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Summary

# Asia Research Report

## **Regional Cooperation Toward the Establishment of an East Asian Community**

**—With a View to Asia in 2020—**

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Japan Center for Economic Research

## Introductory Chapter: Regional Cooperation Toward the Establishment of an East Asian Community – With a View to Asia in 2020

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The momentum is building toward the establishment of an East Asian Community, with the first East Asia Summit held in late 2005. However, a specific road map for the East Asian Community has yet to come into sight. In achieving economic prosperity and social/political stability in the region through the creation of the East Asian Community, a host of problems must be resolved, including the financial system vulnerability revealed in the Asian currency crisis, serious natural resources and energy problems exacerbated by high economic growth, food problems, impediments to trade and direct investment that have been fueling the region's high growth and security problems.

The plan for the creation of an ASEAN Community being promoted by the Association of Southeast Asian Nations (ASEAN) comprises three pillars: an Economic Community, a Socio-Cultural Community and a Security Community. A similar framework may be applicable to the establishment of the East Asian Community. The first stage can be devised as the creation of an East Asian Economic Community evolving from comprehensive free trade agreements (FTAs) that allow the free movement of people, goods, money and information within the region. Included as an important item of the East Asian Economic Community is regional cooperation in a broad range of economic fields covered by this report. Mutual understanding among East Asian countries would deepen through the process of establishing the Economic Community. If the income gaps among those countries narrow through the process of the region's developing countries catching up with industrialized partners, East Asian countries could move ahead toward the greater sharing of values. Consequently, it would become possible for them to create a Socio-Cultural Community and a Political and Security Community, which would lead to the ultimate goal of establishing the East Asian Community.

There are two types of regional cooperation. The first type is cooperation in issues common to all countries in East Asia, or cooperation in areas strongly oriented toward the provision of regional public goods, such as financial institutions and energy. The second type is cooperation in areas that are conducive to the narrowing of gaps among the region's countries, such as physical distribution infrastructure and information technology.

Japan, the most economically developed nation in East Asia, should blaze a trail in establishing the East Asian Economic Community that helps realize East Asia's economic prosperity and in creating the East Asian Community that contributes to the region's social and political stability. For Japan, which is beginning to lose dynamism amid the aging population combined with the

declining birthrate, building and maintaining close relations with other East Asian countries with high growth potential into the future can be considered conducive to the prosperity of its own economy and society. As it is possible to cope with structural adjustment problems that are highly likely to emerge with the establishment of the East Asian Community, what is required of Japan is the planning capability for mapping an appropriate strategy and the political determination to implement that strategy.

## Chapter 1: Economic Integration in East Asia and Changes in Production Networks

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In East Asia, intermediate goods trade occupies a large proportion of trade and its growth rate is robust, while the Grubel-Lloyd index is also high to indicate the progress in intra-industry trade, mainly in intermediate goods, in the region. It may be argued that as varying production processes in East Asia become increasingly interconnected through trade in intermediate goods, the weight of both intermediate goods trade and intra-industry trade has increased.

An examination of changes in local content in industries in East Asia during 1990 to 2000 shows a decline of local content (a rise in import content) in the electronics industry and many other industries. This decline reflects the stronger spatial linkages – interdependence of industries across borders which are linked through transactions of intermediate goods – among East Asian countries that helped form the extensive production networks in the region. In the meantime, as local content in the automotive industry rose most significantly during the same period, the expansion of the production network was limited to mostly within the Association of Southeast Asian Nations (ASEAN) and some neighboring countries.

Changes in local content for the electronics and automotive industries can be explained by the characteristic features of parts and components (transportation cost, architecture) and differences in industrial policy (import-substituting or export-oriented). Of these factors, transportation cost is expected to decline further, thanks to infrastructure development and the progress in logistics and supply chain management (SCM) in East Asia. Within East Asia, the cost of cross-border transportation of goods is expected to drop further as the full impacts are felt of the ASEAN Free Trade Agreement (AFTA) and the ASEAN-China FTA. Thus, the production networks in East Asia are likely to advance further, centering on the electronics industry.

Regarding industrial policy, it has become more difficult to raise the local content for automotive parts and components through policy intervention, as seen in the abolition of local content regulations on automotive parts and components in Thailand through trade-related investment measures (TRIM) agreement of the World Trade Organization (WTO). However, the agglomeration forces in the automotive industry (savings on transportation and inventory costs, closer cooperative relations between assemblers and parts suppliers, etc.) that proved to be a factor conducive to higher local content should work independently of policy intervention. As the opposite forces of agglomeration and dispersion apply to industrial location to make any precise forecast difficult, the

combination of the growing production networks with neighboring countries and rising local content is likely to remain in place for the foreseeable future.

#### Changes in Local Content Ratios (1990 to 2000) \*

<b>Automotive**</b>	3.9	Agriculture	-0.9	Commerce/transportation	-2.4
<b>Other manufacturing</b>	3.6	Construction	-1.2	Crude oil	-2.6
Electricity/gas/water	2.2	<b>Food</b>	-1.2	<b>Machinery</b>	-3.9
<b>Metal products</b>	0.4	<b>Bicycles</b>	-1.5	<b>Rubber products</b>	-3.9
<b>Clothing</b>	0.2	<b>Spinning</b>	-1.5	<b>Ceramics/sand and gravel</b>	-4.0
<b>Basic metals</b>	-0.1	<b>Chemical products</b>	-1.7	<b>Other electric machinery</b>	-4.1
Other mining industries	-0.6	<b>Petroleum refining</b>	-1.8	<b>Other transportation equipment</b>	-4.2
<b>Paper-pulp</b>	-0.6	<b>Basic chemicals</b>	-2.2	<b>Precision equipment</b>	-5.5
Services	-0.7	<b>Lumber/wooden products</b>	-2.3	<b>Electronics products</b>	-5.6

\* Figures represent the percentage changes in the average local content ratios in eight East Asian countries from 1990 to 2000.

\*\* The shaded items show manufacturing industries.

Source: Calculated by the author on the basis of the 1990 and 2000 international input-output tables for Asia.

## Chapter 2: Intra-regional Policy Coordination Necessary through Trade Facilitation

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Intra-regional trade is expanding smoothly in East Asia. The ratio of intra-regional trade has already topped 50%, reaching a level higher than that of the North American Free Trade Area (NAFTA) and also narrowing the gap with that of the European Union (EU) year by year.

Lying behind the stronger interdependence were moves to build a network of intra-regional division of labor among multinational corporations led by Japanese companies. As multinational corporations set up production bases in multiple countries with a view to higher production efficiency and lower costs, traffic of parts and components became active between those production footholds.

However, there still exist many countries in East Asia that impose high tariff rates, while numerous nontariff trade barriers remain in place, including import bans and quantitative import restrictions. Significant barriers also exist in the field of investment, such as restrictions on the scope of industries foreign capital can enter and equity ratios. These barriers should be reduced and/or abolished for the sake of a further expansion of intra-regional trade.

Many companies look to an improvement in trade facilitation measures that streamline and/or unify trade-related procedures and systems. International organizations and researchers alike point out that complex trade-related procedures and systems are hampering trade to a larger extent than by tariff rates. Among trade facilitation areas, this chapter focuses mainly on tariffs, rules of origin and standards and certification.

Regarding tariffs, various questionnaire surveys indicate that many Japanese companies operating in East Asia are facing difficult situations. More specifically, frequently cited problems include arbitrariness in tariff classification and assessment, complex procedures and complex and underdeveloped systems. Concerning rules of origin, companies complain about complicated procedures to obtain certificates of origin and also voice concerns about divergent rules of origin as a result of free trade agreements (FTAs) and economic partnership agreements (EPAs). In the area of standards and certification, there are countries that discriminate against imports with the use of their own standards that are not consistent with international standards.

In these trade facilitation areas, the World Trade Organization (WTO) and the Asia-Pacific Economic Cooperation (APEC) forum are trying to improve and/or harmonize trade rules. However, efforts through the WTO take time to forge consensus because so many member states are involved, while it is difficult to set binding trade rules via APEC. Consequently, it is now important to improve and/or strengthen trade rules on a bilateral basis through FTAs/EPAs. Japan has already been promoting an exchange of information as well as human resources between customs' offices under

EPAs with some East Asian countries, and has also concluded arrangements on the mutual recognition of standards and certification for electric appliances and some other products.

However, efforts to formulate common intra-regional rules in trade facilitation areas will become essential if the future establishment of an East Asian Community is to be brought into view, as companies are expanding operations to conduct procurement, manufacturing and sales in various countries in the region, further heightening the need to provide indirect support to such region-wide corporate management. Japan should take the initiative in improving and harmonizing customs' rules and rules of origin within the framework of ASEAN + 3 (Japan, China and Korea), and should also encourage developing countries in East Asia to promote institution-building and enhance their implementation capabilities through financial assistance and technical cooperation such as the sending of human resources.

#### Trade Liberalization and Trade Facilitation

Trade liberalization	Trade facilitation
<ul style="list-style-type: none"> <li>▼ Tariff reduction               <ul style="list-style-type: none"> <li>- Reduction of protective tariffs</li> <li>- Reduction of financial tariffs</li> </ul> </li> <li>▼ Abolishment of nontariff trade barriers</li> </ul>	<ul style="list-style-type: none"> <li>▼ Export/import procedures and services               <ul style="list-style-type: none"> <li>- Export/import licensing and customs clearance, international transportation, port procedures, etc.</li> </ul> </li> <li>▼ Export/import systems               <ul style="list-style-type: none"> <li>- Tariff systems, animal and plant quarantine systems, etc.</li> </ul> </li> <li>▼ Private-sector procedures and services               <ul style="list-style-type: none"> <li>- Trade transactions (financial aspects and physical aspects)</li> </ul> </li> <li>▼ International systems               <ul style="list-style-type: none"> <li>- Standards and certification systems, etc.</li> </ul> </li> </ul>

Source: Excerpts from Japan International Cooperation Agency (2003), "Tojokoku heno Seido Seibi Kyouryoku (Institution-Building Cooperation in Developing Countries)"

## Chapter 3: Distribution Cooperation in East Asia

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In East Asia after the currency crisis, a string of large-scale construction of infrastructures, such as airports, ports and roads, are under way in many countries. Following the economic rise of China and India, the region has become dominated by optimism about the expansion of intra-regional trade and movements of natural persons, triggering the resumption of projects frozen or postponed after the currency crisis. In addition, massive infrastructure investment is mostly pressured by the intra-regional competition that the export in consumer goods demand swift application of ever-changing technologies and ever-shortened leading time in the Supply Chain Management (SCM). The intensive industrial agglomeration and the division of labor network for manufacturing industries in East Asia have made the comparative advantage in SCM a way to survive intense competition. For countries trying to win the competition, the establishment and improvement of logistics infrastructure are indispensable to continue to attract foreign direct investment.

Needless to point out, however, the expansion and modernization of distribution facilities, particularly the capacity for exports, alone do not ensure reductions in the service costs. Even when bastion ports and airports are well developed, inadequate domestic links between the ports and airports by land, water and air do not help enhance efficiency. Moreover, considering the links with the domestic facilities, such as roads and storage warehouses and time and security costs including customs procedures and settlements, the logistics costs in East Asia actually still exceed those in industrialized countries.

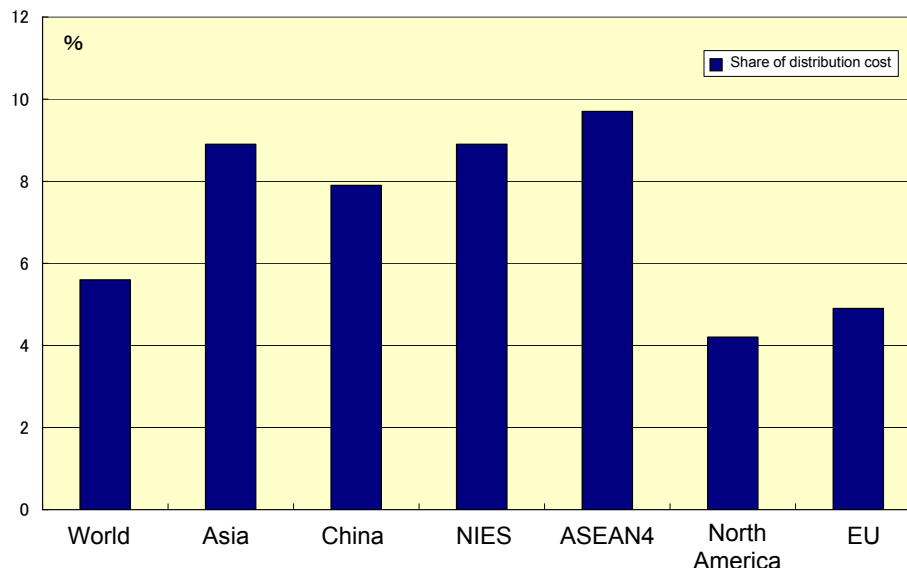
Respective countries can take the lead in improving their infrastructures but should be more concerned about the total cost including the software and the public services. Especially for the purpose of efficient linkage, cooperation such as in regulations and information exchange are expected at the regional level.

In the competition of huge infrastructure building in East Asia, Japan is faced with the risk that its own physical infrastructure could be outdated and left behind with delayed standardization. Despite this, however, the fact still remains that only Japan in the region has accumulated sophisticated knowledge and technologies of its own in abundance. At present, the logistics system covering all of East Asia is rather limited among the major points, but the efforts to link them as the network by providing aggressive and strategic support would yield fairly significant effects. The logistics cooperation should be made into one of major pillars of cooperation linked to free trade agreement (FTA) negotiations, especially if the very practical and non-political characters are considered.

In fact, logistics cooperation should contribute greatly to improving the management environment of Japanese companies operating in the region. On the other hand, cooperation has the merit of helping to strengthen the international competitiveness of East Asian countries. Support for the promotion of the connection and standardization of electronic data interchange (EDI) systems of major ports and airports, which goes beyond simple customs cooperation, should represent an “investment” convincing enough to taxpayers, and should be implemented as a strategic economic cooperation including the supports for latecomer economies.

The latecomers actually have their advantage in logistics. The combination of a string of conditions, such as (1) governments and local large corporate groups capable of strong standardization initiatives, (2) young societies that quickly absorb information technology (IT), (3) industrial structures led by electronics may be suitable for introducing RFID (Radio frequency identification) known as “electric tags”. In fact, the efforts for better logistics have been already initiated by the private sector, but they still need active participation by the government for further deregulation, system conversion and standardization. For Japan, the logistics initiative could also present the possibility of innovating Japan’s seamless logistics further, which has tended to fall victim to the vertically segmented administrative system so far.

Comparison of Logistics Costs of Japanese Companies (FY2004)



Source: Prepared on the basis of Ministry of Economy, Trade and Industry, “Kigyo Katsudo Kihon Chosa (Basic Survey on Business Activities by Japanese firms)”(FY2004)

## Chapter 4: Agriculture/Food Problems Key to the East Asian Community Scheme

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In Japan's free trade agreement (FTA) and economic partnership agreement (EPA) negotiations so far, the handling of agriculture has not been one of the biggest issues. In the case of establishing an East Asian Community, Japan cannot steer around the agriculture problem as agricultural imports from the region's other countries are likely to increase. In considering agricultural trade with the East Asian Community, Japan's farm imports from the Association of Southeast Asian Nations (ASEAN) are likely to be mostly tropical farm products, except for rice and poultry from Thailand. Not many products compete directly with domestic agriculture and tariff rates for them are fairly low. Imports that are expected to give rise to competition in rice and other sensitive farm products are those from China and Korea. This chapter presents an overview of agriculture and agricultural trade of Japan, Korea and China, mulls over the handling of agriculture in the FTA negotiations until now, and then points out some problems involved. Using such an approach, the chapter examines how best to solve the regional agricultural problems in order to move toward the creation of the East Asian Community.

In seeking economic cooperation under FTAs and EPAs with the aim of establishing the East Asian Community, there are a number of issues to be addressed in the agricultural field, besides efforts to reduce and eliminate tariffs on agricultural products. Global agricultural trade, not limited to East Asia, has already entered an era of intra-industry trade, and this means that natural conditions and factor endowment alone do not determine comparative advantages. In particular, large quality differentials are emerging for vegetables and fruits depending on varieties and producing areas, and rice, a land-intensive crop, is no exception. Problems are concerned with trade barriers other than tariffs. In particular, common standards for quarantine systems are an essential factor.

Given the risk of vermination, easy compromises on quarantine systems or the lowering of safety standards are not warranted. That is precisely the reason why East Asia-wide consultations and common rules are necessary. At the World Trade Organization (WTO) as well, common standards are under consideration under the SPS Agreement on quarantine, but little progress has yet been made. It will be of great significance to establish common quarantine rules in East Asia ahead of similar developments at the WTO. If countries in the region can cooperate in creating a unified quarantine system, doing so could also serve as a model for future multilateral consultations.

There also are areas other than quarantine that require common rules. One such example is the protection of varieties of agricultural crops. Japan has developed and nurtured many new varieties of rice, fruits, vegetables, flowers and ornamental plants. However, there is an unending incidence of

developed high-quality seeds and seedlings being taken out overseas and bootleg versions of these varieties being produced in other countries. In order to contain this phenomenon, common rules to protect intellectual property rights are necessary. Under such common rules, efforts to develop new varieties can be undertaken in any of the East Asian countries without discrimination and active research and development investment can be expected.

The East Asian Community envisions not only the free movement of goods but also the liberalization of the movement of capital, labor and services. This freedom should be promoted in agriculture as well. In particular, the free movement of agricultural labor makes the new development of agriculture in East Asia possible. While Japan's agriculture industry has been seeking to save labor through mechanization, there remain many labor-intensive jobs on farmland, and access to cheap labor would help realize a substantial reduction in costs. It also opens the way for farm workers from East Asian countries to acquire agricultural techniques in Japan and make good use of the techniques in promoting agriculture in their home countries. Even now, many Japanese vegetable growers and livestock farmers are accepting foreign workers under the foreign trainee system. However, Japan should develop a system under which foreign farm workers can be hired as fully qualified workers.

It is important to consider the agricultural problem in the region as an issue of the broader East Asian economy at large, instead of treating it just as a problem in the agriculture sector. At the same time, it is important to position the problem as a food problem for all of East Asia to be considered in conjunction with economic cooperation and technical assistance as well as human exchanges and direct investment. It is necessary to promptly launch an international forum on agricultural problems for a comprehensive discussion of agricultural problems that can be found in East Asia. The desire is not to limit participants in the forum to those concerned with agriculture but to include people with various backgrounds to discuss agriculture in the whole of East Asia. By shedding light on the future direction of agriculture in East Asia through discussing ways to cooperate in the development of agriculture in monsoon Asia, this endeavor also represents a path toward building an Asian version of Common Agricultural Policy, which, unlike the European Union (EU), stays open to the outside world.

Various Economic and Agricultural Indicators for East Asian Countries (2003)

	Population (1 million)	Per capita GDP (US\$)	Ratio of agriculture to GDP (%)	Ratio of agricultural workforce to total population (%)	Agricultural trade balance (1 million US\$)
Japan	127.7	31,237	1.4	3.4	-35,294
Korea	47.7	9,993	4.0	8.2	-7,761
China	1,311.7	965	15.4	64.9	-6,569
Thailand	62.8	2,016	9.0	54.1	6,828
Indonesia	219.9	786	17.5	46.3	2,587
Malaysia	24.4	3,889	9.5	16.6	5,247
Philippines	80.0	974	14.7	37.7	-1,206
Vietnam	81.3	482	23.4	66.1	973

Note 1: The ratio of agriculture to GDP is for 2002.

Sources: FAO, FAOSTAT; UN, National Accounts Main Aggregates Database; IMF, International Financial Statistics.

## Chapter 5: The East Asian Economy in 2020 —An Analysis of Economic Effects of the Community

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In recent years, free trade agreements (FTAs) and economic partnership agreements (EPAs) have been actively established, negotiated and studied in East Asia. FTAs/EPAs are likely to have significant economic impacts on FTA/EPA members as well as non-members. In particular, the impacts would be greater if the contents of FTAs/EPAs are extended to include not only liberalization of trade in goods but also broader economic aspects; liberalization of trade in services, investment liberalization, trade and investment facilitations including simplified customs procedures and mutual recognition of standards, and economic cooperation in utilization of human resources, assistance to small and medium enterprises (SMEs), and so on. This chapter examines the impacts of the establishment of an East Asian Community in 2020 on the member economies, using the computable general equilibrium (GGE) model, which is the most popular tool for the analysis of FTAs and economic integration, and discusses what is desired in creating the Community.

We focus on the effects of trade liberalization (removal and reduction of trade barriers to both exports and imports) and trade and investment facilitation measures as the economic impacts of the establishment of the East Asian Community in 2020. In order to examine the effects of trade and investment facilitations, six scenarios in total are examined: three scenarios assume different patterns of trade liberalization and the rest consider those of facilitation measures in addition to trade liberalization. Our results indicate that the implementation of facilitation measures would have significant economic impacts in terms of gross domestic product (GDP), economic welfare, and trade. While trade liberalization through tariff elimination and reduction *per se* is important, the implementation of trade and investment facilitation measures beside trade liberalization would bring greater benefits to the member economies. If trade and investment facilitations can lower the cross-border services link cost, their implementation would promote further development of international production and distribution networks extended in East Asia.

For trade liberalization, given the situation that the World Trade Organization (WTO) negotiations over agricultural trade liberalization has got stuck, we examine the case of full elimination of trade barriers in all industries including agriculture as well as the cases of no liberalization of agricultural trade and partial reduction of agricultural trade barriers. Our results suggest that the economic impacts would be greater in the case of partial reduction of agricultural trade barriers than in the case of excluding the agricultural sector from trade liberalization, and also greater in the case of full elimination of trade barriers, including the agricultural sector, than in the

case of partial reduction in agricultural trade barriers. Therefore, it is important for each economy, including Japan, to promote trade liberalization in all industries including agriculture toward the creation of the East Asian Community in 2020.

Our results also imply that the larger the coverage in terms of membership is, the greater the benefits to the members would be. The Community among the Association of Southeast Asian Nations (ASEAN) + 6 would bring not only positive effects to Australia, New Zealand and India, who are not the member of ASEAN + 3, but also greater effects to each member of ASEAN + 3. Compared with the case among ASEAN, ASEAN + 1 or ASEAN + 2, the establishment of the Community among ASEAN + 3 would bring the greater economic benefits than that among the limited membership, and the establishment of the Community among ASEAN + 6 would bring the greater benefits than that among ASEAN+3. The broader the coverage of economies participating in the Community is, the greater the benefits the Community members would gain from their economic partnership are.

This chapter does not consider the economic impacts of foreign direct investment. If capital accumulation proceeds through the creation of the Community, in particular through increased inflows of direct investment to developing countries, however, the establishment of the Community can be expected to bring economic effects greater than those suggested by the simulation analysis in this chapter. The improved trade and investment facilitations would lower cross-border services link costs, resulting in enhancing further direct investment. In creating the East Asian Community, it is desirable to liberalize trade, including the agricultural sector. Furthermore, it is indispensable to implement trade and investment facilitation measures in addition to trade liberalization within the region.

#### Trade Liberalization and Facilitation in East Asia in 2020: Comparison of Economic Effects

	ASEAN	ASEAN + China	ASEAN + Korea	ASEAN + Japan	ASEAN + China + Korea	ASEAN + China + Japan	ASEAN + Korea +Japan	ASEAN + 3	ASEAN + 6
Real GDP growth: cumulative real GDP growth, relative to the base line (% point)									
Japan	0	-0.01	0	0.17	-0.01	0.39	0.23	0.44	0.55
China	-0.01	0.75	-0.02	-0.04	1.2	1.6	-0.07	2.02	2.13
Hong Kong	0	1.58	0	0	1.72	1.89	0	2.03	2.11
Korea	-0.01	-0.06	0.49	-0.03	2.16	-0.19	1.48	3.06	3.2
Indonesia	0.55	0.92	0.86	1.12	1.22	1.48	1.42	1.77	1.99
Malaysia	2.74	3.57	3.26	4.84	4.07	5.62	5.34	6.09	6.47
Philippines	1.32	1.84	1.79	2.95	2.3	3.42	3.4	3.85	4.1
Singapore	2.26	2.88	2.55	3.29	3.17	3.88	3.57	4.16	4.39
Thailand	1.81	2.62	2.17	3.67	2.95	4.42	4.01	4.74	5.04
Vietnam	1.2	2.13	1.76	1.77	2.66	2.68	2.33	3.2	3.31
Australia	-0.01	-0.02	-0.02	-0.04	-0.03	-0.06	-0.05	-0.09	1.35
New Zealand	-0.01	-0.02	-0.01	-0.02	-0.03	-0.05	-0.04	-0.07	1.85
India	-0.02	-0.04	-0.04	-0.05	-0.06	-0.08	-0.07	-0.1	1.36
Taiwan	-0.01	-0.02	-0.01	-0.02	-0.04	-0.06	-0.03	-0.08	-0.1
NAFTA	0	0	0	0	0	-0.01	0	-0.01	-0.01
EU (15)	0	0	0	0	0	-0.01	-0.01	-0.01	-0.02
Rest of the world	-0.01	-0.01	0.01	-0.02	-0.03	-0.04	-0.03	-0.06	-0.07

Source: Author's simulations.

Note: The simulation results in the above table are all for the case of Simulation 6 (trade liberalization and facilitation in all industries).

## Chapter 6: Information Technology Cooperation in East Asia —Toward International Standardization of Information and Communications Technology

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East Asia's information and communications market (in terms of the number of users) has grown to largely surpass that of Europe or the United States. Yet, the region remains dependent on Europe and North America for much information technology (IT) and applications.

Amid the progress in the globalization of markets, international standardization of IT is becoming a matter of course. The acquisition of international standards has become an important task not only for business corporations but also governments as it significantly influences the international competitiveness of states. Unless adopted as standards, even excellent technologies would lose value and only increase development costs.

As a method of standardization, de facto standards determined by markets, or international standardization following the spread of products or technologies, was previously the dominant trend. In recent years, however, de jure standards, or the practice of establishing standards before the spread of products or technologies through forum activities, including consortiums, or standard-setting organizations, are becoming prevalent. Either way, international standards are not necessarily applicable to excellent technologies but rather depend on successful efforts to garner the support of as many corporations and governments as possible or involve as many markets as feasible.

In European countries and the United States, private and government sectors are joining hands to obtain international standards, and in the European Union (EU), member states are doing the same in union. Europe has standard-setting organizations within the region, and also has research and development programs designed to develop technologies that are highly likely to become international standards, while European governments are contributing to activities of international standard-setting organizations such as the International Organization for Standardization (ISO) and the International Telecommunication Union (ITU). In all, they have a well-developed system in place for the acquisition of international standards.

Until recently, activities to obtain international standards were mainly seen in Europe and the United States. If economic cooperation among countries and regions in East Asia is to advance to lead to the future realization of economic integration, it requires the region to establish an environment where people, goods, money and information can move smoothly across borders, thereby requiring the

standardization of related technologies and applications within East Asia. Since the standardization of IT before its dissemination has now become the dominant trend, it is highly likely that East Asian countries, if they mutually cooperate, can set international standards created in East Asia. Candidates for such standards may include technologies that help narrow the digital divide in East Asia, such as radio network technology including next-generation cellular phones and software that takes advantage of open-source software.

In East Asia, countries that have large enough markets as well as technology development capabilities are Japan, China and Korea. Already, a joint project by these three countries is under way. It seems desirable that as the first step, Japan, China and Korea cooperate in building a mechanism for systematic joint technology development and then push ahead with the standardization of technologies in East Asia. Such a mechanism needs to be adjusted to fit East Asia, where corporate relationships have some way to go before reaching maturity, not identical with the mechanism in Europe that “assumes the cooperation among competing companies in order to share the cost and risk involved in the research and development of technologies evolving into international standards.”

Moreover, as witnessed in the three-way project of Japan, China and Korea where joint development efforts are in progress, companies in East Asia keep rivalry intact. It seems probably difficult for East Asian companies to develop the attitude of cooperation while competing, as seen in Europe, in a short period of time. Governments in the region are being called upon to strive to develop common rules for intellectual property rights, so that companies in the region will be able to cooperate in joint technological development.

Information and Telecommunications Markets in East Asia (2005)

Country	Market			Share in the global market		
	Fixed-line phones (1,000 circuits)	Cell phones (1,000 subscribers)	Internet (1,000 users)	Fixed-line phones	Cell phones	Internet
Japan	58,780	94,745	64,160	4.7%	4.4%	6.7%
China	350,433	393,428	111,000	27.7%	18.1%	11.5%
Korea	23,745	38,342	33,010	1.9%	1.8%	3.4%
Total for Japan, China and Korea	432,958	526,515	208,170	34.3%	24.3%	21.6%
U.S.	177,947	201,650	185,000	14.1%	9.3%	19.2%
Europe	327,862	676,274	269,605	26.0%	31.2%	28.0%
Asia	598,004	875,732	368,438	47.3%	40.4%	38.2%
World	1,263,368	2,168,434	964,272	100.0%	100.0%	100.0%
				Combined share of Japan, China and Korea in Asia		
				72.4%	60.1%	56.5%

Note: “Asia” in the table includes some countries in South Asia and the Middle East.

Source: [www.itu.int](http://www.itu.int)

## Chapter 7: Intensifying Cultural Exchanges

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Cultural exchanges in East Asia have become quite intense over the past decade, when they are captured in terms of data on trade in culture-related goods, movement of people and subcultures. The value of transactions in culture-related goods totaled \$4.1 billion in 2004, growing 2.7 times from \$1.5 billion in 1994. The movement of people within the region increased similarly, with a rapid expansion of arrivals in and departures from economically-rising China and steady increases in two-way flows of people among countries in the region.

An examination of the movement of people in 1995, 2000 and 2004 shows steady increases in the number of both departures and arrivals in Asia as a whole, with the movement of people topping the one-million-mark both ways. Until recently, the flow of people into Japan was rather limited against active flow from Japan into Asian countries. In 2004, however, the movement of people to and from Japan topped one million, with institutional changes, including simplified procedures to obtain visas, apparently contributing to the increased flow of people.

Behind the robust flows of people is the fact that people in East Asia have come to share values in ordinary life as a result of the rise of the urban middle class as economic growth helped raise the standard of living. The purchases of home electronic products, car ownership and living in high-rise condominiums are the phenomena commonly seen among urban residents of East Asia countries, and opportunities to come into contact with foreign cultures are also increasing through the Internet and other means while sitting in the comfort of their homes.

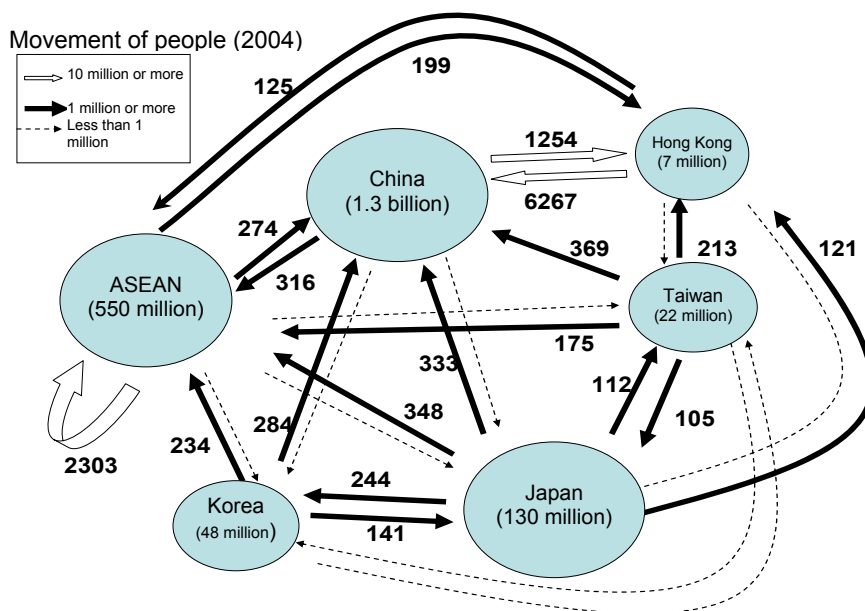
Cultural exchanges usually occur spontaneously on an individual basis. However, considering that an accumulation of individuals' interest and understanding of another country would help generate a national sentiment toward that country, cultural exchanges have a significant role to play in the process of the integration of East Asia. For countries at relatively similar stages of development, the foundation for cultural exchanges, if any, could provide underlying support for their bilateral relationship even when they are faced with difficult political and economic ties. Even for countries at different stages of development, cultural exchanges can be expected to perform the role of narrowing the gaps in political or economic interchanges. Given these circumstances, policy responses to help develop an environment for smooth cultural exchanges are needed. Necessary initiatives in this area include the easing of restrictions on imports of cultures, wider acceptance of the movement of people from other countries, protection of intellectual property rights and language policy.

Restrictions on the importation of cultures are often adopted for the protection of home industries and traditional culture, but such restrictions should be held down to the minimum necessary level. Though there is no end seen to such restrictive measures, including China’s hostile measures against foreign animation films in a bid to nurture a domestic industry, a natural inflow of culture is unstoppable. However, an inflow of subculture, even when spontaneous, may be seen as a cultural invasion if that inflow is too strong. Meanwhile, the protection of intellectual property rights is a desirable response in the interest of culture exporters, and also represents a necessary step in the immediate future in terms of realizing stable cultural exchanges over the long term.

For acceptance of the movement of people, the basic policy priority is to develop an environment that motivates people of other countries to come, regardless of whether their purpose is tourism, work or immigration. The basis of this movement policy, with support measures that may be necessary, is to help those with plans for extended stays build stable relationships with host communities.

Finally, assuming the realization of the integration of East Asia, language policy emerges as a major issue in promoting cultural exchanges. This would require a continued accumulation of careful and considerate discussions on whether a single language should be designated or languages of member states should be respected.

Movement of People in Asia (in terms of entrances and departures)



Sources: Statistics provided by respective countries/regional authorities and World Tourism Statistics (provided by the Asia-Pacific Tourism Exchange Center)

## Chapter 8: Regional Monetary and Financial Coordination in East Asia

Eiji Ogawa

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East Asia has made progress in regional financial and monetary coordination after experiencing the Asian currency crisis in 1997. Regional financial and monetary coordination is being undertaken on the basis of the recognition that the double mismatching of currencies and maturities in the balance sheets of local financial institutions caused the Asian currency crisis. Specifically, the ASEAN (the Association of Southeast Asian Nations) + 3 (Japan, China and Korea) Finance Ministers' Meeting built a network of bilateral currency swap arrangements to manage a currency crisis under the Chiang Mai Initiative (CMI). In contrast, the ASEAN + 3 Finance Ministers' Meeting and the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) are promoting the Asian Bond Markets Initiative (ABMI) and the Asian Bond Fund (ABF), respectively, to help improve the financial system heavily dependent on banks.

It is necessary to conduct surveillance of the regional economies using exchange rates as a new surveillance criterion. As an indicator for that purpose, it is necessary to create a regional monetary unit and use this unit to conduct surveillance.

As a common policy issue in the above-described regional financial and monetary coordination, the creation of the regional monetary unit is under study as an indicator of surveillance of the regional economies or as a denotative currency for Asian bonds. One of the proposed regional monetary units is the Asian Monetary Unit (AMU).

The AMU and the AMU deviation indicator may be useful for the surveillance process among ASEAN + 3 countries. The AMU is calculated as the weighted average of the currencies of 13 countries, including all of the ASEAN + 3 countries. The AMU deviation indicator for each country currency can measure the extent of its divergence from the AMU. Both the AMU and the AMU deviation indicator are expected to contribute to exchange rate policy coordination in East Asia and also to the enhancement of the surveillance function of the monetary authorities.

The common regional monetary unit can be used as a denotative currency in international trade transactions and international financial transactions in the private sector. The Asian Bond Markets Initiative and the Asian Bond Fund/Initiative, with the purpose of nurturing a market for bonds denominated in local currencies in Asia, are organizing funds for investment in bonds denominated in currencies of the region's countries and addressing the creation of bonds denominated in the basket of Asian currencies. In the creation of the regional monetary unit to be used in the private sector, efforts are needed to enhance the convenience of such a monetary unit for private sector users. As the convertibility of currencies in current transactions and capital transactions, or the relaxation of

foreign exchange control, and liquidity affect the user friendliness of currencies, improved convertibility and liquidity of currencies would become necessary. While the Asian Bond Fund II (ABF II) for investment in domestic currency bonds issued by sovereign and quasi-sovereign issuers does not cover yen-denominated bonds, a proposal has also been forwarded for the core AMU that includes the yen, to be used by the private sector.

Regional monetary coordination in Europe has been undertaken in stages, from the introduction of the European Currency Unit (ECU) in 1979 to the introduction of the single currency euro in 1999. Similarly, in East Asia that consists of countries in varying stages of economic development, the desire is to promote regional monetary coordination in stages. It is necessary to move ahead with regional monetary coordination in East Asia in stages in response to stages and differences of economic development for the region's countries. In such a graduated evolution of regional monetary coordination in East Asia, the creation of the regional monetary unit is an important process as the first step.

#### The core-AMU qualification of East Asian currencies

Country	Sovereign Credit Rating (S&P) <sup>1</sup>	FX Spot Market			FX Forward Swap Market			core-AMU qualification
		Regulatory on Current Account <sup>2</sup>	Regulatory on Capital Account <sup>2</sup>	Liquidity <sup>3</sup>	Regulatory <sup>2</sup>	Liquidity within 1year <sup>3</sup>	1Month Swap Bid-Ask Spread in May 2006 (%) <sup>4</sup>	
Japan	AA-/Positive	○	○	Good	○	Good	0.01	Yes
HongKong	AA-/Stable	○	○	Good	○	Good	0.02	Yes
Korea	A+/Stable	○	△	Good	△	Good	0.11	Yes
Singapore	AAA/Stable	○	○	Good	△	Good	0.03	Yes
Thailand	A/Stable	○	△	Good	△	Good	0.1	Yes
Malaysia	A+/Stable	△	△	Good	△	Good	0.19	No
Philippines	BB+/Negative	△	△	Good	△	average	0.19	No
Indonesia	BB/Positive	○	○	Good	△	average	0.79	No
China	BBB+/Positive	×	×	Good	×	Poor	-	No

Note:

1. The data of Sovereign Credit Rating (S&P) are from the website of Asiabondsonline. Each credit rating and outlook is for each Long-term Local Currency Sovereign Bond.
2. Each country's regulatory information is from its central bank and monetary authority website. ○ means no restrictions, △ means some restrictions, and × means transactions are restricted for non residents.
3. Each market liquidity information is from Asian Currency Handbook 2005 (Deutsche Bank).
4. Each 1month swap bid-ask swap spread in May 2006 is calculated by the same procedure of Ogawa and Shimizu (2004). All spot rates and forward rates are collected from Bloomberg currency composite pages and Prebon Yamane Asia Region pages on sample days.

Source: Shimizu and Ogawa (2006)

## Chapter 9: Energy Security and Regional Cooperation in East Asia

Hiroyuki Ishida

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In Asia, against the backdrop of high economic growth, the consumption of primary energy is likely to increase to 5.01 billion tons of oil equivalent by 2020 from 3.06 billion tons of oil equivalent in 2004, with China expected to account for about half of the forecast increase. As a substantial rise in oil production in Asia is unlikely, net imports of crude oil are likely to expand from 710 million tons in 2005 to 1.39 billion tons in 2020, with the dependence on imports estimated to rise from 55% to 84%. Consequently, the region's dependence on the Middle East for oil imports is expected to rise, while the traffic of crude oil through the Straits of Malacca is also likely to expand.

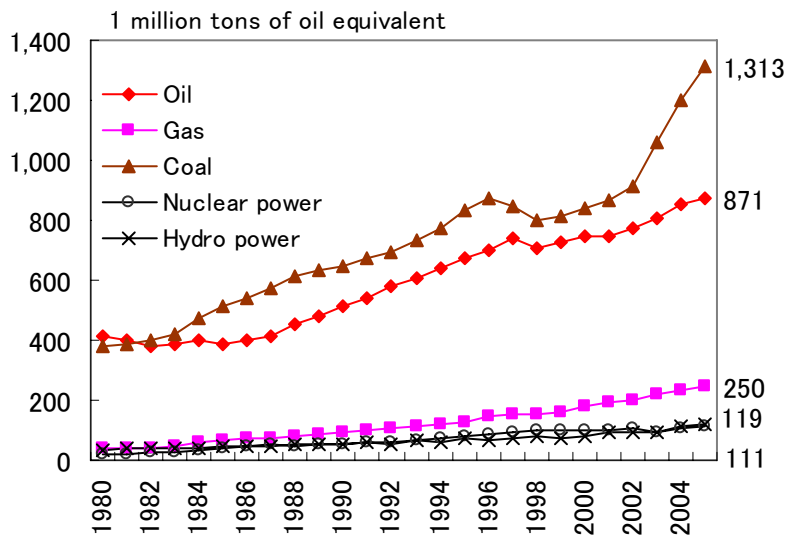
Faced with such an energy situation and also partly because of the recent spike in crude oil prices and the destabilization of the Middle East situation, Asian countries are showing a growing interest in energy security. In order to strengthen energy security toward 2020, it is necessary to curb energy (oil) imports, secure stable imports of energy (oil) and enhance the ability to respond to emergencies. Curbing imports of oil being in short supply in the region requires efforts to rein in energy demand by stepping up energy-saving efforts. For ensuring stable oil imports, efforts to lower the excessive dependence on oil from the Middle East by diversifying import sources are important, together with the safeguarding of import routes. On top of such peacetime efforts, a strengthening of the ability to deal with emergency situations is essential, and from this perspective, an expansion of oil stockpiles and the building of an oil sharing system are desired.

In Asia, the need to further enhance energy security through regional cooperation is gradually being recognized. Energy efficiency in Asian countries other than Japan is low, relative to industrialized countries, and this apparently indicates the large potential for energy saving in Asia. Since enhanced energy efficiency helps strengthen industrial competitiveness, regional cooperation on a business basis becomes important. Also, as the diversification of sources of oil imports requires massive investment in the development and production of such sources as well as the transportation of oil, cooperation by multiple countries sharing the same objective is desirable over single-country approaches to boost the feasibility of such diversification. Nationalism over resources is rising in oil-producing countries, giving rise to concerns over a possible deterioration in the investment environment. If oil-consuming countries in Asia, an important customer base for oil producers, cooperate in enhancing their joint bargaining power, such cooperation may go a long way toward improving the investment environment.

Further, countries along sea lanes for importing crude oil and countries using such lanes need to cooperate in sharing the cost of efforts to secure the safety of the sea lanes. In other areas, in order

to increase the economic effect of oil stockpiles in emergencies, an expansion of stockpiles in Asia and the smooth functioning of oil sharing accommodation among countries in the region are important. Therefore, it may become necessary to consider an Asian version of the oil sharing system, with Japan and Korea leading the effort.

### Primary Energy Consumption by ASEAN + 3



Source: BP Statistical Review of World Energy June 2006

## Chapter 10: Multilateral Security in the Asia-Pacific Region — Possibility of Strategic Convergence of the Multilayer Mechanism

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For the multilateral formation of stable international order, it is important that major countries have a common sense of order about peace and stability and that there exist international security rules to support the common sense of order. However, in the post-Cold War Asia-Pacific region, it was difficult to establish a regional security mechanism and develop it as a system to effectively contain the causes of disputes and ease tensions, due to the diversity that characterizes the region. In addition, partly due to divisive points over the sense of security about regional peace and stability, major countries in the Asia-Pacific region have yet to reach the state where they accept a common system and approach toward security.

While the structure is not yet fully in place to ensure, as a system, responses to a presumable security crisis in accordance with the level of crisis, it is important to consider how to build a mechanism that can recognize latent as well as overt divisive factors in regional security, ease tensions before something happens and resolve conflicts when they actually occur.

Presently, there are three different modes of security in the Asia-Pacific region: (1) bilateral alliances between Japan and the United States and between the United States and South Korea that represents bilateral security relationships; (2) web-type security that can be described as a web of more open security relationships; and (3) cooperative security that focuses on nonmilitary dimensions such as politics and diplomacy rather than on military dimensions.

Regarding bilateral security relationships, the United States and its allies and friendly countries from around the mid-1990s have regarded the alliances as the linchpin of security order and multilateral security as a secondary factor that complements the former. That is, only when bilateral alliances such as the Japan-U.S. alliance are maintained in a stable manner can the agenda for regional security cooperation be determined.

The web-type security helps develop a multifaceted regional approach to common security issues and also advances policy coordination including multilateral joint military cooperation. For example, this primarily focuses on cooperative actions by East Asian countries in response to cross-border problems such as terrorism, illegal drug transactions, acts of piracy and the proliferation of weapons as well as disaster relief operations and search and rescue activities. While maintaining bilateral alliances as the cornerstone, this transforms the system of bilateral arrangements into a more open web of security relationships by drawing it into the pattern of expanded dialogue and cooperation such as multilateral cooperation (for example, cooperation among Japan, the United States and Korea,

ASEAN + 3, ARF, etc.).

An effort of preventive diplomacy by the ASEAN Regional Forum (ARF) established in 1994 can be cited as a framework of cooperative security. Unlike collective security, cooperative security does not involve forcible measures but seeks to put a structure for peace in place in member states by focusing on nonmilitary aspects such as politics and diplomacy rather than on military aspects.

In fleshing out preventive diplomacy by the ARF, it is necessary to push ahead with institution-building, such as providing the ARF chairman with specialized staff, promote coordination to keep preventive diplomacy from being regarded as interference with domestic affairs, and sort out the relationship between preventive diplomacy by the ARF and the response and deterrent function of existing bilateral alliances.

It is important to build a multilayered security mechanism for East Asia through the strategic fusion of the above-described three different modes of security and to have each of the three mutually complement each other. In doing so, it is also essential to develop a relationship between web-type security and cooperative security and other frameworks of security. There can be hope for cooperative relationships of major countries about the order of regional security only through these efforts.

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