

Introductory Chapter Japan, China and South Korea Should Sign an FTA with ASEAN for Broader Cooperation

[Key Points]

1. An effective way to achieve stable economic growth in East Asia is to conclude a comprehensive free trade agreement (FTA) that incorporates cooperation in such fields as energy, information technology (IT), financial markets and human resources development.
2. A realistic approach to the conclusion of an East Asian FTA is for China, Japan and South Korea to conclude FTAs with ASEAN separately, and then integrate them into an ASEAN+3 FTA.
3. Japan-China cooperation is essential for the conclusion of the East Asian FTA, which requires highly political decisions by the leaders of Japan and China with deep insight into the future of East Asia.

1. Wide-Area Cooperation Prompted by the Economic Crisis

1.1 Cooperation Launched at the ASEAN + Japan-China-South Korea (ASEAN+3) Summit

In East Asia, a robust drive is currently under way toward wide-area regional cooperation with a possible free trade agreement (FTA) within the framework of Japan, China and South Korea plus the Association of Southeast Asian Nations (ASEAN). In the backdrop of intensifying regional cooperation is the major blow dealt to the region by the Asian economic crisis that occurred in 1997. Until the economic crisis set in, East Asia had been riding on the rapid economic growth labeled as the “East Asian miracle.” It was then that the contagious crisis touched off by the collapse of the Thai bath in 1997 spread to other East Asian countries. Consequently, many countries in East Asia in 1998 suffered a deep economic slump they had never experienced before. The immediate cause of the crisis was the enormous and rapid outflow of foreign capital that had earlier flowed into the region massively. However, there were also other problems that helped spawn the crisis, such as the vulnerability of the financial and corporate sectors as well as the government sector in East Asian countries. After the East Asian countries failed to obtain the expected assistance from countries outside the region, in their response to the crisis-triggered serious situation, they came to recognize the importance of cooperation within East Asia.

In November 1997, Japan, China, South Korea and ASEAN held the first ASEAN+3 Summit meeting, where they discussed financial support and other issues in dealing with the Asian crisis. Subsequently, the ASEAN+3 Summit has been held every year, and the participating countries not only reconfirmed the importance of regional cooperation in East Asia but also came to form a consensus on efforts toward the realization of an East Asian Community to attain economic prosperity and political as well as social stability in the region in the future. Reflecting the growing

awareness of the need for regional cooperation toward stable growth in East Asia, there have been several instances of specific cooperation in financial and IT areas, but regional cooperation has not made much headway in areas essential for economic growth such as energy and human resources development.

While regional cooperation in East Asia became more active in the wake of the Asian crisis, positive moves also emerged to conclude bilateral FTAs or FTAs among three or more countries. One of the factors that encouraged countries in the region to pursue FTAs was their proactive response to the Asian crisis to seek economic growth through the promotion of trade by mutually opening their markets. Another important factor was the rapid expansion of FTAs in other regions of the world. In Europe, the European Union (EU) has been growing in both its depth and reach, while in North America, the North American Free Trade Agreement (NAFTA) has been established. Since these exclusive regional arrangements with preferential treatment of participating countries tend to limit export opportunities for non-members, non-member states have incentives to form their own FTAs in response. Moreover, with multilateral trade negotiations at the World Trade Organization (WTO) making little progress, countries become more inclined to conclude FTAs. Finding themselves in such a trade policy environment in the late 1990s, countries in East Asia grew increasingly interested in FTAs.

1.2 Brisk Moves toward Bilateral FTAs

The Japanese government was opposed to FTAs until the late 1990s, but later came around to view FTAs as an option in trade policy. The shift in its stance was prompted by two factors. First, the perception of FTAs changed globally. Second, as trade and investment barriers persisted in East Asian countries and other countries such as Mexico despite a degree of progress in trade and investment liberalization, Japanese companies in their pursuit of a freer business environment urged the government to embrace FTAs.

In East Asia, the initial idea about FTAs was not a framework for regional cooperation encompassing all the countries in the region, and countries first moved to conclude FTAs bilaterally or among three or more countries. Before the Asian crisis, the only major FTA that existed in the region was the ASEAN Free Trade Area (AFTA) for ASEAN member states. Around the turn of the century, Japan, China and South Korea, which had not been party to any FTA before, launched aggressive efforts to conclude FTAs. Consequently, an FTA between Japan and Singapore, the first of its kind for Japan, came into force in 2002, and Japan also signed a bilateral FTA with Mexico in 2004. Japan is currently negotiating a bilateral FTA individually with South Korea, the Philippines, Thailand and Malaysia, and was set to begin FTA negotiations with ASEAN in April 2005. China, for its part, brought an FTA with Hong Kong into force in 2004, and completed negotiations with ASEAN over an FTA on goods trade in late 2004. South Korea, in 2004, put into force a bilateral

FTA with Chile, and now is negotiating with Singapore and other countries. Among ASEAN member states, Singapore and Thailand are particularly positive about FTAs, aggressively seeking to conclude FTAs with non-regional countries as well as with countries within East Asia.

1.3 Shifting Stances of Japan and China

There is a consensus established among countries in East Asia that a region-wide FTA would be effective for the economic prosperity of East Asia as a whole. However, any concrete move has yet to emerge toward the conclusion of an East Asian FTA. Since an FTA calls for the liberalization of trade, non-competitive sectors likely to suffer from the liberalization would oppose it. As long as it is limited to cooperation, although it might still involve some burden financially or on human resources, cooperation would normally bring no harm to any specific sector of the economy. For this reason, regional cooperation faces relatively few obstacles. But an FTA progresses much less swiftly since it entails some damage. Particularly in a region like East Asia where countries are in different stages of economic development, an FTA faces quite a few obstacles because the liberalization of trade would require significant industrial adjustments.

Amid the rising interest in intra-regional cooperation in East Asia and an East Asian FTA, big changes, mostly economic, are taking place in East Asia: the rapid economic rise of China and the protracted slump of the Japanese economy. After recovering from the weakness following the Tiananmen Square incident in 1989, the Chinese economy has registered an annual average growth of nearly 10%, though with some fluctuations, from the 1990s through the early years of the 21st century. As a result, between 1990 and 2002, China's gross domestic product (GDP) expanded 5.7 times (3.6 times) in terms of the yuan (U.S. dollar). On the other hand, the Japanese economy has fallen into a protracted period of stagnation following the bursting of the bubble in the early 1990s and has yet to fully recover from it even into the 21st century. Japan's average annual economic growth between 1990 and 2002 was just 1.2%, with its GDP growing only 1.1 times (1.3 times) in terms of the yen (U.S. dollar).

The disparity in economic performance between Japan and China has brought major differences not only in their foreign policy but also in their influence over other countries in East Asia. To put it briefly, China is putting forth a proactive regional policy on the strength of its rapid economic expansion, widening its influence in non-economic aspects as well. On the other hand, Japan has seen its economic weight reduced and also its influence in East Asia decline partly because the economic stagnation is causing its official development assistance (ODA), an important means of diplomacy for Japan, to shrink as well. Despite this difference in direction regarding Japan and China, Japan, at the moment, not only has an economy more than three times as large as China's but also still has an edge over China in areas of importance in economic activities such as technology and human resources.

While there is a consensus among East Asian countries about the need for regional cooperation and conclusion of an East Asian FTA, not much headway has been made toward either of them due to a host of economic, social and cultural obstacles. On the basis of the above-described perception of the present situation, this joint study has been conducted as an analysis of the desired modality of regional cooperation and a region-wide FTA that would help realize stable economic growth and achieve economic prosperity in East Asia. Analyses of each chapter are summarized below and some policy recommendations are presented on the basis of the results of analysis.

2. The Current State and Problems of Wide-Area Cooperation

2.1 Expanding Intra-Regional Trade and Human Migration

The combination of factors that brought about the high economic growth of East Asian countries included economic policy management, which maintained a stable macroeconomic environment, and the existence of a diligent and skilled labor force. But most important among them was the expansion of trade and foreign direct investment (Chapter 1).

Trade and foreign direct investment expanded with two accompanying structural changes. The first structural change is the growing intra-regional interdependence in East Asia, with the rapidly growing importance of China. Another change is the growth of machinery industries, centering on electronics and electrical sectors, characterized by increased components trade. These structural changes reflect the establishment of an intra-regional production network where parts and components are procured within East Asia and final products are also produced within the region. These changes in trade and production structures in East Asia show that the multilayered catch-up and industrialization of the flying-geese pattern have been under way in East Asian countries.

The expansion of trade and foreign direct investment stems from the liberalization of trade and foreign direct investment. Many developing countries in the region have proceeded with trade liberalization since the 1970s, and they also liberalized foreign investment policies in the latter half of the 1980s. However, the degree of liberalization still lags behind major industrialized countries, making it important to further facilitate liberalization through an FTA in order to promote economic growth in the region.

In East Asia, China is reinforcing its regional strategy on the strength of its high economic growth, and proactively pushing for the conclusion of an FTA with ASEAN countries as part of that strategy (Chapter 6). The remarkable growth of the Chinese economy is bringing tremendous benefits to East Asian countries such as ASEAN states, South Korea and Japan by expanding trade. However, in order to realize the well-balanced economic growth of East Asia, ASEAN should develop a genuinely integrated market through thorough implementation of AFTA accords and attract more foreign direct investment (Chapter 1, Chapter 9). Meanwhile, Japan should conclude

FTAs with ASEAN member states and provide economic cooperation particularly with new ASEAN member states in order to strengthen its relations with ASEAN.

As a result of the advance in regionalization of economic activities and the widening supply-demand gap for workers by their line of work, the migration of people within the region is also picking up steam (Chapter 5). The migration of company-employed workers from Northeast Asia to Southeast Asia continues to grow, as does the number of maids, workers in health care, nursing services and other areas moving from Southeast Asia to Northeast Asia. As the competition to draw talented human resources heats up throughout the world, capable people in East Asia are increasingly being drawn to the United States and Europe. As a result, personnel shortages are emerging within East Asia, a factor that potentially constrains economic growth in the region. While the issue of human migration is being addressed in FTA talks from the perspective of the acceptance of foreign workers, this topic needs to be discussed from the viewpoint of strengthening human resources development within the region. Specifically, as Japan and other countries in East Asia are expected to face a rapid aging of the population, it is important to develop and efficiently utilize health care service workers on an intra-regional basis. In order to ensure the efficient utilization of human resources, countries in the region must work to further facilitate human migration and also cooperate in stopping the flow of illegal immigrants and human trafficking.

2.2 Regional Cooperation Inspired by the Crisis

The currency crisis brought home to countries in East Asia the importance of regional cooperation, setting the stage for varied forms of cooperation within the region. In November 1997, immediately after the outbreak of the crisis, the top leaders of Japan, China and South Korea were invited to the ASEAN summit meeting for the first-ever ASEAN+3 Summit. Subsequently, the ASEAN+3 Summit has turned into an annual event, where leaders invariably profess their determination to step up intra-regional cooperation.

The most advanced level of regional cooperation can be found in the finance sector (Chapter 3). To cope with a potential shortage of foreign exchange, which triggered the Asian currency crisis, eight East Asian countries including Japan, China and South Korea joined their hands to establish a scheme (the Chiang Mai Initiative) for mutually accommodating themselves with foreign exchange when necessary. Based on the awareness that the root cause of the currency crisis was the fact that a massive amount of capital was raised from overseas sources despite ample investment funds available within the region, countries in East Asia are cooperating to develop the Asian bond market to encourage the use of intra-regionally available funds within the region. On the monetary front, in gearing up for the formation of a regional currency bloc in the future, it is necessary, in addition to beefing up cooperation already under way, to agree on surveillance and policy dialogues to mutually monitor the economic conditions in each country, and extend this to the establishment of a common

exchange rate system. As a prerequisite for the establishment of such a common exchange rate system, participating countries must ensure currency convertibility and sound financial and capital markets need to be established. Specifically, Japan needs to achieve economic recovery and work toward the internationalization of the yen, while China must realize the convertibility of the yuan in both current and capital transactions, put its financial system on solid footing, and achieve a successful shift from the planned economy to market-based economy.

Against the backdrop of the rising importance of information technology (IT) in economic activities, regional cooperation is also under way in the IT field (Chapter 4). Since the narrowing of the digital divide is essential for the economic growth of East Asia as a whole, Japan, China and South Korea, which are relatively advanced in the IT sector, are helping ASEAN member states lagging in this particular field. Furthermore, Japan, China and South Korea are cooperating toward the development of new technologies in the IT sector dominated by Western countries. Japan for its part must establish a new idea about cooperation in the IT field and create a new framework of official development assistance (ODA) under which resources can be utilized more efficiently. In doing so, cooperation among government ministries and agencies is essential.

The securing of a stable supply of energy is essential for economic growth in East Asia. Offshore energy dependence runs high among the countries of East Asia, with particularly heavy reliance on the Middle East for crude oil (Chapter 2). East Asia is also burdened with the problem of its low energy use efficiency. Regional cooperation is effective in solving these problems. Specifically, Japan, China and South Korea should play the central roles in regional cooperation toward joint stockpiling of crude oil, joint efforts to secure the safety of crude oil shipment routes from the Middle East and diversification of energy sources. With the proven track record in nuclear power generation as well as in wind power generation and photovoltaic power generation, Japan also has a large role to play on the technological and financial fronts in improving energy use efficiency among East Asian countries.

2.3 Brisk Regional Strategies of East Asian Countries with the Focus on FTAs

Though not yet growing into moves at the regional level, countries in East Asia are actively pursuing free trade agreements (FTAs). While FTAs have been rapidly spreading globally, East Asian countries were largely negative toward FTAs until recent years. By the late 1990s, however, Japan and South Korea reversed their opposition and showed keen interest in FTAs, and this in part prompted China to take greater interest in FTAs. As a result, moves toward the conclusion of FTAs intensified in East Asia after the turn of the century.

After securing its access to the world market with the accession to the World Trade Organization (WTO), China has been following a proactive regional strategy in East Asia with FTAs as a principal strategic tool (Chapter 8). Behind China's moves are political and diplomatic considerations as well

as an economic incentive for securing markets. China is pursuing various forms of cooperation with East Asian countries, including FTAs, with the recognition that good economic relations with countries of East Asia are indispensable for its own economic prosperity. In FTAs with ASEAN, China is trying to strengthen ties with ASEAN through such measures as front-loading the import liberalization (so-called “early harvest”) of farm products for which ASEAN countries are competitive and stepped-up economic cooperation with latecomers in ASEAN. China believes that the conclusion of an FTA with ASEAN would go a long way toward establishing its leadership position in reaching an East Asia-wide FTA in the future.

While ASEAN states feel menaced by China on both economic and political fronts, they nevertheless are responding positively to China’s overtures in order to seize on economic opportunities. In order to balance out the growing influence of China, however, ASEAN states are also highly interested in building stronger cooperative ties with Japan and South Korea (Chapter 9). Up to now, Japan has been contributing to the growth of ASEAN economies by establishing numerous manufacturing footholds in the ASEAN region mainly through foreign direct investment. Given the declining importance of Japan-ASEAN relations in the wake of the protracted slump of the Japanese economy, ASEAN countries, while moving ahead with the integration of ASEAN economies, should try to reinforce their relations with Japan by improving the environment for foreign direct investment with the conclusion of an FTA between Japan and ASEAN.

Among Japan, China and South Korea, South Korea was the first to take interest in FTAs, but it took considerable time for South Korea to put an FTA into practice (Chapter 10). South Korea, whose economy depends on exports to a large extent, thought that concluding FTAs with other countries would be effective in securing export markets when FTAs are spreading in other parts of the world. But it faces many obstacles in setting up FTAs due to strong opposition from domestic agricultural and other non-competitive sectors.

3. Toward Establishing a Comprehensive East Asian FTA (EPA) including Economic Cooperation: The Role Japan Should Play

The corporate sector is clamoring for FTAs in their pursuit of a freer business environment. Economic cooperation in a variety of forms is also necessary for stable economic development. Regional cooperation can be classified into two types. One is cooperation on issues that similarly affect all countries in East Asia, or cooperation in areas of regional public goods in nature. Another is cooperation in areas that could narrow gaps among countries in the region, or cooperation tantamount to assistance in nature. The former includes cooperation in such fields as finance, energy and the environment, which requires the cooperation of all countries in the region. The latter, meanwhile, includes cooperation in human resources development and in the IT sector, with

countries in the higher stages of development providing help to countries in the lower stages of development. Cooperation of the former type not only gives rise to the problem of who will be shouldering the necessary funds and personnel but also involves the touchy issue of turning competition into cooperation in areas concerning energy and other limited resources.

3.1 EPA More Effective As It Encompasses Various Forms of Cooperation

Various forms of FTAs and diversified regional cooperation are under way in East Asia. It is necessary to create a framework under which these efforts can be pushed more efficiently and effectively to bring economic prosperity to the region. Below, some proposals are advanced regarding how such a framework should be shaped, how such a framework can be established, and what role Japan should play.

One of the characteristics of East Asia is the differing stages of economic development of the countries in the region. In such a region, a framework effective in facilitating economic development and growth would be a comprehensive East Asian FTA that has all countries of East Asia as its members. More specifically, this should be a comprehensive economic partnership agreement (EPA), which incorporates not only trade liberalization included in conventional FTAs but also liberalization of investment and facilitation of trade and investment as well as various forms of cooperation. In other words, what is needed is an FTA that includes cooperation in such areas as finance, energy, IT and human resources development as analyzed in this joint study. The FTA concluded between Japan and Singapore could serve as a model, but deeper cooperation than this FTA is necessary as proposed in the related chapters.

3.2 Early Accords Needed on ASEAN+3 FTAs

Swift completion of negotiations on an FTA between China and ASEAN, currently under way, and of negotiations to be launched soon on FTAs between Japan and ASEAN and between South Korea and ASEAN is essential for an agreement to establish an East Asian FTA. It is a realistic approach to establish an ASEAN+3 FTA by integrating these three ASEAN+1 FTAs in the next stage. However, a consensus should be secured on the contents of an ASEAN+3 FTA as early as possible. If three ASEAN+1 FTAs are put in place with differing contents without such consensus, it would not be easy to integrate them to establish the East Asian FTA.

While Japan, China and South Korea should swiftly push ahead with their respective FTA negotiations with ASEAN, they also must start efforts toward an FTA among Japan, China and South Korea. Negotiations on an FTA between Japan and South Korea started in 2004 with the targeted end by late 2005, but the talks have so far made little progress because of the numerous contentious issues involved. In order to smooth the way for an FTA among Japan, China and South Korea, it would be appropriate for Japan and South Korea, both members of the Organization for Economic

Cooperation and Development (OECD), to first agree on a high-caliber bilateral FTA and then invite China to join this high-caliber FTA.

An FTA that can facilitate free economic activities by companies and realize economic growth would be a high-caliber FTA that liberalizes trade in all fields. An FTA between China and ASEAN is expected to leave a number of exemptions from liberalization as parties to this FTA are all developing countries. But Japan must set an example by working out high-caliber FTAs that limit liberalization exceptions to a minimum in negotiations currently under way with South Korea, the Philippines, Thailand and Malaysia. But under the FTAs already concluded with Singapore and Mexico, Japan failed to form an exemplary FTA as it persistently resisted liberalization in the agricultural sector. As counterparties in the FTA negotiations currently under way are all pressing Japan to liberalize its farm market, the conclusion of these FTAs would be quite difficult unless Japan complies with their requests. The Philippines and Thailand are also demanding that Japan accept nurses and care workers, and FTAs with these countries would also seem difficult unless Japan responds positively to their demands.

3.3 Japan Should Take the Lead by Accepting Workers from ASEAN

In FTA talks with ASEAN, China clarified its stance of giving much weight to its relations with ASEAN by front-loading measures to liberalize the Chinese farm market, an area of strong interest for ASEAN. Japan should also clarify its stance of seeking co-prosperity with ASEAN by putting forth liberalization of its farm market in coming FTA negotiations with ASEAN. Needless to say, the Japanese government should take steps to help Japanese farmers likely to suffer from the liberalization, such as income support as well as education and training opportunities to help them find more productive jobs. It would also be necessary to improve the competitiveness of Japan's agriculture by carrying out structural reform of the farm sector.

As Japan is likely to encounter a serious shortage of nurses and care workers going forward, in the wake of the falling birthrate and rapid aging of the population, it needs to accept such workers without hesitation. But it is important to require nurses and care workers from other countries to have adequate professional qualifications as well as sufficient Japanese language abilities so that they can provide high-quality services in Japan.

As pointed out earlier, it is desirable for FTAs to incorporate regional cooperation. If FTAs include regional cooperation as an integral part, it should not only help enhance a sense of belonging to the same region but also make it possible to engage in cooperation that further encourages the liberalization and facilitation of trade and investment. For example, if regional cooperation in human resources development actually results in the enhancement of the capabilities of personnel, it should facilitate the transfer of technologies from multinational companies that come to operate in the region following the liberalization of investment, which in turn should help the economic growth in

the region. In the area of regional cooperation, Japan should propose desirable policies from a regional perspective and take the lead in promoting such cooperation in collaboration with other countries in the region. Particularly important in this respect are cooperative relationships with China and South Korea, which have relatively strong economic competitiveness in the region.

As in the case of trade liberalization or acceptance of foreign workers, Japan with the most advanced economy in East Asia should take the leading role in regional cooperation as well. Japan should also recognize that developing and maintaining close relations with East Asian countries that are expected to see robust economic growth in the future should lead to the prosperity of the Japanese economy and society. As pointed out earlier, countries in East Asia expect Japan to proactively promote FTA strategies and regional cooperation. This tendency is particularly noticeable among ASEAN countries that regard China as a serious rival as well as the country that offers them growth opportunities.

In seeking to establish a comprehensive FTA for the whole East Asian region, Japan must push ahead with liberalization by carrying out necessary domestic adjustments. But the East Asian FTA would not be feasible without cooperation between Japan and China. Japan-China relations have recently been strained, as often described as “politically chilled and economically hot.” But their relations need to be improved. Improved relations between Japan and China would require cool-headed approaches to pending bilateral issues as well as a deeper level of mutual understanding through an accumulation of steady down-to-earth efforts such as joint research on historical problems and exchanges between people. Here, education and mass media have a major role to play. That said, what is most needed at the moment is a major political decision by the leaders of both countries, with deep insight into the future of not only Japan and China but also all other countries of East Asia.