

Rise of the Chinese Economy and East Asian FTA - Japan's Strategic Change and Continuity

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“Social history ... was thus the result of a double movement... While on the one hand markets spread all over the face of the globe and the amount of goods involved grew to unbelievable dimensions, on the other hand a network of measures and policies was integrated into powerful institutions designed to check the action of the market....” (Karl Polanyi, *The Great Transformation*, 1944: 79)

1 Introduction

Just as a market needs a social order to function, globalization, that is, a market expansion at global level, also needs some kind of social or political framework. However, nation states play no longer such a role. Rather in the increasingly competitive environment, they are required to adapt to economic globalization. To the extent that states have lost power against the globalization challenge and a single global society does not exist, we need some alternative framework to control it. In this sense, the world-wide surge of ‘new regionalism’ today can be interpreted as an attempt to build a social or political framework to regulate the global expansion of market principle [Spindler 2002: 16].

Nevertheless, regionalism does not go against globalization, but is even an accelerator for it. In this regard, we should distinguish between **regionalization** as increasing interdependence of economic functions within a certain region on the one hand, and **regionalism** as a political movement or project to promote or institutionalize regionalization on the other hand. Although we often refer to a global economy, most of ‘global’ economic activities actually tend to be considerably self-contained within a certain region. The world economy simultaneously becomes globalized and regionalized. Regionalization is not inconsistent with globalization and both are equally fostered through international production networks (IPNs) organized by multinational corporations (MNCs)¹. Therefore, regionalism as a forwarder of regionalization is not also the concept contrary to globalization. In sum, regionalism emerges as a social or political framework to facilitate economic globalization and at the same time to regulate the global extension of market mechanism.

Being exposed to fury of financial globalization, namely the 1997-98 currency and financial crisis, East Asian countries have also started new regional cooperation. To the extent that the monetary problem motivated a regional solidarity, the cooperation is also monetary-led rather than trade-led. The most important forum is the framework of ASEAN plus Japan, Korea and China (APT), a multilateral summit initiated in 1997 and formalized in 1999. Within APT, they cooperate closely with each other for a creation of mutual liquidity provision mechanism based on currency swap arrangements (Chiang Mai Initiative), a plan for an Asian common bond market for outgrowing the heavy reliance on dollars etc. Heribert and Higgott call it ‘monetary regionalism’ and regard it as a form of regionalism in an era of financial globalization [Heribert 2000, Heribert & Higgott 2000].

On the other hand, the East Asian grouping induces another reaction. The regional countries are also activating bilateralism in response to the world-wide spread of free trade agreement (FTA) centering on the European Union (EU) and the United States

¹ Production networks are inter- and intra-firm relationships through which firms organize the entire range of its business activities, from R&D, product definition and design, to supply inputs, manufacturing (or production of a service), distribution and support services..

(US). Indeed, in the region, where there has been no FTA except for the nascent ASEAN Free Trade Area (AFTA), a number of bilateral agreements are being considered or negotiated within APT (or beyond it) (see Table 1). The paper aims at examining the significance or meaning of the bilateralism for East Asian regionalism.

Table 1 Main Bilateral Arrangements in East Asia

	Signed/Implemented	Under Negotiations	Study
Singapore	New Zealand Japan Australia	the US EFTA	Mexico Canada Chile Taiwan
South Korea	Chile	the US	Australia New Zealand Japan Mexico
Japan	Singapore	Mexico	Thailand the Philippines Chile South Korea
China	Hong Kong	ASEAN	
ASEAN	AFTA	Japan China	the US Australia New Zealand

Source: compiled by the author from various source.

Logically, regionalism should follow regionalization to provide appropriate institution and processes. Though East Asian integration has been regarded as ‘regionalization without regionalism’, this does not mean that there has not been any regional strategic thinking in the process. The region also has its own history of cooperation, which has reflected its own regionalization. The main dynamics has been the structural transformation of the Japanese economy and its substance consists of hierarchical regional production networks (RPNs) organized mainly by Japanese MNCs. Accordingly, in order to explore a possibility of bilateralism in the region, we should start with showing the relationship between the Japan-centered networks and its regional strategy. The new reality of proliferating FTAs is a response to new regionalism of EU and the US, and at the same time it is closely related with a transformation of the East Asian RPN and Japan’s strategic change. They are mainly caused by a rise of the Chinese economy.

The paper is organized as follows. First, it will point out the features of Japan’s traditional regional strategy in relation to Japan-led RPNs. Second, it will investigate the causes of its recent policy change in context of changing international political economy after the crisis. Third, I will analyze particularity of the Chinese economy which casts a long shadow on Japan’s FTA strategy. And finally, the paper will examine the political economic dynamics and the possibility of ongoing East Asian FTA movement, focusing on the strategic change and continuity of Japan as the regional core nation.

2 Japan’s Conventional Vision: ‘Flying Geese’ and ‘Open Regionalism’

2.1 Kojima Plan and the Origin of Asia-Pacific Cooperation

Japan has thus far pursued to maintain trade liberalism based on multilateral negotiations in GATT/WTO. It is, therefore, considered that it has no regionalism option. Despite this formal view, Japan has been strongly interested in East Asia just after the WWII. The Japanese government started to conclude reparation agreements with Southeast Asian countries from the late-1950s and, at the same time, the most powerful politicians, Shigeru Yoshida and Nobusuke Kishi devised several ideas for

establishing an anti-communist regional economic zone, such as Asian version of Marshall Plan or Southeast Asian Development Fund plan. And since the mid 1960s, Japan has persistently developed its own regional strategy to support Japanese firms' move on to the region and to a lesser extent maintain its political presence.

Especially, the year of 1965 was the turning point of post-war political economy in Japan and East Asia. In the year, the US started air strike against North Vietnam, the rapprochement treaty between Japan and South Korea was concluded, Singapore was separated from Malaysia, and the Indonesian Sukaruno regime was forced to collapse. Politically, since the year, in the face of threats of communalization of Asia, the US changed its East Asian policy from bilateralism to regionalism approach, which aimed at solidifying relations with the countries around Vietnam, exploiting regional organizations such as Asia Pacific Council (1966), the Asian Development Bank (1966) and ASEAN (1967) [Kikuchi 1995; Rostow 1987]. Economically, since the year, Japan started to register current account surplus, while it changed its aid policy from reparations to loans. Coinciding with the Japanese capital penetration, Taiwan, and then South Korea, Hong Kong and Singapore (later so-called NIEs) established export processing zones (EPZ), shifting their industrialization strategy from import substitution (ISI) to export-orientation (EOI). The year of 1965 was the point when Japan started to expand market and production sites of its firms throughout the region and at the same time East Asia launched the continuous export-led growth.

The year was also the starting point for Japan's regionalism approach. The US policy change opened up doors for Japanese economists and bureaucrats to develop a comprehensive and extensive regional cooperation beyond the Cold War politics. The pioneering figure was so-called 'Kojima Proposal'. Even in 1965, Kiyoshi Kojima proposed a creation of a free trade area among the five OECD members (the US, Japan, Canada, Australia and New Zealand), namely a 'Pacific Free Trade Area (PAFTA)'. Then, this plan was developed into a broader 'Pacific Economic Community' initiative, a plan including developing countries (especially Southeast Asian nations) as associate members and covering an economic development fund and international monetary cooperation. For Kojima, the main focus of the initiative was to associate the regional advanced economies, especially Japan, with regional developing countries, particularly Southeast Asia through trade, aid and investment² [Kojima 1966; 1980: 191-93].

The Kojima proposal was based on clear-cut strategic thinking and therefore it can be regarded as a vanguard of the Japan's regional strategy. Extra-regionally, the primary purpose of PAFTA was to establish a regional group countering against Western Europe, which was deepening and fortifying economic integration, and thereby to increase bargaining power of Japan as a regional core country³. And by embedding the US into a FTA framework, it aimed to maintain openness of the US market against its rising protectionism. Furthermore, given the above-mentioned historical positioning of

² It should be noted in the initiative that the regional developing countries can enjoy benefits from reduction of tariffs by the advanced countries on the basis of most favored nations and without reciprocal liberalization (PAFTA preference), while the latter unilaterally should promote economic development in the former by opening up markets and by providing aids or investments.

³ Kojima argues in retrospect, 'it is Japan and Western Pacific countries that have swayed between the US and Europe...My Pacific Community Initiative was proposed from a sense of crisis how Japan and Western Pacific countries should act in response to inauguration of EEC' [Kojima 1992: 24].

the year of 1965, the initiative intended to provide a framework where Japan re-organizes East Asian economies as its own economic sphere.

Though the Kojima plan was not realized due to the US disinterest and dissidence of developing countries, it aroused an echo among political and business establishment and intellectuals, which launched informal 'Asia-Pacific cooperation'. In 1968, at the direction of Takeo Miki (then foreign minister) influenced by the Kojima plan, Saburo Ohkita, with Kojima, organized the 'Pacific Trade and Development Conference (PAFTAD)' in collaboration with Australian economists, P. Drysdale, J. Croford etc. In the same year, the Pacific Basin Economic Community (PBEC) was also born as a private business-orientated organization. Particularly, PAFTAD had played a significant role in terms of subsequent theoretical discussion and concept building [Crone 1993; Das 1996; Kikuchi 1995; Korhonen 1998].

In the late 1970s, while the US policy shifted from containment against China to reconciliation with it (the Nixon Doctrine), the idea of Asia-Pacific cooperation surfaced at the foreign political level. Especially since the announcement of so-called 'Fukuda doctrine' in 1977⁴, the Japanese government has activated economic diplomacy for ASEAN and at the same time launched Asia-Pacific cooperation in the name of its 'independent' foreign policy. In this situation, the 'Pacific Basin Study Group' was organized in 1979 under the 'Pacific Basin Cooperation Concept'⁵ worked out by Masayoshi Ohira, the prime minister at that time, and based on its achievements, the 'Pacific Economic Co-operation Conference (PECC)' was established in 1980 [Crone 1993: 513-14; Korhonen 1998: 27-28, 49-52; Terada 2001: 196-97].

PECC has cultivated various ideas and plans, which are ultimately inherited by the Asia Pacific Economic Cooperation (APEC). Though APEC was seemingly advocated by the Australian prime minister, Hawke, its creation can be positioned in a continuation of the information exchange, confidence-building, and socialization processes which Japanese economists, bureaucrats, and the government, formally and informally, have sought as the most important ingredients of Asia Pacific cooperation since the Kojima proposal⁶. Therefore, it is based on Japan's regional strategy, and matches the interests of Japan [Ravenhill 2002: 9-10].

⁴ The points of Fukuda Doctrine are as follows: first, Japan, a country committed to peace, would never become a military power, second, Japan would build up relationship of mutual confidence and trust with Southeast Asian countries in wide-ranging fields, social and cultural as well as economic, and third, Japan would cooperate positively with ASEAN and its member countries in their own efforts, as an 'equal partner' and contribute to peace and prosperity in Southeast Asia as a whole.

⁵ According to Terada (1998; 2001), the origin at the foreign policy level dates back to the Asia Pacific policy proposed by Takeo Miki, aiming at associating Japan with Asian developing countries. In contrast, Ohira's conception was not absolutely region-oriented. Placing more emphasis on "Pacific", say the US presence, he conceived the concept as a part of Japan's comprehensive security strategy.

⁶ Pekka Korhonen, who studied the process in details, characterizes Asia-Pacific cooperation as a product of Japan's 'economism' or its post-war peace-oriented diplomacy. He argues that 'the goal of modern Japanese economic project has been to create a peaceful international environment around Japan...The idea relied on the use of economic development to escape from the constraints of scarcity into a world of constantly increasing abundance [Korhonen 1998: 22].

2.2 Flying Geese as Japan's Strategic Theory

Kojima's another contribution is a modernization of the 'development theory of flying geese formation'. The inventor, Kaname Akamatsu formulated the pre-war Japanese development experience as a general theory of catching-up [Akamatsu 1961; 1962]. Kojima developed it into an economic development or integration theory in East Asia and laid the theoretical foundation for the Japan's regional strategy.

The basic formula is as follows: first, a late-comer learns from advanced countries through import of a certain good, produces it for the home market, then exports it and finally imports it again from a less developed country (*basic type of flying geese*). Second, it creates a substance of a national economy by repeating the same cycle step by step in labor-intensive, then capital-intensive and finally technology-and knowledge-intensive industries (*variant type of flying geese*). And third, this late industrialization pattern, which Japan had experienced, is imitated by one regional economy after another through technology transfer and FDI (*international diffusion of flying geese*) [Kojima 1997: 28].

The regional economic development based on these three flying geese can be envisioned as a multi-tiered catching-up trajectory: a certain industry grows sequentially first in Japan, second in NIEs and then in ASEAN-4 in the line with a regional comparative advantage structure; the diffused industry also changes sequentially from labor-intensive to capital-intensive and then to technology-and knowledge-intensive ones in parallel with changes of comparative advantage of each economy. As a result, in the regional flight, where Japan is the leading goose, followed by NIEs as the second tier, and ASEAN4 as the third, every goose would gain from Japan as the leader and would, in time, develop the industrial structure similar to the Japanese economy with a certain time-lag, while a complementary regional trade and industrial structure would be created at a given time [Gilpin 2000; Kojima 1997].

Kojima has thought that a creation of such an East Asian economy based on their complementary industrial structures could strengthen the economic foundation to enhance regional autonomy and bargaining power against the US and Western Europe [Kojima 1981: 125]. In this sense, the vision of the model falls in with the above-mentioned Japan's strategic intent. Indeed, the East Asian economies have formed a chain of higher growth in response to the structural transformation of the Japanese economy. Especially since the mid-1980s, following appreciation of the yen after the Plaza Accord, Japanese FDI in the region soared, which diffused export-led growth from NIEs to ASEAN4. As a result, the model had won a position of a dominant theory to explain this process, which even old EPA and MITI authorized⁷[EPA 1996; MITI 2001].

However, in spite of its popularity, such a development theory of 'national economy' can not explain the substance of the regional economy. Unlike its egalitarian vision, the developmental path has been a process of forming hierarchical regional production networks (RPNs) and virtually re-incorporating this region into the reproduction structure of the Japanese economy. Of course, the RPNs have brought

⁷ Since Okita introduced the term, 'flying-geese', at the 4th PECC in Seoul in 1985, it has been widely used in Japan and East Asian countries. By that time, the name of flying geese had not been openly used, because Akamatsu was an enthusiastic supporter for the Greater East Asian Co-prosperity Sphere and therefore it could invite emotional objection from Asian developing countries. 'The flying geese theory was thus hidden in English texts under euphemisms like dynamic international division of labor in the process of industrialization' [Korhonen 1998: 53].

about the growth chain in the region, a kind of win-win situation between Japan and the other East Asian economies. But it has never been the process through which each East Asian country sequentially creates a national economy similar to the Japanese one⁸.

Within the networks, Japanese MNCs increasingly specialize themselves in higher value-added goods, R&D, product design and marketing, while they relocate their low value-added production into the regional economies, creating inter- and intra-firm networks in collaboration with local firms. This is nothing more or less than regionalization of the Japanese domestic *keiretsu* system, whereby Japanese MNCs have created their own supply-chains and an exclusive market within the region. Consequently, the regional division of labor consists of vertically (not complementarily) organized production networks, in which technology transfer is bound by innovation cycle of the Japanese MNCs, and all of the nodes have been connected with their supply structure of high-tech and high value-added capital goods and components [Hatch & Yamamura 1996; Hook 2002; Gilpin 2000; Yun 2003].

The flying geese model was rather forged as an ideological rationale of its hierarchy. We can detect the point more clearly from Kojima's FDI theory. The theory was originally invented as a criticism of US MNCs. According to Kojima, the US FDIs, as the Vernon's product cycle theory explains, concentrate on capital- or technology-intensive industries and aim at relocating production of innovative goods for the host nation markets in disregard of their developmental stages. Therefore, these FDIs can be not only ineffective in employment creation but also they are likely to increase imports of capital goods and components with little exports of finished products. He claims that FDI contributing to economic development of the host nations is not such '*anti-trade oriented*' but '*pro-trade oriented*', whereby industries compatible with their development stages are relocated, leading to an increase of trade in both advanced and developing countries [Kojima 1981; Korhonen 1998: 60].

Needless to say, the most notable pro-trade oriented FDI for him is Japanese one. According to the flying geese model, Japanese FDI transplants one industry after another (from labor-intensive to capital- or technological-intensive), where Japan lost comparative advantage as a result of its industrial upgrading and therefore East Asian followers can have comparative advantage. In fact, FDI has been the principal means used by Japan to extend its influence throughout the region. The model was restored in the mid 1960s when Japan's penetration into the region came into bloom. Since then, it has justified the process [Gilpin 2000: 270; Hook 2002: 20, 35; Kojima 1981: 125; Korhonen 1998: 61-68].

2.3 East Asian Production Network and 'Open Regionalism'

Just as East Asian regionalization has been led by Japan, regionalism also has been promoted by Japan's strategic thinking. In analyzing the relation between the Japanese strategy and East Asian RPNs, we should note first of all that the Japanese government and economists have not used 'East Asia' but 'Asia-Pacific' or 'Pacific' as the regional concept [Terada: 2003: 254-59]. An important question is why Japan has had strong Asia-Pacific orientation in its regional thinking.

The immediate answer is the importance of the US presence in Japanese diplomacy and security. Even though Japan has declared independent foreign diplomacy, it has

⁸ Especially about the impacts of Japanese production networks on a formation of a national economy in ASEAN-4 countries, refer to Yun(2003).

been designed on the presumption of maintaining the alliance with the US⁹. The continuous close ties with the US have made it practically impossible for the Japanese government to adopt any regional concept excluding the US and therefore it has needed the concept building on East Asia but including the irreplaceable partner. However, apart from the international political factor, at least following two constitutive features of the regional economic structure have a major impact on Japan's regional conceptualization.

First, though the Japanese networks have expanded throughout the region, the most important site for Japanese MNCs has been persistently Southeast Asia or ASEAN. Through a national strategy of FDI, intra-firm trade, and Official Development Aid (ODA), Japan has created a region-wide economy integrated with and dominated by Japan's home economy, which is called 'triune' economic penetration. The Japanese government has deployed **ODA** as a key instrument to providing infrastructure for Japanese firm's penetration, while Japanese manufactures have fostered the region as a production sites through **FDI** and **export** of industrial plant, and general trading companies have organized it as the market [Gilipin 2000: 271-72; Hook 2002: 22]. In fact, the share of Southeast Asia for Japan's total ODA is quite high and Japan is ranked as the number one donor in each country. More importantly, ASEAN-4 plus Singapore accounts for 48.7 percent of Japanese overseas subsidiaries in East Asia in 2000 and 53.5 percent of total FDI in the region (cumulative basis from 1991 to 2001) (see Table 2). Especially, approximately one-third of Japanese electronics giants' overseas plants had concentrated on Southeast Asia by 1999 and a large number of parts-makers have followed the big players, creating *keiretsu*-like industrial clusters in the host nations. As a result, Japanese MNCs have kept dominant position in electronics and automobile industry of Southeast Asia.

Table 2 Distribution of Japanese FDI in East Asia (100 million yen, percent)

	Number	Share	Value	Share
NIES	2,570	39.7	34,081	32.5
South Korea	360	5.6	5,860	5.6
Taiwan	610	9.4	4,712	4.5
Hong Kong	780	12.1	11,744	11.2
Singapore	820	12.7	11,765	11.2
ASEAN-4	2,327	36.0	44,336	42.3
Indonesia	523	8.1	17,318	16.5
Malaysia	607	9.4	7,774	7.4
Thailand	872	13.5	13,249	12.6
The Philippines	325	5.0	5,994	5.7
China	1,573	24.3	21,492	20.5
East Asia Total	6,470	100.0	104,762	100.0

Number as of 2000, Cumulative Value between 1991 and 2001.

Source: METI and MOF.

⁹ Yoshida Shigeru, as the prime minister during the periods of 1946-54, decided the subsequent course of Japan's foreign policy. In his so-called 'Yoshida doctrine', he concentrated on economic reconstruction, development, and trade, while in foreign policy it was considered sufficient to support the United States, in exchange for American military protection of Japan [Korhonen 1998: 21].

Second, the East Asian RPN has not created a trade structure self-contained within the region. In fact, the ratio of intra-regional export (excluding Japan) increased from 26.8 percent in 1985-89 to 38.2 percent in 1995-99, while that of extra-regional export (excluding Japan) also is still high at 54.3 percent (see Table 3). Especially, the region still remains dependent on a tripartite trade structure with the US market continuing to play a key role (for instance, the ratio was 22.0 percent in 2002). And a substantial part of the intra-regional trade was mutual exchange of parts and component. For instance, IT-related goods accounted for 39.6 percent of the intra-regional exports in 2001, of which about 80 percent was IT-related parts, whereas extra-regional export ratio of finished goods reached 74.5 percent [Kimura and Suzuki 2003: 25-26]. In short, the East Asian RPN is characterized as sophisticated regional divisions of labor, where MNCs and local firms mutually exchange parts and component, combine them with high-tech and high value-added ones imported from Japan, and export a considerable amount of finished goods mainly to extra-region, especially the US market.

Table 3 Intra-Regional Trade Ratio in Major Regions
(percent)

	Export		Import	
	85-89	95-99	85-89	95-99
East Asia including Japan	33.9	45.7	40.1	48.8
East Asia excluding Japan	26.8	38.2	27.0	37.1
Euro Zone	63.5	61.5	61.1	59.9
NAFTA	41.8	50.0	32.1	39.5

East Asia includes South Korea, Taiwan, Singapore, Malaysia, Thailand Indonesia, the Philippines, Hong Kong, and China.

Source: IMF, *Direction of Trade Statistics*, various years.

‘Open regionalism’, the most important idea of Asia-Pacific cooperation, is the concept which was invented, reflecting these two elements of Japan-led East Asian RPN. Indeed, the implication of its openness is twofold.

First, its openness is directed to a relationship with developing countries, particularly ASEAN. In reintegrating the region into its economic sphere, Japan had to overcome a structural barrier, the legacy of colonialism. In addition, given a wide economic disparity between Japan and ASEAN, a creation of a ‘closed’ economic bloc would inevitably lead to a vertical power relationship, giving rise to political objection in the latter. When Saburo Okita set up ‘open regionalism’ or ‘open regional cooperation’, Japan’s economic penetration stirred up region-wide criticism of a revival of a second version of the ‘Greater East Asian Co-prosperity Sphere’. Especially in the 1970s, ASEAN was concerned about Japan’s growing dominance in its market and regarded even Asia-Pacific cooperation as ‘a part of strengthening Japanese economic domination’. The criticism eventually led to a movement to boycott Japanese goods in Thailand and Indonesia in 1972. In short, the first implication of the idea is to show, by placing more emphasis on openness of regionalism, that Asia-Pacific cooperation dose not aim at creating a ‘closed or discriminatory trading bloc’, and thereby to persuade ASEAN to join a regional economic cooperation¹⁰ [Kikuchi 1995:37-38, 75; Korhonen 1998: 63; Terada 1998; 345; 2001:204-8].

¹⁰ The reason why APEC was proposed by Australia is also that Japan was willing to avoid foreseeable backlash by showing that APEC was not driven by Japanese

On the other hand, open regionalism now means that Asia-Pacific countries should unilaterally liberalize trade and investment barriers to the maximum extent possible, while they should also continue to reduce barriers to nonmember countries on an unconditional and most favored nation basis [Garnaut 1997: 6-15; Terada 1998: 354-56]. From the view of the East Asian production network, the implication is more concrete. Faced with the US trade protectionism and its demands for managed trade such as in automobiles and other sectors in the 1980s, Japan had become increasingly wary over their heavy reliance on the US. In this context, open regionalism does not only imply that through a expansion of trade liberalization, Japan assures markets for Japanese products in intra- and extra-region, but also that incorporating the US into a liberalization framework enables Japan to constrain the protectionism of the essential market for its RPNs [Gilpin 2000: 269, Hunbashi 1995: 252].

In this manner, Asia-Pacific regionalism has primarily set up for Japan with insurance against the continuing threat of protectionism. At the same time, alleviating the other East Asian countries' wariness, it has also increased the international competitiveness through a vertical multilevel regional production system. However, recently, this holding operation policy is goaded to revisit in the face of a change of international political economy.

4 New Regionalism and Change of Japanese Trade Policy

4.1 FTA and Extension of Production Network

The first challenge for Japan is world-wide proliferating bilateralism since the 1990s. In fact, as of March 2002, 250 FTAs had been notified to GATT/WTO and 57 per cent of world goods trade, according to a WTO's estimation, was covered by FTAs in 1999.

The two centers in this new regionalism are EU and the US. EU, which already has FTAs with the European Free Trade Association (EFTA) and 77 African Caribbean Pacific countries (ACP), is now extending its FTA network into its neighboring countries. In November 1995, EU and 11 Mediterranean countries and Palestinian Authority agreed to create a free trade area by 2010. Under this plan, EU has concluded bilateral FTAs one after another with Tunisia and Israel (1995), Morocco (1996), Palestine and Jordan (1997), Egypt (2001), and Algeria and Lebanon (2002). In October 2002, it decided accession of 10 Eastern/Central European countries (Lithuania, Latvia, Estonia, Poland, Hungary, Czech, Slovakia, Slovenia, Malta, and Cyprus). Furthermore, EU attempts to expand the FTA network across the Atlantic Ocean: starting with the conclusions of FTAs with Mexico in 2000 and Chile in 2002, it is engaged in FTA negotiations with Mercosur and the Andean Community.

In response to EU, the US is also invoking its FTA strategy, following NAFTA and FTAs with Israel and Jordan. Since 1993, it has publicized the 'National Export Strategy' and 'multi-track' approach, making use of bilateral negotiations, regional framework and multilateralism in WTO for the US-led liberalization. And now the Bush administration successfully got the Trade Promotion Authority in 2002 and tries to strengthen its leadership in the Americas. The most notable project is a Free Trade Area of the Americas (FTAA), proposed in the first Summit of the Americas in 1994. The US

initiative. Indeed, MITI was prepared for a plan for a MITI version of APEC as showed by the MITI report in June 1988, entitled 'Toward a New Asia-Pacific Cooperation: Promotion of Multi-tiered and Gradually Advancing Cooperation based on Consensus Approach' [Kraus 2003: 312-15].

and Latin American countries started the negotiation formally in 1998, and at the third Summit in 2001, they agreed to carry the plan to completion by 2005.

As the failure to launch a new round in the WTO Seattle in 1999 illustrated, a comprehensive multilateral negotiation is increasingly difficult. Against this situation, EU and the US try to increase their bargaining powers in international negotiations by creating their own FTA networks. In this regard, it should be noted that recent FTAs cover not only trade liberalization but also the wider range of fields (so-called GATT/WTO+ α), including investment, circulation of labor, intellectual property rights, competition policies, science & technology, and so on [Lloyd 2002: 1282; Urata 2002: 15-16]. In those fields, where network externality of institution strongly works, international rule-making depends on a sort of power relationship. Namely, if a country could share its own rules with as many countries as possible through bilateral FTAs and establish *de facto* standards among them, the country could increase its weight in international rule setting.

More importantly, the novelty of the new regionalism lies in the fact that it reflects structural transformation in the global political economy associated with expanding IPNs [Low 2001b: 5; Spindler 2002: 3]. EU is deeply involved in its neighboring countries, not only because their peace and stability are essential for its social and political stability, but also because they are the most critical production sites or markets for European MNCs. Similarly, US MNCs develop Latin America-based IPNs, though they globally spread their sites and activities.

In fact, given highly interdependence within EU (with its intra-export ratio 62.3 percent and intra-import ratio 59.0 percent in 2000), the 10 Eastern/Central countries, which account for 12.3 percent of total exports and 9.5 percent of total imports, are the most significant partner¹¹. Among them, Poland, Czech and Hungary are the core, absorbing 75.1 percent of total FDIs in the ten countries. And 57.2 percent of FDIs in Poland, 87.7 percent in Czech, and 89.0 percent in Hungary came from EU, while EU absorbed 75.2 percent of exports from Hungary, 70.0 percent from Poland, and 68.6 percent from Czech in 2001¹² [ITI 2002: 28]. As a result, these three economies are virtually embraced in production networks organized by European MNCs (see Table 4). On the other hand, for the US, Latin America is the largest investment recipient and the important trade partner, which absorbed 23.3 percent of its net FDIs and 15.7 percent of its outstanding FDIs in 2001 and accounted for 21.9 percent of its total exports and 17.4 percent of imports. The US MNCs also utilize these economies as markets for their capital and intermediate goods and as low-wage production sites¹³ [Choi and Lee 2002: 171-72; McQueen 1992: 1376-77].

¹¹ EU absorbed 68.1 percent of total exports from Poland, Hungary, Czech Slovakia, Rumania, Bulgaria, and Slovenia and it accounted for 59.1 percent of total imports to these countries in 2000.

¹² The largest investor was Germany. Only Germany accounted for 41 percent of FDIs in these three countries in 1998 and these countries consists of the essential ingredients of production networks of German MNCs.

¹³ The FDI to the region concentrates on Argentina, Brazil and Mexico. The amount of 57.8 billion dollars in 2000 was equivalent to 67 percent of their total inward direct investments. Especially, in Mexico, the US accounts for 60 percent of its total FDI and 62 percent of total imports from the US were parts and other intermediate goods for electric machinery and apparatus, automobile and general machinery [ITI 2002: 75, 85].

Table 4 Presence of Foreign Company in Czech, Hungary, and Poland
(in 1998, percent)

	Share for Total Sales			Share for Total Manufacturing Exports
	Automobile	electronics	Radio/TV	
Czech	82.1	48.1	57.8	47.0
Hungary	96.9	79.9	82.2	85.9
Poland	89.9	n.a.	81.5	52.4

Source: ITI (2002: 61-63)

EU and the US are building so-called ‘hub and spokes’ structure to enable their own IPNs to operate more smoothly and efficiently. The hub of a FTA network can enjoy preferential access to all spokes. Therefore, in the system, MNCs from the hub country could carry principle parts, intermediate and capital goods in production sites based on the spoke countries, and could export and sell finished goods to the home country and other spoke markets through the FTA networks without tariffs and other trade barriers. Today, when competition among MNCs is increasingly intensified, a FTA works as one of the most effective political instruments for promoting expansion of IPNs and for ‘enclosing’ markets and production sites for them [Lloyd 2002: 1287; Low 2001a: 5-7; McQueen 2002: 1371-74].

On the other hand, developing countries also actively utilize the FTA network, which gives rise to other aspects of new regionalism: increasing FTA between countries with different development stages and increasing cross-regional arrangements. Among them, Mexico and Chile regard FTA as one of the most significant development policy instruments. The two countries have established the hub position in Latin American FTA networks and they aim at becoming the hub across the world tripartite regions, namely, Europe, North America and East Asia¹⁴. More specifically, if Mexico and Chile connect themselves to the three main regions, MNCs locating in the two countries could procure inputs at low or zero tariffs from their home nations or other production sites, while they could get access not only to the domestic market but also to the three main regional markets [Pangestu and Gooptu 2003: 90-91; Schiff 2002: 976; Urata 2002: 15-16]. In the intensified competition for inducing FDI or MNCs, the emerging economies also try to establish the hub position of FTA networks to successfully participate in IPNs.

Nowadays, when the global manufacturing is defined by IPNs, new regionalism is spawned by an interaction between the ‘market enclosing strategies’ of the advanced nations and the ‘FTA hub strategies’ of the developing countries [Dobson 2001: 1009; Lloyd 2002: 1285]. Therefore, exclusion from these FTA networks means exclusion from the major markets, which in turn brings about a sort of domino effect of FTA.

¹⁴ Mexico, a member of NAFTA, has FTAs not only with its neighboring countries (Chile, Columbia, Venezuela, Costa Rica, Bolivia, Nicaragua, El Salvador, Guatemala and Honduras) but also with EU and EFTA, extending its network into East Asia such as Singapore and Japan. Chile also expands its FTA network into Latin American countries (Venezuela, Bolivia, Columbia and Peru) by using Economic Complementary Agreement (ACE) of ALADI. And it got the position of an associate member of Mercosur in 1997, while started to negotiate with EU, EFTA and the US and to consider with Japan.

Actually, MNCs from Japan without FTA connecting to those markets suffer substantial losses. The typical example is their disadvantageous position in Maquiladora in Mexico.

In January 2001, Mexico lifted the tax refunding system (PITEX) of export to the US and Canada in Maquiladora, based on the description of NAFTA (Article 303)¹⁵. This is a substantive discriminative measure for Japanese MNCs in Mexico. In Maquiladora, many MNCs had carried cheap and high-quality parts, assembled them and exported finished goods mainly to the US at zero tariffs. The US strongly criticized this system of being the loophole to the US market and decided, in the NAFTA agreement, to abolish it after 7 years moratorium to block it. As a result, firms from Japan without FTA with Mexico could be imposed about 10 to 20 percent tariffs against their parts and material imported from the home. In contrast, MNCs from EU with FTA are given as much tariff preference as US firms in NAFTA [McQueen 2002: 1374; Asakura and Matsumura 2000(1): 64].

In the near future, this situation would not be confined in Mexico. Therefore, the Japanese business community heightens sense of crisis and strongly requests the government to add a FTA option to the trade policy [Keidanren 2000; Kraus 2003: 317]. To the extent that FTA networks are increasing throughout the world and the major economies are expanding their IPNs by using them, international competitiveness of Japanese MNCs would steadily decrease, if Japan had no FTA. In this manner, adoption of FTA option was the most imminent issue for Japan to maintain and promote overseas operation of Japanese firms in rivalry with European and the US MNCs.

4.2 Stagnating APEC Process and Proliferating Bilateralism in Asia-Pacific Area

The second challenge for Japan is the stultification of APEC. The original principle of APEC is that each member country spontaneously and unilaterally carries out trade and investment liberalization, considering the diversity of the region and variations in the development level. And most of Asian members including Japan have shared the recognition that it is not a formal institution for trade negotiations but a consultative body based on open dialogue, consensus and flexibility [Crone 1993: 516, Kikuchi 1995: 135]. This so-called 'concerted unilateralism' or 'Asian Way' was undermined with the actual participation of the US, which shifted its foreign policy from politicism to economism after the end of the Cold War. Since the Seattle Summit in 1993, the US administration has expressed ambition to institutionalize APEC into a negotiating forum to decide binding rules based on NAFTA-style reciprocity. From then on, APEC has been characterized by a conflicting picture between the US and its principal supporters (Australia, Canada and Singapore) for binding liberalization of trade and investment on the one hand, and the Asian group, led by Japan, Malaysia and China, which regards APEC as a loose-knit consultative body on the other hand [Crone 1996: 38; Gilpin 2000; Nesadurai 1996: 46-47; Ravenhill 2002: 10].

The 1997-98 East Asian crisis finalized the stagnation of the APEC process. In fact, the two summits in Vancouver (1997) and Kuala Lumpur (1998) during the crisis were not able to offer any hint on a rescue package at all. Instead, at the Vancouver Summit,

¹⁵ Maquiladora is a sort of export processing zone, accounting for 48.5 percent of total exports and 34.2 percent of total imports in Mexico in 2001. The share of intermediate goods for its total imports in 2001 was 75 percent, of which 69 percent was for export production and 46 percent was for Maquiladora. As of the end of June 2001, 3763 companies including Japanese MNCs were located in Maquiladora zones [JETRO 2002].

a Japanese proposal for an Asian Monetary Fund (AMF) was frustrated by objections of IMF and the US (and partly of China). Furthermore, the failure of Early Voluntary Sectoral Liberalization (EVSL) by Japan's resistance in 1998 had a demoralizing effect not only on the US but also on liberalization boosters such as Singapore, Australia and New Zealand, whereby APEC has lost its centripetal force. After that, the focus, as illustrated in the Shanghai Summit and the Los Cabos Summit in Mexico, has been on policy coordination of security-related issues such as terrorism and nuclear developments in North Korea [Lloyd 2002: 1285; Mahani 2002: 1269; Scollary 2001: 14-15].

Under this circumstance, the US switched its focal point to a FTAA in Latin America, while as for the Asia-Pacific area, US Trade Representative (USTR), Charlene Barshefsky proposed a FTA plan during the APEC Summit in November 1998, later dubbed Pacific Five (P5) comprising Australia, Chile, New Zealand, Singapore and the US. In addition, at the APEC 2002 meeting, the US government put forward a new trade initiative called the U.S. Enterprise for ASEAN Initiative (EAI) aiming at entering into bilateral FTAs with ASEAN countries. Now, through these three projects, the US tries to widen its FTA networks throughout the Asia-Pacific area.

The most active partner of the US bilateralism in the region is Singapore. In absence of a sufficient domestic market, the city state has persistently pursued outward oriented strategy and found its surviving path in incorporation and upgrading in IPNs. IPNs and international markets are virtually the 'hinterland' for the economy. Especially, since the mid- 1980s, it introduced Operational Headquarters (OHQ) incentive schemes to attract regional R&D, distribution, service network and financial activities of MNCs. Since 1993, under so-called 'regionalization program', it has sought to upgrade its industrial structure, while it has transplanted labor-intensive manufacturing into low-wage ASEAN countries [Low 2001a: 11-13; Yeung 2000: 142-45]. As a result, ASEAN, in which industrial agglomeration of MNCs and their production networks have developed, is its growth engine.

However, in a convoy-style liberalization process like AFTA, it does not only take time on coordinating interests of members, but also the pace is likely to be held back by the least willing member. In fact, while growth of exports to the US, which had supported recovery from the crisis, is declining due to a bust of the IT bubble, the ASEAN members are accelerating industrial restructuring and strengthening its inward orientation. Against this, Singapore regards a FTA as a way-out of this stagnation of liberalization. In other words, it tries to create a political momentum to urge other members to liberalize trade and investment by preeminently carrying out liberalization through bilateral FTAs [Dobson 2001: 1009; Mahani 2002: 1267-73; Rajan and Sen 2002: 9-10].

Malaysia accuses the Singaporean bilateralism of possibly undermining AFTA and creating a backdoor to access ASEAN markets. However, Thailand and the Philippines have also started to consider FTA, and now bilateral FTAs are increasing throughout Asia-Pacific or East Asia with Singapore a catalyst. Actually, P-5 project becomes more likely through the conclusions of the Singapore-New Zealand, Singapore-Australia, and the US-Singapore FTA. The proliferating bilateralism also, by necessity, puts Japan under pressure to change its trade and regional strategy. This meant that existing Japanese regional approach was pushed to the limit.

4.3 Japan's Changing Trade Policy and FTA

At least until 1998, the Japanese government still put primary priority on multilateralism, regarding FTAs against it [Ogita 2002: 3]. However, if only Japan adheres to multilateralism under the circumstance of the world-wide proliferation of FTAs, Japanese firms would be discriminated in the major markets and thereby their international competitiveness would be deteriorated. In addition, the stagnation of WTO negotiation and the APEC process means the Japan's policy channels are closed, impoverishing its bargaining power. Therefore, since Japan started to consider a FTA with South Korea in 1998, it launched studies for FTAs with Mexico, Chile, Australia, Singapore and other Southeast Asian nations. Since 1999, Japan had progressively become affirmative to FTAs at the government level [Munakata 2001:13-17].

In *White Paper on International Trade 1999*, for the first time, the Japanese MITI showed the perception that 'regional cohesion or integration' could supplement and strengthen the multilateral trading system. [MITI 1999: 293-24]. The subsequent *White Paper 2000* emphasized on the *dynamic* effects of FTAs on market expansion and competition promotion, regarding Japan's FTAs to be consistent with the actual growing, economic interdependence in Asia [MITI 2000: 105-23]. At last, *White Paper 2001* embarked a new framework named 'multi-layered trade policy', where Japan leverages bilateral fora as well as multilateralism in WTO and regional fora of APEC to achieve the national target of domestic economic revitalization [METI 2001: 173-5].

In this context, Japan concluded the New Age Economic Partnership (JSEPA) with Singapore on 13 January 2002. Apart from AFTA, JSEPA is the first FTA within East Asia as well as for Japan. As shown by the name of 'Economic Partnership', it covers not only the removal of barriers to trade in goods but also GATT/WTO+ α , such as mutual recognition, services trade, investment, intellectual property, competition policies, financial services, information and communication technology, human resource development, small and medium enterprise promotion, and tourism. The Japanese government thinks that it will be a valuable model for Japan's other FTAs.

JSEPA negotiation was not launched by Japan's initiative but Singapore's calling. But we can find Japan's own FTA strategy in it. On this issue, a question is why Japan selected Singapore as the first partner of its FTA. The immediate answer is that the country has only small size of the agricultural sector. As shown later, the most serious barrier to Japan's FTA strategy is strong domestic resistance against agricultural liberalization. Therefore, the fact that a FTA with the country cannot pose any threat to Japanese agriculture was the best condition for Japan¹⁶ [Hook 2002: 34].

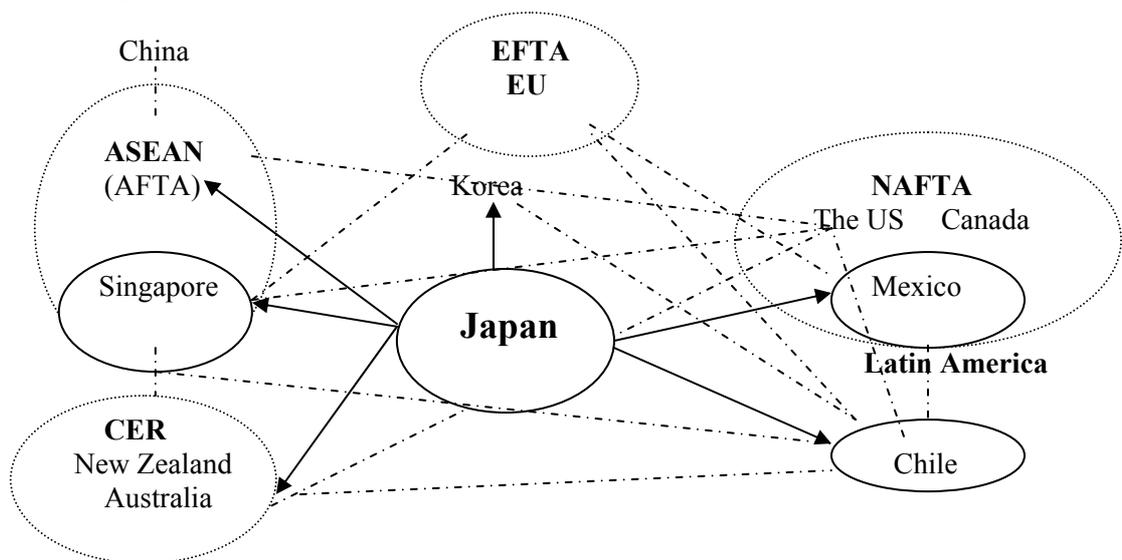
More importantly, Singapore is a hub of ASEAN production networks organized by Japanese MNCs. In fact, a number of Japanese MNCs also locate their regional head quarters in the country and manage their production sites or networks within ASEAN. The primary purpose of JSEPA is to reinforce linkages between Japan and intra-ASEAN production networks. Moreover, as shown above, Singapore is now carrying out the active FTA strategy to establish a position of a FTA hub within the Asia-Pacific area. The FTA with Singapore will enable Japan to assure market access not only to ASEAN but also to the area, where the Japanese presence is threatening owing to the

16 According to METI's calculation, the JSEPA will augment the portion of Japan's import from Singapore with no customs duties from 84% to 94%. Newly duty-eliminated products consist of manufactured goods such as chemicals, oil products and textile. Within manufactured goods, no tariff portion will expand from 88% to 98% (METI 2002: 15). On the other hand, agriculture accounts for just 0.1 percent of GDP and 2 percent of exports in Singapore.

stagnation of the APEC process and its lack of FTA network. Actually, in the US-Singapore FTA, parts and component produced in ASEAN are regarded as made-in-Singapore (Integrated Tariff Initiative) and companies locating in Singapore can export parts and component procured in other ASEAN countries to the US at a zero tariff (Integrated Sourcing Initiative).

We can understand the Japan's strategy of FTAs with Mexico and Chile in the same context. As explained above, the two countries are the hubs connecting South America with North America, especially the US. If Japan enters into FTAs with the two countries, Japanese MNCs locating there could procure parts and capital goods from Japan with zero tariffs and assure free access to the US through their FTA networks. To the extent that EU and the US are enclosing markets for their IPNs by expanding their FTA networks, it was the necessary practice for Japan to assure access to the major markets. Now, Japan tries to achieve the purpose by connecting itself with the FTA hubs of each region and creating its own hub and spokes system within the Asia Pacific area (see Figure 1). This system will provide the better environment, where Japanese MNCs go on their IPNs with ASEAN the most important production sites and with the US the main market.

Figure 1 Future Japanese FTA Network



In this sense, the Japan's FTA strategy reflects the traditional East Asian production structure and aims at institutionalizing it by its FTA networks. However, institutionalization is quite alien to the Japan's conventional strategy for East Asia. Therefore, Japan's adoption of a FTA means transformation of Asia-Pacific regionalism fostered by Japan under the concept of open regionalism. Moreover, a preferential relationship with a specific country could give rise to some discrimination between a member and a non-member. Accordingly, the Japan's FTA strategy could change the dynamics in the East Asian international relation. The largest dependent variable is China, another regional power. The Japan's movement induces a China's FTA offensive, which in turn brings about a geopolitical reaction of Japan alarmed by a structural transformation of East Asian RPNs caused by a rise of the Chinese economy.

5 Rise of the Chinese Economy and Disrupted Flying Geese Formation

5.1 Christmas-Tree Type Industrial Development

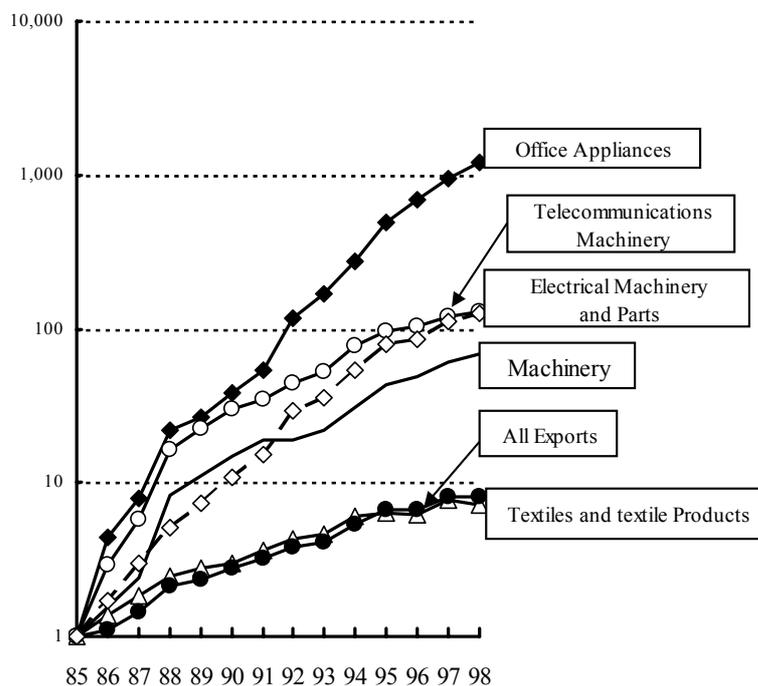
China has achieved annually average 9.3 percent of real GDP growth since 1990, with the size reached 1.2 trillion dollars. Through the rapid growth, it has enlarged and deepened its external relationships. Its trade quadrupled from 115.4 in 1990 to more than 600 billion dollars in 2002. The share of its export for the world increased from 1.9 to 4.3 percent and that of its import from 1.5 to 3.8 percent during the same period.

In the face of the rise of the Chinese economy, the Japanese government has changed its conventional view for East Asian development in the *White Paper 2001*. It argues that owing to the '*unique development pattern*' of China, 'East Asia's industrial structure is moving away from a time when industrial location was determined by a country's level of economic development, with competition intensifying even in leading-edge industries' and declaring the end of the "flying-geese" pattern of development [METI 2001:16-17]. According to the flying geese model, China should be also the goose, following NIEs and ASEAN-4. Certainly, the Chinese developmental path can be also characterized as FDI-led development. FDI inflow into China rapidly increased since 1990s, and reached 82.8 billion dollars (contract-base) in 2002. Nevertheless, why Japan declares the collapse of the flying geese pattern?

The uniqueness of China is attributable to the pattern of industrial development. If the flying geese model were true for China, its industrial development would be gradual one proceeding from light industries, then heavy and chemical ones and to high-tech ones. Whether NIEs or ASEAN-4, their export-oriented industrialization has been at least seemingly subject to this pattern. In contrast, China is simultaneously and rapidly developing industries as wide ranging as the relatively labor-intensive textile industry and the technology-intensive IT industry (see Figure 2). This 'Christmas-Tree' type industrial development reflects its geographical distribution of industrial agglomeration. If we break down its dynamic coastal region into three areas, we can find complementarity among them.

First in the Zhu Jiang Delta (Pearl River Delta), a myriad of assembly firms and parts suppliers build up centering on electric and electronics appliance, being engaged in export-oriented and labor-intensive production by using massive cheaper labor force sourced by its neighboring Sichuan and Hunan Province. In this area, Hong Kong plays business hub roles and both foreign and Chinese firms locating there handle contract manufacturing in the area. Second, in the Chang Jiang Delta (or the greater Shanghai area), industries are largely domestic demand-oriented in expectation of purchasing power of a relatively higher income group in Shanghai. With Shanghai its financial and business-service hub, the industrial development is a full-set type with a relatively broad base, an agglomeration of auto assemblers such as VW and GM and their related parts suppliers, high-tech firms centering on Pudong, and note book PC, its peripherals and telecommunication equipment plants in Suzhou, Hangzhou and Wuxi in addition to traditional heavy and chemical industry. And third, Beijing and Tianjin are growing by domestic demand-oriented IT hard-ware and soft-ware industries. Especially, a number of software-, internet business-, and biotechnology-related firms are located in Zhongguancun, where the IT-related foreign companies in the Pearl and greater Shanghai areas (Microsoft, Intel, Motorola, Nokia etc) set up their R&D sites. In Tianjin, foreign firms concentrate on telecommunication, consumer electronics, and automobile industries [Hirata et.al. 2003: 56-90; Maruya and Ishikawa 2001: 18-27].

Figure 2 Trends in Chinese export values by good
(1985 = 1; dollar base)



Source: MITI (2001).

In this manner, as if there were a different country respectively in northern, middle and southern area of the coastal region, they have achieved the complementary industrial development. The Christmas-tree Type development also results from incorporation into IPNs. However, unlike the enclave-like economy of ASEAN-4, which is deeply embedded in Japanese IPNs, or also unlike South Korea and Taiwan, which connect to the US and Japanese IPNs through supply architecture of intermediate and capital goods or in the form of OEM/ODM, China is now incorporated into IPNs organized by various MNCs including the US, European, Japanese, Korean, Taiwanese, Singaporean and so on. MNCs belonging to various industries relocate their low-cost production sites in China, bringing about the agglomeration of industries ranging from labor-intensive to high-tech industries and ranging from assembly to parts and component. The industrial agglomeration gives rise to a virtuous circle. It enables foreign companies division of roles, complementarity of parts, and accumulation of know-how in one country, which provides a strong foundation to attract more and more foreign companies¹⁷.

¹⁷ Markus Wauschkuhn of Institut für Weltwirtschaft und Internationales Mangement in the Bremen University suggests the interesting view that this Chinese developmental pattern will be a new 'flying geese formation within China'. Actually, it is said that the Chinese government pursues the flying geese strategy, promoting spill-over effects between the regions within the country. We should consider this issue in future research.

5.2 Technological Change in Global Manufacturing and Particularities of China

Then, what factors enable China such peculiar industrial agglomeration? The first answer is a massive labor force supply. In fact, the working population in 2000 is 711.5 million, of which 498.8 million labors are in rural areas¹⁸. According to the Chinese State Council, there are 160 million of redundant works in rural areas, which gives rise to a strong pressure of population outflow from rural to city areas. Combined with a high unemployment ratio in city areas, the domestic labor migration causes a downward pressure on wages. The inexhaustible cheap labor pool enables China to sustain literally the economic growth under ‘unlimited labor supply’ (W.A.Lewis).

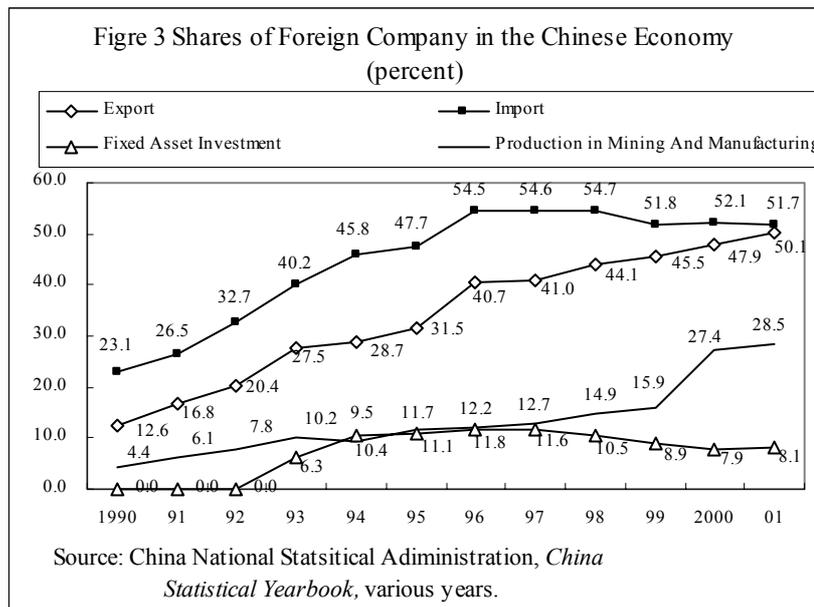
Certainly, apparel and miscellaneous goods are typically labor-intensive, where labor cost accounts for a large part of total costs. Therefore, China has much advantage in those industries, which has encouraged so many foreign firms to relocate their manufacturing sites during 1980s and 1990s. However, the Japanese government declared the end of the flying geese development because in addition to labor-intensive industries, China is developing high-tech industries, leapfrogging ASEAN-4 and challenging against NIEs. In electronics industries such as PCs, percentage of labor cost is very low, and therefore it has been thus far thought that it is not necessary to relocate labor-intensive processes into low labor cost sites.

The rapid growth of high-tech industries is brought about by dramatic changes of technology and market structure in high-tech industries. Global manufacturing today is defined as simplification or standardization of manufacturing process, a progress of ‘*modularization*’. Though parts of high-tech goods including PCs and its peripherals are technology-and-knowledge intensive and higher value-added, they have recently turned out to be highly independent composite units (modular units). As a result of this modularization of production, even their manufacturing process is simplified, including a lot of labor-intensive tasks [Hirata et.al. 2003: 46-47]. In addition, life-cycles of those goods are increasingly shortened. Under the circumstance, when manufactures rely on machine-based plants, they would have to incur huge investment costs to change equipments according with specifications or model change. Therefore, in those industries, where modularization and shortening life-cycle are simultaneously proceeding, global suppliers tend to adopt a production strategy of utilizing labour-intensive production plants so as to adapt themselves to market changes only by increasing or decreasing labor forces or hours, without suffering from massive investments. The optimum location is China with massive cheaper and good quality labor forces.

The China’s industrialization is distinguishable from that of other East Asian economies with regard to its initial condition. South Korea and Taiwan, owing to absence of industrial bases, had to pursue simultaneously EOI and ISI. Industrialization of ASEAN-4 is characterized as EOI without ISI, bringing about a dualism structure with weak linkages between MNCs and local firms and with truncated supporting industries [Yun 2003]. In contrast, though inefficient and at technologically low levels, China had completed a certain level of ISI in the socialist economic era before starting EOI in the full swing, which provided a foundation of the self-contained industrial structure [Watanabe 2001: 44].

¹⁸ Working populations in Indonesia, Thailand, the Philippines and Malaysia are respectively 89.3, 33.0, 27.8, and 9.3 million in 2000 [ADB, Key Indicators]. Even total of them is much less than that in China.

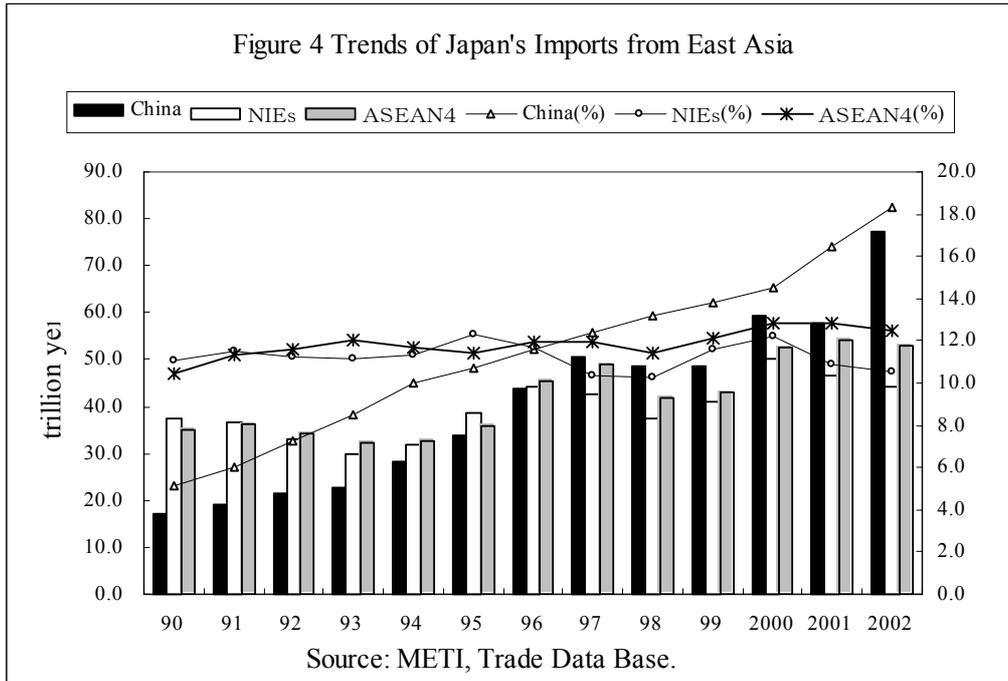
Certainly, presence of foreign companies is so large also in China. As of the year 2001, 28.5 percent of mining and manufacturing production, 8.1 percent of gross fixed capital formation and more than 50 percent of both export and import were attributable to foreign firms (see Figure 3). However, in China, local firms rapidly grow by combining manufacturing skill and production capacity accumulated in the era of socialist industrialization with technology and know-how of MNCs. Especially as opposed to in ASEAN-4, linkages between MNCs and local firms have been established and at the same time local firms such as Haier, TCL, Konka, Galanz, Changhong etc. maintain high shares in the domestic consumer markets. And the shortening life cycle of a finished good, combined with the downward pressure on prices, increases demand for low-price parts made in China, which enables it to develop supporting industries [Hirata et.al 2003: 107-24; Watanabe 2001: 44-45].



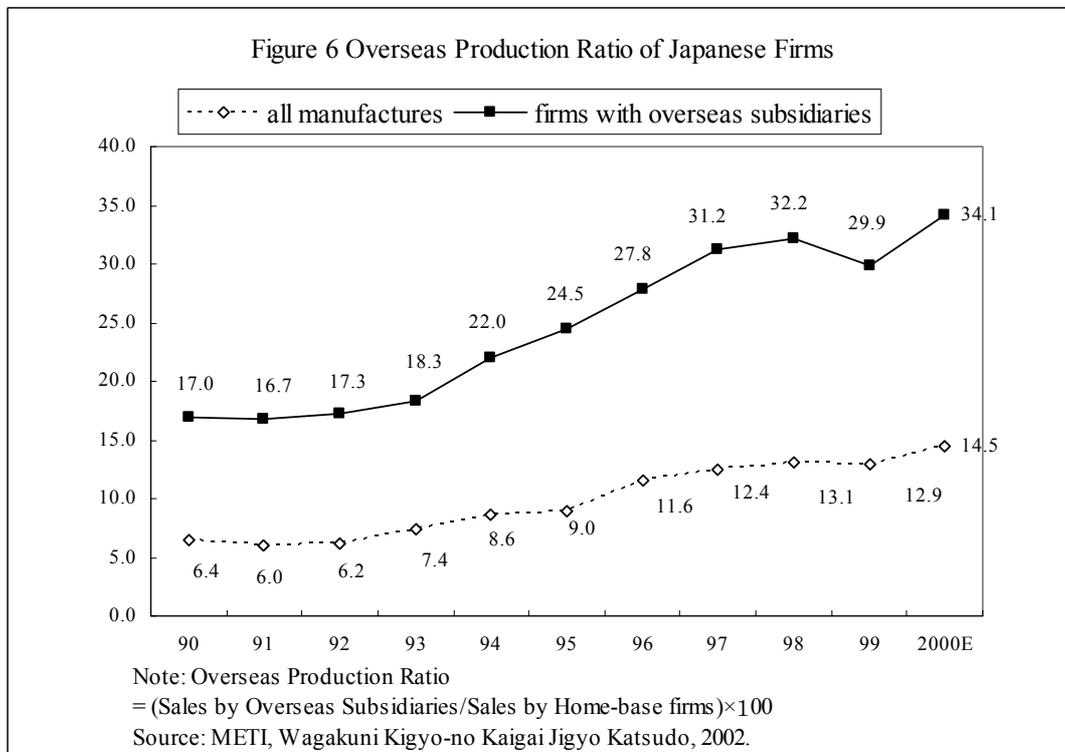
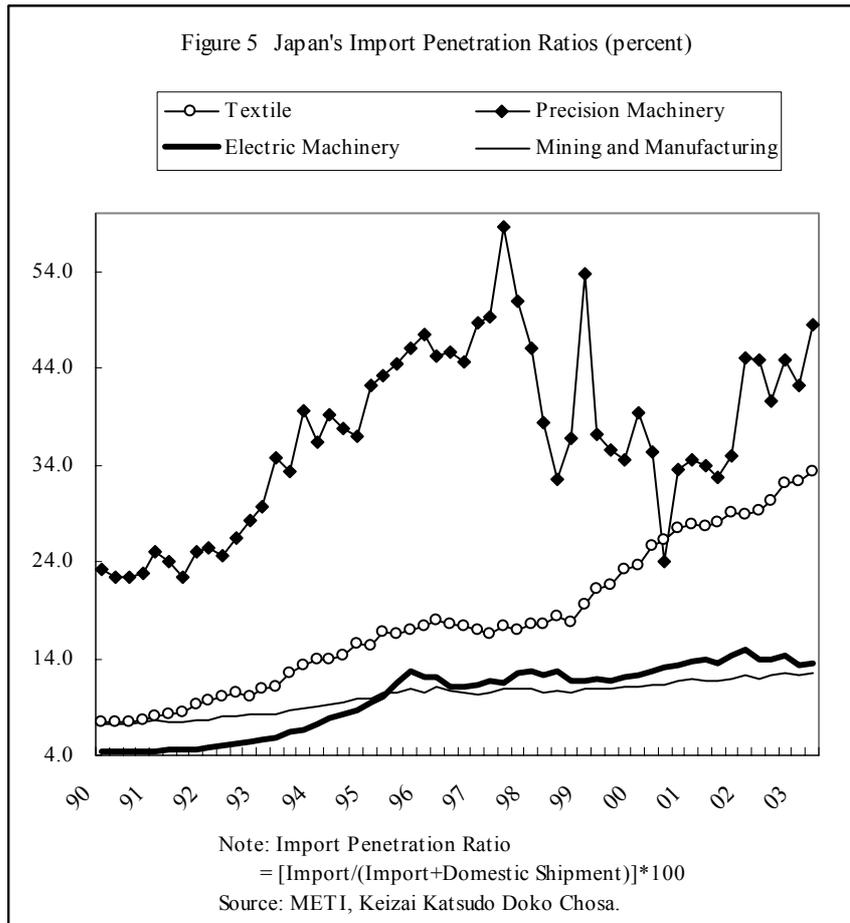
On the other hand, today when a global glut is becoming actualized, the potential of the Chinese market is attractive to global manufactures. Therefore, many MNCs move into the country for export but also for the domestic market, intensifying competition with local firms. Whether they can survive it depends on their ability to get goods meeting the needs of consumers on the market as early as possible. Consequently, more than 100 MNCs, even Japanese firms, set up R&D centers in the country to develop goods fit to Chinese preferences. In China, there are sufficient human resources supporting such activities. In fact, the number of persons with a university degree in science and technology annually increases, reaching 450 thousand in 2000, and a lot of student educated overseas returns. The number is overwhelming compared to other East Asian countries [Watanabe 2001: 147-50]. The cheap and high-quality technical manpower provides a foundation of R&D activities of MNCs and local firms especially in the Beijing and Tianjin area.

5.3 Why is China an Anomaly for Japan?

China is also anomalous to Japan. Heretofore, Japan has played a role as supply base of high-tech and high value-added intermediate and capital goods within East Asian RPNs, registering persistently trade surplus against other East Asian countries. In contrast, its trade with China has showed massive deficits since 1988. Certainly, China also connects to the Japanese supply structure within the RPNs, increasing parts and component imports from Japan. But, Japan's imports from China increase more rapidly than exports. In fact, ratio of China for Japan's total imports dramatically rose from 5.1 in 1990 to 16.5 percent in 2001, approaching that of the US (see Figure 4).



In the deflationary recession, low price propensity is prevailing among Japanese consumers, while China's shift to a labor-intensive EOI strategy puts further downward pressures on prices and profits. Import penetration ratios steadily rise especially in textile, consumer electronics and precision instruments (see Figure 5). Final demand goods accounts for 25 to 35 percent of both exports and imports in trades with ASEAN, Korean and Taiwan, whereas they account for 70 percent of imports in trade with China in 2002. This means that massive imports from China boost up Japan's import penetration ratios. In fact, the shares of China for Japan's imports were the highest in those goods, with 72 percent in textile, 78.2 percent in apparel, 47.8 percent in consumer electronics, 37.8 percent in audio equipments, and 32.1 percent in visual equipments. In addition, overseas production ratio of Japanese manufactures also increases up to more than 30 percent, which raises fears that Japan is gradually being 'hollowing out' (see Figure 6). But Japan is no more than one investor in the country and therefore Japanese MNCs do not have so dominant power as in ASEAN-4. Rather, the Chinese government has rejected to be incorporated into Japanese RPN as the 'last goose', preferentially inducing the US and European MNCs.

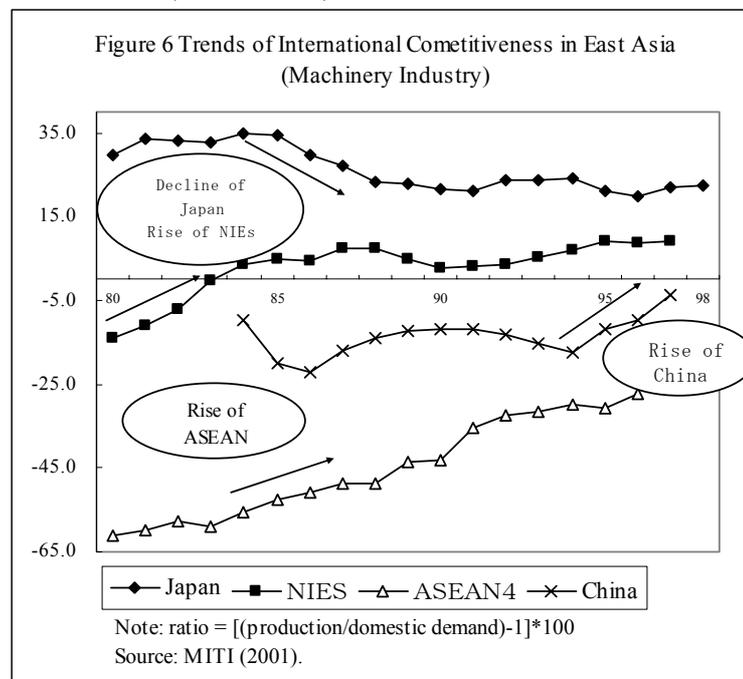


5 Political Economy of East Asian FTA

5.1 China as an Economic Threat to ASEAN

Japan in the historical depression is losing the dynamism that had created leading export industries one after another during the 1980s, while the East Asian economies have emerged as its economic rivals. These do not mean an absolute decline of Japan's industrial competitiveness, but a sort of insecurity or frustration seems to be prevailing in Japan, which induces nationalistic reactions in international relations. Particularly against China, there is a tone to take a geopolitical approach, with spread of concern about 'hollowing-out' of domestic industries. For the moment, it might be only an imaginary fear that China could get ahead of Japan as an economic power. However, at least, it is no doubt that the rise of China forces existing RPNs to transform, which in turn changes power balance in East Asia. The structural transformation of the East Asian RPNs is likely to take the form of decline in power of ASEAN, the cornerstone of the Japan's regional strategy.

China seems to be a threat to the ASEAN economies, because they are not competitive enough to compete with the NIEs and they rely on an export-oriented strategy with the same product lines and sectors as those of China. As shown by Figure 6, in machinery industry, international competitiveness of China has already been superior to that of ASEAN-4, while in labor-intensive industry such as textile, competition between China and ASEAN-4 is increasingly intensified. Generally speaking, the constraint for export-led development of East Asia is the fact that the absorption capacity of major markets such as the US and Japan has its own limit. Given this, a rise of China in export markets means a decline of ASEAN-4. Indeed, China relatively grabs market shares from ASEAN-4 in textile, audio equipments, and miscellaneous goods in the Japanese market and in computer and peripherals and audio equipments in the US market (see Table 5).



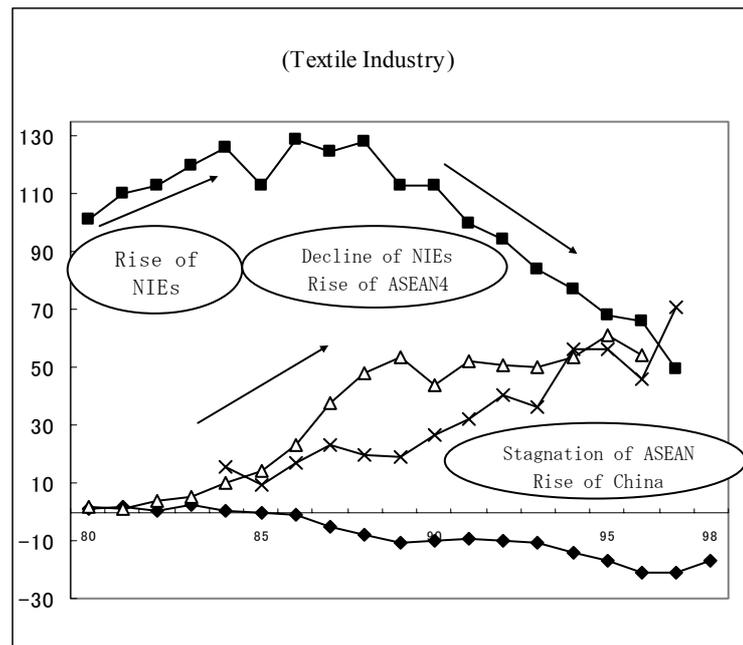


Table 5 Import Shares of ASEAN4 and China in the US and Japan by good (percent)

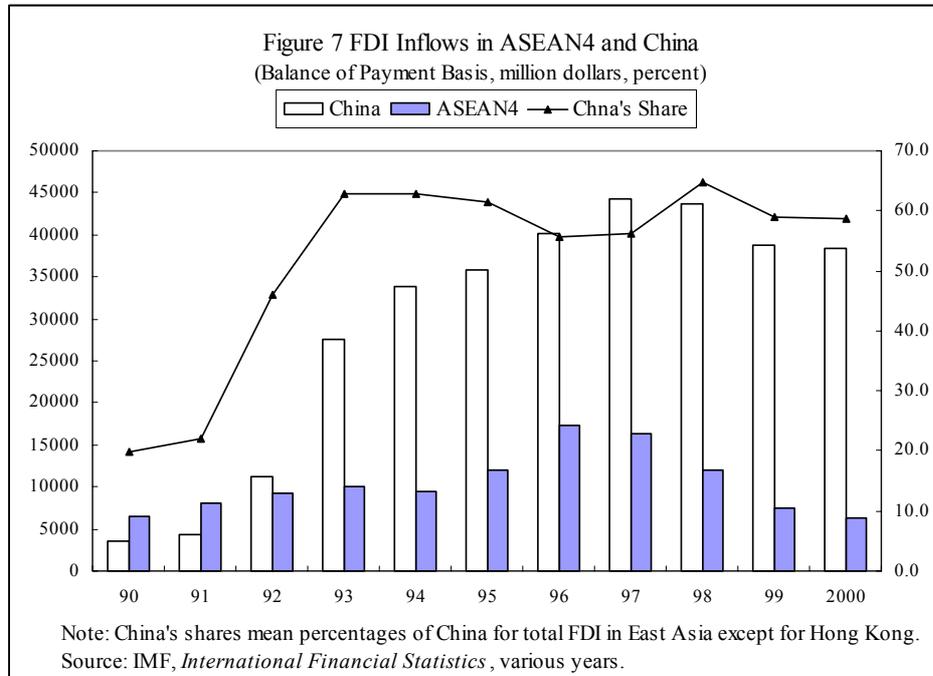
	ASEAN4		China	
	1996	2001.1st half	1996	2001. 1st half
In Japan				
Textile and Clothing	9.4	8.7	53.0	68.6
Audio Equipments	43.5	36.7	20.2	36.9
Semiconductor and Electronics	17.4	29.0	1.1	3.0
Wood Product	43.9	40.2	6.8	11.7
Traveling Kits and handbag etc	5.2	4.3	34.5	42.6
In the US				
Textile and Clothing	13.2	14.6	13.2	10.3
Computer and Peripherals	32.5	27.1	4.6	12.0
Office Machinery	8.0	12.0	13.0	23.7
Semiconductor and Electronics	30.6	33.3	0.6	2.0
Audio Equipments	25.8	17.9	25.7	38.9

Source: Maruya and Ishikawa ed. (2001:11).

Competition also occurs at the level of attracting FDI. FDI determines the course of the ASEAN economy where local firms are not thick-layered and heavily dependent on foreign firms. Actually, one of the main reasons why ASEAN members agreed to a formation of AFTA in 1992, ASEAN Industrial Cooperation (AICO) in 1996 and further a creation of AIA in 1998 was also a rapid rise of the Chinese economy¹⁹.

¹⁹ The AIA scheme was to make ASEAN a competitive, open and liberal investment area through a binding agreement promoting free flow of capital, skilled labor and professionals and technology. The AICO scheme replaced the brand-to-brand complementation and ASEAN Industrial Joint Venture (AIJV) schemes.

Preventing FDI from concentrating on China, ASEAN has tried to assure a position as the core of East Asian RPNs by creating an integrated intra-regional market through AFTA, and by providing MNCs with better investment environment through AICO and AIA [Mahani 2002: 1270]. Nevertheless, FDI into ASEAN has decreased since 1996, while China enjoyed a diversion of FDI from ASEAN. Now, China absorbs more than 50 percent of FDI inflows into East Asia (see, Figure 7). This trend will accelerate after the WTO accession and could have serious impacts on ASEAN-4.



In addition, Chinese products are gradually eroding ASEAN members' domestic markets of labor-intensive products such as textiles, garments, labor-intensive electrical appliances, footwear, and toys, although ASEAN increased its exports to China from 4.5 in 1993 to 31.6 billion dollars in 2001 and registered trade surplus against it. Especially, in the relatively low-income members such as Vietnam, Indonesia and the Philippines, Chinese-made motorcycle, color TV and air-conditioner rapidly grab markets shares from Japanese, Korean and local makers [Hirata et.al 2003: 124-136].

The ASEAN economies are increasingly being squeezed in the middle of the industrial ladder: they have not yet achieved the skill and technological base to compete with NIEs, while they are rapidly being caught up and partly leapfrogged by China. And now numerous MNCs, even Japanese ones consider to divert investments to China and to relocate their production sites from ASEAN. As long as these situations continue, we could not deny a possibility that ASEAN-4 would be forced into stagnation by the rise of China.

5.2 FTA Rivalry around ASEAN between Japan and China

While the fear of 'China as a threat' is rising in the neighboring countries, China has already hammered out various initiatives to strengthen cooperation East Asia-wide to alleviate it. In September 2003, it concluded a Closer Economic Partnership Agreement with Hong Kong and there have been discussions of separate bilateral agreements with Korea and India. But its main focus is nothing more or less than ASEAN. Since the formal inception of APT in 1999, China has pursued a policy of building strong bilateral

China-ASEAN ties. Most notably, at the ASEAN leaders' summit in 2000, China had proposed a FTA with ASEAN (ACFTA) and since then, China has actively continued FTA talks with ASEAN. Particularly to kick-start ACFTA, China unilaterally offered to open its agricultural market to ASEAN without reciprocal liberalization in ASEAN (so-called 'early harvest' provision)²⁰. Finally, at the APT summit in 2001, it successfully agreed to ASEAN that they had decided to create an FTA within ten years.

According to a joint study by Chinese and ASEAN, ACFTA would augment trade on both sides by 50 percent and increase GDP by 0.9 percent for ASEAN and by 3 percent for China [ASEAN-China Expert Group on Economic Cooperation: 2001]. However, the China's FTA offensive is based less on economic interest than on political one. The economic prominence of China, the greatest political and military powers in East Asia, could throw the previous East Asia political economy off balance, arousing the wariness of its neighboring countries. Therefore, China attempts to appease their fear of "the China's threat" by opening up its markets and to relax the wariness by building up cooperative relations with them through FTAs [Hund 2003: 402-403; Pangestu and Gooptu 2003: 96; Urata 2002: 5]. In addition, China has an ambition to establish political leadership ahead of Japan in a regional grouping. Actually, the above-mentioned early harvest provision is based on the strategic thinking that China differentiates itself from Japan, for which it is politically difficult to open its agricultural market, and thereby it aims at seizing the initiative over the nascent movement toward a creation of FTA networks in East Asia.

Recently the economic presence of Japan tends to decline, which arouses the suspicion that China threatens its position in the region. The sharp increase of imports from China in the deflationary repression is likely to accelerate 'hollowing-out' in Japan. And the erosion of the ASEAN markets by Chinese-made goods may challenge the preeminence of Japanese MNCs in the ASEAN markets. More importantly, economic decline of ASEAN means lost of the most important site of the Japan's regional policy. If a formation of an East Asian economic zone is moved ahead on with an ACFTA as its core, its position as a regional core country would be considerably backed off. All of these things give a new momentum to the Japanese bilateralism.

Under these circumstances, in January 2002, Japanese Prime Minister Junichiro Koizumi delivered a speech, entitled 'Japan and ASEAN in East Asia- A Sincere and Open Partnership' and showed the blueprint of a Japan's new East Asian strategy (so-called 'Koizumi doctrine'). The core plan is that Japan, confirming the 'Fukuda doctrine', sets out to enter into a 'Comprehensive Economic Partnership' with ASEAN (AJCEP). It aims to develop, making the best use of the framework of APT, East Asian cooperation based on AJCPE and to expand it into Australia and New Zealand ('Community that Acts together and Advances together'). In addition, it proposed the

²⁰ China agreed to phase out tariffs on selected imports (palm oil, timber, tropical etc.) from ASEAN's six core members over three years beginning no later than January 1, 2004. This proposal was attractive to ASEAN, since its exports of primary products to China tended to decrease. But the cost of this concession is expected to be minimal because China, after its entry to the WTO, will have open its market for commodities and services before 2005-2006 anyway [Hund 2003: 403-404]. On the other hand, China offers further favorable terms to ASEAN. For instance, in November 2001, it proposed financial cooperation for the greater Mekong Basin development project, one of the biggest projects of ASEAN and a railway building between Kunming and Bangkok. Additionally, at the APT Summit in November 2002, it expressed release of part or all of debt claims for the ASEAN members such as Cambodia, Vietnam and Myanmar [Terada 2003: 271]

convening of an Initiative for Development in East Asia (IDEA) meeting to reexamine the past developmental experience and to discuss its regional ODA policy. At the ASEAN Leaders Summit in November 2002, Japan and ASEAN agreed that they would conclude AJCPE as soon as possible after Japan and each major ASEAN member bilaterally enter into an EPA. At the Japan-ASEAN Summit Meeting in October 2003, they adopted 'Framework for Comprehensive Economic Partnership between Japan and ASEAN', where they decided to start the negotiation of AJCPE from the beginning of 2005 and complete it as soon as possible by 2012.

The Koizumi doctrine, despite seemingly praising the China's role, obviously intends to counter the ACFTA plan. While Japan's vested economic and political interests in ASEAN are increasingly challenged by the Chinese influence, it must be newly interested in forging closer ties with ASEAN [Hund 2003: 397-398; Ravenhill 2002: 11-12; Urata 2002: 5]. By the fact that Japan and China, two regional powers, respectively proposed ACFTA and AJCEP, a possibility of establishing an East Asian Free Trade Area (EAFTA), which was merely a visionary fancy until recently, is actively discussed in the region.

However, will these movements toward a creation of FTA networks lead to new regionalism? To answer this question, we should explore at least following three points: first, whether they reinforce the regional concept or identity of 'East Asia', second, whether they head in the direction of overcoming nationalistic problems within some regional framework, and finally, whether they are consistent with the structure of production networks or regionalization as the foundation of regionalism.

5.3 Japan's Strategic Change and Continuity for Regionalism

5.3.1 Japan's Out-of-Dated Asia-Pacific Orientation

Given its overwhelming economic power, Japan is supposed to be centrally located in new East Asian regionalism (see Table 6). At first glance, the Koizumi doctrine appears to aim at creating an East Asian FTA, but, at least at this moment, Japan has no strategic orientation towards strengthening the unity or concept of East Asia. Instead, its FTA strategy is likely to exacerbate the tug-of-war with China and even to disrupt the regional identity. One of the biggest factors is its out-of-dated Asia-Pacific orientation. Whereas Japan shows activism in East Asia, it is not still identifying itself as a predominantly East Asian country.

Certainly, it is noteworthy that Japan, having thus far adhered to the term of 'Asia-Pacific' or 'Pacific', formally inserted the concept of 'East Asia' into its policy [Terada 2003: 268]. In this sense, the Japanese proposal may bring new life into the debate about an EAFTA. However, admitting that it will make the best use of APT, the envisioned 'Community' is the APT member plus (say, Australia and New Zealand). In addition, it postulates engagement by or close partnership with the US²¹. If an economic community should be created by such members, it would be little more than the core of APEC. This means that the Koizumi doctrine succeeds the conventional Asia-Pacific orientation. Such an approach could pour water into enthusiasm within the region for the nascent APT arrangements, and for their potential to create a genuine pan East

²¹ Koizumi said in his keynote address, 'the community I am proposing should be by no means an exclusive entity... In particular, the role to be played by the United States is indispensable because of its contribution to regional security and the scale of its economic interdependence with the region. Japan will continue to enhance its alliance with the United States'.

Asian grouping for the first time²² [Hund 2003: 398-400; Pangestu and Gooptu 2003: 85].

Table 6 Shares of the East Asian Economies for the World GDP and Trade (percent)

	Nominal GDP			Export			Import		
	1985	1995	2002	1990	2000	2002	1990	2000	2002
NIEs	1.6	3.4	3.1	7.8	10.3	9.7	7.6	9.7	8.8
Hong Kong	0.3	0.5	0.5	2.4	3.1	3.1	2.4	3.2	3.1
Korea	0.7	1.7	1.5	1.9	2.7	2.5	2.0	2.4	2.3
Singapore	0.1	0.3	0.3	1.5	2.1	1.9	1.7	2.0	1.7
Taiwan	0.5	0.9	0.9	1.9	2.3	2.1	1.5	2.1	1.7
ASEAN4	1.5	1.8	1.5	2.5	4.2	4.0	2.7	3.2	3.2
Malaysia	0.2	0.3	0.3	0.9	1.5	1.4	0.8	1.2	1.2
Philippines	0.2	0.3	0.2	0.2	0.6	0.6	0.4	0.5	0.5
Indonesia	0.7	0.7	0.5	0.7	1.0	0.9	0.6	0.5	0.5
Thailand	0.3	0.6	0.4	0.7	1.1	1.1	0.9	0.9	1.0
China	2.4	2.4	3.9	1.8	3.9	5.0	1.5	3.4	4.4
East Asia	5.5	7.6	8.5	12.1	18.3	18.7	11.9	16.2	16.4
Japan	10.7	18.2	12.4	8.3	7.4	6.5	6.6	5.7	5.0

Source: IMF, World Economic Outlook data base, WTO, trade data base

Japan's main interest is to ensure the economic security of ASEAN as the base for Japanese production networks, but not regional cohesion. As shown above, the Fukuda doctrine, succeeded by the Koizumi government, was the basic guideline for the Japan's Southeast Asian diplomacy, which was hammered out in the process of Japan's substantial embracement of the ASEAN economy in order to alleviate ASEAN's wariness about its economic dominance [Terada 2001:203]. The main purpose of the Koizumi doctrine is also to strengthen its economic ties with ASEAN and to balance China's growing influence.

However, Japan, due to its serious recession, shrunk considerably in significance to other East Asian countries. By the late 1990s, Japan's share of their exports was little more than half the level of 1985 and the relative decline in Japan's share of FDI in the region is even more striking, with 26 percent in 1990 to 8 percent in 1999. This was less than one half of those from either Europe or the US. While Japan's roles in the region as a market and an investor have diminished considerably, the only area, in which it continues to play a dominant role to raise the development level of ASEAN, is the provision of ODA²³ [Ravenhill 2002: 13-15]. Indeed, after the crisis, the Japanese policy for ASEAN have aimed at upgrading its competitiveness and fostering supporting industries or small-medium enterprises through ODA to countervail against

²² In contrast, China has a strong East Asian orientation. During the October 2002, China's vice minister of foreign trade, Long Yongtu, emphasized publicly the need for Asia to have a platform to "let our voice sound louder in the decision-making process" now dominated by the West [Ong 2003: 62].

²³ Even though Japan has cut the aid budget by 10 percent in the financial year of 2002, it attempt to change quality of its ODA. In contrast, ODA for China is nowadays so much criticized for the reason that ODA fosters its own rival. In the policy change, Japan is considering that aid for China should be confined to environment-related and social development-related areas [<http://www.mofa.go.jp>].

China's rapid climbing of the regional development ladder. Specifically, the government has provided financial support worth 8 billion dollars for retraining human resources and reactivating industries, 1.72 billion dollars for structural reform and employment creation, and 32 million dollars for improvement of technical skills of personnel under the Japan-ASEAN Program for Comprehensive Human Resources. The IDEA is no more than an extension of these efforts.

If Japan is to exercise leadership in institutionalizing an East Asian economic zone, it would be requested to have a grand design to reinforce cohesion of East Asia. This depends on whether Japan first can overcome its Asia-Pacific orientation and identify itself as a member of East Asia, just as it had informally and formally pursued in the previous Asia-Pacific cooperation.

5.3.2 Agricultural Problem and Nationalistic Thinking

Another reason why Japan cannot envision a design for new East Asian regionalism is the agricultural problem. Generally speaking, an agricultural industry is vulnerable to shifts in supply and demand, because price and income elasticity of demand of agricultural products is relatively low. And most countries have protected their agricultural sector, because desolation in rural areas, with massive migration from there to city areas, is likely to bring about social instability. Therefore, the agricultural problems have been often nationalistically dealt.

Japan, which has emphasized on trade liberalism, has also regarded the sector as an exception and has maintained the stance of agricultural protectionism in GATT/WTO negotiations. This policy stance has come from its bureaucracy structure, characterized as vertically divided administrative functions with strong territoriality, and its long one-party-rule by Liberal Democratic Party (LDP) based on rural areas: LDP goes against import liberalization of agricultural products for election race and Ministry of Agriculture, Forestry and Fishery (MOAFF) adheres to the protective policy as its territoriality.

The recent symbolic event was the agricultural trade friction with China for shiitake mushroom, green onion and igusa rush. In April 2001, Japan, in the face of strong pressure from agricultural interest groups, set in motion a preliminary safeguard for the above three items whose imports from China rapidly increased. Against this, China imposed 100 percent special tariff on automobile, mobile phones and air-conditioner imported from Japan. They were on the edge of bogging down the trade conflict. Though the worst situation could be avoided because Japan refrained from formal imposition of safeguard, the event showed how sensitive the agricultural trade is for Japan and how strong nationalistic reaction it gives rise to [Yoshimatsu 2003].

Most of the FTA candidates are high-ranked agricultural exporters for Japan. For instance, shares of agricultural and fishery products for their total exports to Japan in 2001 are respectively 28.0 percent in Thailand, 52.0 percent in Chile and 21.0 percent in Mexico. Therefore, as far as Japan uses trade policy to protect its agricultural sector, it is quite difficult for Japan to enter into FTAs with these countries. Indeed, the FTA negotiation with Mexico at the government level fell apart owing to the pork import problem. Any effort to promote a FTA would inevitably encounter similar impediments.

In this context, JSEPA would be a bad precedent rather than serve as a model for Japan's future FTAs. Despite the fact that Singapore has little agricultural sector and its agricultural trade is trivial, Japan's agricultural lobby and MOAFF blocked the removal of tariffs on agricultural products, say, ornamental fish and cut flowers. JSEPA is not a

‘free trade plus’ but a ‘partnership minus free trade’. Similarly, the proposed AJCEP is not an entire FTA in its true sense, though it covers comprehensive fields and Japan does not deny a possibility that it develops into a FTA [Hook 2002: 34; Pangestu and Gooptu 2003: 85; Ravenhill 2002: 8-9].

Certainly, Keidanren and some economists claim that the main purpose of the Japanese FTA should be set up for facilitating its structural reform. The most impressive target would be the agriculture sector [Keidanren 2000; Urata 2002: 5-6; 18]. But agriculture is the most ill-fitted sector to market principle and therefore simple market opening is not the answer. Japan has to change its policy toward strengthening the sector so as to withstand international competition and at the same time it should promote regional cooperation for consensus building towards a well-ordered agricultural trade. New regionalism plays a role in a national competition strategy. In this sense, regionalism might not be contradictory against nationalism. However, any attempt to solve a national problem by a nationalistic method is contrary to regionalism. As shown by European experiences, we can find a way toward establishment of regionalism in efforts to resolve a national issue through a regional framework.

5.3.3 Inconsistency with Regional Production Network

Regionalism should be a political movement toward a creation or expansion of regionalization, while the latter increasingly influences the nature and scope regionalism from the institutional and policy perspectives [Low 2001: 2; Spindler 2002: 4]. Japan takes great pride in the fact that it has succeeded in transplanting its domestic production and distribution networks into East Asia through FDI, and therefore it has not needed any solid regional strategy other than the Asia-Pacific policy, as far as it could maintain the *status quo*. On the other hand, the potential conflict between Japan and China as well as the US continued engagement and the colonial legacy have also prevented Japan’s political preeminence [Choi and Lee 2002: 183; Low 2001a: 10].

Given the recent structural transformation of the East Asian RPNs, it is unthinkable to design regionalism without China. Whereas, the report “*Japan’s FTA Strategy*,” released in October 2002 by ministry of foreign affairs (MOFA), presented the basic direction that Japan should first pursue FTAs with South Korea and ASEAN, and, ‘based on these foundations, it should explore a possibility of a FTA with China ‘over the mid to long-term’, ‘securing political and economic stability within the larger context of the construction of a regional system’ [MOFA 2002]. From a view of East Asian geopolitics, such a FTA network is equal to creating encirclement around China.

Whether the trade conflict and deficits with China, or increasing import penetration ratios, they are brought about largely by Japanese firm’s activities. Actually, approximately 80 percent of Japanese agricultural and food imports from China are developmental imports by Japanese trading companies, major supermarket and so on. The penetration of Chinese goods in the Japanese markets is also attributable to reverse imports or contract manufacturing by Japanese firms. In fact, reverse import ratio of Japanese subsidiaries locating in China (31.5 percent in 2001) is higher than those in ASEAN-4 (28.1 percent) and NIEs (17.7 percent) and due to its geographical proximity, the share of domestic demand goods is also higher. In addition, though registering trade deficits with China, with its growth, Japan increases its parts and capital goods exports to the country and China is now one of the biggest markets for Japanese manufactures.

In short, from the viewpoint of China, Japanese MNC is one of the major players, but the most significant player in the economy and from the viewpoint of Japan, China

is, along with ASEAN, also becoming the strategic sites of its East Asian RPNs. Accordingly, new East Asian regionalism reflecting the regional production structure should include China. Rather, it could not reach a new dimension until a cooperative relationship between Japan and China is established toward strengthening the East Asian regional identity.

6 Concluding Remarks

According to the conventional theory, regional integration is trade-led one which develops step by step from free trade area, second, custom union, third, common market, fourth, economic and monetary union, and eventually political union. If this path were always true, the recent FTA movement in East Asia might be a starting point for developing from the previous functional or market-led integration to institutional one.

Nevertheless, as shown in this paper, the actual process in the region is driven by a complicated dynamics of international political economy and therefore it is unlikely to go along such a linear developmental path. The central problem is a potential conflict between Japan and China. Especially, Japan, adhering to the out-of-dated vision, has not offered a new vision for East Asian regionalism. Japan's strategic opposition to China prevents East Asia from developing into a more integrated community. Certainly, there is a proposal for forming an 'East Asian Free Trade and Investment Area' at APT level, and the East Asian Vision Group, established by a Korean proposal, considered an East Asian Monetary Fund, a regional exchange rate coordination mechanism with the long-term goal of creating a common currency area and upgrading the annual APT meetings to an East Asian summit [EASG 2002]. But they recede into the background on the eve of bilateral FTA proposals by Japan and China.

More recently, bilateralism of both Japan and China gets ASEAN to a new response. ASEAN affirmed a creation of ASEAN Economic Community (AEC) by 2020 at the leaders meeting in October 2003. ASEAN is in the hub position of proposed FTAs, but this is passive. Its political strategy is to establish the regional order as ASEAN plus and to keep the situation, ASEAN should overcome its own internal weaknesses and ensure its cohesion. As a result of the AEC initiative, there are now three power points in East Asian FTA dynamics. But we could not find any commonality or idea to strengthen regional cohesion. Rather, the picture could be envisioned by a race to capture the market.

In the face of the intense competition in East Asia, Kiyoshi Kojima, who designed the basic ideas of Japan's Asia-Pacific cooperation, proposes a creation of an 'Economic Growth-oriented Community' of ASEAN plus Japan, Korea and China, based on an 'agreed international division of labor' [Kojima 2001]. The flying geese is nothing more or less than a process in which a heterogeneous regional order of economies with different development levels transforms into a homogeneous regional order through continuous catching-up by late-comers²⁴. To tell the truth, according to

²⁴The inventor Akamatsu was also a Hegelian and the flying geese model was a partial theory of his long-term dynamic theory of the world economy, characterized as a dialectics between heterogenization and homogenization. For him, the flying geese theory envisions the shifting process from international division of labor based on comparative advantage (heterogenization) to a homogenized structure. The homogenization intensifies mercantilism competition and finally leads to a new economic hierarchy (advanced heterogenization), which launches a new flying geese formation [Akamatsu 1974□156-57].

the model, the recent intensified intra-regional competition is its necessary consequence. In the homogenized economy, competition among regional economies is necessarily intensified. He argues that to avoid a situation where this intense competition evolves into mercantilism or serious trade conflict, the East Asian regional economies need politically agree to form horizontal international divisions of labor or ordering market. And he thinks that this political consensus will provide a new foundation of East Asian regionalism (or community). However, unlike the past, his proposal has not been reflected on the Japan's East Asian policy.

When we try to organize a certain geographical and cross-border space in a certain regional concept, there exist a certain arbitrariness and political nature. They could be fostered by some '*commonality*' enough to body forth the space as one region. In this context, the East Asian crisis was the common experience that made the concept of East Asia surface [Terada 2003: 264]. With East Asian monetary regionalism, the region showed a possibility of becoming a unit in international political economy. Regionalism need not always follow the traditional trade-led one. The commonality promoting East Asian regionalism might come from monetary sphere. In this sphere, Japan and China have already reached some agreement to cooperate with each other in the East Asian framework.

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