

## How Far Have We Come Toward East Asian Community?

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### 1. Economic and Social Development in East Asia

Section III of our Background Paper gives us a concise overview of the economic and social development in East Asian economies for the past three decades. Their continued growth, often described as a miracle, qualified them as a driving force of the world economy. They suffered from a serious setback at the financial crisis in 1997-98 but most of them have recovered back to the track of dynamic growth by 2004. However, rapid growth itself causes frictions with vested-interests at home which impede reform efforts. The region still involves under-developed areas where humane security is insufficiently provided. Demographic trend toward less children and aging population in advanced economies tends to cripple the region's continued growth, while the movement of people still remains uncoordinated within the region to supplement the decreasing labor force. Regional cooperation has gained momentum in the region for the past several years so that trade and investment liberalization is pursued and financial and currency cooperation are attempted. The region-wide cooperation such as ASEAN plus Three has been established and East Asian Community has started to be mentioned. Then the paper raises such 'Key Questions' for further discussion during the conference as 'viability of the demographic change', 'feasibility of financial cooperation', 'prospect for achieving East Asian Community', and 'emerging need of cooperation for terrorism, epidemic, and Tunami'.

I, by and large, agree on its overview. Some economies made a V-shape recovery in 1999-2000 and almost all East Asian economies have returned to more than 5% growth by 2003-2004. However, there still remain structural deficiency which underlay the financial crisis. I would like to extend the Background Paper's argument focusing on the regional trade cooperation, clarifying the following points. First it has gained momentum in the recovery process from the financial crisis, which reflects a clear economic rationale underlying in it. Although it has been criticized by international organization and economists outside the region, East Asia is a late comer in the regionalization moves and its trade distorting effects has hardly effected yet unlike NAFTA and European Union. East Asian Economic Community is still a remote goal and the region is not ripe yet to fulfill its political and social conditions. Nevertheless, we have to guide its regionalization move of various forms toward the East Asian community. Most of the key questions asked in the Background Paper will be answered in due course.

### 2. How the Regional Integration Emerged in East Asia

Continued economic growth of East Asian economies for the past three decades reflected their success (often described as 'miracle') in meeting to the globalization challenge but their setback due to the Asian financial crisis in 1997 - 1998 was caused by policy failure as well as structural deficiencies.

The regional integration has gained momentum in the recovery process. Their governments sought economic cooperation with neighboring economies in order to avoid a recurrence of the crisis, first in the form of currency cooperation and then in various forms of regional trade agreements. Japan and China have emerged as active participants in these moves.

Trade and investment had increased among East Asian economies for three decades before the crisis, which was achieved without formal agreements among governments and was called a market-driven integration. Nevertheless, trade liberalization, facilitation, and economic cooperation have been implemented in wider regional cooperation such as Pacific Economic Cooperation Conference (since 1980), Asia Pacific Economic Cooperation (since 1989) and World Trade Organization<sup>1</sup>.

Steady expansion of trade and investment has been accompanied by rapid financial integration in terms of increased flows of foreign capital across money and capital markets in the region. Before the Asian crisis the dollar peg and capital-account liberalization supported this integration process. Regular consultation by finance ministers and Central Bank governors had started to facilitate this integration, but did not work in time to prevent the crisis. Japanese financial assistance (such as New Miyazawa Initiative) supplemented insufficient support by IMF in helping the crisis-hit economies out of initial liquidity crisis.

A variety of bilateral free trade areas (FTAs) have been proposed and negotiated, as well as sub-regional integration concepts, such as those involving China and the Association of Southeast Asian Nations (ASEAN), Japan and ASEAN, and ASEAN + 3, the Southeast Asian group plus China, Japan, and Korea. They have mushroomed for the past several years, which invite criticism and warning by economists outside the region. However, as is shown below, they are late-comers in the global trend of regionalization, urged by 'competitive liberalization'. They primarily pursue economic rationales for liberalization and structural reform in the region.

### 3. Current State of East Asian Regionalism

Table 1 lists up major regional integration agreements among East Asian economies and with outside economies at various stages from joint study, negotiation, basically agreed, signed, and to one already effected. Except AFTA, all have started since 2000, and those within East Asia counts only one-quarter, while the remaining three quarters are undertaken with outside economies. Only 6 of the 'within' agreements are effected, while 8 are effected 'with outside', out of which Singapore made 5 agreements effected. Contrary to the often made criticism, East Asia is a late comer in this move, much behind Europe and America and trade diversion effects have hardly been materialized in East Asia unlike NAFTA and EU.

AFTA (ASEAN Free Trade Agreement) started in 1992 and expanded from original ASEAN members to Vietnam, Laos, Cambodia, and Myanmar. The new members has started implementation only partly,

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<sup>1</sup> PECC is a regular forum of consultation participated by three parties of business, government, and academic in 24 members in Asia Pacific, assisted by task forces on various cooperation issues. APEC started as annual meeting of foreign and economic ministers of Asia Pacific economies but was upgraded by adding Leaders' Meeting (Presidents and Prime Ministers) since 1993. Both cover a wider pacific area including Oceania, North and South America as well as East Asia. But they have still remained as voluntary organization without much binding obligations (only peer pressure in implementing their agreements)

while original members keep sensitive areas out side the scheme. Services trades are excluded, which impedes the realization of a 'single ASEAN market'. Bilateral FTAs have proceeded both within and with outside East Asia, reflecting less difficulty in reaching agreement. However, even between two economies, the negotiation meets across strong resistance by vested interest groups and often results in a 'low-level FTA'.

Peculiar in East Asia is sub-regional FTAs such as ASEAN-China, ASEAN-Japan, ASEAN-Korea, and ASEAN + 3 (China, Japan, and Korea). Nowadays there are plenty of opportunities-such as APEC, ASEAN + 3, and Asian Development Bank meetings-for leaders and ministers of East Asian economies to discuss strengthening cooperation. The ASEAN + 3 Economic Ministers' Meeting in Bandar Seri Begawan in September 2002, provided the most important occasion to promote the China-ASEAN and Japan-ASEAN FTAs. Chinese and ASEAN leaders had agreed in November 2001 to form an FTA within 10 years. At this meeting their economic ministers added an "early harvest" implementation of reduced tariffs on hundreds of items in eight agricultural sectors within the 2004-06 period. A framework agreement incorporating these steps was signed by their leaders at a summit meeting in November 2002. Meanwhile, the economic ministers of Japan and ASEAN agreed to conclude an Economic Partnership Agreement including an FTA within 10 years and to start negotiations in 2004. The Korean economic minister has also spoken of his efforts to explore the possibility of forming a FTA with ASEAN members.

China, Japan, and Korea have started consultations on ways to strengthen regional cooperation among themselves. Based on the proposal by Korean President Kim Dae-jung at the three nations' summit meeting in Manila in November 1999, three research institutes representing the countries started a joint study on ways to promote trade and investment facilitation among the three since 2000.

On the other hand, 'ASEAN + 3' has emerged from Expanded ASEAN economic ministers meeting (inviting major partner countries in Asia Pacific). It has followed up the ASEAN members' recovery process from the crisis and promoted various cooperation. One successful outcome is the network of bilateral currency swap agreement in case of crisis among ASEAN and three countries. They have continued to discuss other forms of currency cooperation, technical assistance to strengthening domestic financial systems and governance, coordination in macro-economic policies, as well as trade and investment liberalization and facilitation.

This year it has resulted in the first East Asian Summit, which will be held in Kuala Lumpur in December this year. The participants are expanded to include India, Australia, and New Zealand. Judging from common interests of all 16 participating members, such new issues of international cooperation as terrorism, epidemics, and Tunami are likely to be on its agenda. However, it is yet to be seen how far such economic issues as financial cooperation and liberalization will be deepened in this new enlarged forum.

APEC has still continued its annual summit and ministerial meetings in the middle of this regionalization movements in east Asia. There is witnessed a clear paradigm shift from APEC to ASEAN + 3 in some members of ASEAN + 3 forum. However, East Asian economies should take full advantage of what APEC has experienced and achieved for the past 15 years. Although APEC still works on voluntarism, its task force networks on trade and investment facilitation and economic and technical

cooperation will help ASEAN + 3 members to achieve its objectives. ASEAN + 3 has started to discuss these issues only recently, but, being mainly developing economies, their capability is limited.

APEC also enables a regular consultation on trade and financial issues with other APEC members outside East Asia, especially with the United States. East Asia cannot live alone and will have to continue its trade, investment and financial transactions with outside. APEC helps East Asia to keep its 'open regionalism'. East Asia has started a biannual consultation with EU members, Asia Europe Summit Meeting (ASEM) since 1996, which also helps East Asia to keep its open regionalism stance with EU.

#### **4. The Way toward East Asian Community**

The idea of current FTAs is that neighboring countries should cooperate to liberalize trade and investment and should reform and integrate domestic systems. It would be better if these liberalization efforts were made on a global scale, such as through WTO negotiations, but few can wait for the 144 members of the WTO to reach an agreement, so countries rush towards the achievable goal of achieving regional economic integration with their neighbors.

On the other hand, criticism is heard against the FTA initiatives based on their inconsistency with multilateral liberalization. This criticism is correct in theory because an FTA incurs a trade-diverting effect on nonmember countries. It is based on the negative static effects of the elimination of tariffs and non-tariff measures between members resulting from the formation of FTA. Many economists, however, admit these negative effects are likely to be more than offset by the positive dynamic effects of intensified competition, economies of greater scale, promotion of investment, and technology flows. Furthermore, the criticism addresses the conventional concept of FTAs defined by Article XXIV of GATT more than 50 years ago, focusing on the elimination of tariffs. Many of the current FTA initiatives aim to pursue the dynamic effects mentioned above through greater coverage of areas including investment and services, rules of origin, harmonization of rules and standards, intellectual property rights, and dispute settlement mechanisms, as well as tariffs and non-tariff measures. This has been shown in the comprehensive Economic Partnership Agreement (EPA). This approach provides a new type of regional integration, different from conventional free trade areas, which minimizes discrimination against nonmembers and is strengthened by trade facilitation and ecotech, or economic and technical cooperation.

Nevertheless, some observers warn against regionalization in East Asia. They contend that new bilateral FTAs are inconsistent with the Bogor goals, may erode APEC's fragile efforts for liberalization, and will impede liberalization efforts under the WTO. These people state that an East Asian free trade bloc will become so inward-looking that it will discriminate against non-East Asian members of APEC and thus stimulate similar regional groupings in other regions, especially in North and South America, and APEC will fall apart into Free Trade Area of the Americas and the East Asian bloc.

However, this reflects fear of imaginary threats and a bit of overreaction, while neglecting the region's need for closer cooperation. East Asian economies are latecomers in terms of FTA initiatives. Here the move toward regionalism is never an aggressive one but no more than a pragmatic approach within the scope of competitive liberalization.

Another rationale for FTAs is joint international implementation in structural reform. It will be helpful in this context to provide guidance in the form of success stories from other countries. The structural adjustment lending offered by the World Bank and IMF already play this role. However, when international institutions encourage structural reforms in specific countries, they may not be in line with the circumstances of the country or region and may create an impression within the recipient country that it has been “forced” to make reforms. By contrast, the mediation of a regional cooperation organization may be able to induce structural reforms in ways that are better suited to the specific conditions of the region. APEC ecotech plays this role in some aspects.

So we rely on closer regional cooperation for joint promotion of liberalization, facilitation, and structural reform. There are two reasons for this joint promotion. First, this approach allows us to better utilize external commitments to our neighbors and peer pressure to break through the vested interest groups’ resistance. Second, our companies operate across national borders and concerted efforts are needed to suggest the best practices or to encourage the implementation of minimum standards at least. This latter point suggests that East Asian cooperation is good for outside companies and other APEC members as well.

The dynamic effects of an FTA are realized only through structural changes to the status quo, and they inevitably meet strong resistance from vested interest groups. Such an agreement can succeed only by breaking these groups’ resistance, which is also the case with WTO liberalizations. In this respect forming a FTA serves as a laboratory for breaking through domestic resistance and thus contributes to the preparation for liberalization under a broader framework such as APEC or the WTO.

Regional cooperation also helps East Asian economies to efficiently implement environmental protection and to secure supplies of food and energy, taking advantage of the complementary positions of Japan and the Asian NIEs with other regional members. Successful integration in East Asia will also intensify competition, however, and will inevitably cause trade disputes between members. A network for closer cooperation is required to resolve disputes and implement industrial cooperation in time for early settlement.

East Asian Economic Community is still a remote goal. A clear economic rationale is identified by many economists for promoting regional integration in East Asia, but economic disparities among Japan, Korea, and China, differences in economic systems, a lack of experience in regional economic integration, and residual distrust from events of the past century have prevented the successful formation of a regional economic community. However, success in the era of globalization will require that the countries of East Asia make every reasonable effort to achieve successful economic integration, such as bilateral and multilateral integration schemes. East Asia should aim at an East Asian Economic Community as its ultimate goal, while making interim efforts to form bilateral and multilateral FTAs to be consistent with the multilateral rules and the APEC/PECC guidance for high-level FTAs so that the momentum of liberalization and reform efforts be continued in the region .

## References:

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