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Japan Pursues a 'Thailand-Plus-One' Strategy

*By Pavin Chachavalpongpun**

EXECUTIVE SUMMARY

- Thailand's political crisis has shown no sign of subsiding and has had a far-reaching political and economic impact on its relations with economic partners, such as Japan.
- While Thai-Japanese economic ties remain strong, Japanese companies are closely monitoring political developments and have put in place back-up plans for fear of an escalation of political conflict in the kingdom.
- One of Japan's backup plans is the realisation of a Thailand-Plus-One business model, which seeks to transfer labour-intensive industries from Thailand into its neighbouring countries. The Thailand-Plus-One initiative allows for Japanese businesses to diversify risks in their operations in Thailand.
- The impact the Thailand-Plus-One policy on Thailand could be immense should it fail to recover from its prolonged crisis. Its neighbours are at the same time eager to welcome foreign investors, and are formulating attractive policies to encourage inflows of foreign direct investments.

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INTRODUCTION

Anti-government protesters led by Suthep Thaugsuban, former member of parliament from the opposition Democrat Party, kicked off months-long demonstrations at the beginning of November last year. Their objectives are manifold. They object to the government's controversial blanket amnesty bill and disapprove of the ruling Pheu Thai Party's proposed amendment of a provision in the constitution to change the Senate from a partially-elected to a fully-elected chamber. They also want to eliminate the so-called "Thaksin regime", once and for all. Thaksin Shinawatra was Prime Minister from 2001 to 2006, and was the most popular Thai premier since the abolition of absolute monarchy in 1932. Thaksin won two landslide elections and has continued to cast a long shadow over Thai politics, including during the current premiership of his sister, Yingluck Shinawatra.

The present political conflict can be traced back as far as 2005, a year before the military coup that toppled Thaksin. His popularity and electoral success were seen to pose too great a threat to the old power structure in Bangkok. Prior to the emergence of Thaksin, Thailand had been dominated by an elite network centred around the monarchy. This particular network—known commonly today as the 'network monarchy'—sustained a system that kept civilian governments vulnerable. As Thaksin increasingly strengthened his power base through effective populist policies, his enemies felt compelled to defend their position. The end result was the 2006 military coup. But the coup that was meant to protect the interests of the establishment gave birth to a new and opposing movement whose members identify themselves as 'red shirts'. Since the coup, the pervasive influence of Thaksin has continued to haunt the traditional elites. The struggle between the network monarchy and the new political force driven by Thaksin has become increasingly intense. In addition, the imminent royal transition has heightened anxiety on the part of Thaksin's enemies. They have sought to lessen, or even deracinate, Thaksin's political sway to prevent him from influencing the royal succession.

The protracted crisis has had a far-reaching political and economic effect on the country's partners. The United States and China have voiced concern, possibly fearing that prolonged instability will affect their investments and their cooperation in other areas. The Chinese government even breached its rule of non-interference by suggesting that all opposing sides in Thailand find a peaceful solution to the crisis.¹ Meanwhile, some members of the American Congress and mass media have put pressure on the US government to clarify its position on the Thai crisis; they have continued to depict the protesters as being somewhat undemocratic in their demands and behaviour.²

¹ See detail <<http://www.thaigov.go.th/en/news-room/item/81687-chinese-ambassador-hopes-for-peaceful-dialogue-to-end-thailand%E2%80%99s-current-political-conflict.html>> (accessed 26 February 2014).

² See, "Thailand's Anti-Democracy Protests should Provoke a Harsh Rebuke from the US", *Washington Post*, 16 January 2014 < <http://www.washingtonpost.com/opinions/thailands-anti-democracy-protests-merit-a-rebuke->

But the United States and China are not the only two powers affected by the crisis. Japan, a major economic partner of Thailand, has felt the political heat too.

THAI-JAPANESE BUSINESS TIES

In November 2001, Thaksin visited Japan to meet his counterpart, Junichiro Koizumi. The two agreed to commission a study for a “Japan-Thailand Free Trade Agreement” and an “Economic Agreement for Partnership”.³ These two initial ideas later gave birth to the negotiations for the JTEPA (Japan-Thailand Economic Partnership Agreement). Prior to the JTEPA, bilateral trade had already expanded significantly over several decades. According to Japanese trade statistics, trade between Thailand and Japan totalled JPY2.85 trillion in 2002. Japan had in fact long been Thailand’s largest trading partner. Meanwhile, Thailand ranked as Japan’s 8th largest trade partner. Moreover, Japan had remained the largest investor in the kingdom both in terms of the number of investors as well as the amount invested. In 2002, according to Thailand’s Board of Investment, Japanese investors in Thailand totalled 215, equivalent to 45 per cent of the kingdom’s total investors.⁴ Hence, JTEPA was expected to enhance trade, investment and cooperation between two countries.⁵

The JTEPA was achieved in 2007, one year after the departure of Thaksin, and immediately came into effect. The total trade volume between Thailand and Japan, as well as Japan’s direct investment in Thailand, noticeably increased after its implementation. In general, it is estimated that JTEPA improved the real GDP growth of the Thai and Japanese economies by 0.42 per cent and 0.11 per cent respectively. As would be expected, consumption and investor confidence improved with the increase in national incomes. Thai-processed agricultural products noticeably benefited the most with outputs and exports growing by 29.58 per cent and 85.17 per cent respectively. Meanwhile, agricultural products enjoyed a 3.08 per cent growth in output. Japan, on the other hand, expanded its production in most manufacturing sectors, with motor vehicles and parts benefiting by 1.10 per cent and 1.81 per cent in output and export growth rates, respectively.⁶

from-the-us/2014/01/15/ca2205a8-7e1b-11e3-95c6-0a7aa80874bc_story.html > (accessed 26 February 2014).

³ “Visit to Japan of Prime Minister of the Kingdom of Thailand, H.E. Pol. Lt. Col. Thaksin Shinawatra”, Ministry of Foreign Affairs of Japan, 26 November 2001. Source: Japan’s Ministry of Foreign Affairs.

⁴ *Japan-Thailand Economic Partnership Agreement Task Force Report*, Ministry of Foreign Affairs of Japan, December 2003 <<http://www.mofa.go.jp/region/asia-paci/thailand/joint0312.pdf>> (Accessed 26 April 2009).

⁵ Pavin Chachavalongpun, *Reinventing Thailand: Thaksin and His Foreign Policy*, (Singapore: Institute of Southeast Asian Studies, 2010), p.212.

⁶ Pachara Lochindaratn, *The Evolution of Thailand’s Preferential Trading Agreements with Australia, New Zealand, Japan, China and India – The CGE Approach*, The Global Trade Analysis Project, Centre for Global Trade Analysis, Department of Agricultural Economics, Purdue University (10 April 2008) <<https://www.gtap.agecon.purdue.edu/resources/download/3726.pdf>> (accessed 26 April 2009).

As the country fell into deeper political crisis with the overthrow of the two Thaksin-backed governments of Samak Sundaravej and Somchai Wongsawat through a pair of 'judicial coups' in 2008, confidence in Thailand's political stability among Japanese investors decreased. In late 2011, Thailand suffered enormously from the devastating floods in large parts of the country. Japanese factories in the central plains of Thailand, particularly in Ayutthaya where 180 Japanese companies were located, were forced to halt operations, causing massive disruption to the global supply chain for automobiles and electronics.

Political divisions quickly re-emerged as the flood waters reached the Bangkok Metropolitan Area, a key constituency of the opposition under the leadership of Bangkok Governor M.R. Sukhumbhand Paribatra. The governor, a key member of the Democrat Party, had been at loggerheads with Yingluck since the beginning of the national disaster. Japanese conglomerates expressed grave anxiety over the impact of the floods on their businesses. Interviews with a number of Japanese businessmen revealed that what they feared most was not the floods, but the political tides.⁷

The current political wrangling has shown no sign of subsiding and has been hurting the kingdom's appeal as an investment destination. This has caused Japanese companies to re-examine their strategies. Already, the crisis is exacting a significant toll on the economy, which is expected to grow 4.3 per cent this year, down from an earlier projection of 5.2 per cent. The Finance Ministry has warned that growth may fall to as low as 3 per cent if the unrest persists.⁸ For now, many foreign investors remain committed to Thailand. Japanese companies are however closely monitoring developments, and have put in place backup plans for fear of an escalation in the conflict. According to a recent survey, 73 per cent of Japanese joint venture companies have already called on the Thai government to maintain political stability especially during the Bangkok shutdown protests. Some of the others are more optimistic about the situation.⁹ In fact, former Japanese Defence Minister, Yuriko Koike, went further by stating:

In essence, what is happening in Thailand is an attempted nullification of democracy by the opposition and the country's entrenched elite. Unable to compete successfully with Thaksin for votes, they now want to dilute Thai democracy in order to prevent the electorate from ever again choosing a government that goes against their will.¹⁰

⁷ Interviews conducted in the areas of Osaka and Kyoto, during Thailand's floods crisis, 2011.

⁸ See Kathy Chu and Nopparat Chaichalearmmongkol, "Thai Protests Put Foreign Investment at Risk", *Wall Street Journal*, 8 January 2014 <<http://online.wsj.com/news/articles/SB10001424052702303754404579308042512208898>> (accessed 25 February 2014).

⁹ "Japanese Investors Bemoan Political Turmoil", *Thailand Business News*, 29 January 2014 <<http://www.thailand-business-news.com/news/top-stories/48436-japanese-investors-call-stability.html>> (accessed 25 February 2014).

¹⁰ Yuriko Koike, "Who Lost Thailand?", *Project Syndicate*, 26 February 2014 <<http://www.project-syndicate.org/commentary/yuriko-koike-criticizes-democratic-countries--indifference-to-the-threat-posed-by-the-thai-opposition-s-strategy-of-protest>> (accessed 26 February 2014).

Echoing the apprehension of Japanese businesses, Japanese Ambassador Shigekazu Sato expressed his own concern in December 2013. Referring to the stance of Prime Minister Shinzo Abe and Foreign Minister Fumio Kishida, Sato emphasised to an audience of about 100 at an event to celebrate Japanese Emperor Akihito's 80th birthday that "[a]s the largest foreign investor in the country with a big Japanese community living here, we wish all parties concerned will resolve the conflicts in a peaceful and democratic manner within the framework of the constitution."¹¹

THE THAILAND-PLUS-ONE POLICY

Japanese firms have started to capitalise on a Thailand-Plus-One strategy in Southeast Asia by using Thailand as a hub to expand their business in the region and reap the benefits of upcoming regional integration and free trade agreements. In addition, this strategy allows Japanese companies to penetrate neighbouring markets and adjust for divisions of labour. It was an idea catalysed by the Japanese business community, which looked into relocating some of the labour-intensive production to Thailand's neighbours, especially the so-called CLM, namely Cambodia, Laos and Myanmar. Thailand, in other words, has become too expensive for certain labour-intensive manufacturing activities. Other challenges facing Japanese investors include rising minimum wages and shortage of labour.

Due to the protracted crisis, more Japanese firms are pursuing the Thailand-Plus-One strategy to avert the risk of concentrating all production in one country. Even a high-ranking Thai official admitted that the unending political turmoil could have driven Japanese companies to shift part of their production from Thailand to take advantage of the political stability and abundant inexpensive local resources found elsewhere. Sihasak Phuangketkeow, Permanent Secretary of the Thai Foreign Ministry, reiterated that Japanese companies have shifted parts of their businesses to "Plus-One" locations such as Laos and Cambodia.¹²

The Plus-One idea in itself is not new. In the past two decades, Japan has been investing in China as a low-cost production base. But the Chinese economy matured, and is no longer just a place where low-priced textiles and toys are produced, but also one where high-end items like computers and cars are also made. As wages climb and skill levels rise, China stopped being Asia's cheapest labour market. This situation gave birth to the China-Plus-One strategy. Instead of relying on China as their sole beachhead in Asia, foreign companies relocated parts of their factories

¹¹ "Thai Politics Worry Japan Envoy", *Bangkok Post*, 20 December 2013 <<http://www.bangkokpost.com/news/local/385921/japan-hopes-conflict-ends-soon>> (accessed 25 February 2014).

¹² "Japan Vows to Aid Mekong States toward ASEAN Economic Community", *Global Post*, 18 February 2014 <<http://www.globalpost.com/dispatch/news/kyodo-news-international/140217/japan-vows-aid-mekong-states-toward-asean-economic-com>> (accessed 25 February 2014).

from China to its neighbours, such as Vietnam, Indonesia and India.¹³ Learning from these experiences, Japanese businesses are now implementing their Thailand-Plus-One policy to relieve economic burdens, exploit growing markets in Thailand's orbit and diversify political risks away from the kingdom. It is important to note that, as in the Chinese case, instead of searching for sophisticated markets to pursue lucrative businesses, Japanese companies are attracted to the idea of linking up their production base in Thailand with small and medium cities in border areas as alternative locations for manufacturing.

Economically speaking, and as alluded to earlier, labour-intensive industries in Thailand have increasingly become unviable due to rising wages—as seen in an increase of up to 30 per cent in the past few years—and labour shortages (Thailand's unemployment rate is under 1 per cent). In terms of political risks, relentless conflicts marked by intensifying political violence will delay foreign direct investments, including from Japan. The prospect of the conflict coming to an end soon is slim, based on the argument that it has been prolonged mainly because of anxiety among the traditional elites over the impending royal transition, a process that may be drawn out.

Perhaps as a spill-over effect of the relocation of Japanese production, Thailand's neighbours have seen improvements in their domestic economic conditions with rapid growth being seen in Cambodia, Laos and Myanmar. Their growth rates have exceeded those of the original members of ASEAN. The governments of Cambodia, Laos and Myanmar have been eager to welcome foreign investors, and are formulating attractive policies to encourage inflows of foreign money. Incentives such as infrastructure upgrades, fairer business laws, concessions for foreign investments and political stability guarantees are on offer to potential investors, from near and far.

Myanmar, in particular, has recently captured the interest of Japanese business. Prime Minister Abe paid the first visit to Naypyidaw, the first such high-level visit by Japan in 36 years. During the trip, Abe voiced support for the country's ongoing reforms, and sought to secure privileged access for Japanese firms. Japan also wrote off nearly US\$2 billion in debt, and extended new aid—as part of its Thailand-Plus-One strategy—for an industrial zone being developed by Japanese companies. The opening up of Myanmar will not only benefit Japan, in terms of reducing its investment risks in Thailand, but also place Japan in a better position to meet the rise of Chinese influence in this part of the world.

Thailand-Plus-One also stands to benefit from the transportation infrastructure developments that come under the Greater Mekong Sub-region Development Project, which will supply cheap labour from Cambodia, Laos and Myanmar to Thailand's industrial sites.¹⁴ Some Japanese automobile parts producers, electronic parts makers

¹³ Stuart Witchell, "China Plus One", BCCJ Acumen, May 2011 <<http://bccjacumen.com/features/business-risk/2011/05/china-plus-one/>> (accessed 25 February 2014).

¹⁴ Keiichiro Oizumi, "Indochina's Economic Growth and Thailand Plus One", *The Asahi Shimbun*, 21 August 2013 <<http://ajw.asahi.com/article/views/opinion/AJ201308210030>> (accessed 25 February 2014).

and consumer goods manufacturers operating in Thailand have indeed begun to relocate their labour-intensive production just across the Thai border to places such as the Laotian province of Savannakhet and Koh Kong province and Poipet town in Cambodia.¹⁵ As for Myanmar, the Thai-led project at Dawei, a deep-sea port and industrial estates project, has already attracted Japanese investors. Tokyo has confirmed its interest in developing the Dawei Special Economic Zone.¹⁶ Prime Minister Yingluck recognises that Japanese partnership will be essential to the success of the megaproject, and she made attempts during her visit to Tokyo in May 2013, to entice Japanese businesses to invest in Dawei.

CONCLUSION

The Thailand-Plus-One initiative is designed to consolidate Thailand as a regional hub of manufacturing, controlling smaller-scale production bases in Cambodia, Laos and Myanmar. Japan, at the same time, is able to expand its economic presence in the region, not only to pave the way for potential investments from Japanese businesses but also to raise Japan's own competitiveness in fierce competition with China. From this perspective, Japan's Thailand-Plus-One policy is a win-win formula for its businesses and the local hosts. Japan has no wish to abandon its long-term investments in Thailand because of the strength of the Thai economy, its skilled labour force and a considerably reliable production process.

However, the political crisis has encouraged Japanese companies to search for more reliable partners in the region. With Japanese investors already nervous about the fragile global recovery; competition with China, and Japan's own economic recession, Thailand's political stalemate lessens its appeal to Japanese business and has led to dangerous capital outflows. To be sure, after more than three months of demonstrations in Bangkok, the impact on the economy is palpable. As the tourism industry gets hit hard, foreign investors delay their purchasing decisions. Unavoidably, the relocation of various legs of production to the CLM countries at this critical point in Thai politics, will be taken as a sign of diminishing confidence in the country's economy. As the largest economy in mainland Southeast Asia, and second only to Indonesia in ASEAN, Thailand's economic trajectory, during the current crisis and in its aftermath, will greatly influence the regional economy. Political uncertainty in Thailand may cause huge disruption to the regional integration process. Japan's Thailand-Plus-One policy may solve a part of its investment dilemma in the region, but it also sounds the alarm on the seemingly unending instability in Thailand.

¹⁵ Ibid.

¹⁶ Onrawee Tangmesang, "Japan Remains Strongly Interested in Dawei", *The Nation*, 21 October 2013 <<http://www.nationmultimedia.com/business/Japan-remains-strongly-interested-in-Dawei-30217533.html>> (accessed 27 February 2014).

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