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Catching Up or Staying Ahead

Japanese Investment in the Mekong Region and the China Factor

Françoise NICOLAS

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Executive Summary

As the most advanced economy in East Asia, Japan has long been the number one provider of official development assistance (ODA), and also the number one foreign direct investor in neighboring countries, in particular ASEAN, starting in the mid-1980s. In the following years, China also rose as a popular destination for Japanese investment. But, over time, China has become a foreign investor in its own right and a potential rival for Japan (even with respect to development assistance) in what used to be its backyard.

At the same time, changes in ASEAN (with the establishment of an ASEAN Economic Community, AEC, in 2015) and the economic rise of the latecomers in the region (Cambodia, Laos, Myanmar and Vietnam, the so-called CLMV) provide new opportunities for their more advanced partners.

Within ASEAN, the "wave" of Japanese investment is now entering the CLMV, which account for about 20 per cent of total Japanese outward flows to the region. The drivers behind Japan's rising interest in the CLMV countries are many. They combine push as well as pull factors, including competition with China and Korea, the shrinking Japanese market, the rise in labor costs in Thailand (and China), and the economic liberalization in countries such as Myanmar.

While Japan still dominates in the ASEAN6 countries, its relative importance as a foreign direct investor is much smaller in the CLMV and China is far ahead in most of them, with the notable exception of Vietnam. Also Japan's influence seems to be on the rise in Myanmar.

There is no denying that the Mekong region has become an economic battleground where the two regional giants are competing to gain and sustain economic influence in the region. However, each country has managed overall to create or maintain its own sphere of influence, thus reducing the risk of direct head-to-head competition. Even within one single country, Japan and China tend to be involved in different areas, in different types of activities and through different instruments, thus avoiding real confrontation. Japanese investment in the CLMV exhibit a number of characteristics that set it apart from Chinese investment.

First, a major feature of Japanese investment in the CLMV is its concentration in Special Economic Zones. In Cambodia and Myanmar in particular Japanese investors have been instrumental in the development of such zones. Private Japanese companies (such as Sumitomo, Sojitz, Mitsui and Itochu) play the role of developers and marketers. Their involvement in economic-zone development aims at attracting Japanese and other foreign manufacturing companies, but, in all the parks or zones developed by a Japanese company, most of the tenants are Japanese.

Secondly, in addition to cheap labor, some Japanese firms also seek to make the best of Cambodia's and Lao's proximity to Thailand, following the so-called Thailand+1 strategy, and transferring the most labor-intensive part of their production process to countries where labor is much cheaper than in Thailand. Indeed, as the historical basis of production for Japanese companies, Thailand lies at the heart of vertically integrated regional production networks.

Thirdly, Cambodia, Lao PDR, Myanmar and Vietnam are not exclusively perceived by Japanese investors as potential sources of cheap labor. Due to the rise in their GDP per head over the past few years, they are also increasingly perceived as potential markets. In a number of sectors, Japanese firms are faced with a shrinking local market, as well as secularly declining growth in industrial economies; they thus need to turn to more promising markets to grow further.

Infrastructure development is arguably the area where competition, between Japan and China is most direct in the Mekong region. Japanese companies and government agencies have had a long head start in infrastructure investment in the region. In general, Japan tends to focus its ODA on infrastructure development, and the Mekong region is no exception. JICA provides loans for the development of SEZs (as explained earlier), but it also provides funding (grants and loans) for the construction of roads and bridges, with a view to enhancing regional connectivity.

One obvious side-effect of infrastructure development with public funds is the improvement of business conditions for Japanese companies operating in the region. In particular, ODA-backed infrastructure clearly helped Japanese manufacturing companies to construct production networks on the basis of division of labor among different countries. This is no coincidence; it is the result of a deliberate strategy that reflects Japan's habit of ODA-to-FDI leveraging. Interestingly, Japan's desire to sell infrastructure and to expand overseas production bases dovetails with the CLMV's priority of enhancing economic development.

In an effort to better connect its southern provinces to the Mekong region, which constitutes a natural backyard, China has also recently engaged in infrastructure investment, and even more so over the past few years in the context of the recently launched Belt and Road Initiative (BRI). As a result, the Mekong region has become a battleground between the two big regional powers.

The competition is particularly fierce with regard to funding. Japan responded to the China-backed Asian Infrastructure Investment Bank (AIIB) by launching its own initiative, Prime Minister Abe's "Partnership for Quality Infrastructure" (PQI), the objective of which is to provide development funding in line with the usual standards imposed by multilateral banks.

Behind economics, however, the two countries are also competing for political influence, and their commitment to development promotion, and in particular to infrastructure development, may be instrumentalized with strategic objectives in mind. While Japan's interest in assisting infrastructure development in the region is nothing new, the country's approach has apparently changed under China's pressure and has become more "strategic" and to a large extent "politicized". This is perhaps where the impact of the China factor has been the largest on Japan's stance vis-à-vis the region.

Résumé

En tant que pays le plus avancé de la région d'Asie orientale, le Japon a longtemps été le premier fournisseur d'aide au développement mais également le principal investisseur direct auprès des pays voisins, et notamment de l'ASEAN. À compter de la fin des années 1980, la Chine est également devenue une destination de choix pour les investissements japonais, puis elle a progressivement émergé comme un investisseur direct à part entière et, partant, comme un concurrent potentiel du Japon dans ce domaine (de même que dans celui de l'aide au développement) dans une région qui avait été jusque-là son pré carré.

En parallèle, diverses évolutions intervenues au sein de l'ASEAN (mise en place de la Communauté économique ASEAN –CEA – en 2015) ainsi que la montée en puissance économique des nouveaux venus que sont le Cambodge, le Laos, le Myanmar et le Vietnam (généralement désignés comme les CLMV) offrent de nouvelles possibilités de coopération à leurs partenaires plus économiquement avancés.

La vague d'investissement direct japonais touche désormais également les CLMV, qui recueillent près de 20 % des investissements japonais à destination de la région. L'intérêt que les investisseurs japonais portent à ces pays tient à de multiples raisons, telles que la concurrence avec la Chine et la Corée, mais aussi la faiblesse du marché japonais, la hausse des coûts de la main-d'œuvre en Thaïlande (voire en Chine), ou encore la libéralisation économique dans des pays comme le Myanmar.

Si les investisseurs japonais demeurent dominants au sein de l'ASEAN6, leur importance relative est bien moindre auprès des CLMV, où la Chine fait la course en tête, à l'exception du Vietnam. Néanmoins l'influence du Japon semble être à la hausse au Myanmar.

La région du Mékong est incontestablement devenue un champ de bataille où les deux géants économiques de la région s'affrontent pour accroître ou maintenir leur influence économique dans la région. Toutefois, chacun d'entre eux est parvenu à créer ou préserver sa propre sphère d'influence, réduisant ainsi le risque d'une confrontation directe. De même dans chacun des pays concernés, le Japon et la Chine ont tendance à intervenir dans des domaines d'activité ou dans des secteurs distincts, et au moyen d'instruments différents. Les investissements japonais dans les

CLMV présentent des caractéristiques particulières qui les distinguent des investissements chinois.

Une première caractéristique des investissements japonais dans les CLMV est leur concentration dans des Zones économiques spéciales (ZES). Au Cambodge et au Myanmar en particulier les investisseurs japonais ont largement contribué à la mise en place de ces zones. Des sociétés japonaises privées (telles que Sumitomo, Sojitz, Mitsui et Itochu) jouent ainsi le rôle de promoteurs. Leur objectif est d'attirer des entreprises manufacturières (japonaises ou autres) dans les pays en question, mais dans les zones mises en place par un promoteur japonais, la grande majorité des locataires sont japonais.

Deuxièmement, au-delà d'une main-d'œuvre bon marché, certaines entreprises japonaises cherchent à exploiter la proximité avec la Thaïlande et suivent, au Laos et au Cambodge par exemple, une stratégie dite « Thaïlande + 1 », ce qui consiste à transférer les activités les plus intensives en main-d'œuvre dans les pays où celle-ci est moins chère qu'en Thaïlande. En tant que base historique de la production des entreprises japonaises dans la région, la Thaïlande se trouve désormais au cœur de réseaux de production régionaux obéissant à une logique d'intégration verticale.

Troisièmement, Le Cambodge, le Laos, le Myanmar et le Vietnam ne sont pas exclusivement perçus par les investisseurs japonais comme des réservoirs de main-d'œuvre bon marché mais également comme des marchés potentiels du fait de la hausse de leur PIB par tête. Dans certains secteurs, les sociétés japonaises sont confrontées à un marché local de plus en plus restreint et à une croissance de plus en plus faible des marchés des économies industrialisées, c'est pourquoi la poursuite de leur croissance doit passer par le recours à des marchés plus prometteurs.

Le développement des infrastructures est sans doute le secteur dans lequel la concurrence entre le Japon et la Chine est la plus directe dans la région du Mékong. Dans ce domaine les entreprises et les agences publiques japonaises ont longtemps fait la course en tête. Généralement, l'aide au développement japonaise met l'accent sur le développement des infrastructures et la région du Mékong ne déroge pas à la règle. Ainsi l'agence japonaise d'aide au développement JICA octroie des prêts pour la mise en place de ZES, mais elle fournit également des financements (prêts et dons) pour la construction de routes et de ponts afin d'améliorer la connectivité régionale.

Le développement d'infrastructures sur base de fonds publics permet à l'évidence d'améliorer les conditions dans lesquelles les entreprises japonaises peuvent opérer dans la région. Il ne fait ainsi aucun doute que l'expansion des réseaux régionaux de production s'appuyant sur une division régionale du travail n'aurait pas été possible en l'absence d'infrastructures soutenues financièrement par l'aide au développement japonaise. La stratégie japonaise cherche traditionnellement à encourager les synergies entre aide au développement et investissements directs, or il se trouve que ce double objectif est également en parfaite cohérence avec la priorité accordée par les CLMV au développement économique.

Cherchant à améliorer la connectivité entre ses provinces du Sud et la région du Mékong, la Chine s'est récemment lancée dans un vaste effort d'investissement dans les infrastructures, qui a pris une tout autre ampleur au cours des dernières années dans le cadre de l'Initiative des nouvelles routes de la soie (Belt and Road Initiative – BRI). De ce fait la région du Mékong est devenue un lieu d'affrontement entre les deux puissances régionales.

La concurrence est particulièrement vive dans le domaine du financement. Le Japon a répliqué à l'initiative chinoise de création de la Banque asiatique d'investissements dans les infrastructures (BAII) en lançant sa propre initiative de Partenariat pour des infrastructures de qualité (« Partnership for Quality Infrastructure »), dont l'objectif est de fournir des financements respectant les standards habituels imposés par les banques multilatérales.

Au-delà de l'économie, la concurrence entre les deux pays porte sur l'influence politique, et leurs efforts d'aide au développement et de promotion des infrastructures cachent bien souvent des objectifs stratégiques. Si l'intérêt du gouvernement japonais pour l'aide au développement des infrastructures dans la région n'est pas une nouveauté, son approche a néanmoins changé au cours de dernières années sous la pression de la Chine, pour devenir en quelque sorte plus « stratégique ». En d'autres termes l'aide au développement japonaise dans la région s'est incontestablement « politisée ». Tel est peut-être là le principal impact du facteur chinois sur la posture japonaise dans la région du Mékong.

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Introduction

As the most advanced economy in the region, Japan has long been the number one provider of official development assistance (ODA), and also the number one foreign direct investor in neighboring countries, in particular ASEAN. In the wake of the yen appreciation (*endaka*) resulting from the Plaza accord in 1985, Japanese companies chose to relocate part of their production facilities in countries where they could enjoy more favorable production conditions. The ASEAN-4 countries (Indonesia, Malaysia, the Philippines and Thailand) were the natural targets. At the same time, ODA to most countries in the region was continued. Within ASEAN, Thailand became the main destination for Japanese outward direct investment (ODI) and rapidly emerged as the hub of automobile production in the region.

In the following years, China also rose as a popular destination for Japanese investment. But, over time, China has become a foreign investor in its own right and a potential rival for Japan (even with respect to development assistance) in what used to be its backyard. Indeed, China has become increasingly proactive and assertive in the region, not only in the diplomatic sphere but also in the economic area, with initiatives such as "One Belt, One Road" (OBOR, now called the Belt and Road Initiative – BRI) and the creation of the Asian Infrastructure Investment Bank (AIIB).

At the same time, changes in ASEAN (with the establishment of an ASEAN Economic Community, AEC, in 2015) and the economic rise of the latecomers in the region (Cambodia, Laos, Myanmar and Vietnam, the so-called CLMV) provided new opportunities for their more advanced partners.

All these developments have deeply affected the economic environment, as well as the assessments made by Japanese companies and the Japanese government, necessitating adjustments in the strategies followed so far. At the diplomatic level, Prime Minister Shinzo Abe's repeated visits to the region underpin growing Japanese strategic concerns in ASEAN and the opportunity to play a more proactive role. But the challenges are no less important for the private sector.

The objective of this paper is to assess the impact of the changes highlighted earlier, primarily from the perspective of Japanese players (companies as well as government), with a focus on their changing

involvement in the Mekong region, which is traditionally perceived as an important region for Japan, but also as a "natural" area for China's rising influence.

The paper starts by providing an overview of general trends in Japanese investment in SEA, with a view to highlighting the changing role played by China. In the next section, it looks in detail at the situation in individual countries, and analyze Japanese firms' strategies in the context of rising competition with Chinese players. The last section focuses on the infrastructure development sector, which is thought to be an ideal battleground for Sino-Japanese rivalry.

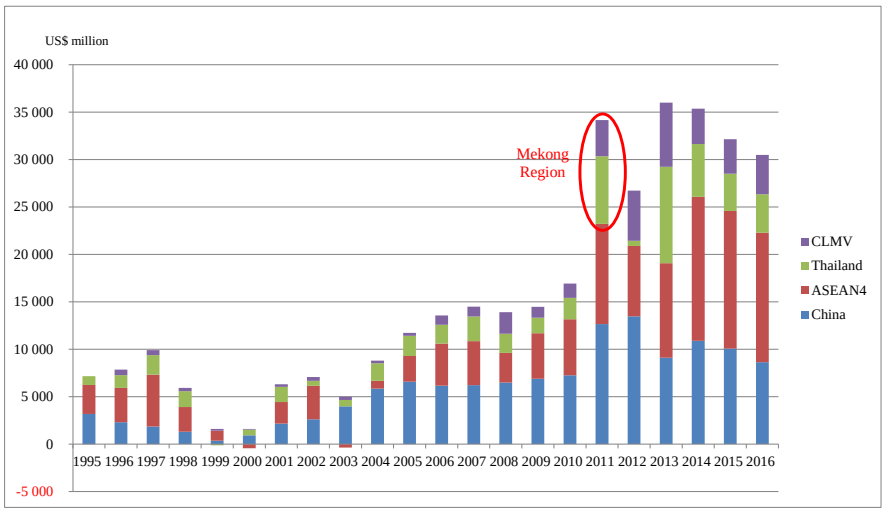
Japanese investment in the Mekong region: General trends

China vs. ASEAN

ASEAN has been a major destination for Japanese outward direct investment (ODI) since the mid-1980s. As of 2015, 11,328 Japanese companies had expanded their operations into the region. Thailand has the biggest number of Japanese companies, with 4,788 (30.4%), followed by Singapore 2,821 (17.9%), Vietnam 2,527 (16.0%), Indonesia 2,021, Malaysia 1,672 and the Philippines 1,334. Myanmar lags far behind, with 296 companies.

Over time, however, as can be seen in Figure 1, Japanese investment in ASEAN5 (ASEAN4 and Thailand) has lost ground to other destinations, in particular China. From the early 2000s onwards, Japanese ODI soared in China, and in the mid-2000s Japanese ODI was almost equally distributed between China and ASEAN. But the distribution started to change again in 2012 with a sharp decline in Japanese investment in China and a parallel rise in ASEAN (including in the least advanced countries in the region, the CLMV).

Figure 1: Japanese ODI Flows, 1995-2016

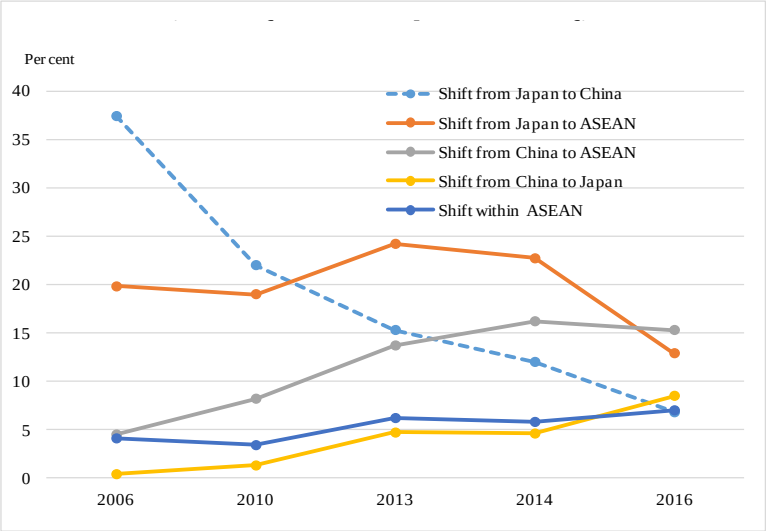


Source: MoF Balance of Payments Statistics, compiled by JETRO.

The shift can be explained by a combination of economic and political factors. As a result of rising labor costs in China, many China-based labor-intensive manufacturers (whether Japanese or of other nationalities) started to show keen interest in shifting their manufacturing and product sourcing to locations outside China. Within Asia, they are increasingly finding their way to ASEAN countries, in particular the four CLMV nations.[1] Japanese investors are no exception, but, in their cases, the deterioration in relations between Tokyo and Beijing – following the sharpening dispute over the Senkaku/Diaoyu islands in September 2012 – provided an additional incentive.[2] As a result of these changes, ASEAN is now far ahead of China as a destination for Japanese ODI.

The successive surveys conducted by JETRO on Japanese firms' intentions to move their locations of production within Asia also confirm the rise of ASEAN as a destination for investment, at the expense of China. This is due to the reorganization and optimization by Japanese companies of their production process. Japan is, notoriously, the dominant source of GVC-FDI[3] in Asia, and these observed shifts reflect changes in the organization of the production networks.

Figure 2: Main transfer patterns by Japanese firms



Source: JETRO.

1. Such is the case, for instance, for the Korean Samsung, which shifted to Vietnam in 2013.
2. The ties between the two countries had started deteriorating as early as 2010 after the collision between a Chinese fishing boat and Japanese patrol ships, which led to a ban on rare-earth exports to Japan and anti-Japanese demonstrations in China.
3. Global value chain/foreign direct investment: This expression refers to the situation of companies relocating parts of their production process in search of lower production costs for re-exporting intermediate and/or final goods either to their home country (vertical FDI) or a third country (export platform FDI).

A JETRO survey (2017) on investment intentions confirms the shift of Japanese companies' attention away from China and toward ASEAN. Of manufacturers responding to this survey, only about 48 per cent said they intended to strengthen or expand businesses in China, versus 73 per cent in 2011. Comparing China with ASEAN, the proportion of firms that selected "expansion" as their approach to future business challenges in the next one or two years was higher in China from 2008 to 2011. In 2012, however, ASEAN (61.4 per cent) overtook China (52.3 per cent), and it has consistently come out on top (higher than China by around 10 percentage points) since 2012, when China showed a sudden decline. However, after peaking at 16.1 percentage points in the 2015 survey, the gap decreased to 7.4 percentage points in 2017.

This reversal in the trend is confirmed by Japanese balance-of-payments statistics, which suggest that, in the second half of 2016 and the first half of 2017, Japanese ODI toward China picked up again, although it remains at a level below that of ODI toward ASEAN. This recovery in Japanese investment in China may be accounted for by the rise in demand for automobile engines and parts, as well as the Chinese government's policy of enhancing the sophistication of its industries (the so-called "Made in China 2025" plan {MIC 2015}, which aims to develop hi-tech, next-generation industries). Indeed, Japan is expected to be China's technological partner in the 10 key industries identified by Beijing in the context of MIC 2025 (Sako 2017). It remains to be seen, however, whether this trend will be long-lasting.

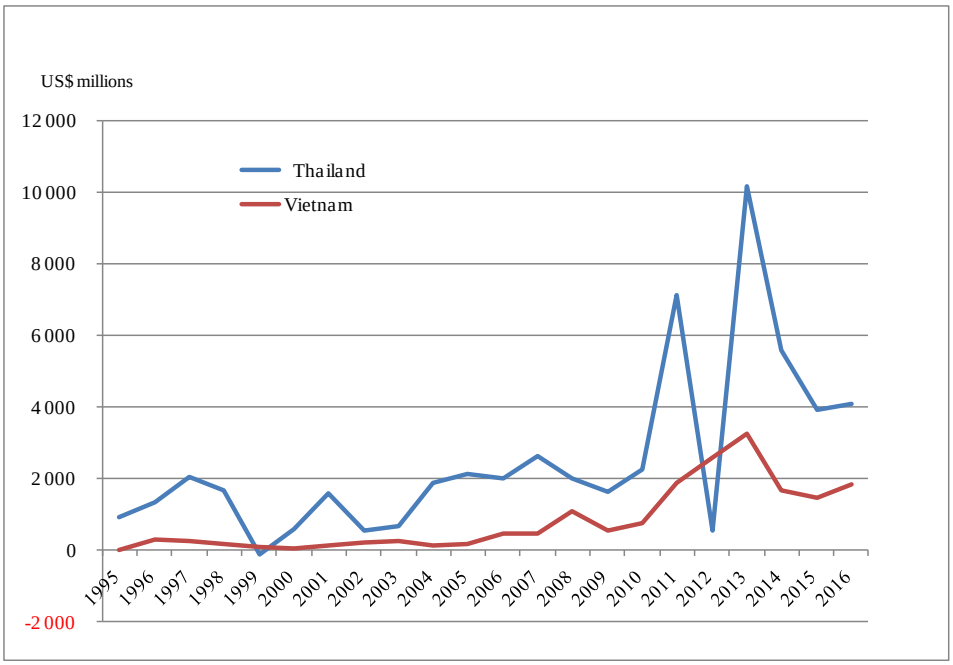
Japan's rising interest in the CLMV

As can be seen in Figure 1, Japanese investment in ASEAN has been rising sharply in recent years, reaching a historical high in 2013. Within ASEAN, the "wave" of Japanese investment is now entering Cambodia, Lao PDR, Myanmar and Vietnam, which account for about 20 per cent of total Japanese outward flows to the region.

The drivers behind Japan's rising interest in the CLMV countries are many. They combine push as well as pull factors, including competition with China and Korea, the shrinking Japanese market, the rise in labor costs in Thailand (and China), and the economic liberalization in countries such as Myanmar.

Focusing now on individual countries, various sources confirm Japan's rising interest in the CLMV countries, with a special role played by Vietnam as a destination for investment.

Figure 3: Japanese ODI to Thailand and Vietnam



Source: Ministry of Finance.

Interestingly, the results of the JBIC survey 2017 suggest that the interest in the CLMV countries is here to stay, with more than 60 per cent of the surveyed firms indicating their willingness to expand their activities in Myanmar (60.6 per cent) and Vietnam (66.4 per cent), and 52 per cent in Cambodia.[4] The percentage is lower in the rest of ASEAN (48.4 per cent)[5] as well as in China (43.1 per cent on average, with a maximum of 46 per cent for southern China and a minimum of 32.8 per cent for northeastern China).

Mid-tier firms/SMEs had strong "strengthen/expand" intentions in the countries surrounding Thailand, the so-called Mekong region, amounting to over 75 per cent for each country.

The JETRO survey 2017 confirms the trend, with Myanmar and Vietnam having the highest shares of Japanese companies willing to expand their businesses, at 70.7 per cent and 69.5 per cent respectively.

Despite the rise in Japanese interest in the CLMV countries, these countries still lag far behind other ASEAN countries, such as Thailand, Malaysia, Indonesia and the Philippines, as destinations of Japanese ODI.

4. The only exception in the region is the Lao PDR, with 33.3 per cent.
5. Among the ASEAN5 countries, Indonesia and the Philippines appear to be the most attractive locations, with close to 57 per cent and 55 per cent, respectively, of companies planning to strengthen or expand their business.

Rising competition from China in the Mekong region

ASEAN is an important production hub for Japanese multinationals, a strategic source of raw materials and energy, and a consumer market of growing importance. Japan used to be, and still is, by far the largest single source of investment into ASEAN[6] and its third-largest trading partner. The Japanese government has also offered sizeable development assistance to the bloc.

Over time, however, Japan's relative importance as a foreign direct investor has tended to decline compared to China, and this is particularly true in the CLMV countries. Despite a rise in Japanese investments in these countries, China is far ahead in most of them, with the notable exception of Vietnam.

One possible explanation has to do with the persistence of substantial disparities in institutional and infrastructure capacity amongst ASEAN member states, leading to their unequal integration into value chains driven by Japanese multinationals. As a result, Japan is dominant as a foreign direct investor in ASEAN6, but not in the CLMV.

Figure 4: FDI inflows into ASEAN6

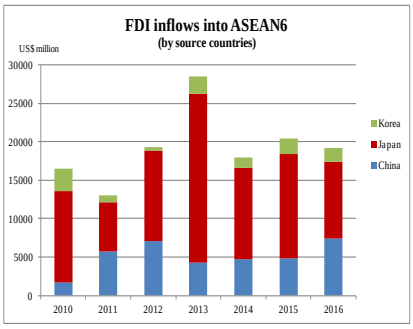
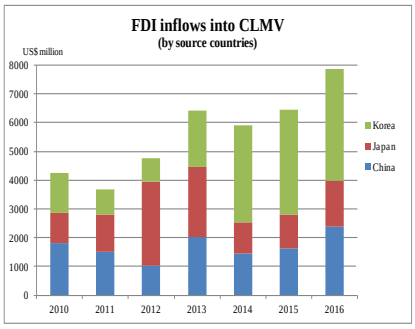


Figure 5: FDI inflows into CLMV



Source: ASEAN Secretariat.

As can be seen above, in the CLMV countries the competition is apparently fierce not only with China but also with Korea.[7]

The following section examines how Japan operates in the Mekong region, focusing on its involvement in individual countries, and highlighting the competition with China.

6. In 2016, Japanese direct investment accounted for 14.5 per cent of total inflows into ASEAN, ahead of the US (11.3) and China (6.8).
7. An analysis of the competition between Japan and Korea, although interesting, is beyond the scope of this paper.

Japanese investment in the Mekong Region: Individual case studies

Of the three northeast Asian economic powers, Japan was the earliest to enter the Mekong region, using a three-pronged strategy of "investment, trade and assistance" to deepen ties with the five Mekong regions in ASEAN (CLMVT). It began investing aggressively in the region as early as the 1970s, especially targeting Thailand and then Vietnam.[8] Initially, most of these investments went through the ADB or JICA. While Japanese private investments targeted Thailand at a very early stage, this is not the case for the less advanced countries in the Mekong region. This section will examine Japan's involvement in each of the five Mekong countries, including both ODI and ODA.

Thailand: increasingly challenged by China

In the Mekong region, Japanese ODI still concentrates on Thailand, which is at the center of a Mekong-wide hub and spoke system. Between 1985 and 2016, Japanese investment in Thailand totaled US$85 billion (2017 rates), more than double the amount invested by the next biggest investor, the US. For this period, investment from Japan alone represented 43 per cent of all foreign investment into the kingdom. Interestingly, Japanese investment in Thailand has also been relatively shockproof, reflecting the strength of Japanese firms' commitment to the country. Although Japan's share dropped somewhat (to 25 per cent of total inflows) in the wake of the Asian financial crisis, and again after the 2011 floods, it recovered quickly.

As of now, 144 Japanese companies have their headquarters in Bangkok,[9] and Thailand has the largest number of Japanese companies, 4,788 (30.4%), followed by Singapore 2,821 (17.9%), and Vietnam 2,527 (16.0%). In terms of sectors, Japanese investment is concentrated in two major sectors (metal products and machinery, including transportation equipment, and electrical and electronic equipment). Thailand has long

8. After the conclusion of the Paris Peace Accords on Cambodia in 1991.
9. As of April 2017, there were 1,748 members in Bangkok's Japan Chamber of Commerce.

been an investment hub for Japan's auto industry.[10] The success of the Japanese car industry helped pave the way for companies in the electronics, textiles and food-processing sectors to move in.

Most of the ODA grant aid to Thailand was officially terminated in 1993, but JICA continued to provide loans and technical assistance. In the recent period, for instance, assistance was granted for the development of a mass transit network in the Bangkok Metropolitan Area, with the construction of an additional line (the purple line, which started operating in 2016).

Although Japan seems to be a well-established investor in Thailand, it has been challenged lately by an increasingly pro-active China. In 2016, Chinese ODI soared, while Japanese ODI was sluggish. Other signs point in the same direction, such as a sharp rise in the number of Chinese tourists and expatriates.

Paradoxically, the complementarity between Thailand and neighboring economies may to some extent explain the recent slowdown in Japanese investment in Thailand. Thailand has already benefited from the progress in the implementation of the ASEAN Economic Community (AEC); parts and components but also finished goods are more easily moved around as a result of tariff elimination, so there is a consolidation of regional production networks, with Thailand as the preferred hub for historical reasons. Although a traditional destination for Japanese investors, Thailand is now increasingly connected to the CLMV, and some labor-intensive activities are being shifted out of Thailand and to some of its neighboring economies.

The challenge coming from China's pro-active strategy in the country remains a reality that Japan cannot ignore. And the recent green light given by the Thai authorities to a Chinese consortium[11] to build a high-speed railway line linking Bangkok to southern China (as part of the Belt and Road Initiative) was no doubt perceived as another blow.

As a result, Japan has pledged to support Thailand's recently launched Eastern Economic Corridor plan (EEC)[12] along the eastern coast of Thailand, where Laem Chabang Port, a leading deep-sea port, is located. The EEC development is Thailand's flagship project to create special economic zones in the three eastern provinces of Chon Buri, Rayong and

10. Hundreds of Japanese car and auto parts makers are located on the Eastern Seaboard, Thailand's largest industrial zone (east of Bangkok).
11. And with particularly favorable conditions.
12. The project, launched in 2017, is the continuation of the Eastern Seaboard development scheme, which dates back to the mid-1980s. It is hoped that the project will be completed by 2021.

Chachoengsao.[13] The objective is to develop Thailand's industry and help turn the economy into an innovation-based economy under the Thailand 4.0 vision.

Both the Japanese government and Japanese firms have expressed interest in the project, which is in line with Japan's interests as it would help connect Thailand and its neighbors, thus facilitating the consolidation of regional production networks. To that end, a Japan–Thailand memorandum of understanding (MOU) was signed in June 2017 (with substantial investments in automobile and electronics sectors). For Japan (including both the private and public sectors), the number one objective of participation in the EEC is to maintain a strong economic presence.[14] There is also a clear convergence of views between the two partners. The emergence of Thailand as a better-structured regional hub (through the development of the EEC) is in line with Japan's Thailand+1 strategy in which the complementary locational advantages between Thailand and its neighbors are maximized.

Japan is also seeking to regain ground in the development of infrastructure; it is in charge of the feasibility study for a high-speed railway line connecting Bangkok and Chiang Mai.

China's aggressive move into ASEAN, including Thailand, does not yet show in the statistics, but a number of big-ticket projects, such as the HSR project, have grabbed the headlines. But Chinese rivals have also deepened their influence in other sectors. Ali Baba is about to build a big logistic hub for the AEC area. Japanese companies were also interested but proved to be too slow.

For the time being, the competition remains limited to some sectors while Japanese still dominates in others, in particular in the automotive sector. Japanese ODI remains the leading foreign investor in the country, with about 40 per cent of the total over the period 2005-15. And Thailand's diplomacy, trying to play one partner against the other, is unlikely to side unequivocally with China. However, Japan's traditional domination is undoubtedly being challenged in what used to be its backyard.

13. It will target 10 industries (including biochemical, next-generation automotive industry, medical and tourism sectors).
14. Interview with a JETRO official in Bangkok, September 2017.

Cambodia and Laos: still lagging behind

Cambodia

Japan's investment in Cambodia has long focused on aid. Japanese ODA dates back to the early 1990s, when Tokyo financed the construction of bridges (such as the Friendship Bridge in Phnom Penh, 1994[15]) and other infrastructure. Over the period 1992-2013, Japan was the leading donor (with 16 per cent of the total ODA disbursed), ahead of China (12 per cent[16]). Most of Japan's development assistance is provided through grants and technical assistance.

In contrast, China overtook Japan as Cambodia's biggest foreign investor several years ago, and is now by far the leading foreign investor, ahead of Korea and Japan (over the period 2007-16).[17] However, over the past couple of years, Japanese ODI has picked up, and Japan is now ahead of Korea. According to a JETRO report, Cambodia ranked among the top countries as an investment destination for Japanese firms in 2015, but over the past year it has apparently lost ground to Myanmar (Sako 2017).

Japanese ODI is traditionally concentrated in manufacturing in Cambodia, as Japanese firms sought to take advantage of the cheap labor force. The businesses with the largest investments are in the non-textile manufacturing sector (electrical machinery, electronics and spare parts for vehicles, and rubber and leather).

Over time, however, some diversification has taken place, and Japanese investment increasingly also targets the local market. The latter development is exemplified by the construction (by Aeon) of a large mall in downtown Phnom Penh in 2015,[18] as well as by the rising number of restaurants or chain coffee shops (Kiriya, for instance). This relative diversification is in contrast with Chinese investment, which still tends to be mostly limited to the garment industry.

Interestingly, Japanese companies have been major contributors to the development of special economic zones (SEZs) in Cambodia, first as developers, secondly as marketers, and lastly as active investors in the zones.

Cambodia set up a special economic zone (SEZ) program in 2005. The motivations behind this move were many, but the primary one was to

15. The Chinese Friendship Bridge was built twenty years later in 2014 next to the Japanese one.
16 But as China is not a DAC member, the comparison is not really possible.
17. CDC statistics, www.cambodiainvestment.gov.kh.
18. A second one, almost 50 per cent larger than the first, is planned in the coming years.

facilitate export development and create employment by providing the high-quality infrastructure and utilities needed to encourage investment. Cambodia's SEZs tend to be privately owned and managed. Japanese companies have been instrumental in the development of such zones.

Established in 2006, the Phnom Penh SEZ (PPSEZ) is a Cambodian-Japanese joint venture. Located on the outskirts of Phnom Penh, about 8km from Phnom Penh International Airport, the zone is also connected to National Road No. 4, the main highway connecting the capital with the deep-sea port in Sihanoukville. The PPSEZ is one of the most developed SEZs in the country in terms of infrastructure and other supporting facilities.[19] As of November 2016, the PPSEZ had attracted US$470 million of FDI.

Similarly, the Sanco Poipet SEZ (in north-west Cambodia, along the Thai border) is a joint-venture between Japanese and Cambodian companies, and the Techno Park Poipet was developed in the same area by Toyota Tsusho.

Japan also contributed to the development of the Sihanoukville Port SEZ (SPSEZ), a public-private joint venture financed by a JICA loan.[20] The SPSEZ is deemed to be a failure, however, with only three operating companies, while the nearby China-funded Sihanoukville SEZ (SSEZ) is very successful, with 74 investors. The latter is the first economic co-operation zone developed under a bilateral government agreement between China and Cambodia. The zone was jointly developed by China's Jiangsu Taihu Cambodia International Economic Cooperation Investment Co. Ltd. and Cambodia International Investment Development Group Co. Ltd. Located in southern Cambodia, about 210km from Phnom Penh, the SSEZ is the largest SEZ in the country, with a total planned area of about 1,690 hectares – about five times the size of the PPSEZ. The zone is well situated, with access to key transport links, including National Highway No. 4, as well as Sihanoukville Airport and Sihanoukville Autonomous Port, the country's only deep-sea port, which handled more than 70 per cent of Cambodia's total container throughput in 2016.

Economic zones offer investors (tenants) the choice of convenient sites where facilities and infrastructure are readily available, and operating in these zones also helps address complex aspects of land issue regarding the right to use land as a foreign investor. According to Japanese investors, in Cambodia investing in SEZs is more about a more secure and easier environment (better infrastructure, initially cheaper and more stable

19. The other successful SEZ is the Sihanoukville SEZ (see below).
20. The PPSEZ is managed jointly by Cambodian (78%) and Japanese (22%) capital.

access to electricity,[21] one-stop service, easier customs procedures, etc) than about getting access to more favorable fiscal or regulatory conditions.[22]

SEZs appear to be particularly attractive to Japanese investors.[23] The PPSEZ has about 80 tenants, almost 60 per cent of which are Japanese firms (Toyota, Yamaha, Denso, Minebea, and Ajinomoto among others), followed by those from Taiwan, China, Singapore and Malaysia. The Japanese domination should not come as a surprise since Sumitomo Corporation was in charge of marketing the zone and finding tenants. The activities in the zone are diversified (at least more than in the rest of the country where foreign investors are heavily concentrated in the textile sector). In the Tai Seng Bavet SEZ (located along the border with Vietnam), close to 50 per cent of the tenants are Japanese.

A specific feature of the SEZs is their location close to the Gulf of Thailand, and the Thai and Vietnamese borders, allowing for possible integration in regional production networks. In these zones, the presence of Japanese car parts producers acting as suppliers to car-makers located in Thailand confirms this hypothesis. For instance, the SEZs located along the Thai border have attracted Japanese companies in wiring harness manufacturing and automotive parts manufacturing (Yazaki in Koh Kong SDEZ, Yazaki and Nidec in Poipet SEZ). Another example is Japan's NHK Spring, which produces car seat covers in Sanco Poi Pet SEZ, which are transported to Toyota's plant on the Eastern Seaboard in Thailand. In other words, economic zones can serve as useful tools for promoting intra-regional trade and enabling greater involvement in GVCs.[24]

Laos

As in the case of Cambodia, Japan is the leading ODA provider in Laos, but it lags far behind China in ODI flows. Japanese firms are also actively involved in SEZs, in particular those located along the Thai border. But, in contrast to Cambodia, they played less of a role in the development of these zones, which in Laos are government-led.

21. In the PPSEZ, there is an on-site power plant ensuring that factories are supplied with power 24 hours a day, seven days a week.
22. Interview with JETRO Cambodia (March 2016).
23. This also holds true in the case of Japanese investment in Myanmar (see below). In contrast, Korean investors tend to shy away from SEZs because fees are deemed too expensive and electricity supply unreliable. As for the Chinese, they have been operating in the country since the mid-1990s, well before the SEZs were put in place.
24. ASEAN and UNCTAD (2017).

A Japanese company is a minority stakeholder (20 per cent) in the joint venture which established the Savan-Japan joint development in Savannaketh, while another one (Nishimatsu Construction) holds, together with a private Lao partner, a majority stake (70 per cent) in the Pakse Japan SME SEZ located in the Champasak SEZ (south of the previous one).

Compared to the Chinese-funded ones, the SEZs initiated by the Laotian government or in joint ventures with various foreign partners, are industrial investments integrating the country into global production chains. This is the case in particular for the Savan-Seno SEZ in Savannaketh, where Japanese automotive component manufacturers Toyota Boshoku started operations in 2014. The factory sources raw materials from Thailand, transports them to its plant in the Savan-Seno SEZ to produce car-seat covers, and then exports them back to Toyota Boshoku Thailand. A similar strategy is followed by Japan's Nikon, which manufactures lenses in the Savan-Seno SEZ, which are then transported to its factory based in Thailand. Other MNEs such as MMC Electronics (Japan) and Dai-Ichi Denshi (Japan) are also connecting the country to regional production networks (AIR 2017).

It is worth mentioning that the Savan-Seno SEZ developed after the 2011 floods in Thailand which disrupted Japanese companies' supply chains in some industries (automotive and electronics in particular). The development of the zone clearly reflects an attempt at risk diversification by Japanese companies.

Myanmar: playing catch up with China

Japan has traditionally maintained close relations with Myanmar (formerly Burma). Although the war-time occupation caused much suffering and loss, there was a perception that Japan helped Burma gain independence. In 1954, Burma was the first recipient of Japanese reparations in Southeast Asia and the first country to sign a peace treaty with Japan. For decades afterwards, Japan was Burma's largest aid donor and trade partner (Schoff 2014).

Although Japan gave in to US pressure and applied sanctions to Myanmar,[25] it maintained close contacts throughout the junta era. Through private diplomacy and individual connections, Tokyo maintained its networks with businesses and officials in Yangon and, since 2005, with Naypyidaw, the new capital.

25. It suspended its ODA provision under pressure from its allies but also in application of the recently adopted ODA charter.

When the civilian government came to power in 2011, Tokyo was quick to re-engage Myanmar, granting a unilateral total debt write-off of close to $3 billion, resuming aid and committing to new loans for a range of infrastructure projects. A substantial amount of Japanese aid has been devoted to assisting with the development of the local rail system, health facilities, and other civic amenities.[26] As for FDI, although there was an early wave of Japanese ODI in Myanmar in the late 1990s (in particular with the development of the Mingaladon Industrial Park in 1998), the flows dried up fully during the junta era and have apparently not picked up in any substantial way.

As of today, Japan is Myanmar's number two ODA donor (behind China), but it does not rank among the top investors in the country, lagging far behind China, Singapore, Thailand, South Korea and the United Kingdom.

As Japan's development assistance arm, JICA has provided Myanmar with more than US$6.5 billion in loans, grants and technical cooperation over the period 2011-15. It has also been helping with capacity-building in areas such as agriculture and information technology. For instance, JICA and the Japan Science and Technology Agency (JST) are collaborating with Myanmar's government in rice genomic breeding to boost the sustainable use of bio-resources.[27]

Japanese firms are increasingly interested in Myanmar, as indicated, for instance, by the sharp rise in the number of companies visiting the JETRO office in Yangon,[28] but for the time being, the projects have yet to materialize. One possible reason for the apparently low level of Japanese investment is that some of it is going through Singapore, and thus does not show in the data.[29] Moreover, Japanese ODI is necessarily small in comparison to Chinese large-ticket investments in oil, gas and extractive industries.

Since 2012, Japan has directly invested over US$717 billion in Myanmar (including US$220 million in the fiscal year 2015-16), with some of the most notable going to the Thilawa SEZ, a 2,342-hectare industrial

26. Purnendra Jain and Tridivesh Singh Maini, "India-Japan 'Soft Power' Cooperation in Myanmar", *The Diplomat*, April 7, 2015.
27. Tridivesh Singh Maini and Sandeep Sachdeva, "China Faces Increasing Competition in Myanmar", *The Diplomat*, November 14, 2017.
28. In 2012, the Yangon office recorded the largest number of visitors out of the 70 JETRO offices around the world, with between 500 and 600 visitors in a month. Interview with JETRO official in Yangon, September 2017. According to other sources, in 2013, some 66,187 Japanese visited the country, triple the figure two years earlier.
29. Some Japanese (such as Koyorad, Fujifilm and Foto Electric) invested in Thilawa through subsidiaries or regional headquarters in Singapore.

area just outside Yangon. The Thilawa SEZ was built through a public-private partnership, Myanmar Japan Thilawa Development (MJTD), and is 49 per cent[30] owned by JICA (10 percent) and three major Japanese trading houses: Marubeni, Sumitomo and Mitsubishi (39 per cent). A trio of Japanese banks – Mizuho Bank, Sumitomo Mitsui Banking Corporation and Bank of Tokyo Mitsubishi UFJ – also hold minor stakes in the MJTD.

The Thilawa SEZ became operational in September 2015 as the first SEZ in Myanmar. As of September 2017, 81 companies occupy the area, 32 factories are already in operation (including Yusen logistics and Kubota), and others are being constructed. Almost half of them (41) are Japanese companies.[31] A total of 49 of the companies in the SEZ are domestically oriented and 24 are export-oriented; the others are logistic companies.

There are two other SEZs in Myanmar: the Thailand-backed Dawei SEZ (located south of Yangon) and the China-backed Kyaukpyu SEZ (located in the Rakhine state to the north-west of Yangon).

Two months before the opening of Thilawa SEZ, the Japanese government decided to participate in the Dawei SEZ projects, along with Myanmar and Thailand, though this project ran into funding problems. The reason for Japan's interest in the Dawei SEZ is that it includes a deep-sea port and logistics hub, and constitutes a western gateway to the southern economic corridor (see appendix on "Greater Mekong Transport Corridor").

A Chinese consortium led by China's CITIC group, and featuring China Harbor Engineering Company and China Merchants Holdings, won two contracts to build a deep-sea port and a corresponding SEZ in Kyaukpyu on the Bay of Bengal. China's strategic involvement in Kyaukpyu is motivated by sea-lane and energy security concerns, as the site provides an alternative to the Strait of Malacca sea route. An oil and gas pipeline constructed by the China National Petroleum Corporation now links Kyaukpyu overland to the landlocked Yunnan Province. More generally, Chinese ODI in Myanmar is heavily concentrated in the power (63 per cent) and oil and gas sectors (25 per cent).

However, Japanese firms are not exclusively confined to the Thilawa SEZ, and the degree of diversification of Japanese ODI in Myanmar is much higher than the Chinese. Japanese firms are active in a wide range of activities, spanning infrastructure development, trading (Mitsui,

30. The remaining 51 per cent are split between the Myanmar government (10 per cent) and the consortium Thilawa SEZ Holdings Co (41 per cent).
31. 2 Thailand, 5 Taiwan, 5 Korea, 5 Singapore, 3 Malaysia, 2 Myanmar, and others.

Marubeni), power generation (Mitsubishi, and electrical transformer substation – Hitachi), optical communications network, consumer goods (Unicharm, disposable nappies), engineering (JFE engineering), distribution, consumer/food processing (Acecook, Asahi – and Kirin about to follow). And three Japanese banks (the Bank of Tokyo-Mitsubishi UFJ, Sumitomo Mitsui Banking Corp, and Mizuho Bank) were among the first foreign banks to be granted a license to operate in Myanmar. All this suggests that Japanese companies see Myanmar as a production location as well as a market.

Overall, the competition between Japan and China in Myanmar is a reality, but it is not direct as the two countries tend to operate in different areas and in different sectors. Moreover, Japanese ODI is rather diversified; Japanese companies are involved in building telecommunications networks, bridges, airports and other infrastructure, as well as in manufacturing, in food and consumer goods retailing, and logistics, while Chinese investment is primarily in oil and gas production and pipelines, dams and related roads and port facilities.

Vietnam: staying ahead

Unlike most of the major relationships of Japan and Vietnam, bilateral ties between the two have generally been problem-free and carry no historical baggage.[32] By 2016, Japan had become the largest source of ODA, the second largest source of FDI (after South Korea[33]), the third largest source of tourist arrivals, and the fourth largest trade partner of Vietnam.

Vietnam is viewed very positively by Japanese investors. Nearly 70 per cent of Japanese businesses operating in Vietnam in 2017 considered expanding operations, and none of them wants to leave (JETRO survey 2017). And, according to another survey (JBIC 2017), Vietnam is the country where Japanese companies have the most stable expectations. Looking at the evolution of rankings of promising countries (long-term prospects, 10-year), Vietnam has consistently been seen positively over the past ten years.

To Japanese companies, Vietnam's attractiveness lies in the size and quality of its labor force,[34] the size of its market, and its political stability.[35] As a result, Japanese investors target Vietnam for two major reasons: to

32. Le (2017).
33. South Korea replaced Japan as Vietnam's leading source of foreign investment in 2015.
34. As well as in productivity.
35. Interview with JETRO official in Ho Chi Minh City, September 2017.

take advantage of its cheap but relatively skilled (and easily trainable) workforce, and to make the best of its growing market.

Vietnam is clearly targeted by some companies as a substitute for China. According to a JETRO report (2015), as many as 25 per cent of Japanese firms leaving China choose to relocate in Vietnam, following the so-called China+1 strategy.

However, due to the size of its market and the rise in its potential middle class, Vietnam is also perceived by Japanese investors as an attractive market.[36] The presence of big players in retail activities (Aeon Mall and Takashimaya among others) and their expansion of networks in Vietnam are a testament to the attractiveness of the market. Aeon Mall alone has four shopping malls in Vietnam, while it is moving ahead with a plan to build a fifth one in Ha Dong district in the suburbs of Hanoi. Other companies, such as food-processing company Acecook, also target the local market. Such consumer-oriented Japanese investment tends to be concentrated in the south due to the income differential between the two regions.

As in the rest of the region, Japanese investors have been instrumental in the development of industrial parks in Vietnam. Sumitomo Corporation, which is a significant investor, developer and marketer of industrial parks in the Mekong region, is involved in three industrial parks in Vietnam (Thang Long Industrial Parks I and II, and the forthcoming Thang Long Industrial Park Vinh Phuc). In a joint venture with the Vietnamese Ministry of Construction, Sojitz owns 60 per cent of the Long Binh Industrial Park, Shimizu contributed to the development of the Hanoi South Supporting Industrial Park in a joint venture with Vietnam's N&G Group, and Nomura Group owns 70 per cent of Nomura Haiphong Industrial Zone in a joint venture with Haiphong City Authority.

Overall, in contrast to the Myanmar case, Japan dwarfs Chinese involvement in Vietnam, and it is also far ahead of China in terms of infrastructure funding. For instance, JICA has provided US$781 million in loans for the development of a major deep-sea port at Lach Huyen to the east of Haiphong, while plans have been approved for the development of another deep-water port for trans-shipment, on Hon Khai island, in the southern province of Ca Mau, using public private partnership (PPP). Major projects registered during the first half of 2017 include a Japanese thermal power plant in the northern province of Thanh Hoa, with approved

36. According to a report by the BCG, the number of middle-class affluent Vietnamese (with an income above US$714 per month) is expected to double in size between 2013 and 2020 (equivalent to two-thirds of Thailand's middle-class population); quoted in ANZ (2017).

investment of US$2.79 billion. The 1,200-megawatt plant makes Japan the country's biggest foreign investor in the first half of the year, with total pledges of more than US$5 billion.

However, Japan is to some extent in competition with China for the development of an urban mass-transit railway system in the two major Vietnamese cities. The Ho Chi Minh City Urban Rail Project is currently under construction with the help of Japanese investment and ODA in association with a number of other participants (ADB, the European Investment Bank, the German Bank for Reconstruction, and the Spanish government). The Hanoi Urban Rail Project, in contrast, is primarily being built and funded by Chinese players, but one line is also being funded by Japanese ODA, in association with the ADB, the French government and the European Investment Bank. The two projects have encountered many difficulties and accumulated delays[37] and the jury is still out as to which of the two partners will come out on top.

Summarizing Japanese investment in the Mekong region

In the Mekong region, Thailand occupies a special position in Japan's strategy. As the historical basis of production for Japanese companies, it lies at the heart of vertically integrated regional production networks, and concentrates the largest share of Japanese investments in the region.

The motivations for Japanese direct investment in the CLMV countries are many, but, on the whole, they may fall into one of the two following categories: 1) cost-efficiency-seeking, and 2) market-seeking. Of course, the motivations for investment may be mixed and may also differ across countries.

- Cost-efficiency-seeking investments:
  - The first major motivation of Japanese firms investing in Cambodia, Lao PDR, Myanmar and Vietnam is to take advantage of the cheap labor force. This is the case, for instance, of Japanese firms in the garment, automotive and electronic sectors.
  - In addition to cheap labor, some Japanese firms also seek to make the best of Cambodia's and Lao's proximity to Thailand, following the so-called Thailand+1 strategy. In line with this strategy, Japanese firms are not pulling out of Thailand,[38] a major export hub, but are simply transferring the most labor-intensive part of their production process to Cambodia and/or Lao PDR where labor is much cheaper than in

37. The problems encountered by China seem to be more serious, and Chinese contractors are increasingly viewed with scepticism because of their unreliability.

38. Because of their long-standing presence in the country and the importance, as well as the nature, of their investments.

Thailand. In other words, as a result of the Thailand+1 strategy, Japanese firms engage in further fragmentation of their production process, giving rise to the emergence of new supply chains involving less advanced countries such as Cambodia and Lao PDR. Although this strategy is not yet widespread, it is prevalent in sectors such as the automotive and electronics sectors, where Thailand is a major Japanese industrial zone.

- Myanmar is not yet fully part of the Thailand+1 strategy because of persistently high transportation costs and the lack of appropriate transport infrastructure.
- Because ASEAN is deemed to be safer (and less expensive) than China as a production base, some Japanese firms have also been gradually shifting away from China and toward ASEAN. This approach is usually described as a China+1 strategy, the objective of which is to cut production costs and diversify risk. In some specific sectors, Cambodia and Lao PDR are perceived as alternative investment locations (as exemplified in the case of Uniqlo shifting production from China to Cambodia, for instance), but Vietnam tends to be preferred.
- CLM countries are thus good choices for a Thailand+1 strategy and Vietnam for a China+1. It is worth stressing that the China+1 strategy and the Thailand+1 strategy do not reflect the same logic, with vertical integration prevailing in the latter and not (at least not to the same extent) in the former case.

- Market-seeking investments:
  - Cambodia, Lao PDR, Myanmar and Vietnam are not exclusively perceived as potential sources of cheap labor. Due to the rise in their GDP per head over the past few years, they are also increasingly perceived as potential markets. In a number of sectors, Japanese firms are faced with a shrinking local market, as well as secularly declining growth in industrial economies; they thus need to turn to more promising markets to grow further. In the case of Vietnam, the growth potential of the domestic market is regularly mentioned by Japanese companies as the first reason to invest in the country.
  - In line with this objective, Japanese investments can be found in the service sector (especially in distribution activities) as well as in the consumption-goods sector in the CLMV countries. Because of the size of its population, Myanmar is perceived to be a more promising market than the two other countries. However, Japanese firms' interest is still at a very early stage and they seem relatively hesitant to go ahead.
  - Interestingly, service activities such as banking systematically follow manufacturing investments. This is a standard pattern observed elsewhere. Japanese banks investing in the CLMV are primarily, although not exclusively, targeting Japanese firms operating there.
  - Besides demand for consumption goods, demand for infrastructure is also very strong in the CLMV countries. Japanese firms are active in this sector where they clearly benefit from the Japanese ODA policy, although there is no guarantee that Japanese firms will be awarded the markets.

Lastly, Japan has been instrumental in developing SEZs and industrial parks in some of the CLMV countries, in particular Cambodia and Myanmar. Private Japanese companies (such as Sumitomo, Sojitz, Mitsui and Itochu) play the role of developers and marketers. Their involvement in economic-zone development aims at attracting Japanese and other foreign manufacturing companies, but, in all the parks or zones developed by a Japanese company, most of the tenants are Japanese. Contributing actively to the development of such zones is thus a way of attracting more Japanese investment. The propensity of Japanese firms to concentrate in such zones may be easily accounted for by their higher risk aversion compared to other investors.

As in other areas, Japanese developers are now faced with rising competition from China. Chinese players are increasingly visible in the development and ownership of economic zones in ASEAN, and the Mekong region is no exception. Holley Group and a local partner developed the Thai-Chinese Rayong Industrial Zone in Thailand, Fuhua Co Ltd developed and operates the Yun Zhong Industrial Park in Vietnam, and Jiangsu Taihu Cambodia International Economic Cooperation Investment Co Ltd co-owns the SSEZ in Cambodia. A consortium of the Chinese state-owned conglomerate CITIC and other Chinese companies is developing the Kyaukpyu SEZ in Myanmar, and Chinese company Xuanye/AVIC International Beijing Co Ltd signed a MoU to develop an agricultural industrial park in Lao PDR. In the latter country, many SEZs were developed by Chinese owners.

Infrastructure development, the new battleground

Japan's focus on promoting connectivity

Japanese companies and government agencies have had a long head start in infrastructure investment in the region. In general, Japan tends to focus its ODA on infrastructure development, and the Mekong region is no exception. JICA provides loans for the development of SEZs (as explained earlier), but it also provides funding (grants and loans) for the construction of roads and bridges, with a view to enhancing regional connectivity. Interestingly, Japan's desire to sell infrastructure and to expand overseas production bases dovetails with the CLMV's priority of enhancing economic development.

Japan's ODA focuses in particular on helping develop the Southern Economic Corridor linking Bangkok (and, further to the west, Dawei) to Ho Chi Minh City through Phnom Penh; as well as the East-West Economic Corridor connecting Mawlamyine (a city to the southeast of Yangon) to the Vietnamese port of Da Nang, through central Thailand and Laos, potentially linking the Indian Ocean to the rest of the ASEAN region. A third, southern corridor links the ports of Dawei in Myanmar to Quy Nhon and Vung Tao (south of Danang) in Vietnam, through central Thailand and Cambodia. The improvement of these corridors is expected to facilitate overland access across the Indochinese Peninsula, greatly benefiting the transportation and distribution of goods. This approach is also perfectly in line with the Master Plan on ASEAN Connectivity.

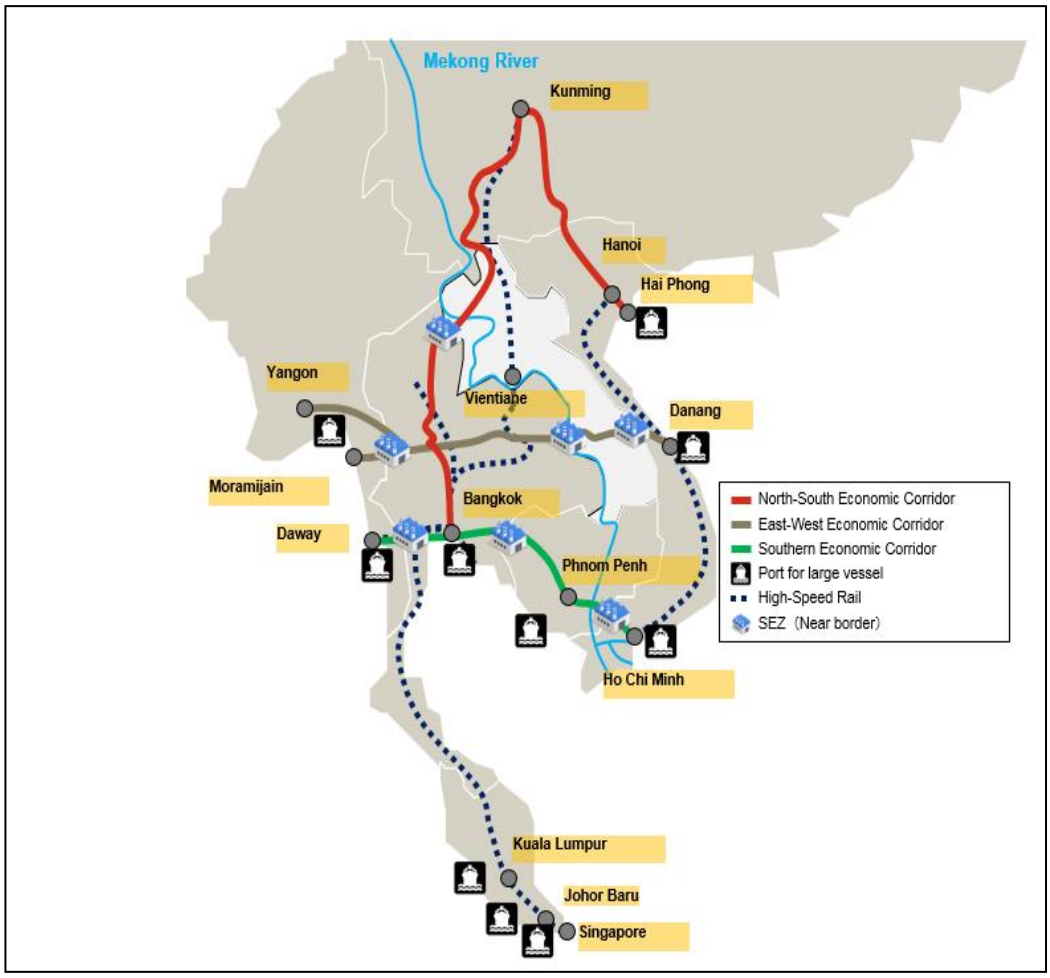
A number of bridges crossing the Mekong were funded by JICA. The first to be built, with a grant of some US$56 million, was the Kizuna Bridge (2001) linking eastern and western Cambodia. A loan was granted for the construction of the second Mekong international bridge connecting Laos and Thailand, as part of the East-West Economic Corridor connecting Vietnam and (hopefully one day) Myanmar (through Thailand and Laos). Situated about 60km east of Phnom Penh and strategically located between Thailand and Vietnam on the ASEAN highway, the Tsubasa Bridge is the third large-scale bridge donated so far by Japan to Cambodia. Built by Japan's Sumitomo Mitsu Construction, the Tsubasa Bridge opened in 2015, reducing transportation costs by about 40 per cent and cutting the previous

four-hour road journey from Phnom Penh to Vietnam to just two and a half hours. Another full-scale bridge across the Mekong was also donated to Laos: the Lao-Nippon Shimizu Bridge connecting Laos with Thailand. In addition, Japan has invested substantially in the maintenance of the road network in the region, such as National Road Number 1 from Phnom Penh to Sihanoukville and National Road Number 5 connecting Cambodia to Vietnam as part of the Southern Economic Corridor.

One obvious side-effect of infrastructure development with public funds is the improvement of business conditions for Japanese companies operating in the region[39] and facilitating the development or deepening of GVCs and production networks. ODA-backed infrastructure clearly helped Japanese manufacturing companies to construct production networks on the basis of division of labor among different countries.[40] This is no coincidence; it is the result of a deliberate strategy that reflects Japan's habit of ODA-to-FDI leveraging. The convergence of interests between the public and private sectors explains why Japanese authorities have focused on east-west connections rather than north-south corridors. This contrasts with China's approach, which favors the development of vertical north-south corridors connecting the southern Chinese provinces of Yunnan to Thailand, through Laos.

39. The complementarity between Japanese public policies and Japanese private companies' interests is also reflected in public support for the development of SEZs, as highlighted earlier.
40. Hatch 2010, quoted in Yoshimatsu (2017).

Figure 6: Major infrastructure in the GMS



Source: ADB.

It is worth stressing that the government policy was actively supported by the private sector, which regarded the export of infrastructure systems as a promising source of revenue as well as a necessary condition/prerequisite for the further expansion of economic activities in the country under consideration.

Interestingly, the Japanese government does not exclusively focus on hard infrastructure; it also supports the development of soft infrastructure, and provides technical assistance to facilitate cross-border flow of goods, for instance, in particular through training courses for customs and trade administration agencies. Moreover, Japan is also seeking to export its customs management system (the Nippon Automated Cargo and Port Consolidated System – NACCS)[41] to the CLMV countries so as to ease

41. The system electronically manages customs procedures and centralizes interactions with relevant government bodies.

Japanese business expansion into the region. Vietnam and Myanmar have already adopted Japan's system, and Cambodia and Lao are the next possible adopters of it. In Vietnam, the introduction of NACCS and "the Customs Intelligence Database System (CIS)" has reduced the time required for import and export customs clearance and improved the predictability of the international supply chain.

In an effort to better connect its southern provinces to the Mekong region, which constitutes a natural backyard, China has also recently engaged in infrastructure investment, and even more so over the past few years in the context of the recently launched Belt and Road Initiative (BRI). As a result, the Mekong region has become a battleground between the two big regional powers.

Table 1: Number of infrastructure projects (2010-2016)

Countries	China-backed projects	Japan-backed projects
Cambodia	20	2
Lao PDR	31	6
Myanmar	6	8
Vietnam	30	84
Thailand	5	22
ASEAN10	**191**	**237**

Source: BMI Research.

As can be seen in Table 1, Japan is still ahead of China in terms of the number of infrastructure projects it has funded in the region, but the table also reflects the same reality as with ODI flows: Japan is dominant in Thailand and Vietnam, while China prevails in Cambodia and Laos. In Myanmar the number of projects is balanced, suggesting that this may be the country where the competition is fiercest.

Japan's response to China's activism in the region

Next to the BRI, the formation of the Asian Infrastructure Investment Bank (AIIB), at Beijing's instigation, proved to be a game changer in the infrastructure development sector in ASEAN. The idea was first floated in autumn 2013, after which the AIIB project took shape with remarkable speed. Officially launched in 2014 when around 20 countries signed a draft treaty, the bank started operations on 25 December 2015.

As its name suggests, the purpose of this multilateral institution is to facilitate the funding of vast infrastructure projects in order to improve "connectivity" between the different countries in the Asian region. Although the AIIB is not officially related to the BRI,[42] it aims precisely at facilitating the expansion of such infrastructure projects. As such, it was perceived as a potential rival to the Japan-backed ADB, but also to the World Bank. This perception explains why the US and Japan chose not to join the initiative, but they also made the decision out of concerns about the management of the new lender. To be more specific, they feared that the new institution would not meet the highest standards of governance, environmental and social safeguards, and debt sustainability.

However, Japan also responded by launching its own initiative. In May 2015, Prime Minister Abe's "Partnership for Quality Infrastructure (PQI): Investment for Asia's Future" was Japan's strategic response to retain its influence in infrastructure development in the region. The amount of US$110 billion was undoubtedly meant to counterbalance the AIIB, which had a proposed capital of US$100 billion. Also, the deliberate focus on building "quality"[43] infrastructure can be seen as a direct attack on the perceived flaws of Chinese-built projects. Lastly, the objective was also to provide development funding in line with the usual standards imposed by multilateral banks. Indeed, a crucial feature of the "partnership" was the combination of bilateral support through JICA and JBIC with multilateral commitments by the ADB. The initial initiative was eventually enhanced as the "Expanded Partnership for Quality Infrastructure" (announced in May 2016). An important feature was the promotion of quality infrastructure investment as an international standard. At the Ise-Shima Summit in May 2016, the G7 leaders adopted the G7 Ise-Shima Principles for Promoting Quality Infrastructure Investment. This document calls on Japan and the other G7 countries to provide assistance related to infrastructure investment and development so as to contribute to the global efforts for the SDGs, stressing in particular the need to address social and environmental impacts. Also, additional means are being made available: approximately US$200 billion will be allocated to infrastructure projects across the world.

42. Many Chinese officials and researchers insist on the lack of connection between the AIIB and the BRI, but the fact that both were started up by the same government in the same year for a similar purpose (to improve infrastructure and, by extension, economic connectivity throughout Asia – although the BRI's geographical scope is much broader) suggests that there is a strong connection.

43. PM Abe made it clear that Japan's initiative was to promote quality infrastructure as opposed to a "cheap but shoddy investment approach".

While Japan's interest in assisting infrastructure development in the region is nothing new,[44] the country's approach has apparently changed under China's pressure and the objective is no longer purely economic but also includes a strategic dimension. As argued by Yoshimatsu (2017), in sustaining the export of infrastructure systems, the Japanese government now pursues the twin goals of creating a new growth engine to revitalize the Japanese economy (as part of the so-called Abenomics[45]) and strengthening strategic links with Asian countries to balance China's regional influence.

Interestingly, under pressure from rising competition from China, Japan's approach to infrastructure development has become more "strategic" and to a large extent "politicized".[46] In the case of Japanese loans to Vietnam, for instance, the geopolitical dimension of the strategy is quite clear, since support for the development of port infrastructure does not merely contribute to smooth logistics operation and to the promotion of economic development, but has undoubtedly a geopolitical implication by raising the country's resiliency to counter China in disputes in the South China Sea.

Although the attempt by Japan to use its involvement in infrastructure support to exert pressure on Cambodia with regards to the Permanent Court of Arbitration's ruling on the South China Sea[47] has not proved successful (at least not so far), it constitutes another example of the connection between infrastructure commitments and geopolitical objectives.

44. The DPJ New Growth Strategy was formulated in June 2010, and the Infrastructure Export Strategy was published in May 2013,
45. Officially the objective is two-fold: to support Japan's economic growth and to help the economic development of partner countries.
46. The recently launched Japanese "Initiative for a Free and Open Indo-Pacific" provides another illustration of this shift.
47. Zhao (2018).

Conclusion

There is no denying that the Mekong region has become an economic battleground where the two regional giants are competing to gain and sustain economic influence in the region. Japan has lost out to China in various areas (countries or sectors) despite its long head-start in investing in the region, but it still maintains an entrenched position in Thailand as well as in Vietnam, and its influence seems to be on the rise in Myanmar.

However, each country has managed overall to create or maintain its own sphere of influence, thus reducing the risk of direct head-to-head competition. Even within one single country, Japan and China tend to be involved in different areas, in different types of activities and through different instruments, thus avoiding real confrontation. From the host countries' perspective, this rivalry can be positive.

Behind economics, however, the two countries are also competing for political influence, and their commitment to development promotion, and in particular to infrastructure development, may be instrumentalized with strategic objectives in mind. This is perhaps where the impact of the China factor has been the largest on Japan's stance vis-à-vis the region.

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Appendix

Greater Mekong Transport Corridor

Source: Hong Kong Trade and Development Council.

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