

February 2008

Asian Research Report 2007

Larger Benefits from Expanding the Economic Sphere Structural Reform Initiatives Centering on Agriculture

Shujiro Urata

Senior Economist, Japan Center for Economic Research

Professor, Waseda University

Benefits for nations participating in East Asian economic integration would be greater, if integration was promoted within the framework of the wide-area integration of the Association of Southeast Asian Nations (ASEAN) + 6, encompassing India, Australia and New Zealand, in addition to Japan, China and South Korea. Japan should press ahead with its liberalization and structural reform, centering on agriculture, and should play a leading role in the establishment of a free-trade agreement among the ASEAN + 6.

Since the Asian currency crisis of 1997, regional cooperation has been promoted in East Asia within the framework of the ASEAN + 3 (Japan, China and South Korea) through summit and ministerial meetings and issue-specific conferences. Within this context, based on Japan's proposal and with the help and support of Singapore and Indonesia, the first East Asian Summit was held in December 2005 with the participation of 16 nations (the ASEAN + 6).

Increasing Presence of the ASEAN + 6

Japan has been taking the initiative in promoting cooperation among the ASEAN + 6 in economic partnership, the environment and other areas. It proposed and has been working for the creation of an East Asia/ASEAN economic research center (ERIA), which will make policy recommendations for the promotion of economic growth in East Asia and which will be seen as an East Asian version of the Organization for Economic Cooperation and Development (OECD). Japan also proposed and has been working for Comprehensive Economic Partnership in East Asia (CEPEA), which will include free-trade agreements.

Cooperation within the framework of the ASEAN + 6 has just begun. The Japan Center for Economic Research (JCER) has examined the significance of and problems in including India, Australia and New Zealand in the regional cooperation framework of East Asia and presented its recommendations for surmounting the problems the initiative faces (the study was headed by this writer).

Against the backdrop of high growth in China and India, the ASEAN + 6 are

growing in importance in the world economy. In 2005, these nations combined accounted for a quarter of the world's gross domestic product (GDP) and a half of the world's population. The expansion of their economies has also increased intra-regional trade in goods and services, and foreign direct investment. The degree of dependence on intra-regional trade among the ASEAN + 6 has been rising and has exceeded 40 percent. While that of Australia and New Zealand is extremely high at around 55 percent, that of India is low at below 30 percent.

High Potential of the Indian Market

Among the ASEAN + 3, intra-regional production networks have been built through foreign direct investment by multinational enterprises, centering on the machinery industry. India, Australia and New Zealand have not been incorporated into these networks. In computers, automobiles and some other product groups, however, India is being incorporated in these production networks through the provision of parts and information services.

The addition of India, Australia and New Zealand will greatly benefit the ASEAN + 3 in securing sources of mineral resources and other primary products and in cultivating the consumer market in India. However, the Indian market, in which value added is not very high, will be a difficult market to do business in for many Japanese enterprises, which tend to focus on providing high value-added goods and services. On the other hand, if Japanese firms remain passive about doing business in India, they will miss out on the enormous demand, set to arise in that market.

Although many observers have a bright outlook for the Indian economy, there are still many problems that need to be addressed in realizing high economic growth, which is designed to expand jobs and reduce poverty: 1) More radical easing of regulations and the improvement of governance at government level, especially at local government level, are urgent tasks; 2) labor market reform has not made progress and 3) infrastructure is not adequate.

India, Australia and New Zealand will be able to promote their economic growth by enhancing their trade and investment relations with the ASEAN + 3. For the expansion of trade and investment, their liberalization is essential. India has continued to liberalize since its reform of 1991, but its cumbersome tariff system and non-tariff barriers are still intact. Although the sectors in which foreigners may invest have been increasing, activities of foreign enterprises are being restricted. There is still much room for further liberalization.

A simulation analysis using a general equilibrium model shows that trade liberalization through the formation of an FTA among the ASEAN + 6 will push up the GDP of the ASEAN + 6 by 2.1 percent. It will increase Japan's GDP by 0.5 percent.

At present, FTAs in the form of the ASEAN + 1 (such as the ASEAN + China and the ASEAN + South Korea) are being formed with the ASEAN serving as their axis.

Effect of East Asian FTA on GDPs (%)

	ASEAN+3	(ASEAN+1)×6	ASEAN+6
Japan	0.4	0.1	0.5
China	4.7	0.2	4.8
Korea	3.6	0.2	3.7
ASEAN	5.7	2.1	5.9
India	-0.1	0.5	3.5
Australia	-0.1	0.2	1.4
New Zealand	-0.1	0.1	1.9
ASEAN+6	1.7	0.3	2.1

At the same time, discussion of an ASEAN + 3 initiative (East Asian FTA initiative) is under way. Simulation analyses of the ASEAN + 6 FTA and ASEAN + 1 FTAs show that the former will bring the greatest economic benefit to the ASEAN + 6 (Table). Behind this result is the increased opportunity for division of labor coming from the enormous Indian market despite the fact that it tends to be closed. However, since the above-mentioned result does not take into account foreign direct investment and other factors which contribute to economic growth, it may well be underestimating actual effects.

An obstacle to FTAs is said to be agriculture. An examination of the agriculture of the ASEAN + 6, which include Australia (a major farm product exporter), New Zealand (with its large comparative advantage in dairy products) and India (where many forms of agriculture are practiced in its huge territory) reveals a picture which is different from that of the ASEAN + 3.

Australia, New Zealand and India are all net exporters in agriculture. The net export position of India is partly a result of a misguided agricultural policy. Hence, in the future, exports are expected to decline as domestic consumption increases with the increase in population and rising incomes. On the other hand, exports from Australia and New Zealand will continue. The net import trends of Japan and South Korea are likely to continue in the future. In China, exports and imports of agricultural products are in equilibrium at present. However, given expected increases in demand for food and progress in industrialization, it may well become a net importer.

Although there are farm product exporting countries and importing countries in the ASEAN + 6, the degree of dependence on intra-regional trade is small. This suggests that there is a very large possibility that greater intra-regional trade will raise the food self-sufficiency rate within the region.

In the area of energy, the addition of India and Australia is expected to bring welcome effects. India's presence is growing in the international energy market, and, like China, its energy demand is expected to increase sharply. Its cooperation in the ASEAN + 6 will lead to a strengthening of the negotiating power of the ASEAN + 6 vis-à-vis the Middle East and Russia, which wish to secure demand. The addition of

energy resource-rich and energy resource-exporting Australia in regional cooperation will raise the rate of intra-regional dependence in coal and natural gas.

Political Leadership and Public Support Essential

Another useful function of regionalism, such as the ASEAN + 6, is that it builds regional networks of working-level officials of various ministries and agencies pertaining to trade and finance through various conferences, and thereby creates a means of close information exchange at many levels. This would likely nurture a “sense of solidarity” among working-level officials in East Asian countries, and help the participating countries share common policy interest. The enhancement of this function is all the more desirable in East Asia, where conspicuous differences of opinions and interests hamper the discussion of how to proceed with regional cooperation.

While Japan is taking the initiative in the framework of cooperation among the ASEAN + 6, it should not only urge discussion but also actually take steps toward cooperation. Specifically, in order to make ERIA and CEPEA fully operational and in cooperation with the ASEAN + 6 countries, Japan needs to invest human resources and funds for the creation and efficient operation of their secretariat. At the same time, along with the countries which share its views, it should work hard to involve India, Australia and New Zealand in the meetings and projects taking place within the framework of the ASEAN + 3.

The pillar of the ASEAN + 6 economic partnership will be an FTA. Japan should take the initiative in establishing an ASEAN + 6 FTA. However, since it faces strong opposition from its agricultural sector, which fears damage from trade liberalization, it has failed to play its expected role. Although discussion of the liberalization of agricultural trade in Japan focuses on the damage to Japanese farmers, measures to ease the damage are feasible. Moreover, by implementing its structural reform simultaneously with liberalization, Japan could envisage a bright future for its agriculture.

If Japan works for the liberalization and structural reform of its agriculture and plays a leading role in the creation of the ASEAN + 6 FTA while extending cooperation in various fields, including energy and the environment, it will contribute to creating a bright future for Japan and East Asia. For Japan to assume these roles, strong political leadership with foresight, along with the support of the Japanese people, are essential.

(The original Japanese article appeared in the January 25, 2008 issue of The Nihon Keizai Shimbun)

Copyright © 2008 JCER

Japan Center for Economic Research (JCER)

Nikkei Kayabacho Bldg. 2-6-1 Nihombashi Kayabacho, Chuo-ku, Tokyo 103-0025, Japan
Phone:81-3-3639-2801 / FAX:81-3-3639-2839 / E-mail:jcernet@jcer.or.jp