

Strengthening Regional Cooperation in East Asia

【Executive Summary】

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The Japanese government has proposed the concept of an East Asian Community. Unfortunately, however, up to this point no concrete policy has been formulated indicating how to proceed with efforts towards the establishment of such a community. What policy initiatives will be necessary to enable the development of closer relationships between Japan and East Asia? This report considers the problems and the potential inherent in cooperation between Japan and East Asia, chiefly in the economic field, and offers concrete policy proposals concerning the direction in which Japan and the region should proceed.

Thinking about an East Asian Community

At present, the economic ties between East Asian nations are becoming stronger. The concept of an East Asian Community can be seen as an endpoint of the deepening cooperation between the region's nations. It will be necessary to develop a shared awareness regarding certain points: What areas should cooperation be deepened in, what will Japan be required to do to this end, and will it be possible for an entity that can be termed an East Asian Community to emerge from these efforts? In developing such a shared awareness, serious consideration should be given to the following points.

- ✓ Keeping pace with the speed of change in East Asia
East Asia is changing at a rapid pace. The Chinese economy is growing

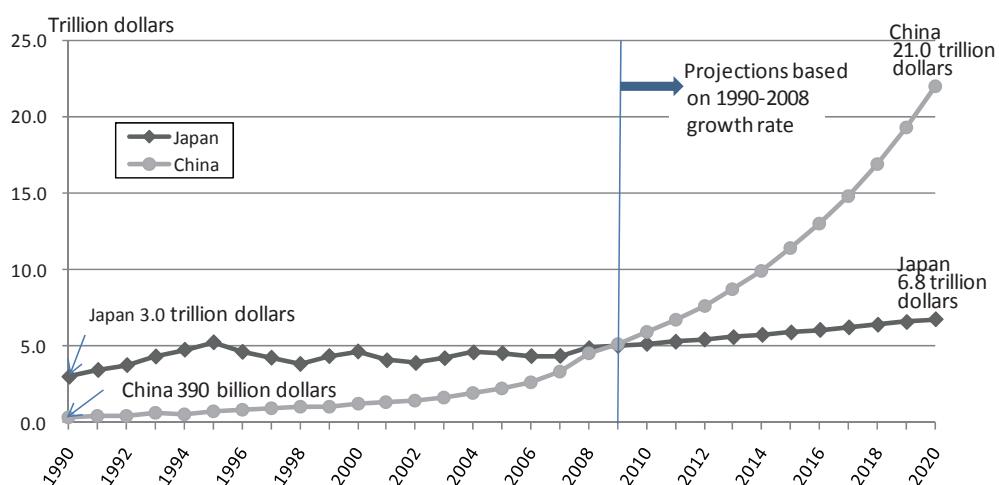
particularly rapidly, and if this trend continues without change, it is predicted that China's economy will be more than three times larger than Japan's in 2020 (Figure 1). However, Japan is not keeping pace with the speed of this change on either the political or the economic fronts. Right now, it is essential for Japan to craft an East Asia strategy predicated on the major changes that are taking place. Japan must avoid at all costs being excluded from East Asia's growth.

- ✓ Learning the lessons of the EU

The experience of European unification offers numerous valuable lessons in considering regional cooperation in East Asia. While the present European financial crisis demonstrates the difficulty of currency unification, the EU did achieve significant successes by pursuing regional unification, including the stimulation of regional trade and investment and the enhancement of political stability. In the East Asian region also, it is necessary to increase the level of economic cooperation in order to prevent political confrontations and discord. Learning from Europe, East Asia must also cooperate as a region, and take the initiative in creating frameworks and systems not merely for the region but for the world.

Figure 1 Trends in nominal GDP for China and Japan

In 2020, China's GDP will far exceed Japan's



* Report, p. 4 (Figure II). Figures up to 2008 are actual figures. Figures from 2009 onwards are projected by NIRI based on the average annual growth rate of nominal GDP, expressed in U.S. dollars, for the period 1990-2008.

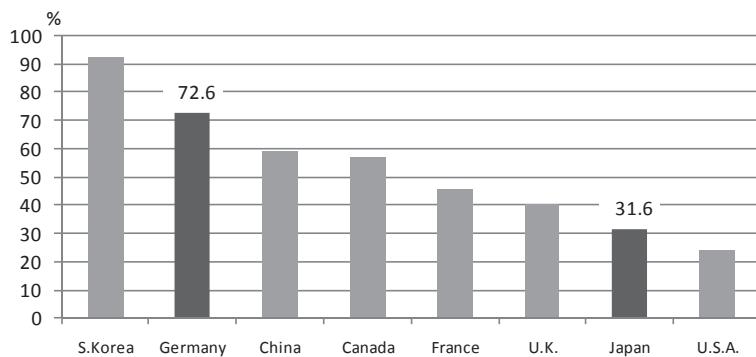
- ✓ Taking the opportunity to increase trade dependency

Japan's level of trade dependency is too low (Figure 2), and it will be necessary to increase it in future. The potential for economic growth in Japan's East Asian neighbors to contribute significantly to expanding the nation's own trade volume is

increasing, and promoting this expansion and smoothly realizing the subsequent large-scale changes in the nation's industrial structure will be a major agenda for Japan's economic policy. East Asia possesses excellent characteristics for promoting a regional division of labor, and there is tremendous significance in proceeding with the formation of EPA and FTA. In addition to increasing the pace of its EPA negotiations, it will be essential for Japan to enter into negotiations towards the conclusion of a Japan-China-Korea EPA, looking towards the establishment of a free trade area that encompasses all of East Asia.

Figure 2 Trade dependency of major nations

Japan's level of trade dependency is less than half of Germany's level



* Report, p.7 (Figure III).

✓ Becoming an “outward-looking” nation

In the 20 years since the collapse of the bubble, Japanese society has, unfortunately, become extremely inward-looking. Opening Japan up to East Asia via regional cooperation will also be very effective in providing the motive force for positive reform in the Japanese economy and in Japanese society. It will be necessary to reexamine, with our gaze turned to the outside, issues that have previously only been considered from a domestic perspective. With the rapid growth of East Asian nations, the trend towards openness is intensifying throughout the region. This is also a tremendous opportunity for Japan, and now is therefore not the time for Japan alone to remain inward-looking.

✓ Recognizing the present importance of multi-tracking

At present, attempting to define an East Asian Community in a concrete form is neither practical nor desirable. The desirable option is to progress step-by-step via the channels that are available to us. What is important above all in the region is maintaining a good relationship between China and the U.S. At present, multi-tracking represents the foundation for regional cooperation. It can be expected that proceeding with cooperation from multiple directions will produce a clearer vision of a future East Asian Community.

✓ Supporting the peaceful and stable growth of China

Regional cooperation in East Asia cannot be considered without China. China's neighbors must support its peaceful and stable growth, not merely via their own economic relationships with the nation, but by constructing mechanisms for regional cooperation in many fields. The maintenance of a stable relationship between China and the U.S. will also be necessary to controlling China's military expansion, and Japan must also not neglect diplomatic efforts to ensure that the relationship between the two nations remains a good one.

✓ Learning from the Asian financial crisis

Responding to a financial crisis is difficult for a single nation in isolation. There are also limits to the functions of international organizations such as the IMF. Mechanisms enabling all the nations in the region to cooperate in responding to a financial crisis are needed. A variety of forms of currency and financial cooperation are proceeding in the region, and the establishment of the Asian Monetary Fund (AMF) now appears as a future possibility. It will be necessary to establish frameworks for currency and financial stabilization, in addition to forums for dialogue concerning fiscal and monetary policy and policy coordination in these areas.

✓ Setting a timeline for regional cooperation

As in the case of trade negotiations, the fact that the nations of the region continue discussions and negotiations at a variety of levels within a variety of regional frameworks is itself of great significance (the "bicycle theory"). It will be necessary to set a timeline for these discussions, and to adopt an approach that incorporates at least the following three points.

- (1) Formulation of policy issues that can be taken up with a view towards concrete realization in one or two years
- (2) Setting of policy targets for five to ten years in the future
- (3) Development of the concept of an East Asian Community from a longer-term perspective

【Individual fields】

1 . The Evolution of an EPA/FTA Network in East Asia –Towards the Realization of Wide-area Economic Partnership Agreements

EPAs and FTAs represent an important policy tool in promoting the economic unification of East Asia and enabling Japan to view the growing Asian market as a “domestic market.” At present, based on the existing regional EPA/FTA network, discussions are proceeding looking towards the realization of multiple visions of wide-area EPAs, for example involving ASEAN+3, ASEAN+6, or the APEC nations. In order to proceed smoothly with this process, it will be necessary to formulate roadmaps towards the realization of these visions, to share targets between the nations of the region, and to manage progress in a variety of regional cooperative forums.

It has been estimated that the liberalization and facilitation of trade by means of such wide-area EPAs would boost Japan’s GDP by 16.2 – 20.4 billion U.S. dollars (0.22 – 0.27% of national GDP) and the region’s GDP by 186.2 – 578.4 billion U.S. dollars (0.62 – 0.86% of regional GDP). If the effects of the liberalization of services and investment and various types of cooperation are included, these figures become higher. Japan must engage in its own internal reforms, such as strengthening its agricultural base, and proceed actively and strategically with EPA/FTA negotiations.

(Tetsuo Ota)

Figure 3 Economic effect of wide-area economic partnership agreements in East Asia

Wide-area EPAs will revitalize the regional economy

(1) Changes in actual GDP (billion U.S. dollars (Rate of change, %))

	①EAFTA (ASEAN+3 region)		②CEPEA (ASEAN+6 region)		③FTAAP (APEC region)	
	Japan	Region	Japan	Region	Japan	Region
(a) Trade liberalization (non-agricultural sectors)	1.9 (0.03)	29.7 (0.10)	2.1 (0.03)	51.5 (0.14)	2.4 (0.03)	90.4 (0.13)
(b) Trade liberalization (all sectors)	2.3 (0.03)	32.1 (0.11)	3.4 (0.05)	58.7 (0.17)	4.6 (0.06)	97.1 (0.14)
(c) (b) + trade facilitation	16.2 (0.22)	186.2 (0.62)	16.6 (0.22)	276.0 (0.78)	20.4 (0.27)	578.4 (0.86)

(2) Changes in economic welfare (billion U.S. dollars)

	①EAFTA (ASEAN+3 region)		②CEPEA (ASEAN+6 region)		③FTAAP (APEC region)	
	Japan	Region	Japan	Region	Japan	Region
(a) Trade liberalization (non-agricultural sectors)	20.8	62.7	26.4	101.4	26.7	108.0
(b) Trade liberalization (all sectors)	19.2	66.4	25.9	107.4	26.5	115.0
(c) (b) + trade facilitation	40.3	229.7	45.7	315.7	41.2	579.7

* Report, Figure 1-5. Results generated by a simulation based on dynamic analysis of GTAP model.
See *Strengthening Regional Cooperation in East Asia* for details of methodology.

2. A New Stage of Currency and Financial Cooperation in East Asia – The Creation of an Asian Monetary Fund

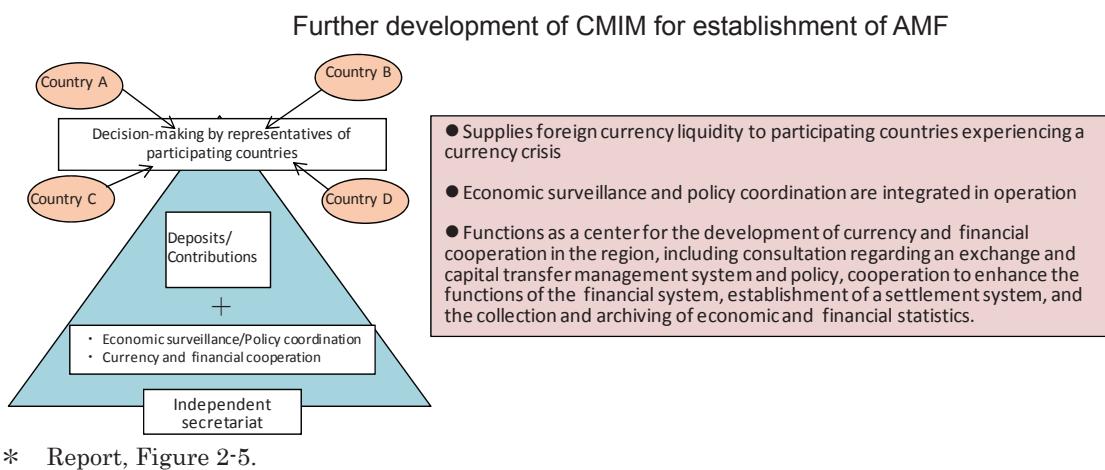
A variety of initiatives towards currency and financial cooperation have proceeded based on the lessons of the Asian financial crisis, such as the Chiang Mai Initiative (CMI) and efforts to foster Asian bond markets. In order to increase the effectiveness of the CMI, it will be necessary to

- 1) Establish mechanisms for decision-making and implementation
- 2) Increase the scale of funding and increase the scope of delinking from the IMF
- 3) Incorporate economic surveillance and establish an independent secretariat

At present, these issues are being responded to through the multilateralization of the CMI and other initiatives. What should now be investigated as one viable option is to move one stage further and bring together functions and structures related to currency and financial cooperation that presently exist within decentralized systems, in the medium-term creating an Asian Monetary Fund (AMF) (see Figure 4). The establishment of a fully-fledged secretariat will be essential in order for an AMF to fulfill its various functions (responses to financial crises, economic surveillance, various forms of cooperation, etc.). Cooperation between individuals from a wide range of fields in the operation of an AMF could also be expected to assist in fostering financial personnel in East Asia.

(Tetsuo Ota/Masatoshi Jinno)

Figure 4 Image of AMF



3. East Asian Regional Cooperation and a Strategy for the Development of Human Resources – Exchanges of Foreign Students as a National Strategy

The further development of economic cooperation in East Asia will demand a

new strategy for the fostering of human resources to conduct activities that transcend national borders. Against the background of economic growth in East Asia, the number of students proceeding to higher education is growing, and there is increasing exchange of foreign students in the region. The contact with diverse cultures and societies offered to large numbers of young people through these exchanges represents an unparalleled opportunity to develop valuable characteristics – the ability to communicate, the ability to solve problems, and the ability to consider issues from multifaceted perspectives. As a strategy to foster human resources suited to a new era, Japan should enter into cooperation with the other nations of the region in promoting exchange between foreign students. Japanese universities should develop unique strategies to provide a diverse range of programs for foreign students. In addition to providing a foundation with world-leading centers for research and education, it will be necessary to offer internationalized universities at which units can be taken in English; at other universities, special programs only available in Japan could be offered. At the same time, it will be essential to create an environment that increases the ease of studying overseas for Japan's younger generation.

(Terumi Hirai)

4. The Expansion of Population Mobility in East Asia and Japan – International Migration for the Vitalization of Economies and Labor Markets

International migration within East Asia is increasing. It is expected that the rate of international migration within the region will continue to grow with further progress in regional cooperation. However, the low birth rates of East Asian nations results in a decline in the potential mobility of their populations in the region, and it is possible that in the long term competition to secure human resources may increase in East Asia.

In order to attract highly-qualified foreign workers to Japan, it will be essential to improve the working environment by fundamentally revising systems and customs that have until today been exclusively focused on Japanese employees, and to create a sound labor market for foreign workers.

The government will be required to proceed steadily with a variety of initiatives to enable Japan to accept foreign human resources, including 1) Reviewing the scope of acceptance of foreign human resources; 2) Establishing a domestic system for the acceptance of foreign human resources; 3) Proceeding with the conclusion of social security agreements; and 4) Providing education for social integration. These measures should be implemented in an integrated and consistent manner via the formulation of a comprehensive policy framework concerning the acceptance of foreign human resources.

(Akiko Tsuji)

5. Open Skies over East Asia – Towards “One Sky”

Asia’s airline market is expanding significantly, and the trend towards liberalization is also gaining strength. Liberalization agreements centering on the U.S. have realized “open skies,” enabling airlines to decide freely on routes and numbers of flights. The EU, by contrast, has realized total liberalization by allowing cabotage, enabling airlines from any member country to offer transport services between any two points within the EU region. With the abolition of regulation within the region, the EU has gone beyond the concept of “open skies” to realize “one sky.”

The U.S.-Japan Aviation Pact was concluded in December 2009, but in order to increase the significance of this agreement, it will be important to realize “one sky” together with China, South Korea, and, further, with the ASEAN countries. It will be desirable to form a more organic and efficient network, for example through systematization via circulatory transport between multiple cities and the functional use of alliances from a strategic perspective. (Naoki Shimoji)

6. Environmental Cooperation in East Asia – Towards the Establishment of a New Type of Infrastructure

East Asia’s environmental problems transcend national borders. These are urgent issues, and the necessity for enhancing environmental cooperation in the region is increasing. In dealing with these issues, what is required is a paradigm shift, away from the establishment of infrastructure as a foundation for economic development, and towards the establishment of environmental infrastructure in order to create sustainable economies and societies. When proceeding with the establishment of such environmental infrastructure in the nations of the region, it will be necessary to formulate an “environmental grand design” which will function as a comprehensive blueprint, and to ensure that the interests of different fields do not clash. It will also be essential for private sector environmental businesses to be actively involved.

Based on the lessons it learned in overcoming its own pollution and environmental problems, Japan should maximize its use of its advanced environmental technologies in order to expand regional environmental cooperation. To this end, the creation of an ongoing and comprehensive framework for cooperation between the public and private sectors will be indispensable.

(Naoko Mori)

7 . The Process of European Unification and its Lessons for East Asia

As the most advanced example of regional unification, European unification provides an important model. By deepening its unification, the EU created a single market and a single currency, revitalized its regional economy, and improved Europe's position in the world economy. However, in order to maintain these achievements, further deepening of the unification will be necessary, for example by correcting regional imbalances and further enhancing cooperation in fiscal policy.

Despite the fact that numerous differences exist between Europe and East Asia in terms of historical background, basic conditions, etc., in both regions common regional goods provide the motive force for the systematization and further deepening of unification. Using wide-area EPAs as a platform to advance economic unification, we must create a free and vigorous economic zone in East Asia. However, given the significant differences in levels of economic development between the nations of the region, and the fact that the existing environment does not promote the transfer of authority in relation to fiscal and monetary policy, it would be wise to be prudent with regard to currency unification in East Asia.

(Tetsuo Ota/ Tetsushi Saito)