

# Chapter 1 New Regionalism and Japan's Options; Evaluating Recent Trends in North-South Regionalism of Vertical Integration

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The new regionalism flourishing in the post-Cold War world has influenced not only Japan's trade relations but its general foreign policy as well. The past critical view of FTAs has already undergone a complete change at the turn of this century. The dynamics of regionalism in Asia that has been accelerated by China, India and ASEAN is now pressing Japan to review its policy of involvement in Asia. Taking these trends into consideration, the JIIA conducted a research project with a special focus on regionalism across the North and the South, aiming to give some implications for Japan's foreign policy. This report provides the results of the project.

This chapter gives a general introduction to the report. The first half of the chapter (Section 1-4) attempts to describe an overall picture of the new regionalism based on the case studies presented in the following chapters. The latter half (Section 5-8) covers the implications for the Japan's foreign policy that is composed of the personal opinions and suggestions of each researcher.

## 1. Regionalism under the WTO regime

Since the beginning of the 1990s, regional economic integration, especially free trade agreements have become increasingly popular in every part of the world.

Indeed, this recent flourish of regionalism is not the first. During the Great Depression in the 1930s, regionalism took hold in the form of bloc economies and eventually became a remote cause of World War II. Needless to say, the lesson from the past practice was a driving force behind the development of the postwar Bretton Woods system. In the 1960s, European integration made regionalism the forefront once again under the multilateral system. Encouraged by the success in Western Europe, regional integration was also promoted in Central and South America. In Africa, newly independent nations as well attempted regional integration, which succeeded to the colonial regimes. However, many attempts at regional integration during this period resulted in failure and regional integration in Western Europe itself entered a stagnant phase. Confronted with these circumstances, regionalism faded from attention.

Considering the rise and fall of regionalism so far, the present popularity of regionalism could

be regarded as the third momentum. This new regionalism has four characteristics. First, the Bretton Woods system that was formed primarily by developed countries has been transformed into a global system, in which the WTO and the IMF/World Bank have played a major role and many developing countries have come to participate. Second, deregulation has moved ahead in customs areas (free trade areas and customs unions): it has become possible to proceed with liberalization through enabling clause for developing countries in addition to the conditions stipulated in Article 24 of GATT. Third, regional integration has proliferated geographically, shifting in nature from a "North bias" to a "North-South ubiquity." This proliferation has manifested itself in the emergence of mega-regional regimes and a tangled "spaghetti bowl" of bilateral agreements. Fourth, the process of integration has also become diversified. The formerly principal approach was called the passive integration model (the Balassa/Tinbergen Model) that border restrictions were gradually abolished, phasing in regional integration from free trade areas and customs unions, through common markets and economic/monetary unions to full integration. However, regional integration has gone beyond simple liberalization of border controls and now includes such forms as harmonization of regulations and reciprocal recognition of standards. In fact, many regional agreements concluded in recent years are aimed at "comprehensive economic partnership." This comprehensive sphere of integration is partly related to the fact that the WTO now governs a variety of sectors such as service- and investment-related sectors in addition to trade in goods.

It is clear that today's regionalism is closely connected with the WTO. At the same time, however, multilateral liberalization does not seem to have made much further headway under the WTO regime. This has resulted in the recent tendency that more and more countries have been pursuing liberalization among like-minded countries in response to economic globalization. In sum, the new regionalism emerged with the establishment of the WTO, and it has even more flourished because of the inadequate function of the WTO.

## 2. Various cases of North-South regionalism of vertically integration

FTAs have attracted particular attention among the various forms of new regionalism. Another important form of regionalism for Japan is cooperative arrangements between developed and developing countries, although it is not so widely noticed. This would be called North-South regionalism of vertical integration.

The prototype of this kind of regionalism is probably the "association" between the EEC and Mediterranean/African countries, on the extension of which comes the Lomé Convention that

developed out of the Yaounde Convention as the Britain joined the EC. The Lomé Convention institutionalized special economic relations between the former colonial powers that furthered EC, and the newly independent countries of Africa, the Caribbean, and the Pacific (ACP countries) that lost their protected status at the time they won their independence from the former colonial powers. Having concluded in 1975 and subsequently revised a few times, the Lomé Convention transformed into the Cotonou Convention with the establishment of the WTO. Under the new regime, member countries agreed on the abolishment of the preferential treatment that developing countries had enjoyed under the Lomé Convention. In particular, countries that have achieved some development are driven by necessity to conclude reciprocal (equal footing for both parties) regional economic partnership agreements (REPA) with the EU.

The countries of North and South America became consolidated as a region with the formation of the Organization of American States (OAS) after World War II. The United States took a negative attitude toward FTAs in pursuit of multilateralism, while Central and South America (including Mexico) actively pursued regional economic integration from the 1960s. Although their drastic initial plan ended in failure, other attempts followed, including the formation of Mercosur. In the 1990s North America, which had furthered economic integration through NAFTA, and South America, which had established the Andean Community and Mercosur, agreed to form a Free Trade Area of the Americas (FTAA; negotiations have not been completed as of 2004). The principle of the FTAA is the reciprocal trade liberalization, despite the fact that the FTAA would include both the developed countries of North America and the developing countries of Central/South America.

North-South regionalism of vertical integration has emerged even in Asia, where countries had been slow of economic integration. The establishment of APEC was no doubt a turning point. Founded in 1989 by five developed countries on the Pacific Rim, South Korea, and the ASEAN countries, APEC is an institution that aims to liberalize and facilitate trade and investment, and to pursue economic and technical cooperation. With the turn of the century, Japan and ASEAN agreed to pursue comprehensive economic partnership, including FTAs. ASEAN itself could be considered a case of North-South regionalism of vertical integration as it includes Singapore that ranks alongside the developed countries in economic level. Nevertheless, the ASEAN Free Trade Area is basically an agreement between equals. ASEAN raised the issue of intra-regional disparities only after Indochina and Myanmar (Burma) joined ASEAN in the latter half of the 1990s.

Although North-South regionalism of vertical integration has taken a variety of forms

mentioned above, it is essentially different from traditional North-South relations.

### 3. Transition in the North-South relations

It was not until the 1960s that the term “North-South relations” was used to describe relations between the developed and developing countries, and “North-South problem” to denote economic disparity between the two groups. Decolonization transformed closed relations between colonial powers and their colonies into open relations between developed and developing countries, and economic cooperation and official development assistance became major issues for the international community. While the “North-South” designation reflected geographical distributions, it also implied an additional perspective along by the “East-West”, a synonym of the Cold War structure. The “South” and the “East” have formed coalitions in the United Nations and other forums to stand up to the “North equal to West,” and development issues have been warped by political and ideological conflicts.

After the end of the Cold War, development issues took on a new political significance in the international community. On the one hand, the North imposed their ideal vision of the South more strongly than before. As clearly illustrated by the frequent use of the keywords like “structural adjustment,” “democracy,” and “human rights,” the North sought to change the political and economic systems of developing countries in line with the demands of the North (particularly the United States). The intention of the North in supporting the economic development in the South was rather to ensure that the South would no longer be a drag on the North than to allow the South to catch up to the North. Since the 1980s, the goal of economic assistance has changed to the achievement of certain minimum levels as indicated in the keywords like “basic human needs,” “human development,” and “poverty reduction.” The South, on the other hand, insisted that the North should provide the South with capital and technology through ODA and direct investment, and open its markets to encourage economic development in the South.

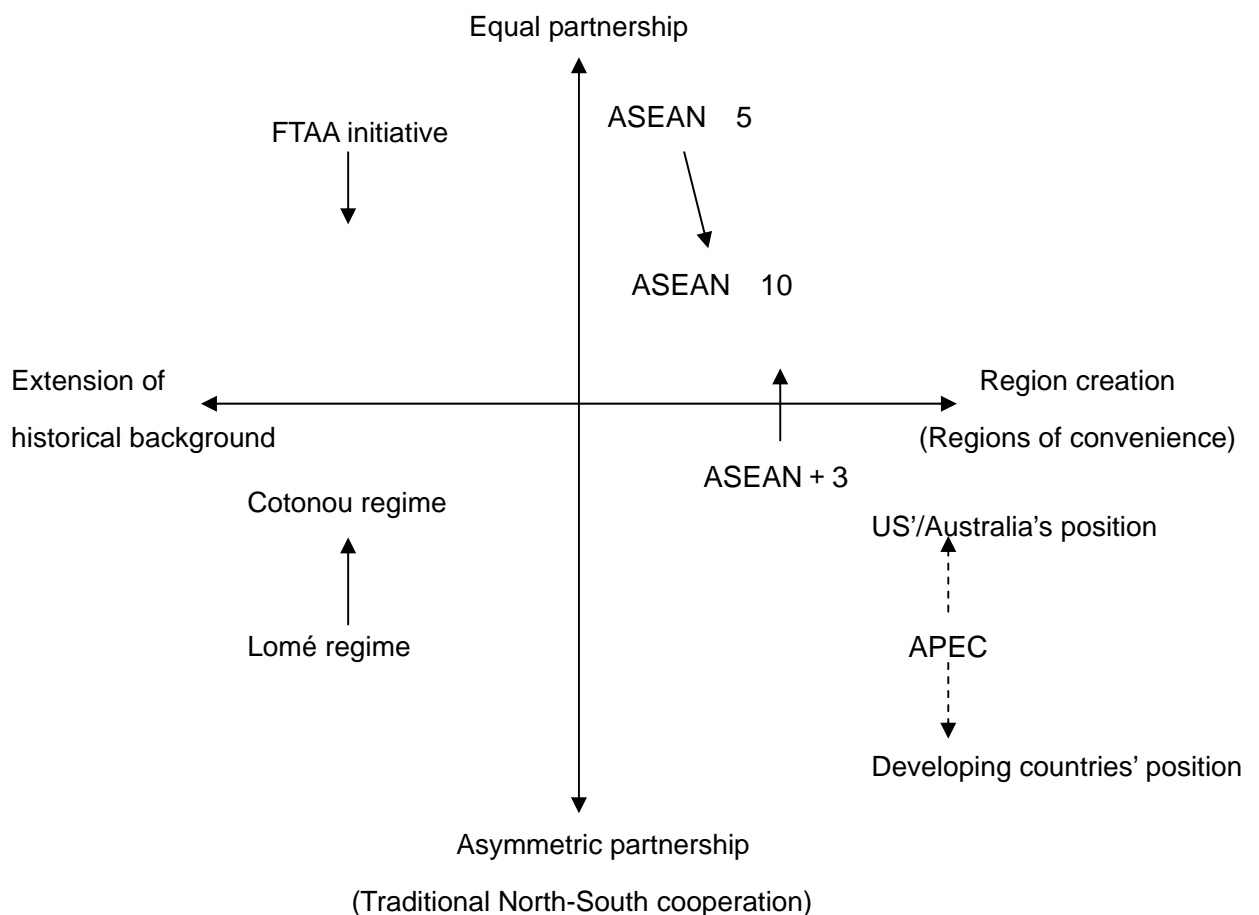
It was in the midst of this transformation in North-South relations that both the North and the South have come to seek mutually inclusive regional economic integration despite their continuing differences of opinion. It could be said that cooperative element was added to the long-lasting tensions between the North and the South such as unilateral dependence and the reaction against it, influence of the East-West conflict, and conditionality. The South tends to be pushed to the periphery of the global economy as the North steer the course of economic globalization. The South needs a new form of cooperation with the North in order to achieve

their economic development.

#### 4. Typology of North-South regionalism of vertical integration and Japan's options

A close look at the cases described above reveals that North-South regionalism of vertical integration has diverse patterns of cooperation. On the one hand, APEC, for example, embodies asymmetric partnership based on traditional North-South relations such as assistance from the North to the South, and on the other hand, FTAA illustrates symmetrical partnership of equals. Looking from a different perspective, institutionalization of economic partnership, in some cases, means to provide an additional field of cooperation in existing regional framework while in other cases, it is completely new attempt followed by forming a new region itself. The following shows the typology of North-South regionalism of vertical integration classified by these two axes

Typology of North-South regionalism of vertical integration (quadrant format )



The 1<sup>st</sup> quadrant (upper right) denotes narrowly defined regionalism in which countries try to form a new region through equal partnerships. Many of today's FTAs would fall into this classification. Among examples of North-South regionalism of vertical integration, the initial AFTA could be applied to this classification. The 2<sup>nd</sup> quadrant (upper left) designates attempts at further economic integration in areas where historical background had already produced regional consolidation. The FTAA basically fits into this classification. The 3<sup>rd</sup> quadrant (lower left) indicates regionalism through asymmetrical partnerships based on historical background. Typical examples of such partnerships are the regimes established for cooperation between former colonial powers and their former colonies. The Lomé regime belongs to this category. The 4<sup>th</sup> quadrant (lower right) shows attempts to form new regions through asymmetric partnerships. The typical North-South regionalism of vertical integration should be plotted here in the sense that North-South disparities are being considered and new regions are being created. APEC is one such example, as it incorporates economic/technical cooperation in its objectives.

The two intersecting axes in the typology do not just qualitatively divide specific examples of North-South regionalism of vertical integration into four groups. They also have a quantitative significance (at least to some extent) in revealing the relative impacts of historical background and future orientation, and the weight given to equal partnership factors and asymmetric partnership factors. Although the typology may be somewhat impressionistic, it does attempt to show relatively and quantitatively the changes seen in each example. For instance, ASEAN in the 21<sup>st</sup> century has taken up the problem of intra-regional disparities ("the ASEAN divide"), and in this sense, ASEAN itself has incorporated asymmetric cooperation into its usual equal partnerships. This is represented in the typology by a shift of ASEAN from the 1<sup>st</sup> quadrant toward the 4<sup>th</sup> quadrant. The Cotonou regime clearly had more aspects of equal partnership than the Lomé regime, which corresponds to a shift from the Lomé system in the 3<sup>rd</sup> quadrant to the Cotonou regime in the 2<sup>nd</sup> quadrant. The intra-regional disputes in and stagnation of APEC in the mid-1990s can be illustrated as antagonism between the position of the United States and Australia that seeks to promote trade liberalization based on equal partnerships, and that of the ASEAN countries that tries to secure assistance from the North to the South: the former is shown as a force pulling APEC toward the 1<sup>st</sup> quadrant, and the latter is shown as a force pulling APEC toward the 3<sup>rd</sup> quadrant.

Japan should adopt two different approaches in pursuing North-South regionalism of vertical integration. One would require Japan to be involved in regionalism that has already been

highly institutionalized in its historical developments, but putting Japan in the position of an outsider. More specifically, the issue at hand is how Japan should be involved in regionalism in the Americas and in Europe/Africa. The other approach is regionalism actively directed at creating a region in which, in Asia at least, Japan is regarded as a member. In the latter case, Japan itself would be one party to North-South regionalism of vertical integration and would therefore need to address the questions of what it can do and how it will change. The particular task for Japan is how to develop approaches toward APEC and ASEAN+3.

North-South regionalism of vertical integration does not necessarily seek to an exclusive region which consists only of the South with close historical ties to the US and Europe. For example, networks of bilateral FTAs continue to extend across regions. Neither Japan-ASEAN economic cooperation nor East Asian economic cooperation in the ASEAN+3 framework is an exclusive regionalism. In fact, North-South regionalism of vertical integration is developing in consistent with multilateral international economic regimes and international development assistance regimes. It can also be said, however, that traditional policies cannot adequately cope with this new developments.

##### 5. Japan's foreign policy and Asia-Pacific regionalism

Mr. Kikuchi analyzes Asia-Pacific regionalism for this report, and presents the following ideas.

A key feature of Asia-Pacific regionalism is that it includes both North and South. While the liberalization of trade and investment and the coordination of domestic regulatory systems are also important issues in Asia, regionalism is simultaneously viewed as a means of upgrading the socioeconomic infrastructure of countries in the South that are critically important for the developing countries to make institutional adjustment more smoothly. Tackling with institutional adjustment, developing countries face an abundance of problems, but there are serious limits to the material and intellectual assistance that the international community as a whole (UN, WTO, IMF, etc.) can provide. Regionalism can contribute greatly to development in such countries by creating mechanisms unique to the region. "Development cooperation (especially those to enhance institutional framework such as the change of domestic regulatory mechanisms)" remains an important issue in Asian regionalism. Above all, China in recent years has intensified and expanded its economic cooperation with the countries of Southeast Asia, but there are a lot of "governance issues" in China to be further enhanced. Regionalism in the region could contribute to enhancing domestic governance in China by providing a

variety of supports such as human resource development program and intellectual supports.

Spirited diplomatic campaigns are being waged by Japan, China, and ASEAN to determine the form that regionalism should take in East Asia, and the principal stage for this diplomacy at present is the bilateral arena (Japan-ASEAN, China-ASEAN). The key concern for Japan is ensuring that this bilateral-based diplomatic maneuvering does not lead to results that are contrary to international rules and norms. Japan should carefully follow the progress of bilateral negotiations and convey its wishes whenever necessary so that all agreements reached will be in accord with international rules and norms set down by such international institutions as GATT/WTO and the IMF. In this regard, Japan should make full use of its ties with ASEAN to exercise influence on ASEAN's external relations (through genial dialogue).

Diplomatic negotiations on regionalism in East Asia will focus on ASEAN for the time being. In carrying out these negotiations, Japan should explicitly demonstrate positive involvement in tackling the problems confronting ASEAN (both individual member countries and the organization as a whole), as has been its traditional policy toward ASEAN. Japan should be particularly active in promoting capacity-building projects in ASEAN countries. On that point, Japan's efforts thus far to strengthen relations while respecting the wishes of its ASEAN counterparts so as not to highlight the disparity in power between Japan and ASEAN are to be commended. This experience should be put to good use in future as well.

It should be borne in mind that the image of Japan held in ASEAN countries has undergone rapid change. Although it is not the case that the perception of the "rising China and declining Japan" evident in media coverage is unthinkingly given credence within ASEAN countries, it does merit attention that the countries of ASEAN do believe this perception could conceivably become future reality and are accordingly moving to adjust their policies toward Japan, China and the US. The age of contentment with past achievements in Japan-ASEAN cooperation is quickly drawing to a close.

Institutional enhancement is needed within the Japanese Government. Southeast Asia is an important region both politically and economically for Japan. Nevertheless, the systems in place for comprehensively examining and executing Southeast Asian policy within the Ministry of Foreign Affairs and the government as a whole are inadequate. A bureau responsible for administering comprehensive economic cooperation was recently set up in the Prime Minister's Office, and establishing such an organization for Southeast Asian policy would be a good idea. In the meantime, however, a bureau with wide-ranging responsibility for implementing the agreement reached at the December 2004 Japan-ASEAN Summit Meeting



should be set up as soon as possible. Japan's commitment in this regard will greatly enhance confidence in Japan's foreign policy among countries in the region. Quite a number of "recommendations" and "agreements" have been proposed in connection with Japan-ASEAN relations, but no objective studies have been conducted on the progress made in implementing these. Assessments and reviews carried out principally by outside private sector experts are also needed. The era of foreign policy being proposed and implemented solely by the government is over.

It is essential that Japan itself changes to strengthen relations with the countries of Asia. The ongoing negotiations on comprehensive economic partnership agreements (including FTAs) with the ASEAN countries offer excellent opportunities to show visibly how Japan has changed. Japan should offer up bold initiatives on opening its markets. China has adopted the Early Harvest Program (although in fact this has not quite met ASEAN's expectations) and other "visible initiatives," and Japan needs to implement similar experiments.

Finally, regionalism in the Asia-Pacific (such as APEC) ranks alongside East Asian regionalism in importance. East Asian regionalism must be underlined by robust Asia-Pacific regionalism, given military, political, economic and social ties that bind both sides of the Pacific. East Asia and the Asia-Pacific regionalisms should not be mutually exclusive. APEC today continues to pursue closer economic and technical cooperation with developing countries in line with the Doha Development Agenda, thereby contributing to enhancing global multilateralism as well as developing regional mechanisms to further facilitate economic interchanges. Japan's efforts in this sector are also significant. Japan should also encourage active participation by Asian countries in collective efforts to enhance global regimes such as the WTO.

## 6. Japan's foreign policy and regionalism in the Americas

Mr. Yanagihara analyzes regionalism in the Americas for this report, and presents the following ideas.

First, let us consider the significance of the development of regionalism in the Americas for Japan's foreign policy toward Central and South America. Progress toward regional economic integration throughout the Americas as typified by the effort to create the FTAA is dominantly influenced by disputes and compromises between the US and Brazil (or the US and Mercosur, as the foreign policy posture of the current Argentinean administration is close to that of Brazil). Establishment of the FTAA is basically being driven by foreign policy

considerations, with economic interests of secondary importance. The US and Brazil have been lobbying the countries of Central and South America in order to bolster their respective positions, and it can be readily supposed that these Central and South American nations have determined their own stances so as to derive the maximum foreign policy benefits from their relationships with the US and Brazil; the EU plays a key role as an extra-regional actor within this scheme. Brazil in particular is seeking to strengthen ties between Mercosur and the EU to gain leverage in its relationship with the US, and likely desires closer relations with Japan for much the same reason. Japan should bear in mind that its ties with Brazil could have an impact on its relations with the US in the Americas (though Japan's influence is seen as far smaller than that of the EU).

The diplomatic postures of American countries are to a degree prescribed by their relations with the US in the economic sphere, but other factors stemming from cultural, social, and political values are given due consideration. The prestige and influence of the US vis-à-vis the countries of Central and South America has apparently fallen to new lows under the current Bush administration (and the US' prestige and influence vis-à-vis Europe has similarly dropped). Attention should be paid to how the US attempts to remedy this situation.

On the other hand, the Lula administration in Brazil has pursued third-world diplomacy on a global scale. The essence of this approach is intensifying diplomatic relations with other major Third World countries – e.g., China, India, and South Africa – and amplifying the voice of developing countries as a group in such forums as WTO negotiations (closer economic ties with these countries through trade and investment are being pursued simultaneously). As a result of this policy, the Third World has emerged for the first time in many years as a major player in global diplomacy. Japan should realize that an “anti-Third World” stance will become increasingly conspicuous in face-offs between the group of developed countries and the group of developing countries (for the time being focused on agricultural subsidies).

The Lula administration is also seeking to exercise influence as the flag bearer of the global socialist movement through the Socialist International and the World Social Forum. The Socialist International convened an October 2003 World Congress in Sao Paulo, whose mayor is the Deputy Chairman of the Democratic Labor Party. The World Social Forum held its first three assemblies in Porto Alegre, whose city government is dominated by the Democratic Labor Party, but the 4<sup>th</sup> Assembly was “exported” to Mumbai, India in January 2004. Both of these organizations are expected in future to play a more important role in forming public opinion and influencing policy agenda worldwide as groups advancing a global socialist

movement. Japan should assess Brazil's role in that regard carefully.

## 7. Japan's foreign policy and Africa under the Cotonou regime

Mr. Watanabe analyzes the Cotonou regime, successor to the Lomé regime, for this report and presents the following ideas.

An examination of economic policies towards Africa (development assistance and policies towards developing countries in multilateral trade negotiations) indicates that regional integration schemes such as the East African Community (EAC) and the Economic Community of West African States (ECOWAS) will grow in importance alongside bilateral economic relations with Japan. Growing attention is being focused on the political roles of these regional integration schemes in such matters as the resolution of regional conflicts, as seen with ECOWAS. Nevertheless, these integrated regions should be recognized as economic units and considered as counterparts for bilateral development assistance from Japan.

Confronted with economic stagnation lingering since the 1980s, economic liberalization through structural adjustment and stabilization policies directed by the World Bank and the IMF, the conditionality (democratization, respect for human rights, etc.) imposed on multilateral and bilateral assistance in the 1990s, and compliance requirements for multilateral trade regimes, the governments of Africa tend to have extremely limited freedom in policy formulation and decision-making. The preferential treatment that the countries of Africa enjoyed under the Lomé Convention will be restricted by the more GATT/WTO-compliant Cotonou Agreement. This is one consequence of the trend described above.

The Cotonou Agreement is likely to have major impacts, especially on Kenya, Nigeria, and other non-LLDC countries. Unless these countries conclude reciprocal free trade agreements with the EU ("Regional Economic Partnership Agreements" [REPAs]), they will lose their comparative advantage vis-à-vis other non-ACP countries in access to EU markets, on which their exports rely heavily. The EU views regional integration as essential for stability in Europe and is therefore actively promoting expansion of the EU itself as well as regional integration in peripheral areas such as the Mediterranean countries. REPAs under the Cotonou Agreement regard the EAC, ECOWAS and other regional integration schemes of ACP countries as expected counterparts to the EU. These schemes were created or revived in the early 1990s by African countries which saw risks to be marginalized within an increasingly globalized world economy. The achievements of these schemes are gradually coming to light, as seen in the expansion of intra-regional trade from the latter half of the 1990s.

These two factors – the views of African countries on regional integration and the demands of their principal trading partner the EU – will no doubt stimulate future regional integration in Africa, and will constitute significant variables that must be taken into account in formulating developing policies towards Africa.

#### 8. Japan's foreign policy and international development assistance regimes

Mr. Inada analyzes international development assistance regimes in connection with vertically integrated North-South regionalism for this report, and presents the following ideas.

Given the present status and future possibilities of international development assistance regimes, what options does Japan have and how should it respond? Arguments could be offered from a variety of standpoints, but the key issues are as follows:

How far can partnership regimes (typified by the PRS regime) be undertaken jointly as a global framework? Should Japan adopt a “common pool” approach or follow an independent course?

Should Japan focus on Asia or emphasize support of impoverished nations, including those in Africa? This issue also entails a choice of priorities: loan assistance to middle-income countries or grant assistance to impoverished countries.

In reality, the options for are limited. With partnership regimes gaining momentum within the overall international development assistance scheme, it would be quite difficult for Japan to adopt an independent stance when aiding the development of partner countries. The only path open to Japan in asserting its own contributions and roles is to interact with donors and counterparts in partner countries, participate in local sector meetings/discussions, and present persuasive arguments and proposals at these meetings/discussions. The current Tokyo-centered scheme for assistance policy decision-making makes it difficult at times to respond to circumstances, and Japan is under pressure to switch to a local-based system and duly alter its approaches to personnel assignments and the utilization of specialists.

The PRS regime formulated in recent years is an extremely potent international framework, so an approach suited to this framework is needed. Of course Japan requires country-specific assistance strategies as well, but these should be developed in consultation with the partner countries as well as with other donors.

is an extremely serious issue for Japan, which has thus far provided ODA primarily through yen loans. JBIC, in charge of dispensing yen loans, has had little choice but to concentrate on Asia as many African countries have become HIPC's, making the provision of

loans difficult. Even so, the need for concessionary loan is being called into question internationally and, despite JBIC's opposition, perhaps the only viable long-term solution lies in providing assistance within a larger context that includes non-concessionary government loan (i.e., financing from the former Export-Import Bank of Japan) and private-sector capital.

At the same time, JICA and the Ministry of Foreign Affairs, the principal administrators of grant assistance, have been compelled to shift their assistance more toward impoverished countries, meaning a further increase in the relative weight of Africa. Although this corresponds to the current trend in assistance internationally, just how long can Japan stay in step with that trend? Japan is constrained by certain limitations, including a scarcity of Japanese experts on the region and a slowdown in the flow of private capital. Taking into account the differing relative weights of its regional roles internationally, Japan should perhaps adopt a global approach toward those countries and regions that receive relatively little assistance from European and American donors, in particular Asia, which has strong ties to Japan.