



# KGRI Working Papers

No.1

Advancing The ASEAN Economic Community: The Role of  
China and Japan in Supporting ASEAN's Regional Integration

Version1.0

March 2017

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## **Abstract**

The Association of Southeast Asian Nations (ASEAN) quest for regional integration entered into a new phase in 2016 as the long awaited ASEAN Economic Community (AEC) entered into force. The organisation's drive towards economic integration began in the early 1990s with the initiation of the ASEAN Free Trade Area (AFTA). Since AFTA, the member states have incrementally progressing in integrating the region culminating in the development of the AEC and ASEAN Connectivity projects. While ASEAN members have been the driving force behind integration, the project would not be possible without its regional partners, especially China and Japan. This paper seeks to examine the concepts behind regional integration, the role the two major Asian powers have played in supporting the AEC and ASEAN Connectivity, the common and differing interests of the actors involved, if the structure and depth of the two states relationship with ASEAN differ, and the range of mechanisms in place to facilitate cooperation. With the AEC entering into force in 2016 and the continuing negotiations of the Regional Comprehensive Economic Partnership (RCEP), analysing the role and how to bolster China-ASEAN and Japan-ASEAN relations becomes all the more necessary.

## 1. Introduction

Asian Nations (ASEAN) Economic Community (AEC) establishment, the incremental progress has raised concerns over the implementation, benefits, and future of the project. While the AEC is ASEAN's ambitious scheme to develop a single production base and investment destination, the organisation's plans would not be possible without the participation and engagement of its partners, especially China and Japan. As a response to fears surrounding the European Union (EU) and the North America Free Trade Area (NAFTA), one of foundational purposes behind initiating ASEAN regional integration was to attract global attention and engagement. Over the past decades, China and Japan have played a foundational role in institutional development and facilitating regional integration; however, tensions over territorial disputes, especially the South China Sea, have raised concerns over China - Japan cooperation, ASEAN - China cooperation, and ASEAN unity. As ASEAN and its free trade agreement (FTA) partners seek to finalise the negotiation of the Regional Comprehensive Economic Partnership (RCEP), advance the AEC, and develop critical infrastructure, it is an imperative to examine the rationale, depth, and style of cooperation behind China and ASEAN, and Japan and ASEAN relations, and the commonalities and differences in their approach.

In examining ASEAN's institutional evolution and regional integration processes, China and Japan have been critical partners in supporting the organisation's goals.<sup>1</sup> Even though China - Japan relations have been strained and tense, the rivalry between the two powers have from ASEAN's perspective been beneficial to the institutional development and progression of the integration agenda. While both states have significantly bolstered their relations with ASEAN

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<sup>1</sup> While the chapter treats the state, both Japan and China, as unitary actors this is done for analytical clarity. The author acknowledges the differing rationales and positions the respective country ministries had in advancing and implementing policies. For further insight into the roles of differing Japanese ministries please see Takeshi Terada's "The Origins of ASEAN+6 and Japan's Initiatives: China's Rise and the Agent-Structure Analysis." *The Pacific Review*, Vol.23, No.1, March 2010.

over the past decades, the rationale and style behind China and Japan strengthening ties differ. These differences may have significant implications for ASEAN going forward.

The paper proceeds by analysing the concept and history of economic integration in ASEAN; second, the examining current ASEAN plans including ASEAN Community, the AEC, and the Master Plan on ASEAN Connectivity (MPAC); third, China-Japan-ASEAN economic cooperation, their role, and similarities and differences in approaches; and fourth, conclusion and recommendations.

## **2. ASEAN, Open Regionalism, and Regional Integration**

Following decades of strife and hostility in Southeast Asia, ASEAN was formed in 1967 with the signing of the Bangkok Declaration by the leaders of Indonesia, Malaysia, the Philippines, Thailand, and Singapore<sup>2</sup> in order to mitigate regional conflict, prevent the spread of communism, establish a regional voice, and bolster relations with the international community. As these diverse set of states were not culturally or politically similar, Southeast Asian regionalism had to be developed through interaction. “Such interaction could only be purposeful if they were consistent and rule based, employing those rules which would ensure peaceful conduct among the member states.”<sup>3</sup> It was in this environment that the ‘ASEAN Way’ emerged and established the ‘ground rules’ for interaction in the region. The core elements of the ‘ASEAN Way’ complement and reinforce each other; first, non-intervention and non-interference; second, emphasis on informality, and aversion to legalism and institutionalisation; third, peaceful settlement of disputes and non-use of force; fourth, regional autonomy; fifth, state sovereignty and equality; and sixth, consultation and consensus decision

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<sup>2</sup> The original ASEAN members Indonesia, Malaysia, the Philippines, Thailand, and Singapore are also known as the ASEAN-5.

<sup>3</sup> Amitav Acharya. *Constructing a Security Community in Southeast Asia 2nd Edition*. (Stanford: Stanford University Press, 2009): 54

making.<sup>4</sup> In beginning years, ASEAN's institutional development occurred at a snails pace, highlighted by the fact that it took the organisation nine years to host its first summit in 1976.

During the 1976 ASEAN Summit, the organisation signed the ASEAN Concord and embarked on its initial foray with economic cooperation. The ASEAN Concord laid the foundation for both the further institutionalisation of the organisation by establishing the Secretariat and economic cooperation between member states.<sup>5</sup> ASEAN's first attempt towards economic cooperation occurred in 1976 with the initiation of several project including the ASEAN Preferential Trading Arrangement (APTA), ASEAN Industrial Projects (AIPs), the ASEAN Industrial Complementation (AIC) Scheme, and the ASEAN Industrial Joint Ventures (AIJVs). While all these initiatives proved to be unsuccessful due to a range of factors including lack of guidelines, non-tariff barriers (NTB), and the exclusion of sensitive sectors from the agreements, they did mark ASEAN first attempt towards pursuing economic regionalism.<sup>6</sup>

The 1980s would prove tumultuous for many ASEAN economies as political and economic crises engulfed the region. The mid-1980 collapse in global commodity prices pushed Indonesia, Malaysia, and Singapore into recession, and the Philippines own economic and political crises inhibited the role it could play in the organisation. In addition to the crises in Southeast Asia, several other external events would push the organisation towards adopting a more comprehensive approach towards economic cooperation and integration. These include, first, the emergence of a new international order following the end of the Cold War; second, the creation of NAFTA and the signing of the 1991 EU Maastricht Accord; third, the emergence of China following its economic reform program and rising attractiveness to foreign direct investment (FDI); and fourth, the establishment of the Asia-Pacific Economic

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<sup>4</sup> Ibid.

<sup>5</sup> ASEAN (1976) 'Declaration of ASEAN Concord', Bali, 24 February 1976.

<sup>6</sup> Hal Hill and Jayant Menon. "ASEAN Commercial Policy: A Rare Case of Outward-Looking Regional Integration." ADB Working Paper Series on Regional Economic Integration, No. 144, November 2014.

Cooperation (APEC) and continuing World Trade Organisation (WTO) negotiations.<sup>7</sup> As the ASEAN member states were beginning to transition to more open economies and seeking to attract more FDI, the rise of alternative regional arrangements in NAFTA and the EU stoked fear in ASEAN over the possibility trade and FDI diversion. ASEAN's fear was only further compounded by China's economic rise as the country began to attract increasing amounts of FDI at the expense of ASEAN member states. Between 1991 and 1993, FDI headed to China increased substantially from U.S.\$4.9 billion to U.S.\$26 billion in the two year span, amounting to twice the amount headed to ASEAN.<sup>8</sup> It was in this context that the concept of ASEAN's open regionalism and regional integration would emerge. In the face of these mounting pressures, ASEAN began to embark on its most comprehensive economic cooperation and integration initiative, the ASEAN Free Trade Agreement (AFTA) in 1992.

In defining open regionalism and why the ASEAN states embraced the concept, its necessary to explain how NAFTA and EU stood in contrast to the concept as they were examples of discriminatory regionalism. Discriminatory regionalism established official trader barriers at members' borders that were lower for the member states than for non-members.<sup>9</sup> In contrast, open regionalism and its application to ASEAN, there are two key elements, trade facilitation, which seeks to enhance cooperation across borders to reduce transactions costs, and trade liberalisation on a non-discriminatory basis. Non-discriminatory trade liberalisation has two component parts. First, regional cooperation in regional and extra-regional trade negotiations were to secure liberalisation at both home and abroad. Second, cooperation should bolster efforts in unilateral liberalisation among like-minded partners to ensure the both economic

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<sup>7</sup> Ibid.

<sup>8</sup> Richard Stubbs. "Signing on to Liberalization: AFTA and the Politics of Regional Economic Cooperation." *The Pacific Review*, Vol. 13, No. 2, (2000)

<sup>9</sup> Ross Garnaut. "Open Regionalism: Its Analytical Basis and Relevance to the International System." *Journal of Asian Economies*, Vol.5, No.2, 1994.

gains and political support for liberalisation.<sup>10</sup> Crucially, AFTA highlighted the organisation's initial pursuit and implementation of the open regionalism concept.<sup>11</sup> Specifically in application to ASEAN, "open regionalism is aimed primarily at advancing the competitive position of business in global competition, or to attract wealth-creating FDI to the region amid competition with other sites for it. The main driving force behind open regionalism is the concern with economic efficiency, or more broadly, with ensuring economic growth through participation in global wealth creating activities."<sup>12</sup> This concept would develop into the basis for ASEAN's economic cooperation and integration initiatives, and attempt to further integrate the region into the international economic system.

In framing why the organisation embraced open regionalism, which is outward-oriented, and AFTA, the structure of the organisation's trade and investment flows highlights why forming an inward looking economic and trade bloc would not have been in the interest of ASEAN. Since the organisation's establishment, ASEAN economies have predominately traded extra-regionally, and intra-regional trade has generally hovered in-between 15% to 30% of total ASEAN trade.<sup>13</sup> In terms of FDI flows, ASEAN depended and still heavily relies on investment flows from extra-regional sources, indicating that there is a synergy between trade and investment flows.<sup>14</sup> In response to the regional and external factors, ASEAN announced the AFTA initiative during the Fourth ASEAN Summit in 1992. As opposed to previous attempts that floundered, AFTA was adopted with a clear timetable for implementation, member states

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<sup>10</sup> Ross Garnaut. "A New Open Regionalism in the Asia Pacific." Paper presented at the International Conference on World Economy, Colima, Mexico. November 25, 2004.

<sup>11</sup> For a more in-depth analysis and history of the open regionalism concept and how it emerged in Asia and the Asia Pacific Economic Cooperation (APEC) organisation, Michael Sutton and Ross Garnaut, respectively, provide a comprehensive examination in their articles. Michael Sutton. "Open Regionalism and the Asia Pacific: Implications for the Rise of an East Asian Economic Community." *Ritumeikan International Affairs*, Vol.5, pp.133-152, 2007, and Ross Garnaut. "A New Open Regionalism in the Asia Pacific." Paper presented at the International Conference on World Economy, Colima, Mexico. November 25, 2004.

<sup>12</sup> Helen E.S. Nesadurai. "Attempting Developmental Regionalism through AFTA: The Domestic Sources of Regional Governance." *Third World Quarterly*, Vol.24, No.2 (April, 2003), 237.

<sup>13</sup> Hal Hill and Jayant Menon. "ASEAN Commercial Policy: A Rare Case of Outward-Looking Regional Integration." *ADB Working Paper Series on Regional Economic Integration*, No. 144, November, 2014.

<sup>14</sup> Mohamed Ariff. "Open Regionalism a la ASEAN." *Journal of Asian Economies*, Vol. 5, No. 1, 1994.

adopted a negative list approach to trade liberalisation, and ASEAN leaders agreed through the common effective preferential tariff (CEPT) rates to reduce tariffs between states to 0%-5% by 2003.<sup>15</sup>

In the years following AFTA's initiation, ASEAN would not only continue to advance liberalisation and integration but also significantly expand its membership with the inclusion of Vietnam, Laos, Cambodia, and Myanmar by the end of the 1990s. In line with seeking to attract FDI to the region, ASEAN leaders began to negotiate and implement the ASEAN Framework Agreement on Services (AFAS) in 1995, which sought to eliminate restrictions in services trade among member countries and pursue liberalisation that went beyond what was enshrined in the General Agreement on Trade in Services (GATS), and the ASEAN Investment Area (AIA) in 1998 which attempted to develop formal instruments and promote cross-border investment among its members.<sup>16</sup> However in the midst of attempting to develop an integrated ASEAN, the Asian Financial Crisis of 1997-1998 would prove to be a critical juncture for the organisation. The Asian Financial Crisis would profoundly shape ASEAN's institutional development and attempts to integrate regionally and into the global economy. Crucially, the financial crisis not only demonstrated ASEAN institutional weaknesses in dealing with the fallout, but also the necessity of bolstering the organisations relationship with its East Asian partners, especially China and Japan. It was in this political and economic context following the devastating effects of the Asian Financial Crisis that the ASEAN+3 grouping, the Chiang Mai Initiative (CMI), the ASEAN Community and AEC, and MPAC initiatives were developed.

### **3. The ASEAN Economic Community and ASEAN Connectivity**

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<sup>15</sup> Hal Hill and Jayant Menon. "ASEAN Commercial Policy: A Rare Case of Outward-Looking Regional Integration." ADB Working Paper Series on Regional Economic Integration, No. 144, November 2014.

<sup>16</sup> Ibid.



During the Ninth ASEAN Summit and following the progression made with the negotiation and implementation of AFTA and related initiatives, the organisation initiated the process of developing the AEC in 2003. In line with the concept of open regionalism, the AEC expanded AFTA and affiliated schemes by seeking to establish a fully integrated regional market and production base. The AEC expands the scope of economic integration by advancing the further liberalisation of services, trade, and investment regulations; the harmonisation of customs laws and procedures, product standards, and tariff codes; the elimination of NTBs; and facilitating the free flow of capital and skilled labour in the region. As FDI remains a crucial component of regional and domestic economic development, one of the AEC's primary goals is to further attract FDI and multinational corporations (MNC) to the region through the establishment of an integrated regional production base.<sup>17</sup> The rationale behind the AEC, the single market, and production base was to "allow ASEAN to benefit from economies of scale and efficiency in production network processes. ASEAN could leverage on economies at different levels of economic development to provide complementary locations for production networks. An integrated market and production base would clearly boost intra-regional trade and investment flows while an ASEAN consumer market of over half a billion would be attractive for investors."<sup>18</sup> While the AEC's lofty and ambitious goals have begun to be implemented, one of the main barriers to integration has been the region's hard and soft infrastructure.

As a supplement to the AEC and to tackle the barriers to integration, ASEAN developed the MPAC in 2010 as a strategic blueprint to facilitate the development of the ASEAN Community. The MPAC is based upon three pillars, first, physical connectivity; second, institutional connectivity; and third, people-to-people connectivity. The physical connectivity pillar addresses the infrastructure deficit in the region by proposing projects that seek to improve the

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<sup>17</sup> Helen E. S. Nesadurai. "The Association of Southeast Asian Nations (ASEAN)." *New Political Economy*, Vol. 13, No. 2, June (2008).

<sup>18</sup> Siow Yue Chia. "The ASEAN Economic Community: Progress, Challenges, and Prospects." ADBI Working Paper Series, No.440, (October, 2013), 11.

poor road conditions, missing railway links, develop maritime ports and aviation facilities, and meet the growing demand for energy. The institutional connectivity pillar highlights the need to resolve impediments to the movement of goods, people, investment, capital, and services. Plans include the need to deal with tariff and NTBs, harmonise standards and procedures, and implement key ASEAN agreements, such as the ASEAN and national single windows. The people-to-people connectivity pillar seeks to facilitate the movement of ASEAN nationals and skilled labour through out the region, for example, through the development of mutual recognition arrangements (MRA) and the relaxation of visa requirements.<sup>19</sup> Critical to MPAC and its successful implementation is the vital role of ASEAN's dialogue partners in supporting, developing, financing, and implementing the MPAC plans. The involvement and support of ASEAN's partners, and development banks and financial institutions is critical as the Asian Development Bank (ADB) estimates that ASEAN requires roughly U.S.\$8.3 trillion in infrastructure investment between 2010-2020.<sup>20</sup>

Despite ASEAN's numerous plans and blueprints, implementation and infrastructure development remain key bottlenecks in fulfilling its regional integration plans. In the 2015 ASEAN Secretariat monitoring report, the Secretariat estimated that as of October 2015 the implementation rate of the full AEC Scorecard was 79.5%.<sup>21</sup> While this should still be considered an achievement, the organisation still has significant hurdles to overcome in meeting its objective as "a lot of this relates to tariff liberalisation and other "low hanging fruit" reforms. ASEAN has removed customs duties on most intra-ASEAN trade but... this has been achieved mainly through AFTA."<sup>22</sup> Additionally, many of the outstanding initiatives that have

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<sup>19</sup> ASEAN (2010). Master Plan on ASEAN Connectivity. (Jakarta: 2010).

<sup>20</sup> Asian Development Bank and Asian Development Bank Institute, *Infrastructure for a Seamless Asia*, Manila and Tokyo, 2009.

<sup>21</sup> ASEAN Secretariat (2015), ASEAN Economic Community 2015: Progress and Key Achievements, Jakarta: The ASEAN Secretariat. It should be emphasised that the Secretariat provides differing estimates regarding the implementation rates in the report, the estimates range from 79.5% to 92.7% depending on the measurements and projects taken into consideration.

<sup>22</sup> Hal Hill and Jayant Menon. "ASEAN Commercial Policy: A Rare Case of Outward-Looking Regional Integration." ADB Working Paper Series on Regional Economic Integration, No. 144, November 2014, 14.

yet to be implemented require are not only the most difficult but also require domestic and regional political will and cooperation. In order for ASEAN to realise the AEC and MPAC goals, ASEAN needs to work towards enhancing China and Japan's participation in these numerous initiatives and in concluding the on-going RCEP negotiations.

#### **4. China – Japan – ASEAN Cooperation in fostering an integrated Southeast Asia**

While ASEAN has emerged as the fulcrum of regional architecture in East and Southeast Asia, the organisation's success and development would have not been possible without the assistance of both China and Japan. In examining the relationship between the two East Asian powers and ASEAN, the often-bitter relationship and rivalry between the two powers in vying for influence in Southeast Asia has directly contributed to the ASEAN's institutional development and advancement of regional integration and connectivity initiatives. Despite the positive benefits of the rivalry, the lack of cooperation between the two states and their differing strategic rationales may inhibit ASEAN's ability to adequately implement the AEC and MPAC.

The following section examines the history of Japan – ASEAN and China – ASEAN relations; how the strategic rivalry and quest for influence benefitted ASEAN and spurred institutional development; the differing rationales and motivations undergirding their engagement with ASEAN; and current status of their cooperation in facilitating regional integration in the region.

#### **5. Japan – ASEAN Relations**

As the relationship approaches its 44<sup>th</sup> year, the importance of the Japan – ASEAN relationship in regional development, especially institutionally and economically, cannot be

understated. The first instance of cooperation occurred in 1973 when the two sides held the Japan – ASEAN Forum on Synthetic Rubber, which was a business-level dialogue aimed at resolving commercial disputes between Japanese synthetic rubber firms and ASEAN latex producers. The relationship was further solidified in 1977 with the first ASEAN – Japan Summit and the introduction of the Fukuda Doctrine, which laid out the principles of Japanese foreign policy towards Southeast Asia, which was founded upon a cooperative relationship on the basis of equal partners.<sup>23</sup> While the Japan – ASEAN relationship blossomed after the organisations establishment; Japan had been engaged in Southeast Asia since the 1950s through a range of economic cooperation efforts that sought to promote mutually beneficial economic relations, which included both state aid, export credits, and private capital flows.<sup>24</sup> “In 1958 Japan started to provide so called ‘yen-loans’, predominately to Asian countries. The extension of yen loans and war reparations during the 1950s and 1960 aimed at expanding export markets and securing raw material imports for Japan.”<sup>25</sup> In the following decades, Japan and its aid would help repair the damages from the war and help construct infrastructure, but also was a means to introduce Japanese industry and commercial interests to the region.<sup>26</sup>

In the following years, Japan’s economic engagement with the region would have a profound impact on the development of regional production networks, especially in the 1980s. After the 1985 Plaza Accord, which caused the sharp appreciation of the Japanese Yen, Japanese MNCs began not only to increase their FDI to Southeast Asia but they also “began to shift labour-intensive goods and production processes, such as assembly, to industrialised countries, including the newly industrialised economies and ASEAN member states, to exploit

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<sup>23</sup> Hitoshi Sato. “How can ASEAN and Japan Mutually Benefit from ASEAN Economic Integration?” ILO Asia-Pacific Working Paper Series, October, 2014.

<sup>24</sup> Séverine Blaise. “Japanese Aid as a Prerequisite for FDI: The Case of Southeast Asian Countries.” Australia-Japan Research Centre, ANU College of Asia & The Pacific, Asia Pacific Economic Papers, No.385, 2009.

<sup>25</sup> André Asplund. “Values vs. Interest: Strategic use of Japanese Foreign Aid in Southeast Asia.” EIJS, Stockholm School of Economics Working Paper 241, May 2015: 4.

<sup>26</sup> Ibid.

inexpensive labour costs. Indonesia, Malaysia, the Philippines, and Thailand (ASEAN-4) were the most popular destinations at that time.”<sup>27</sup> Japanese FDI to the ASEAN-4 increased substantially as these networks emerged, growing from roughly \$900 million annually in 1986 to close to \$4.6 billion in 1989, and in the three years between 1988 and 1991, Japanese firms invested over \$15 billion into ASEAN.<sup>28</sup> The growth of FDI from Japan to ASEAN had a profound effect on structuring the regional production networks that would emerge in Southeast Asia.

Supplementing Japan’s FDI and economic engagement in 1980s, Japan’s official developmental assistance (ODA) provided much needed aid and was predominately allocated towards infrastructure projects in Southeast Asia. Japan’s ODA and FDI policies towards Southeast Asia constituted singular approach that provided an economic rationalisation of the assistance programs. In doing so “Japanese aid acted as a prerequisite to future private investments: it came to supplement a national effort, by directly stimulating the development of economic infrastructure and indirectly promoting the inflow of private capital and improving their absorption.”<sup>29</sup> This highlights that there was a private-public partnership between the Japanese government and corporations with regard to ODA policies and FDI in supporting regional development, and in securing natural resources and business opportunities for Japanese businesses. “Since the beginning of the 80’s, Japanese ODA has represented about 20 per cent of investment in electricity production in Indonesia, 22 per cent in Thailand, 50 per cent in Malaysia; 50 per cent of investment in telecommunications in Indonesia and respectively 12 and 15 per cent of investment in railway and motorway in Indonesia, 58 and 6

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<sup>27</sup> Hitoshi Sato. “How can ASEAN and Japan Mutually Benefit from ASEAN Economic Integration?” ILO Asia-Pacific Working Paper Series, October, 2014: 7.

<sup>28</sup> Richard Stubbs, “The Political Economy of the Asia-Pacific Region,” in *Political Economy and the Changing Global Order* ed. Richard Stubbs and Geoffrey R.D. Underhill. (New York: St. Martin’s Press, 1994).

<sup>29</sup> Séverine Blaise. “Japanese Aid as a Prerequisite for FDI: The Case of Southeast Asian Countries.” Australia-Japan Research Centre, ANU College of Asia & The Pacific, Asia Pacific Economic Papers, No.385, 2009: 3.

per cent in Thailand.”<sup>30</sup> Japan from the 1980’s till the 1990’s had been one of the leading ODA donors to Southeast Asian countries, and a key pillar of Japan’s economic diplomacy to ASEAN and its member states.

While the relationship between Japan and ASEAN member states would continue to grow economically, Japan’s relationship with ASEAN as an institution remained underdeveloped until the late 1990s and early 2000s with the onset of the Asian Financial Crisis. This was due to the fact that Japan “did not seek formal regional institutions in East Asia because of its ‘network power’, the influence derived from its extensive network of informal business relationships.”<sup>31</sup> Japan’s strategy towards ASEAN would transform from a reliance on these types of relationships towards engaging in multilateral diplomacy and institution building due to the rise of China, the Sino – Japan rivalry for influence in ASEAN, and the challenge China represented to the existing U.S. dominated international order.

## **6. China – ASEAN Relations**

China – ASEAN relations have evolved rapidly over the past 25 years since China and the organisation established official ties in 1991. Prior to 1991, the relationship had been hindered by the historical legacies of the security challenges that China and communism posed to the ASEAN member states, as the organisation was originally established partly as an anti-communist bloc. Leading up to the establishment of relations, the reform process undertaken in China had laid the foundations for the country’s shift towards a market economy and integration into the world economy.<sup>32</sup> Following the restoration of relations between Indonesia and Singapore with China in 1990, the ASEAN – China relationship was formalised, and by

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<sup>30</sup> Ibid: 11.

<sup>31</sup> Gregory P. Corning. “Between Bilateralism and Regionalism in East Asia: The ASEAN-Japan Comprehensive Economic Partnership.” *The Pacific Review*, Vol. 22, No. 5, December 2009, 642.

<sup>32</sup> Rodolfo Severino, *Southeast Asia in Search of an ASEAN Community: Insights from the former ASEAN Secretary-General*. (Singapore: Institute of Southeast Asian Studies 2006)

1994, China had become a consultative partner of the organisation, and in 1996 became a full dialogue partner.

The China – ASEAN economic relationship began to solidify following the Asian Financial Crisis and China's accession into the WTO. "Relatively unaffected by the 1997 crisis, China was able to continue doing business with Southeast Asian countries badly affected by the crisis. More importantly, it kept its promise not to devalue the Chinese currency. These factors gave ASEAN countries a positive impression of China which stood in stark contrast to the bullying behaviour of the IMF which was widely believed to be a proxy of Washington."<sup>33</sup> Furthermore, China's accession into the WTO in 2001 facilitated the entrance of more MNCs into China and the establishment of production facilities in the country. For ASEAN, this represented a new opportunity to bolster trade relations with China, as the member states could become suppliers in the global production networks emerging on the mainland.<sup>34</sup> It was in this context that Chinese Premier Zhu Rongji proposed setting up an FTA between China and ASEAN in 2000.

## **7. The China – Japan Rivalry for Influence in ASEAN:**

### **Spurring Institutional Development and Facilitating Regional Integration**

Following the devastating impact of the Asian Financial Crisis, ASEAN began to look for new opportunities to not only integrate further into the global economy but also bolster relations with East Asia. In examining the strengthening of Japan's relationship with ASEAN, especially institutionally and economically, Japan's actions can be viewed as reactionary to China's own engagement and initiatives with ASEAN. The Sino – Japan rivalry and competition for regional leadership and influence can be witnessed in the development of the

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<sup>33</sup> Yang Mu and Heng Siam-Heng. "China-ASEAN Relations after CAFTA." In Kwa, Chong Guan and Li Mingjiang ed. "China-ASEAN Sub-regional Cooperation: Progress, Problems and Prospects." World Scientific, 2011, 126-128.

<sup>34</sup> Ibid.

ASEAN+3 grouping, the CMI initiative, the establishment of the ASEAN+3 Macroeconomic Research Office (AMRO), and the proposal for a Japan – ASEAN FTA. While Japan’s approach towards ASEAN and regional integration shifted from bilateral basis to multilateral engagement, China rationale for bolstering its involvement in ASEAN’s regional integration agenda differs significantly. As Japan was already a developed nation, China was in the nascent stages of development and was still an emerging power in the international economy. While Japan sought to ensure that its business, trade relations, and production networks did not fade in ASEAN, China sought to harness regional integration in the region to support its own domestic development, policy goals, and enhanced role in the international arena. This can be witnessed in China’s provincial development approach, “going-out” policy, and development of institutions in ASEAN and Southeast Asia.

In the midst and initial aftermath of the Asian Financial Crisis, ASEAN, China, Japan, and South Korea formed the ASEAN+3 grouping, which brought together the heads of government from each of the states involved. The ASEAN+3 grouping would quickly emerge as the principal forum for economic integration in East Asia. Critically, the ASEAN+3 finance ministers in May 2000 agreed to create the CMI as a response mechanism to the 1997 crisis based upon a network of individually negotiated bilateral currency swap arrangements. Concomitantly, while Japan still in the process of shifting its attention from an exclusive focus on multilateral trade fora in 2000, China announced its intention to begin FTA negotiations of the ASEAN – China FTA (ACFTA). In direct response to China’s action, Japan initiated its own FTA negotiations with ASEAN, the ASEAN – Japan Comprehensive Economic Partnership (AJCEP), in January 2002.<sup>35</sup>

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<sup>35</sup> Gregory P. Corning. “Between Bilateralism and Regionalism in East Asia: The ASEAN-Japan Comprehensive Economic Partnership.” *The Pacific Review*, Vol. 22, No. 5, December 2009.



China's ability to weather the financial crisis, its growing economic power and influence, and shift in policy as evident in the initiation of ACFTA resulted and spurred Japan's shifting policy towards engaging Southeast Asia. From Japan's perspective, it feared that its relationship with ASEAN could diminish in the face of China's enhancing relations with ASEAN especially with the initiation of ACFTA negotiations. Additionally, Japan was concerned over its and the U.S. role in the changing order in the region. As the U.S. was excluded from the ASEAN+3, "the U.S. was worried that China could gain a predominant influence as ASEAN+3 continued to grow, and this was shared by not only Japan, but also by other nations such as Indonesia and Singapore. Singapore, for instance, considered it difficult for any nation including Japan to block China's predominance within ASEAN+3 and it feared China would be a rule-setter as a result."<sup>36</sup> As a response, Japan would not only begin to attempt to bolster its economic engagement with ASEAN, but also expand the membership of ASEAN related fora to stem China's influence in the region.

In the face of these structural changes and challenges, Japan's Prime Minister Junichiro Koizumi called for the establishment of an East Asian community in January 2002 which sought to not only include the ASEAN+3 states but also the inclusion of Australia and New Zealand as core members of the grouping and eventually India as well. This was Japan's attempt to "resist China's growing influence, by involving Australia and India who were seen as nations which shared the same basic democratic values and who were useful counterbalances against China."<sup>37</sup> While the East Asia Community did not lead to the establishment of a formal grouping, Japan's attempts to balance against China's rising clout can be seen in the establishment and membership of the East Asia Summit (EAS). Initial discussions over the formation of the EAS would be divided between two camps, those favouring limited

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<sup>36</sup> Takeshi Terada. "The Origins of ASEAN+6 and Japan's Initiatives: China's Rise and the Agent-Structure Analysis." *The Pacific Review*, Vol.23, No.1, March 2010, 76-77.

<sup>37</sup> *Ibid*, 73.

membership, which included China and Malaysia, and those who favoured expanded membership, which included Japan, Indonesia, and Singapore. Ultimately the expansionist camp prevailed resulting in the inclusion of the ASEAN+3 states, Australia, New Zealand, and India.<sup>38</sup>

The Sino – Japan rivalry for influence in the region would not only help cement ASEAN as the centre for East Asian economic architecture, spur institutional development, and the inclusion of a broader set of member states, but also lead to concrete mechanisms and initiatives. This process can be seen in the evolution of the CMI into the Chiang Mai Initiative Multilateralisation (CMIM) scheme. “Against Japan’s attempts to widen the APT [ASEAN+3] process in terms of membership, Beijing was keen to deepen the grouping, particularly where its growing wealth gave it an advantage, in international finance.”<sup>39</sup> In 2005, the ASEAN+3 states came to an agreement to collapse the bilateral currency swaps into a single pool that any member could draw upon. In setting up the new CMIM, the members agreed that 80 per cent of the funds would come from China, Japan, and South Korea, with the other 20 per cent coming from ASEAN. During the negotiations, the Sino – Japan rivalry would benefit the development of the CMIM as both states competed for leadership in the scheme. As Japan and China vied for influence, both states were unwilling to seed ground to another resulting in tensions over which state would provide the largest financial contribution to the scheme, as this would be reflected in the voting weight. This stalemate would last for over a year. In March 2010, a compromise was reached where both Japan and China would each contribute 32 per cent or \$38.4 billion to the CMIM.<sup>40</sup>

This same tension was witnessed in the establishment of AMRO where China and Japan duelled over who would become the director of the monitoring research institute. “A

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<sup>38</sup> Ibid.

<sup>39</sup> Chien-Peng Chung. “China and Japan in “ASEAN Plus” Multilateral Arrangements: Raining on the Other Guy’s Parade.” Asian Survey, Vol.53, No.5, 808. **YEAR**

<sup>40</sup> Ibid.

compromise was reached in April 2011 whereby the Chinese candidate, Wen Benhua, a senior PRC official who had served in the People's Bank of China, the Asian Development Bank, and the IMF, would hold the post for the first year. The Japanese candidate, Nemoto Yoichi, a counsellor at Japan's Ministry of Finance, would serve for the remaining two years of the term."<sup>41</sup> As seen in the development of the CMIM and AMRO, the Sino – Japanese rivalry instead of having a detrimental effect on the region and integration actually benefitted ASEAN by spurring institutional development and mechanisms to facilitate regional integration.

## **8. Regional Integration ASEAN :**

### **Japan and China's Similarities and Differing Approaches**

As ASEAN progresses down the road of enhancing regional integration and implementing the newly proposed AEC 2025 and MPAC 2025, the challenges the organisation faces are substantial and require the support of both China and Japan. With the AEC entering into force in 2016, cooperation and coordination between ASEAN, China, and Japan in implementing initiatives becomes all the more vital. While both states have played critical role in supporting ASEAN's agenda, the similarities and differences in approaches and cooperation have raised concerns in ASEAN, especially in light of the simmering tensions in the region.

Since the early 2000s, both China and Japan have bolstered their relationship with ASEAN and its member states through deepening cooperation and institutional linkages. As highlighted previously, Japan's approach transitioned from a reliance on bilateral business networks to a strategy founded upon a multilateral diplomacy and institutional development in response to China's rise, contestation for influence in the region, and the implications of China's ascendance to the international and regional order. In supporting the AEC, the Asian

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<sup>41</sup> Ibid, 809-810.

Development Bank (ADB), which Japan and the U.S. are leading share holders, has had a significant role in developing, researching, and financing integration initiatives. In order to strengthen Japan and ADB's support for the initiatives, Japanese Prime Minister Shinzo Abe in 2015 announced that Japan and the ADB would be providing U.S.\$110 billion in infrastructure funding over the next five years.<sup>42</sup> This is part of Japan's new development program, "The Partnership of Quality Infrastructure," and is seen as a direct response to China's newly established Asian Infrastructure Investment Bank (AIIB). The new development partnership for infrastructure has four key pillars; first, "expansion and acceleration of assistance through the full mobilisation of Japan's economic cooperation tools, such as official development assistance and the Japan International Cooperation Agency (JICA); [second], collaboration between Japan and the Asian Development Bank (ADB); [third], measures to double the supply of funding for projects with relatively high risk profiles by such means as the enhancement of the function of the Japan Bank of International Cooperation; and [fourth], promoting "Quality Infrastructure Investment" as an international standard."<sup>43</sup> The program proposes to increase Japanese ODA loans for Asian infrastructure by 25 per cent, expand ADB lending capacity by 50 per cent and expand its lending portfolio to the private sector, establish a new collaboration mechanism between JICA and the ADB to facilitate the use of public-private-partnerships (PPP), and empower Japan Bank for International Cooperation (JBIC) to provide funding for infrastructure that have relatively higher risk profiles. Additionally, in order to mitigate the development gap between ASEAN's developed and developing members, Japan is the largest contributor to ASEAN's Initiative for ASEAN Integration (IAI), which seeks to narrow the development gap between the more developed and developing member states.

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<sup>42</sup> Sanchita Basu Das. "ASEAN's Regional Integration will be Determined by Better Connectivity in the Future." ISEAS Perspective, 31 May 2016.

<sup>43</sup> Kei Koga. "Japan's "Strategic Coordination" in 2015 ASEAN, Southeast Asia, and Abe's Diplomatic Agenda." Southeast Asian Affairs, 2016: 67-79.

As part of the Japan – ASEAN Plan of Action 2011-2015, Japan has been providing technical support for the ASEAN Secretariat and member states through institutions linkages; the four key Japanese institutions involved are the JICA, the Association for Overseas Technical Scholarship (ATOS), the Japan Overseas Development Corporation (JODC), and JBIC.<sup>44</sup> As highlighted as part of the Partnership for Quality Infrastructure, the Japanese parliament in May 2016 approved a change to JBIC’s charter, which allows the bank to make riskier infrastructure investments through a new special account. “Under the revised charter, JBIC may finance infrastructure projects that benefit a country’s economy and will generate revenue but do not independently meet the bank’s strict credit requirements for commercial viability and cash flow.”<sup>45</sup> Japan and ASEAN have also continued to bolster business ties and interaction through regularly held summits and conferences between ASEAN and Japan’s Nippon Keidanren and Federation of Japanese Chambers of Commerce Industry in ASEAN. This has led to the improvement of business ties and assistance in developing human resources in the region.<sup>46</sup> In focusing on the national level, Japan has also strengthened its bilateral engagement with ASEAN members. For example, Japan and the Philippines signed a U.S.\$2 billion loan agreement for the development of a rail project, which is Japan’s largest assistance package ever provided, and Japan’s Mitsui & Co. is engaged in helping expand Jakarta’s main port.<sup>47</sup> While Japan has strengthened its existing institutional relationship with ASEAN through the ADB and other Japanese organisations reflecting its support for the existing institutions, China has developed new institutions and strategies to support regional integration.

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<sup>44</sup> Siew Yean Tham and Fukunari Kimura. “ASEAN-Japan Strategic Partnership in Southeast Asia: Economic Pillar,” in Rizal Sukma and Yoshihide Soeya ed. *Beyond 2015: ASEAN-Japan Strategic Partnership for Democracy, Peace, and Prosperity in Southeast Asia*, Japan Center for International Exchange, November 2013.

<sup>45</sup> Financial Times. “Japan Inc to raise investment in ASEAN infrastructure.” Financial Times, May 20<sup>th</sup>, 2016.

<sup>46</sup> Keidanren, “Stronger Ties with ASEAN States: A Message to the ASEAN-Japan Commemorative Summit Meeting.” December 11, 2013. <http://www.keidanren.or.jp/en/policy/2013/109.html?v=s>

<sup>47</sup> Sanchita Basu Das. “ASEAN’s Regional Integration will be Determined by Better Connectivity in the Future.” ISEAS Perspective, 31 May 2016.

In contrast, China's approach to regional integration differs from both Japan and ASEAN. China's strategy towards Southeast Asia reflects its rise economically and new status on the international stage. While ASEAN's open regionalism and Japan's multilateral diplomacy has focused on developing existing institutions, China's approach seeks to advance a 'hub-and-spokes' regional integration model with Beijing as the hub and other countries as the periphery. This evolving model has three aspects; first, reciprocity in bilateral relations, "if others respect China, China will reciprocate with material benefits; but if others do not offer proper respect, China will find ways to punish them."<sup>48</sup> The second aspect is China's preparedness to utilise force to protect its core interests, which includes its territorial claims and sovereignty. The third aspect is China's aversion to turning to international tribunals to resolve sovereignty disputes.<sup>49</sup> While recent China – ASEAN relations have been contentious due to the South China Sea dispute; China has invested considerable effort, political will, and capital towards supporting ASEAN regional integration project.

As a result of China's disaffection with the existing international financial institutions and the Bretton Woods System, and as a means to address the need for infrastructure funding in Asia, in early 2013 China's finance ministry proposed the idea of developing the AIIB as an alternative multilateral development bank. In June 2015, the AIIB's Articles of Agreement were signed by 57 countries in Beijing and outlined the role of the bank in focusing on infrastructure and physical connectivity in order to facilitate regional integration. The AIIB will have a capital base of \$100 billion with China holding the largest voting percentage.<sup>50</sup> The establishment of the AIIB signifies China's attempt to shift international financial institutions

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<sup>48</sup> David Arase. "China's Two Silk Roads: Implications for Southeast Asia." ISEAS Perspectives 2015, No.2, 22 January, 2015, 2.

<sup>49</sup> Ibid.

<sup>50</sup> Zhao Hong. "AIIB Portents Significant Impact on Global Financial Governance." ISEAS Perspective 2016, No. 41, July 15, 2016.

and multilateral development banks' development framework embodied by the Washington consensus, which some see as a "North-South" orientation, to a South-South relationship.<sup>51</sup>

In 2013, China's President Xi Jinping unveiled China's new national strategy of developing a 21<sup>st</sup> century Maritime Silk Road and New Silk Road Economic Belt, which are collectively known as One Belt One Road (OBOR), and it's a key part of the country's "going-out" strategy<sup>52</sup>. The "overarching strategy is reflected in Vision and Actions, which sets out a vision in which China- led infrastructure construction, reduced tariffs, and simplified customs administration would allow trade to flow seamlessly between China and countries along OBOR by both rail and ship."<sup>53</sup> OBOR seeks to connect China to South, Southeast, East, and Central Asia, and Europe. In regards to infrastructure, OBOR seeks to develop two types, hard and soft infrastructure. The hard infrastructure includes the resources, such as steel and concrete, that will go into constructing ports, railways, aviation facilities, industrial parks, and special trade zones. The soft infrastructure encompasses the international financial institutions, cooperation forums, tourism and cultural exchanges, and trade and investment agreements.<sup>54</sup>

Integrating ASEAN's own MPAC, China through its OBOR plans is seeking to develop its own less developed western provinces through integration with ASEAN. There is discussion to develop a high-speed railway from Guangxi that will travel along Vietnam's coast and all the way down to Singapore. China hopes to develop Guangxi into a gateway into ASEAN. Another key gateway province to ASEAN that China is developing is Yunnan and the province's capitol, Kunming. Two key projects in MPAC and in China's own strategy are the Singapore – Kunming Railway Line (SKRL) and Asian highway network, which will establish

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<sup>51</sup> Ibid.

<sup>52</sup> China's 'going-out' strategy seeks to promote the global operations of Chinese firms with the goal of improving resource allocation and competitiveness.

<sup>53</sup> Zhao Hong. "China's One Belt One Road: An Overview Of The Debate." ISEAS Trends in Southeast Asia 2016, No.6, 2

<sup>54</sup> David Arase. "China's Two Silk Roads: Implications for Southeast Asia." ISEAS Perspectives 2015, No.2, 22 January, 2015.

Kunming as the land transportation hub.<sup>55</sup> With developing both hard and soft infrastructure, China hopes to further attract and integrate ASEAN into its production networks, provincial economies, and strategies.

## **9. Conclusion: Pushing Cooperation Going Forward**

As the AEC proceeds into its second year with concerns mounting, it's an imperative that ASEAN push and facilitate cooperation between its external partners, especially China and Japan. Even though Japan and China have differing interests in bolstering ties and participating in the development of the AEC and implementation of the MPAC, there is significant room for both countries to cooperate. There are early indications of this occurring, especially in regards to infrastructure financing and development. In 2016, the AIIB has begun signing framework agreements and memorandums of understanding with both the World Bank and ADB, respectively. The President of the AIIB, Jin Liqun, and World Bank President, Jim Yong Kim, signed a co-financing framework agreement in April 2016, and have now initiated discussions on the possibility of co-financing 12 infrastructure projects in Asia, and the presidents of the AIIB and ADB signed a cooperation memorandum on strengthening cooperation in international development. Additionally, the AIIB's board approved a \$509 million in investments for its first four projects, which three are being co-financed with the World Bank, the ADB, and other multilateral development banks and financial institutions. While these projects are taking place outside of Southeast Asia and ASEAN plans, the early indications are bright that ASEAN will be able to facilitate cooperation in financing its own infrastructure projects and integration agenda.<sup>56</sup>

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<sup>55</sup> Ibid.

<sup>56</sup> Zhao Hong. "AIIB Portents Significant Impact on Global Financial Governance." ISEAS Perspective 2016, No. 41, July 15, 2016. It should be emphasised that the ADB has said that there will be no co-financing with the AIIB unless ADB safeguard policies are implemented.



Through examining ASEAN institutional development, the Sino-Japanese rivalry and quest for regional influence instead of being detrimental to ASEAN's institutional development was actually a catalyst for its institutional upgrading and expansion. This could be seen in the initiation of both the China and Japan FTAs with ASEAN, the competition for influence in the ASEAN+3 and CMIM institutions, and now is witnessed in competition over infrastructure projects in Southeast Asia. China's OBOR initiative and component Maritime Silk Road, AIIB, and Japan's Partnership for Quality Infrastructure and JBIC's revised charter highlight how this competition continues to benefit ASEAN and its member states. While issues such as the South China Sea and tensions between China and Japan continue to pose challenges for ASEAN, the competitive rivalry continues to advance regional integration and infrastructure development in the region.

In charting a way forward, one of the recommendations to bolster ASEAN integration and China's involvement is to synergise China's OBOR initiative with ASEAN's AEC and MPAC plans to facilitate efficiency and effective implementation of the differing plans. One way to help strengthen coordination and implementation of the plans would be to upgrade the policy coordination between China and the individual ASEAN countries. We have already begun to see this style of collaboration in the construction of the Sino-Laos and Sino-Thai railway projects, and industrial parks that have been jointly developed between China and Malaysia, China and Thailand, and China and Cambodia. By forming this type of collaboration, China and the individual ASEAN states can further align both regional and national development projects.<sup>57</sup> In addition, China should continue to utilise and strengthen existing institutions and mechanisms between ASEAN and China, such as the Greater Mekong Subregion (GMS) Economic Cooperation, which further links China and the mainland Southeast Asian states. In

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<sup>57</sup> Zhao Hong. "Can China's OBOR Initiative Synergize with AEC Blueprint 2025?" ISEAS Perspective, No.62, November 16, 2016.

bolstering the GMS grouping, Chinese Premier Li Keqiang in December 2014 pledged USD \$3 billion to the GMS in order to finance infrastructure connectivity and other initiatives.<sup>58</sup>

In seeking to further the Japan – ASEAN relationship, Japan has already begun taking the necessary policy steps to enhance the relationship. Specifically, Prime Minister Abe’s Japan – ASEAN Economic Cooperation Roadmap 2012-2022 and Partnership for Quality Infrastructure will further facilitate goods and services trade, and the initiation and implementation of infrastructure project, respectively. The Partnership for Quality Infrastructure has already begun to take shape through several new projects. These include Japan’s interest in the Kuala Lumpur – Singapore railway and the utilisation of the Japanese Shinkansen system, providing USD \$2 billion loan to the Philippines for the construction of the “North-South Commuter Railway Project,” and providing USD \$1.3 billion in loans to Vietnam for three infrastructure projects.<sup>59</sup>

Supplementing the infrastructure partnership, Japan has also provided significant ODA to ASEAN member states that seek to address soft infrastructure and social goods. For example, Japan has provided two loans of USD \$9 million and USD \$82 million to Laos for two projects, the Project for Acceleration of UXO Clearance for Rural Development and Poverty Eradication, and the Economic and Social Development Programme, respectively. Additionally, Japan has established a new ODA deal with Cambodia for the development and improvement of Cambodia’s National Road No. 5.<sup>60</sup> One recommendation to supplement and compliment Japan’s existing initiatives towards ASEAN would be to strengthen JICA’s PPP assistance and promotion activities. As Southeast Asia still requires tremendous infrastructure funding, developing long-term plans to suit these needs has been a challenge. JICA and Japanese

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<sup>58</sup> David Arase. “China’s Two Silk Roads: Implications for Southeast Asia.” ISEAS Perspectives 2015, No.2, 22 January, 2015.

<sup>59</sup> Kei Koga. “Japan’s “Strategic Coordination” in 2015 ASEAN, Southeast Asia, and Abe’s Diplomatic Agenda.” Southeast Asian Affairs, 2016: 67-79.

<sup>60</sup> Ibid.

businesses can help mitigate these issues through working with respective local governments to assist in developing sustainable project models, and in securing public and private financing.

While the relationship between China and Japan may be tense in regards to political and security affairs, one area that both countries and ASEAN can cooperate on is towards the successful conclusion of the RCEP trade negotiations. With the demise of the Trans-Pacific Partnership (TPP) negotiations, which included Japan, Malaysia, Brunei, Singapore, and Vietnam, it is all the more necessary for the RCEP members to conclude the negotiations. The RCEP agreement not only coalesces the ASEAN+1 FTA partners into a single agreement but also replaces nine economic partnership agreements and FTAs between the negotiating countries. This will help address the “noodle-bowl” issue of overlapping FTAs, which has caused confusion because of the differing rules stipulated in each agreement, by consolidating the agreements into a single FTA. In establishing the FTA, it would facilitate and accelerate the development of regional supply chains and boost the flow of trade and investment.<sup>61</sup>

While concerns mount as both the AEC and MPAC continue to be implemented, albeit with challenges remaining, the supporting role of both Japan and China cannot be underemphasised. Both states have played a pivotal role in advancing and supporting ASEAN’s institutional development, regional integration, and infrastructure. Even though the strained relationship has created political and security uncertainties, China and Japan are actively enhancing their relationship with ASEAN and its member states through numerous economic, developmental, and infrastructure initiatives. It is essential that ASEAN further strengthen these relationships and cooperation mechanisms in order to address the infrastructure deficit in the region and enhance its integration into the global economy.

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<sup>61</sup> Versetti, Angel, and Adam Heal. “Japan-ASEAN Economic Partnership: Prospects for 2015 and Beyond.” United Nations Economic and Social Commission for Asia and the Pacific, Trade Insights, Issue No.5, February, 2015.