

Chapter Eleven

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Japan and the Asia-Pacific

Executive Summary

- Economically, Japan benefits from regional growth, but domestic challenges cause its economy to struggle against other rapidly growing countries. Particularly problematic are Japan's high yen, increasing resource scarcity, demographic change and government debt.
- Regional militaries are rapidly changing, bringing with them security challenges for Japan. Particularly challenging are the growth and modernization of China's military, North Korea's nuclear weapons and missile programs, and increasing Russian activity in the Far East.
- Japan is prioritizing a mix of methods to minimize these challenges. Economically, the mix includes increasing taxes, creating trade agreements, and engaging in multilateral trade forums. In the security realm, it includes developing dynamic defense forces, continued reliance on the U.S.-Japan alliance, strengthening other bilateral relationships, and participating in multinational efforts.
- Japan is a committed member of APEC and has consistently provided funds for APEC projects. However, because APEC did not meet Tokyo's expectations in terms of trade liberalization, Japan has put greater emphasis on other economic partnership agreements. Japan continues to place a priority on APEC as a means to consult major regional players and promote open regional economic cooperation.

Introduction

Japan remains focused on reconstruction from the March 11, 2011 Great East Japan Earthquake, which killed or left missing about 20,000 people. However, it must do so at the same time the Asia-Pacific region is undergoing profound changes that pose economic and security challenges to Japan.

Economically, Japan benefits from regional growth, but domestic challenges mean that its economy continues to struggle vis-à-vis other rapidly growing countries, such as India and China. While Japan's per capita GDP still ranks far above other economies and remains the second largest contributor to organizations like the IMF, World Bank, and UN, in 2011 Japan suffered its first trade deficit since 1980. Two factors contributed to this: a high yen and increasing resource scarcity. These will continue to challenge Japan in addition to demographic change and government debt.

Similarly, regional militaries are rapidly changing. While Japan maintains one of the most modern militaries in Asia, regional changes bring with them security challenges. Specifically, Japan is challenged by the growth and modernization of China's military, North Korea's nuclear weapons and missile programs, and increasing Russian activity in the Far East.

While the challenges are numerous, Japan is prioritizing a mix of methods to minimize their impact. Economically, this includes increasing taxes, moving forward on trade agreements, and engaging in multilateral trade forums. In the security realm, it includes developing Dynamic Defense Forces, continuing reliance on the US-Japan alliance, strengthening bilateral relationships with key regional states, and participating in multinational efforts. While there is no guarantee it will be successful in tackling all of the challenges, Japan will undoubtedly continue to make active efforts to minimize their effects.

Economic Challenges

Yen

Despite the devastating March 2011 disasters, Japan's yen appreciated, peaking at a postwar high on October 31 at 75.32 yen to the US dollar. Economists believe the primary driver was the ongoing financial uncertainty stemming from the European sovereign debt crisis and continuing financial problems in the U.S. Both problems sent traders to the yen, considered a safe haven currency.

The yen's rise had a deleterious effect on Japanese exports. Concerned voices in Japan have begun to worry reduced profits could motivate firms to move production overseas, thereby hollowing out Japan's manufacturing sector. Other worries include the loss of jobs and the shuttering of small- and mid-size companies. It is precisely because of these fears that the Bank of Japan conducted multiple interventions in the exchange rate market in 2011. While the interventions had little effect, the worst appears over as the fiscal situations in Europe and the United States are improving. As long as this trend continues, the yen will continue to weaken.

Resources

As a direct result of the ongoing problems at the Fukushima nuclear power plant, the Japanese government has been shutting down nuclear plants nationwide when they go offline for regularly scheduled maintenance. Currently (May 2012), none of Japan's fifty-four reactors are in use and there is no clear plan as to when (or if) any will be restarted.

Because of the reduced nuclear power, which makes up one-third of Japan's energy mix, the country has turned to increased oil imports and alternative energy. Specifically, Japan increased its reliance on liquefied natural gas (LNG). LNG imports in 2011 marked a record high of 78.53 million tons, up 12 percent from the preceding year.¹ This figure is likely to increase because, while

¹ "Japan 2011 LNG Imports Hit 78.5 Million Tonnes," LNG World News, January 25, 2012. Accessed April 17, 2012. Available at: <http://www.lngworldnews.com/japan-2011-lng-imports-hit-785-million-tonnes>.

Japan continues to rely heavily on oil, it has been forced to reduce imports from Iran due to US pressure. With crude oil prices expected to rise as tensions over Iran continue, this will further push Japan toward LNG imports.

Demographics

Japan's toughest long-term challenge is its demographics. The population is rapidly shrinking. According to a January 2012 report by the National Institute of Population and Social Security Research, Japan's current population of 128 million will fall to 86 million by 2060.² This is because of falling fertility rates (the expected number of children born per woman over her lifetime). In 2010, it stood at 1.39 and will fall to 1.35 in 2060 (both figures are well below the population-maintenance level of 2.1). Moreover, Japan's population is rapidly aging. Today, the average life span is 79.64 for men and 86.39 for women. By 2060, both will increase to 83.67 and 90.34, respectively.

As countries age and produce fewer births, their population composition changes. Today, 63.8 percent of Japan's population is of working age (fifteen to sixty-four years old). By 2060, it will shrink to 50.9 percent. As the population shrinks, the percentage of elderly will grow from today's 23 percent to 39.9 percent, resulting in a shrinking working-age population with increasing financial burdens (i.e. social security, child rearing). With fewer workers responsible for more costs, the economy will shrink, as there will be fewer liquid assets among consumers.

Debt

A similarly difficult challenge is Japan's debt. The CIA World Factbook estimates that Japan's debt-to-GDP ratio in 2011 stood at 208.2 percent. This is the highest among all industrialized countries and second only to Zimbabwe's 230.8 percent. While many

² "Nihon no Shourai Suikei Jinkou (Japan's Future Estimated Population)" (National Institute of Population and Social Security Research, January 2012), available at: <http://www.mhlw.go.jp/stf/shingi/2r98520000021dhc-att/2r98520000021dit.pdf>.

economists do not worry because the debt is primarily held by Japanese, it does constrain Tokyo's monetary policies, especially its reconstruction efforts. At some point, Japan will have to curtail spending or raise taxes, which could carry negative impacts on growth. Worse, if Japan's current account balance falls into a deficit, it will be difficult for the government to redeem the bonds.

Security Challenges

China

It is undeniable that Chinese economic influence has grown. Japan welcomes a prosperous China, evident by their close trade relations. Despite this, China remains Japan's top security challenge. Japan is concerned with how China's economic growth has led to growing defense expenditures (which have grown about eighteen-fold over the past twenty years), promoting the expansion and rapid modernization of its military. This includes the modernization of its nuclear and missile forces, including anti-access, area-denial capabilities, the refurbishing of a Ukrainian aircraft carrier, the construction of new submarines and surface combatant ships with improved air defense and anti-ship missile capabilities, and the development of a fifth-generation stealth fighter. Because the motives and objectives of China's militarization program remain unclear, Japan continues to push for more transparency regarding procurement goals, locations of major units, and detailed breakdowns of the defense budget.

Tokyo's concern is reinforced by increasingly assertive Chinese behavior in waters and airspace close to Japan and within its Exclusive Economic Zone. This activity, thought to be training drills or intelligence-gathering activities, includes People's Liberation Army Navy (PLAN) vessels and aircraft, patrol ships and aircraft from the State Oceanic Administration or Fisheries Bureau of the Ministry of Agriculture, and private fishing trawlers. While the September 2010 incident of a Chinese trawler ramming two Japanese Coast Guard vessels is best known, incidents also

include submerged submarines navigating into Japanese waters, aircraft buzzing Japan's Self-Defense Force (SDF) vessels and aircraft, aircraft approaching Japan's air defense identification zone or crossing the Japan-China median line, and PLAN vessels passing through Japanese waters on their way to the Pacific Ocean, like the October 2008 passage through the Tsugaru Strait and numerous passages between Okinawa and Miyako Island. As long as China resists transparency and continues this assertive behavior, it will remain Japan's top security challenge.

Korean Peninsula

Japan believes that peace and stability on the Korean Peninsula are important for Japan and the region. Japan is concerned with North Korean behavior, which not only increases tension on the peninsula, but potentially destabilizes the region. Specifically, this refers to the development of nuclear weapons and the development, deployment, and proliferation of ballistic missiles. Given that North Korea has tested nuclear weapons twice, Japan is concerned its work to improve its ballistic missile capabilities could enable the missiles to serve as delivery vehicles for these weapons. This is particularly disconcerting for Japan because North Korea has a record of firing missiles over the country, putting all of Japan within range. This includes the most recent long-range rocket test in April 2012. Although the rocket failed, Japan went on high-alert, preparing for the launch by deploying Aegis ships equipped with sea-to-air Standard Missile-3 interceptors to the Sea of Japan to track the launch and Patriot Advanced Capability-3 missile batteries to its southwestern islands.

Moreover, North Korea appears willing to engage in provocative behavior. This is evident by its proliferation of ballistic missiles or related technologies as well as its activity on the Korean Peninsula, including the sinking of South Korea's Cheonan in March 2010 and the shelling of Yeonpyeong Island in November 2010. Tokyo continues to worry about North Korean behavior that may indirectly affect Japan's security (i.e. war on the Peninsula, regime

collapse) or directly impact Japan (i.e. missile launches, abducting citizens, spy ships). These concerns were particularly piqued after Kim Jong-Il died. Although the transition to Kim Jong-Un appears to have gone smoothly, Tokyo remains vigilant of the North Korean challenge.

Russia

Like China, Russia is modernizing its military. Of particular interest is Russia's move to accelerate the development and introduction of new nuclear weapons, such as the Topol-M and RS-24 ICBMs. Additionally, Japan is closely watching Russia's development, procurement, and deployment of new equipment, such as its fifth-generation stealth fighter, which had its first flight in January 2010.

Moscow continues to have a considerable scale of military forces (including nuclear) in the Far East, albeit smaller than during the Soviet era. Increasing activity of these forces, including drills and exercises, concern Tokyo. Of particular concern is an increase in large-scale exercises, such as Vostok 2010, that are aimed at verifying an ability to rapidly deploy forces to the Far East far from where they are stationed. Additionally, Tokyo is concerned by an increase in Russian military vessels and aircraft operating in the vicinity of Japan, such as the Russian bomber that circled the Japanese archipelago for more than fourteen hours in September 2011.

A bilateral territorial dispute continues to constrain advances in relations. President Dmitry Medvedev's visit to Kunashiri Island (one of four islands in dispute) in November 2010 did not help, as he was the first head of state ever to visit. He was followed by cabinet ministers and commitments to strengthen the defense of these islands. All these moves angered Tokyo, which sees the territory as an integral part of Japan. While there are moves to prioritize common economic interests over the territorial dispute, Tokyo will remain vigilant of Moscow's military activity in its Far East.

Economic Priorities

Consumption Tax

Given the pressures the demographic changes and rising debt are having on Japanese monetary policies, Prime Minister Yoshihiko Noda is prioritizing raising the consumption tax from its current 5 percent to 8 percent in April 2014 and 10 percent in October 2015.³ If successful, the increase will help address Japan's rising debt, as well as the increased social security costs that will come with an aging society and declining population. Noda's success is uncertain though, as his plan is causing significant strain within his party.

Bilateral Agreements

Because the high yen hinders export-led growth, Japan is prioritizing Economic Partnership Agreements (EPA). In August 2011, a comprehensive EPA went into effect with India, removing duties on 94 percent of products over the next 10 years and ensuring greater access for goods, services, and investments in each other's markets. There are currently moves to advance EPA negotiations with South Korea and Australia and to initiate negotiations with the EU and trilateral negotiations with China and South Korea. The purpose of these moves is to expand markets for Japanese business.

Because of reduced nuclear energy, Japan's relations with Russia have turned to focus on economic interests. After the March disasters, Russia promised to divert 6,000 MW of electricity from its Far East and send 200,000 tons of LNG.⁴ Similarly, Japan's Parliament ratified an agreement on nuclear-energy cooperation that makes it possible for the two to trade nuclear energy-related technologies and uranium. This prioritization of economic issues holds a pro-

³ "Shakai Hoshou to Zei no Ittai Kaikaku no Kanren Houan wo Kakugi Kettei (Cabinet Decision on Legislation Related to Integrated Reform of Social Security and Taxes)," (Democratic Party of Japan, March 30, 2012), available at: <http://www.dpj.or.jp>.

⁴ Zoe Murphy, "Japan Earthquake: Living with Blackouts" (BBC, March 15, 2011), available at: <http://www.bbc.co.uk/news/world-asia-pacific-12731696>.

mising future because Japan ranks first globally as a natural gas and coal importer while Russia ranks third globally as a coal exporter and first as a natural gas exporter.⁵

Multilateral Forums

Japan, along with Australia, is responsible for the creation of the Asia-Pacific Economic Cooperation (APEC) in the late 1980s. Since its inception, Japan has remained a committed member, including the provision of funds for conducting APEC projects. However, because APEC did not become the means for trade liberalization, Japan has put greater emphasis on bilateral EPAs and, most recently, the multilateral Trans-Pacific Partnership (TPP). That said, Japan hosted the 2010 APEC meeting in Yokohama and continues to place a priority on APEC as a means to consult major regional players and promote open regional economic cooperation in various fields with a growing number of economic partners.

Under its June 2010 economic growth strategy, Tokyo wants to double the flow of people, goods, and money by 2020. Its December 2011 “Strategy for Japan’s Rebirth” calls for increasing exports of agricultural, forestry, and fisheries products and food items to the 1 trillion yen level by 2020. With these goals in mind, Japan has prioritized joining the TPP which the Cabinet Office estimates will boost Japan’s real GDP by 2.5 to 3.2 trillion yen by 2018. Additionally, the TPP enables Japan to participate in rule-making to strengthen the regional-trading architecture. As with Noda’s push to raise the consumption tax, many members of his party oppose this action. While Noda remains committed, it is uncertain whether he will be successful.

⁵ International Energy Agency, *Key World Energy Statistics* (2011), 13, available at: www.ica.org.

Security Priorities

Dynamic Defense

One of the biggest changes in Japan's security priorities came in the December 2010 National Defense Program Guidelines. Given the diverse challenges Japan faces, officials developed the concept of Dynamic Defense Forces. Different from the Basic Defense Force concept that emphasized deterrence through the existence of defense forces, Dynamic Defense relies on developing and utilizing advanced technology and intelligence capacities that can be used as active resources to carry out various roles. These forces are characterized by readiness, mobility, flexibility, sustainability, and versatility.

This has meant changes to the SDF posture. Japan is focusing on reducing Cold War era equipment and organization and revising the geographical alignment and operation of units away from the ground units in the north (where a Soviet invasion was expected) to the maritime and air units in the southwest (where China is the concern). Much priority has been on developing and strengthening the functions of warning and surveillance, maritime patrol, air defense, ballistic missile response, transport, and command communications, which will also aid in detecting activities of North Korea and Russia.

U.S.-Japan Alliance

SDF capabilities are primarily a deterrent force that supplements US forces. As such, the health of the alliance remains Japan's top priority, as it is the primary means by which to ensure regional peace and stability as well as ensure it is not alone in dealing with its security challenges. When the current government came to power in 2009, promises to relocate US forces outside of Okinawa prefecture led to a tumultuous time in alliance relations. However, after a change in prime ministers and both countries working together in the aftermath of the March disasters, political relations improved (although the Okinawa issue remains unresolved). This

was evident at the June 2011 Foreign and Defense Ministers meeting (called a 2+2 Meeting), in which they agreed on a number of areas to deepen and broaden the alliance.

Militarily, relations remain close, continuing an upward trend of close cooperation and increasing interoperability gained through joint exercises and training. The fruits of their labor were evident during *Operation Tomodachi*, the joint effort of response to the March 2011 disasters. Japan continues to prioritize work to enhance and expand its cooperation in a number of areas, such as warning and surveillance, trilateral cooperation with Korea and Australia, and humanitarian assistance and disaster relief. Japan's prioritization of the alliance will continue.

Bilateral Relationships

Given Japan's security challenges, primarily from China, it is prioritizing the development of new security relationships with key regional partners. The biggest changes have come with Japan's relations with Australia and India. Japan signed Joint Declarations on Security Cooperation with both states that set the groundwork for greater exchanges of military personnel, policy coordination, joint exercises and training, and 2+2 meetings. The partnership with Australia has arguably gone the farthest: the two countries signed an Acquisition and Cross Servicing Agreement in 2010 and are negotiating an Information Sharing Agreement. The partnership with India has also deepened, albeit via different means. Japan provides billions of dollars in Official Development Assistance for Indian infrastructure upgrades, such as the \$90 billion Delhi-Mumbai Industrial Corridor, and signed the comprehensive EPA referred to above.⁶ This year, the two will begin bilateral naval exercises.

Japan is also prioritizing new partnerships with key Southeast Asian countries. It upgraded relations with Vietnam and the Philippines to Strategic Partnerships, complete with more frequent

⁶ For Japan's involvement in the Delhi-Mumbai Industrial Corridor project, see "Financial Analysis of DMIC Project," Delhi Mumbai Industrial Corridor, available at: <http://delhimumbaiindustrialcorridor.com/financial-analysis-of-dmic-project.php>.

summits and annual ministerial exchanges, and exchanges between their militaries and coast guards. They also agreed on shared strategic interests, such as freedom of navigation and resolving the South China Sea dispute in accordance with international law. With Singapore and Indonesia, Japan has built relationships focused on similar shared interests but, so far, these relationships are limited to increased bilateral discussions.

Multilateral Cooperation

Because military cooperation is not the only means by which to address security challenges, Japan maintains a high priority on multilateral cooperation. This includes dialogue and confidence-building measures, efforts to develop and enhance regional order and common norms, and multilateral security operations.

While Japan remains committed to the United Nations, it also remains active in regional multilateral forums. In addition to the ASEAN Regional Forum, it participates in the Shangri La Dialogue and welcomed the First ASEAN Ministers' Meeting-Plus (ADMM Plus), a government-hosted, multinational meeting of regional defense ministers started in October 2010. Japan hopes this latter meeting will promote the development and enhancement of regional security cooperation. Specifically related to the North Korean challenge, Japan remains committed to the Six Party Talks, in which it has an important role to play via its economic power.

Japan is also working to develop and/or enhance regional order and common norms. We see this most clearly in numerous 2011 agreements in which Japan stipulated the necessity of freedom of navigation and the peaceful resolution of the South China Sea dispute in accordance with universally accepted international law, such as the UN Convention on the Law of the Sea. It also made an effort to include this issue in the final statement produced at the November 2011 East Asian Summit, although it was not successful.

Finally, Japan remains committed to multilateral security operations to ensure regional stability. This is evident by SDF partici-

pation in Humanitarian Assistance/Disaster Relief operations in Indonesia following the 2004 tsunami and in Pakistan following the 2005 earthquake and 2010 floods. Additionally, since 2009, the SDF has been involved in anti-piracy operations off the coast of Somalia, which has important sea lanes for Asia. It is also a charter member of the Proliferation Security Initiative, making Japan an active partner in preventing the illegal movement of WMDs or related technologies.

Conclusion

Given the rapid changes underway in the Asia-Pacific, Japan is not alone in having to confront a new set of economic and security challenges. Its challenges are nevertheless complex. Economically, this includes a high yen, increasing resource scarcity, rapid demographic change, and rising government debt. In terms of security, Japan is challenged by the growth and modernization of China's military, North Korea's nuclear weapons and missile programs, and increasing Russian activity in the Far East. Tokyo is prioritizing a diverse set of policies to minimize their impacts. Economic policies include increasing taxes, creating trade agreements, and engaging in multilateral trade forums. In the security realm, its policies include developing Dynamic Defense Forces, continued reliance on the U.S.-Japan alliance, strengthening other bilateral relationships, and participating in multinational efforts. While there is no guarantee these policies will be successful in overcoming all of Japan's challenges, the policies will nevertheless remain at the forefront of Tokyo's regional engagement for the near future.