid.⁹⁴⁸ China's politically motivated and non-transparent aid is a challenge for Japan. These tensions emerge most clearly in Southeast Asia, as an area of strategic concern to both parties.

One example of where this is happening is in Burma, one of the poorest countries in the region, ruled by a military junta. Both Japanese yen loans and the ADB operations in Burma were suspended in 1988 in the aftermath of the coup. However, China is less fussy about dealing with authoritarian governments, and stepped into the vacuum to prop-up the military junta economically and militarily. China's moves in Burma are widely regarded as having pushed Japan to rejoin the Burmese aid game, even at the risk of deflecting from the ADB, which has continued the embargo.⁹⁴⁹ Moreover, China has replaced Japan as the largest source of total economic assistance to Burma, including \$1.4 billion to \$2 billion in weaponry in 2003, and an additional loan of \$200 million. By way of comparison, Japan provided a yearly average of \$26 million in ODA to Burma, a fraction of China's offer.

Another example of these tensions can be found in the Philippines – where the ADB itself is headquartered. While China has contributed aid in the past for disaster relief (such as in the case of mud slides), Chinese aid to the Philippines is increasingly involved in areas in which the Japanese aid and ADB had been dominant, such as infrastructure. In 2004, the China Export-Import Bank provided US\$400 million to finance the construction of the first phase of the North Rail project at a highly concessional rate (3% over 20 years). The generosity of this offer prompted Presidential spokesperson Bunye to say, "What I know is that this is one of the most generous packages extended by any institution or country to the

station on Kiribati, with obvious military applications. But Kiribati again defected to Taiwan in November 2003 taking the station with it. See, Phillip C Saunders, "China's Global Activism: Strategy, Drivers and Tools," in *Occasional Papers* (Washington: Institute for National Strategic Studies, 2006). 8 Fergus Hanson, "China; Stumbling through the Pacific," in *Policy Brief* (Sydney: Lowy Institute, 2009). and Purnendra Jain, "The World Cup, China and Cricket," *Eye on Asia*, April 16 2007.

⁹⁴⁶ There is growing concern that Chinese aid project do not facilitate development to the same extent as other, more transparent, programs.

⁹⁴⁷ Jane Perlez, "China Competes with West in Aid to Its Neighbours," *The New York Times* 2006.

⁹⁴⁸ Indeed, China continues to regard the details of its aid program as a state secret and publishes no annual reports. Fergus Hanson, "China; Stumbling through the Pacific," in *Policy Brief* (Sydney: Lowy Institute, 2009). p. 5

⁹⁴⁹ Toshihiro Kudo, "Myanmar and Japan: How Close Friends Become Estranged," *IDE Discussion Paper* 118(2007). Japan has made several attempts to restore its relationship with the Burmese and continues to provide humanitarian grant aid.

Philippines. This [is] more than competitive [emphasis added].”⁹⁵⁰ This statement represented an indirect criticism of Japan and ADB which had moved away from infrastructure loans. In late 2006, China appeared to pledge over lunch a further \$2 billion to the Philippines every year for the next three years over lunch, dwarfing ADB and Japanese loans.⁹⁵¹ While this later turned out to be clever arithmetic involving projected gains from the ‘early harvest’ clause of a China-ASEAN FTA, the announcement itself sent shockwaves into Japan’s ODA policy makers.

China has also stepped up its aid to Laos, a country for which foreign aid represents really 20% of GDP (although still only a mere \$250 million). Loans from the ADB total roughly \$80 million of that amount in any given year, with Japan coming second at \$65 million. However since 2001, China has reportedly become the second largest provider of aid to Laos, overtaking Japan. Moreover the high profile public works, such as a hydro power project worth \$178 million and \$45 million in technical cooperation and debt forgiveness, are clearly aimed at painting China in a positive light within Laos. China has also become a large player in Cambodia, giving ten times as much as the ADB in FY2006.⁹⁵²

In December 2006, Beijing halted aid to Vietnam in response to the Vietnamese government’s formal invitation to Taiwan, a major investor in the country, to attend the APEC November 2006 summit in Hanoi. Similar expansion of Chinese aid has occurred in Indonesia; Hu Jintao and Indonesian President Susilo Bambang Yudhoyono signing in 2005 a declaration of “strategic partnership” that was accompanied by \$300 million worth of concessional loans. Indeed, despite the fact that its mission is to lift Asian states out of poverty, the ADB now predominately lends not to the region’s poorest, but to its middle income countries – allowing China to step into the gap left behind.⁹⁵³

China’s growing aid diplomacy has therefore undermined the ADB’s operations, and harmed Japan’s interests in the region.

⁹⁵⁰ "China Loan for North Rail Most Generous -- Bunye," *Manila Standard*, Sept 11 2004., And in January 2007, a state water agency swapped outright its borrowing to the China Export-Import Bank from the ADB on the grounds that the Chinese were offering cheaper rates and faster approval.

⁹⁵¹ Jane Perlez, "China Competes with West in Aid to Its Neighbours," *The New York Times* 2006.

⁹⁵² The ADB’s package was for roughly US\$60m across all sectors, China gave US\$600m mostly to infrastructure. Some have suggested a link between this aid and the ongoing Khmer Rouge trial under way in Cambodia, more likely is Cambodia’s overall strategic value to China. One ADB official commenting off record that China’s aid is degrading the improvements in governance in Cambodia. Author’s Confidential Interview with ADB Official, November 2008. Tokyo.

⁹⁵³ Lincoln in "China’s New Spring Role," *South China Morning Post*, 8 May 2002.

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