



# East Asia's Rising Geoeconomics and the Strategy for Japan

Saori N. Katada, Associate Professor, University of Southern California

January 2018

## Japan and Shifting Geoeconomic Grounds

In the 21<sup>st</sup> century, great power rivalry unfolds not only in security and military affairs, but more prominently through economic interactions such as trade and investment. Geoeconomics, therefore, has become a vital component of power politics. This constitutes a major departure from the time of the Cold War, where the United States and the Soviet Union competed politically and militarily without this competition spilling into economic governance. In today's Asia, which is characterized by high levels of economic interdependence—the same interdependence which made China's rise possible in the first place—economic statecraft has become the foreign policy instrument of choice for great powers.

In times past, economic statecraft has taken place in the form of bilateral competition over trade, protection of foreign investment interests, or economic sanctions. However, what is more striking about recent initiatives advanced by the United States and China is their determination to define the global and regional economic order. In particular, recent introduction of mega free trade agreements (e.g. TPP, RCEP, or FTAAP) and the emergence of new financial institutions such as the Asian Infrastructure Investment Bank (AIIB) and BRICS' (Brazil, Russia, India, China and South Africa) New Development Bank reveal fierce competition in rule-setting and institution-building dynamics in the region. In this landscape, the Japanese government has the opportunity to tip the balance between the two great powers.<sup>1</sup>

---

<sup>1</sup> Saori N. Katada, "At the Crossroads: The TPP, AIIB, and Japan's Foreign Economic Strategy," *AsiaPacific Issues*, No. 125. May 2016. East West Center.

The election of President Donald Trump, with “America First” economic priorities and disdain for multilateral institutions, however, presents new challenges for Japan on two interrelated fronts. The first is the withdrawal of the United States from institutional competition, most clearly represented by Trump’s decision to withdraw from the Trans-Pacific Partnership (TPP). The second is China’s constant push to reconfigure regional geoeconomic and geostrategic order through the Belt and Road Initiative (BRI).

Japan has both the motivation and the potential to influence the regional economic order. Its economic prosperity depends significantly on trade and investment in the Asia-Pacific, and as the world’s third largest economy, it is large enough to affect change. The opportunity for Japan continues to be its ability to shift the power balance in the region, while the challenges revolve around how Japan can independently lead rule-based institutions. As the shifting geoeconomic balance introduces greater uncertainty, the Japanese government must contribute to create a robust regional order that will support the region’s continued prosperity regardless of changes in the US administration or upswing in China’s geopolitical ambitions.

### **TPP versus AIIB, and the Trump Shock**

The TPP was a challenging proposition for Japan as it emerged from a small but high quality free trade agreement (FTA) among Singapore, New Zealand, Chile, and Brunei in the mid-2000s. When the United States became involved in 2008, TPP negotiations transformed into a vital endeavor for defining the rules for regional trade and investment. By the time the Japanese government entered negotiations in mid-2013, the 12 TPP negotiating members covered 40 percent of global GDP and one-third of world trade.<sup>2</sup> On the one hand, the TPP was a great opportunity for member countries to access large markets around the region and to install modern-day commercial rules and standards such as intellectual property right protection and e-commerce. Of course, this was in exchange for stringent liberalization and reform requirements, which were either feared or welcomed by the negotiating members. In Japan, opposition was strongest from the country’s vocal agricultural sector.

On the other hand, among the countries which were left out (or opted out), there were concerns of being excluded from such benefits. Particularly for China, the TPP was seen as a way to contain or at least constrain its economic position, as evidenced by some of the TPP’s rules such as the chapter on state-owned enterprise (SOE) control. Then-US President Barack Obama famously promoted the idea that “if

---

<sup>2</sup> The TPP member countries were: Chile, New Zealand, Singapore, and Brunei (original P-4 members); the United States, Australia, Peru, and Vietnam (joined negotiations in 2008); Malaysia (2010); Canada and Mexico (2011); and Japan (2013). Among these 12, the United States and Japan are the largest economies which, combined, account for approximately 78 percent of the TPP GDP.

the United States does not write those rules [of trade and investment by failing to conclude the TPP], China will.”<sup>3</sup> Such pressure led China to support the Regional Comprehensive Economic Partnership (RCEP) negotiations as an alternative regional FTA that is more inclusive (with 16 regional members of ASEAN+6) and sensitive to concerns among countries with varying levels of development through special and differential treatment. Yet, while RCEP provides a more accommodative template, East Asian leaders—including those in China and Japan—are also aware of the need for their countries to liberalize, reform, and implement transparent rules for their economies in order to move to the next level. For China, that means further liberalizing protected sectors and making progress towards a consumption-based economy emphasizing higher value-added industries. For Japan, it is engaging in rule-setting for and economic liberalization of the region so as to enable smoother expansion of its businesses to the growing regional market. Thus, the TPP’s appeal goes beyond the power play of the United States resisted by China.

Meanwhile, after taking office in 2013 Chinese President Xi Jinping began to promote the “China Dream” and to address the country’s economic “slowdown” by forcefully establishing China’s economic leadership. President Xi unveiled China’s initiative, the AIIB, to support its geoeconomic grand strategy centered on the One Belt One Road (more commonly known as BRI). With a \$100 billion initial funding commitment for infrastructure investment, the AIIB was inaugurated with 57 founding members including most of the countries from Asia and Europe, but without the United States or Japan. This new development bank has imposed pressure on existing development banks such as the World Bank and the Asian Development Bank (ADB), which have traditionally been dominated by the United States and Japan, respectively. In recent years, these institutions have decreased the emphasis on infrastructure investment. The United States has been distancing itself from global infrastructure investment for some time, and Japanese businesses have not been able to successfully bid on development projects due to higher costs of operation.

Nonetheless, the demand for infrastructure investment has remained high. It is estimated that Asia alone would need approximately \$26 trillion of such investment in the next 15 years. Funding availability has fallen far behind, and so immense attention was paid to the AIIB as an alternative option. As a result, the World Bank and the ADB not only began to collaborate with the AIIB on infrastructure investment, but also accelerated their institutional reform and loan-approval process to make their programs more attractive. Many developing countries in the region welcomed this Chinese initiative with high hopes for more investment, while others were fearful of China’s ulterior political motives.

---

<sup>3</sup> Another famous quote was by the US Defense Minister Ash Carter who noted that passing TPP “is as important to me as another aircraft carrier.” [Remarks on the Next Phase of the U.S. Rebalance to the Asia-Pacific](#) (McCain Institute, Arizona State University), April 6, 2015.

It is clear that the TPP and AIIB initiatives address different economic needs in the region, but the underlying geoeconomic consideration was similar: the desire to secure the rules of economic exchange in the region. As such, both the TPP and the AIIB aim to shape Asia's regional economic governance in the future. Such competition would have given Japan leverage. As it helped promote the US agenda by signing onto the TPP, Japan could also help improve the quality of the AIIB's investments by casting a vigilant view on this new institution directly and by cooperating with it through other multilateral development banks.

Yet, this opportunity was disrupted by President Trump's electoral victory. After five years of negotiations, the TPP was very close to coming into effect, having been signed by the 12 member states in February 2016. But President Trump's first order of business was to withdraw from it in January 2017. The Trump administration is also dismissive of multilateral institutions such as the World Trade Organization (WTO), the World Bank, and the ADB. Key American positions in these institutions remain unfilled after President Obama's appointees stepped down at the time the administration changed. Furthermore, the Trump administration has started to use multilateral institutions to further its own bilateral agendas by threatening to cut off funding for institutions that do not support the US position.<sup>4</sup>

### **Japanese Economic Statecraft**

Due to the constraints imposed by Article 9 of the country's constitution, economic statecraft has long constituted a large part of the Japanese government's regional policy since Japan regained independence in the 1950s. At the same time, Japan has a history of ambivalence regarding how to foster regional economic cooperation and it lacks a grand strategy independent of the United States. This has undermined its credibility as a leader.

Since 2010, Japan has adopted two strategies in response to the changing geoeconomic environment in the Asia Pacific. The first is Japan's hedging strategy against uncertainty by actively engaging China in building the regional economic order. The second element is for Japan to emphasize institutions and rules in governing regional economic order. Japan should continue to build on these two strategies.

Japan's hedging strategy is not new, but it has become even more important with President Trump in office. Japan has often managed its relations with China in the manner of "cooperative competition" where Japan proactively engages in regional

---

<sup>4</sup> Two recent cases include the US' push against the World Bank over its loans to China (Bethany Allen-Ebrahimian, "[Trump Takes Aim at World Bank over China Loans](#)," *Foreign Policy*, October 2017) and American Ambassador Haley's comments at the UN General Assembly on December 21, 2017 as the Assembly overwhelmingly voted against the US move to recognize Jerusalem as the capital of Israel.

projects led largely by China such as RCEP.<sup>5</sup> Despite being known as a conservative nationalist, Prime Minister Shinzō Abe was quite strategic and pragmatic as he flirted with the idea of Japan taking part in the BRI in May 2017. Furthermore, despite not joining the AIIB, Japan has indirectly supported it by cofinancing projects with the AIIB through the ADB, an organization in which Japan is the leading contributor.<sup>6</sup> Japan increases the credibility of these regional projects in two ways: by providing Japan's economic expertise and commitment to quality, and by calming concerns among smaller Asian nations over China's attempt to further its geopolitical ambitions through regional initiatives.

Japan utilized the second element—emphasizing institutions and rules in governing regional economic order—over the last few decades. Using rule-based institutions such as the WTO to settle trade disputes, and also formal treaties such as Bilateral Investment Treaties, Japan helped shape the region's investment rule-making. Even as the United States withdrew from the TPP, Japan has insisted on the TPP's continuation by becoming the first country to ratify the agreement, and by continuing to lead TPP-11 (without the United States) negotiations in 2017. Of course, keeping the TPP alive in the form that was agreed upon in 2015 makes it easier for the United States to rejoin this mega-FTA in the not-so-distant future, as wished by many of its current 11 members. However, for Japan (and probably countries like Singapore), it is also a way to use the trade and investment rules established via TPP-11 to influence RCEP rules and negotiations. Since China proposed the Free Trade Area of the Asia Pacific (FTAAP) as the host of the 2014 APEC Summit, it is increasingly important for Japan to use the higher standards and rules established by the TPP as a template for the region. In general, these rules and institutions can protect the region from falling prey to the power struggle between the two regional superpowers, and enhance the open trade environment. They can also augment Japan's credibility as the provider of regional public goods. Finally, such rule-based economic order helps Japanese businesses expand their investment and market access in the growing region.

Japan can achieve significant influence in the current regional geoeconomic environment if it effectively implements these strategies. Three factors crucially influence their feasibility and sustainability. The first is the importance of the US-Japanese alliance, especially in the context of an increasing nuclear threat from North Korea. Given the Trump administration's inclination to leverage or flaunt the US military dominance, there could be a limit to how independently Japan can operate, dodge bilateral trade liberalization pressure, and prevent security issues from being linked to economic ones. Such issue linkage will make it difficult for Japan

---

<sup>5</sup> Michael Auslin, "[Asia's Other Great Game](#)," *National Interest*, October 2017, p. 20.

<sup>6</sup> Although Japan and the United States each hold 15.6 percent of total shares in the ADB, the Japanese government has by far the largest contribution to the ADB through special funds that it has created over the course of the last few decades.

to sustain its hedging strategy against the wishes of the United States. Second, it is challenging to continue engagement with China under increasingly nationalistic rhetoric in both Japan and China. Japan's public opinion on China has turned increasingly negative in the last two decades, which restricts the policy flexibility of Japanese leaders. The same political dynamic is true for China, making Sino-Japanese relations extremely complex.

Finally, Japan's capacity for regional geoeconomic leadership could be hampered by its domestic political economy. In order to become the leader and promoter of the rule-based economic order in the Asia-Pacific, the Japanese economy itself has to be open, and domestic rules and regulations have to be transparent and fair. Since assuming office in December 2012, Prime Minister Abe has pushed for the three arrows of Abenomics to revive the Japanese economy and implement economic reform. Despite its relative success at getting the Japanese economy out of a deflationary spiral in the last five years, the success of third arrow (structural reform) has been limited due to opposition from domestic vested interests.

Geoeconomics is a prominent feature of Asia's security environment. In this environment, Japan has clear leverage as the great power rivalry between the United State and China develops over regional economic governance. Smaller regional players also welcome Japanese leadership in promoting transparent and rule-based institutions and governance. Since regional economic order provides a crucial vehicle for continued prosperity for the Asia Pacific, Japan has an important role to play during this period of uncertainty. ■

*The author would like to thank Alex Yu-Ting Lin for his research assistance in producing this paper.*

*The views represented in this paper are those of the author and do not necessarily represent the views of the Chicago Council on Global Affairs. This paper was made possible by the generous support of the Consulate General of Japan in Chicago.*