Integration of East Asian Economies: A Role for the United States and Japan

Opening Remarks by Osamu Watanabe, Chairman and CEO of JETRO at the Center for Strategic and International Studies (CSIS) in Washington, D.C., United States on December 14, 2005

Introduction

Last year here in Washington, JETRO held a seminar on economic integration in East Asia. At the seminar, I spoke about the region’s de facto integration that resulted from the production network Japanese and American firms built in the region. I said that the trend in East Asia now is to conclude FTAs and EPAs, a sign that governments in the region are committed to accelerating the integration process.

This acceleration continues: in Kuala Lumpur at the “ASEAN Plus Three Summit” on December 12th—and at the first “East Asia Summit” held today—country leaders discussed further integration of the region and talked about issues towards building an “East Asian community”. This seminar today, coming so close to these key summits, offers a timely occasion to discuss (as we did last year) the roles expected of the United States and Japan in the region.

1. Japanese economy on a solid recovery track and integration of East Asia

(1) “Japan is back”

After hitting rock bottom in January 2002, the Japanese economy had been on a recovery track for about 30 months. The recovery hit a soft patch and slowed somewhat in mid 2004, but returned to a solid recovery track this summer.

Japan’s economic turnaround owes much to restructuring efforts made in the private sector, as firms worked to shed past excesses of facilities, employment and debt. “Japan is back”. Corporate profits have greatly increased, and the benchmark Nikkei average is now at twice the level it had sunk to in early 2003.
(2) Japanese firms’ business network in East Asia

There is another factor in Japan’s recovery. Japanese companies have been building production bases across East Asia, including ASEAN, where Japanese firms have been for years, and China, where Japanese investment continues to flow. Utilizing the network of production bases in East Asia and Japan, these firms have formed a strategy for optimal production and procurement that is proving profitable. As a result, East Asia is now covered with division-of-labor networks built by multinationals from Japan and other countries. This new business model is a natural course for Japanese firms, considering that Japan’s population will start declining.

An American economist friend of mine pointed out that, in the United States, immigration adds to the population and workforce. This is not the case for Japan, he said, and that the country will face a shrinking GDP as its population declines. I told him my belief that the Japanese economy will grow together with East Asia. As a result of the strong network Japanese companies have built in East Asia, Japan’s economic sphere will continue spreading across the whole region, allowing Japan to utilize excellent human resources available in ASEAN and China, while (at home) working to raise its total-factor productivity. In other words, East Asia will become one seamless economic entity.

2. From East Asia Free Trade Area to East Asian community

(1) Towards an East Asia Free Trade Area

About 53% of East Asia’s total trade is intra-regional—somewhat less than 67% for the EU 27 (including Bulgaria and Romania, both scheduled to join in 2007), but higher than 46% for NAFTA. The East Asia figure suggests that the region’s integration is rapidly intensifying.

ASEAN is leading the move in East Asia to give government-level form to the region’s existing de facto integration. Under the ASEAN Free Trade Area, or AFTA, ASEAN member governments aim to eliminate all import duties for trade among its six original members by 2010—and among the full ASEAN 10 by 2015.

ASEAN and China agreed on an FTA—scheduled for completion by 2010—in which tariff rates are already being reduced. ASEAN and Korea, at yesterday’s summit
meeting, signed a basic agreement on an FTA to be completed by 2010. ASEAN is also negotiating a comprehensive EPA with Japan, which is scheduled for completion by 2012 or earlier. So, by 2010—or 2015 at the latest—East Asia will have three FTAs that have ASEAN on one end.

At the same time, ASEAN’s partners (Japan, China and Korea) are negotiating FTAs among themselves. So by 2020, an East Asia FTA, covering the entire region, should be in place.

ASEAN is also looking to the west and south: ASEAN and India are now working to reduce tariffs and other barriers by 2011; and ASEAN opened FTA talks with Australia and New Zealand earlier this year. It seems likely that the East Asia Free Trade Area will someday include these western and southern partners as well.

(2) Movement towards building an East Asian community
Integration of East Asia is progressing with ASEAN in the driver’s seat: ASEAN started with six member countries, the “ASEAN 6”, and added four more in the late 90s to become “ASEAN 10”. In the wake of the Asian financial crisis in 1997, ASEAN, Japan, China and Korea held the first ASEAN Plus Three Summit, under the common recognition that broad cooperation and collaboration were necessary in the region. ASEAN Plus Three meetings initially discussed cross-border economic issues covering trade & investment, currencies and finance, and later added social, cultural and also political and security matters to the agenda.

As the ASEAN Plus Three meetings became a platform for discussion on a broad range of topics, member countries realized the need for institutional integration, in addition to the functional integration they have been working on. Institutional integration, in the idea of the members, was to evolve the ASEAN Plus Three Summit into the East Asia Summit, and to create an East Asian community. There was a difference of opinion among member countries on the concept and framework of the new summit and the East Asian community: It is my understanding that China and some ASEAN members insisted that the building of an East Asian community should be discussed only among the ASEAN Plus Three members. Japan and the other ASEAN members—out of concern that such a limited framework would allow China to expand its influence over East Asia—made the point of including India, Australia and New Zealand in the community. After much debate, it was finally settled to have two summits: the East Asia
Summit, including ASEAN Plus Three and India, Australia and New Zealand; and the original ASEAN Plus Three Summit.

It was agreed at the summits that the ASEAN Plus Three process will be the “main vehicle” in realizing the East Asia community, and that the East Asia Summit will play a “significant role” in community building.

Back in January 2002, Prime Minister Koizumi made a speech in Singapore in which he proposed the building of an East Asian community or, to use his words: “the creation of a community that acts together and advances together”.

Japan’s basic stance on an East Asian community is built on three pillars. First, it should be created in accordance with the principle of “open regionalism” (that is, it should be transparent and inclusive). Second, it should focus on promoting functional cooperation in areas such as finance and FTAs. Third, it should respect universal values, such as democracy and human rights, as well as global regimes, such as the WTO.

Standing on the “open regionalism” principle—and because India, Australia and New Zealand have already been moving towards economic integration with ASEAN—Japan supports the inclusion of these countries and discussion of an East Asian community at the East Asia Summit.

(3) The US’s concern and roles of Japan
I understand that there is concern in the United States that an East Asian community may restrict the United States’ say in the region’s security issues and economic policy, or that China may expand its influence over ASEAN.

The security framework in East Asia is built on the “hub and spoke” system, with the United States at the center; the American presence is essential to the peace and stability of the region. Moreover, for most countries in the region, keeping favorable trade ties with the United States, their largest export market, is a prerequisite for economic development.

Economic integration of East Asia is a natural process that cannot be reversed. Realizing this, the United States should increase its engagement with the region.
As the United States’ most important ally in East Asia, Japan is responsible for convincing the United States that the East Asian community and American engagement in the region are compatible. Both countries should work together to set out concrete measures and prove them through implementation.

3. Positioning China

(1) Japan-China relations
While Japan represents 60% of the combined GDP of ASEAN Plus Three, China accounts for 20%. A good relationship between Japan and China, the region’s two largest economies, along with China’s sustainable development, is therefore vital to the stability of an integrated East Asia.

Summit and ministerial talks between Japan and China have been put on hold for some time. It is not uncommon for two neighboring countries, especially major ones, to have differing views and outstanding issues. But, as with any neighbors, the cause of discord often lies with both sides. My point is that Japan and China should make every effort to improve and develop bilateral relations through active exchange on various levels.

(2) Challenges for China
China faces a number of structural problems that put sustainable development at risk.

Firstly, China must deal with the growing disparity between the rich and the poor, and between coastal and inland provinces. Regarding the latter, China’s Vice Premier Wu Yi pointed out that China must continue shifting as many as 250 million to 300 million people, over the next 10 to 15 years, from under-productive rural areas to cities. Urban development and job creation are imperative to facilitate this population flow.

Secondly, the country needs to shift its industrial structure toward one that is energy efficient: China’s energy consumption per unit GDP is about eight times that of Japan.

Thirdly, China must play its part in environmental issues, including global warming, and, fourthly, better protect intellectual property rights. Although the Chinese government has increased efforts to crack down on IPR infringements, there is still room for improvement.
4. US Commitment in regional issues and US-Japan cooperative efforts

(1) Managing risks concerning China

The biggest challenge facing East Asia today is how to manage the risks associated with China’s economic rise—such as an economic slowdown, energy and environment-related problems, as well as political and social destabilization. Whether the region can achieve stable and sustainable growth—and whether American and Japanese businesses can benefit from such growth—will depend on how well the region manages these risks. It should be done not by confronting or excluding China, but by convincing the country that following multilateral rules is for its own good, and by encouraging China to bring its legal and administrative systems in line with such rules.

(2) Significance of Indonesia

As I said, ASEAN is the hub of East Asia’s economic integration. Therefore, it is important that ASEAN remain united and competitive to ensure that integration proceeds smoothly. ASEAN’s stable growth very much depends on Indonesia, the region’s anchor. But for years following the 1997 Asian financial crisis, a lack of strong leadership impeded Indonesia’s economic development and cast a shadow over ASEAN’s development as well. Today, under the leadership of President Yudhoyono, Indonesia has the best (and perhaps last) chance to set its economy on a road to sustainable economic development. I think Japan and the United States should join hands to support Indonesia’s efforts.

(3) Framework for Japan-US collaboration in East Asian issues

In closing, I would like to propose a three-tier approach for Japan and the United States to collaborate in dealing with various issues facing East Asia. The three tiers—bilateral, plurilateral and multilateral (primarily APEC)—should be formed on various levels, varying from government, academia and businesses to NPOs.

The first tier, or bilateral approach, should consist of two-party forums to discuss strategic issues concerning East Asia, especially China: issues may include intellectual property rights protection, investment climate and liberalization of capital transactions. An example of this is a recent proposal by the US-Japan Business Council urging governments of both countries to explore the feasibility of a Japan-US EPA. For a pair of close allies that share common values, this is indeed an issue to work on.
The second tier, or plurilateral forums—such as the six-party talks on North Korea’s nuclear programs—is a framework in which relevant countries can discuss particular issues. These frameworks should be built in such a way that China is obligated to make reforms at home, in return for drawing solutions for its energy conservation issues, urban problems and others.

A good example is the “Asia-Pacific Partnership for Clean Development and Climate”. Under the six-country pact, initiated by the United States and supported by Australia, China, India, Japan and Korea, joint projects are already underway in the field of energy conservation and development and sharing of clean energy technologies. I feel that the framework, although still in its infancy, will prove beneficial.

As for the third tier, the multilateral approach, we have an existing framework, APEC, that needs to be revitalized. At the 2005 APEC meetings held last month in Busan, Korea, it was agreed to drive forward the WTO Doha round negotiations and to adopt a roadmap to achieve the Bogor Goals (of liberalizing trade and investment by 2010 for developed economies and by 2020 for developing economies). I would like to suggest that APEC be further revitalized and that the United States and Japan jointly lead programs for capacity building, cross-border protection of intellectual property rights and other areas where the interest of developing countries is high.

Closing

I had the impression that, after the 1997 Asian financial crisis, the United States seemed to pull back from East Asia. So the huge outpouring of aid and assistance from the United States following last December’s terrible tsunamis was deeply appreciated by the people of the region. I would like to conclude by saying that East Asia is committed to shaping its own future, and at the same time strongly believes in the United States’ continued presence and constructive engagement in the region.

Thank you for your kind attention.