

Japan in Emerging East Asian Regionalism

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Abstract

Japan's trade policy is currently undergoing a major shift. It is now focusing on bilateral and regional approaches, in the face of its traditional policy of multilateralism. Japan must make this shift for it to continue to be globally competitive and remain a leader in the world economy.

While the trend toward regional trading arrangements appears relatively new in Asia, and specifically Japan, intellectually it has been discussed for over three decades. Professor Kiyoshi Kojima, at a conference at The East-West Center in the 1960's, spoke of creating free trade agreements (FTA's) to promote trade and investment in the Asia-Pacific region. Kojima and like-minded colleagues began working together on this subject and this led to the formation of the Pacific Trade and Development Conference (PAFTAD). PAFTAD and other early efforts were the precursor to APEC, the Asia-Pacific Economic Cooperation.

Japan's shift to regional integration and the success of this shift inevitably requires two important adjustments. First, Japan must implement structural adjustments to its domestic economy, which can be forced by entering FTA's. Secondly, the bilateral agreements entered into by Japan must work with, not replace, the current multilateral agreements already in place.

This paper focuses first on the forces and trends towards regional integration. Second, it highlights as an example, the recently concluded Japan-Singapore Economic Partnership Agreement (JSEPA). Next it suggests some future directions for ASEAN integration. Finally, the paper concludes with analysis of Japan's FTA policies, in particular, the implications of the FTA's for Japanese domestic structural adjustment.

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I. Introductory Comments

Japan, and Asia in general, have come to a critical juncture. The burgeoning of East Asian developing economies, branded the Asian Miracle, seems to have passed and along with it. The oft-cited Flying Geese Pattern of Economic Development, which derived in part from an ostensible “orderly” structure of economic growth said to characterize Asian development, has been thrown into disarray. For example, the Japanese economy continued to have major economic problems over the last ten years, though it has recently begun to show some sign of life again. The Asian Financial Crisis of 1997 and 1998 disrupted the high growth of affected economies and, while there has been a rebound in most countries—Indonesia being a major exception—the recovery has been uneven and the growth trajectory at a lower pace. Growth projections for 2004-2005 are strong by international standards but continue to be lower than pre-Crisis rates for Crisis-affected economies, while imbalances in global markets create an important uncertainty in these projections. China has been doing well, but it continues to show worrying signs of overheating, financial excesses, various financial “bubbles,” and uncertainties associated with its new responsibilities as a WTO member and protagonist in the regionalism movement.

Japan and Asia in general are beginning to forge new trade and economic relations. Free-trade agreements (FTAs) now being formed in Asia present a path that can bring the sorely needed restructuring of the Japanese economy. Free-trade agreements provide an opportunity to grow closer with other Asian countries as they provide access to each other in goods, services, and finance, perhaps create an important source of stimulus for all. Not only can they force Japan to implement the structural

adjustments necessary to stay competitive, but they can also provide an opportunity to grow closer to other Asian countries while collectively protecting themselves from the negative effects of other regional agreements in North America and Europe.

In my remarks, which bring together my thoughts regarding the future of Japan in the global system, I will stress that now is a pivotal point for Japan, in that the opportunity to pursue FTAs with other countries is at hand, and they must be capitalized upon if Japan is to remain competitive with rising economies like that of China. Japan cannot afford to idly sit by, if resurrecting her economy and reestablishing herself as the leader of the Asian markets is to occur. To understand this requires looking at the evolutionary process that has brought us to the present, the developments taking place today, and how we can extend them into the future.

Japan must also realize that it is also going to face increasing competition from its OECD partners for a leadership role in Asia. As I will discuss below, the United States has been a major protagonist of regional cooperation in the Asia-Pacific region and has recently been extremely aggressive in pursuing free-trade areas with some of Japan's most important Asia-Pacific markets. The EU has also been investing a tremendous amount of resources into its relationship with China and other countries in the Asia. If Japan does not take a proactive, forward-looking approach to its relationships with its Asia-Pacific partners, it will certainly be left behind.

In the post-war years, Japan has relied on global liberalization in promoting its exports and economy. Based on multilateralism, the reduction of world tariffs has become a source of economic stimulus, leading to innovative enterprises that in turn have resulted in the development of new products and high economic growth. However, over

the last few years, Japan's trade policy is on the verge of major change; moving away from multilateralism and towards bilateral and regional approaches. Regional integration is now assuming center stage in the discussion and implementation of its main trade policy. Still, in comparison to the rest of the region, Japan seems to be a latecomer and follower rather than a leader of the recent trend toward the regional approach.

Japan has recently signed an FTA with Singapore called the Japanese Singapore Economic Partnership Agreement (JSEPA). Japan has also been negotiating or conducting studies with South Korea, Mexico, Chile, Australia, New Zealand, as well as ASEAN and within the ASEAN Plus Three (China, South Korea and Japan) framework. My presentation will cover: (1) the forces and trends toward regional integration; (2) the nature of JSEPA; (3) the future direction of ASEAN integration; and (4) Japan's FTA policies and the implications FTAs have for Japanese structural adjustment. But first, I would like to preface my discussion with a summary of my own background and experience in the area of regional cooperation in Asia.

II. Personal Reflections on the Evolution of Regional Integration in Asia

As a graduate student and then a young faculty member at the University of Wisconsin in the mid-1960s, I was involved in a project called Economic Development in Southeast Asia. I recall the conclusion of our study was to suggest Southeast Asian countries should pool their resources together and form a regional cooperation grouping. The countries we suggested were Indonesia, Malaysia, Philippines, Singapore, and Thailand. We were elated when these same countries formed the Association of Southeast Asian Nations (ASEAN) in 1967. Ever since, I have followed the progress of ASEAN and spent some of my most memorable years working in the ASEAN region.²

In 1990, I was asked by the ASEAN Secretariat to chair an advisory group consisting of high-ranking officials from ASEAN countries and scholars to review the prospect of future ASEAN economic cooperation. Our report outlined a framework for ASEAN forming an FTA, and of course, we are pleased that ASEAN adopted one in 1992 in the form of the ASEAN Free Trade Area (AFTA). Until very recently ASEAN was the only regional integration arrangement in Asia . When it was formed in 1967, it was much more politically motivated and largely intended to combat the spread of

² As a note of interest, it was when I was a visiting professor at Thammasat University in Bangkok, I had the pleasure of meeting Professor Ichimura. He was visiting Southeast Asia to conduct a joint research project and help train many young scholars in the region. It was the period when Japan began to expand rapidly and Japanese firms started investing in the region. There was a great deal of anti-Japanese feeling as exemplified by the huge demonstration against Japan when Prime Minister Tanaka visited Southeast Asia in the early 1970's. Although I will not elaborate, over the years, the relationship between Japan and ASEAN countries has improved significantly. As these countries began to achieve high economic growth--which was partially stimulated by Japan's trade, investment, and ODA policies--I also feel that the intellectual and cultural links that people like Professor Ichimura and his successor at ICSEAD, Professor Yamashita developed with Southeast Asia, were an integral part of the improved relations between these countries

communism, but beginning in the mid-1970s and especially in the last 1980s, the region began to pay attention to economic cooperation.³

Initially, ASEAN established a preferential trading arrangement (PTA) to exchange tariff concessions. But some of us involved in ASEAN studies were often very frustrated with the slowness of ASEAN's efforts toward tariff reductions. Countries often exaggerated the tariff preferences given to other countries. The offer lists of concessions included a large number of items which had little effect on trade expansion. Such lists, for example, included batik and wood products, which were already major export items of the countries offering concessions.⁴ Also, matches were listed when already the tariff was zero to begin with. Furthermore, the list of products was expanded by the inclusion, as separate products, of matchbooks and boxes containing different numbers of matches! Even snowplows were items to be liberalized, the utility of which is dubious for countries spanning the equator. To some extent, this reflected the differences in the stage of economic development and their un-preparedness to open their doors even to neighboring countries. In many ways, they were not self-contained economically, culturally, and in other areas. Moreover, import-substitution was a popular approach to industrialization in those days.

I have observed carefully the economic growth of ASEAN countries over time, and beginning in the late 1980s, it became clear to me that the region had gained

³ There are a number of reasons for this change in approach, but I would argue that by the late 1980s, the key political problems that ASEAN needed to deal with (the Cultural Revolution and the Vietnam War when ASEAN was founded; the unification of Vietnam in 1975 and the invasion of Cambodia shortly afterwards) had either been reduced in importance or disappeared, allowing the region to focus on economics in order to perpetuate the success of the organization.

⁴ Of course, if intra-ASEAN trade were of the *intra-industry* type, this would not be a problem; developed-countries do most of the trading in the world and most of this is intra-industry (cars for cars, computers for computers, etc.). However, for goods characterized by *inter-industry* trade (like the products offered for

sufficient self-confidence to carry out serious trade liberalization. This process manifested itself in a comprehensive trade rationalization (e.g., removing non-tariff barriers, reducing tariff peaks which created great discrepancies in effective rates of protection) and liberalization drive in the ASEAN-4 countries, and was in evidence with the establishment of AFTA in 1992. After achieving the goal of reducing tariffs on intra-ASEAN trade to 0%-5%, several years in advance of the stated deadline for many products, ASEAN countries are targetting the elimination of tariffs altogether. In October 2003, the ASEAN countries agreed to create an ASEAN Economic Community (AEC) by 2020, in which there will be a free-flow of goods, services, capital, and skilled labor.

As is well known, ASEAN now encompasses all 10 Southeast Asian countries as members, including its most recent members: Vietnam (1995), Myanmar (1997), Laos (1997), and Cambodia (1999). ASEAN has been playing an important role as the center of regional cooperation in Asia, but has also arrived at a critical point. The post-ASEAN crisis recovery has been uneven and regional economies now face the prospect of having to take some painful steps to push ASEAN integration forward, especially if the AEC is to be realized. These adjustments will be crucial, for ASEAN integration is emerging as the conduit for East Asian regionalism through bilateral agreements with Japan, South Korea, and China, as well as ASEAN Plus Three. But I will explain this in greater detail later.

tariff reductions in the PTA), there is little room for trade (a country producing rubber does not need to import rubber!).

III. General World Trend: Steering towards regional agreements

As will be noted below, it is apparent that the Asian FTA effort is a late comer to a trend that has been widespread throughout the world for some time. Regionalism has become a critical part of the new international trade order. We are seeing a surge in regional arrangements since the early 1990's. The GATT-WTO has been notified of over 250 regional trading agreements up to December 2002. An additional 70 are estimated to be operational without notification. This is a ponderous figure, given that the backbone of the GATT-WTO is supposed to be non-discrimination. Its founders allowed for exceptions with conditions under Article XXIV and the Enabling Clause for developing countries. But the exception is proving to be the rule. Moreover, the trend is very recent with the establishment of over 130 FTA agreements since 1995. In particular, the two most well-known integration developments, the European Union (EU) and the North American Free Trade Area (NAFTA), indicate that integration is not only deepening but widening as well. Both are continuing to expand in membership and deepening in the number of issues they address. The EU has been active in broadening (extending its membership by an additional ten Central and Eastern European countries in May 2004) and deepening (in particular, the Single Market Program and European Monetary Union). Currently, on the other side of the Atlantic Ocean, there is a move to establish a Free Trade of the Americas (FTAA), which will be intended to essentially extend NAFTA to all of North and Latin America (with the exception of Cuba, of course). The U.S. has signed FTAs, patterned after NAFTA, with Chile, Morocco, Singapore, and Australia.

To some extent, countries realize economic integration can be undertaken more expeditiously and comprehensively through an FTA agreement than within the

multilateral, one-hundred-forty-plus-member framework of the WTO. In fact, the Uruguay round took eight years to complete when it was originally planned for four years. And we all recall the strong protests leading to the breakdown of the WTO meetings in 1999 in Seattle.⁵ The WTO was established in 1995, but it was not until the 2001 Ministerial at Doha that the organization was able to have a conclusive meeting on the new round. It is very unlikely that the Doha round will be completed by the originally-anticipated date of end-2004, especially since 2004 is an election year in many countries, notably the United States. When you have nearly 150 WTO members, it is not that easy to come to a consensus. Furthermore, there is a great deal of anti-WTO and anti-world liberalization by environmentalists, labor unions, and NGO's who have launched a fairly-successful publicity campaign against globalization.

In addition, the disagreements go much farther than mere trade rules. There are many complicated areas of discussion, such as services, competition, anti-dumping, intellectual property rights, trade-related investment measures, and subsidies, particularly in agriculture, the complexity of which makes it understandable as to why sub-regional approaches have been pushed so hard. But expanding regionalism is still a recent phenomenon everywhere outside of Western Europe, especially in Asia. Although there is a great deal of effort now being directed towards FTAs in Asia, only a few exist involving Asian countries, aside from ASEAN. Perhaps the two most notable existing agreements have been signed between (1) Singapore and Japan (January, 2002), and (2) South Korea and Chile (November, 2002). These are not major accords.

⁵ In fact, when I was the director of the economics ministry of the State of Hawaii and we were organizing the annual meeting of ADB in Hawaii in 2001, our main concern was how to deal with protesters, which took up a great deal of our time.

IV. The Evolution of Asian Integration

At this point I should reiterate that, although throughout the 1990s and early 2000s the global marketplace has witnessed an unprecedented surge in FTAs, regional integration has existed conceptually in Asia for some time. In Asia and the Pacific, it is largely the result of an evolutionary process initiated by Japanese intellectuals in the 1960s. I recall in the early-1960s listening to Professor Kiyoshi Kojima at a conference hosted by the East-West Center, at which he proposed an FTA to promote trade and investment in the Asia-Pacific region. Few thought his ideas were realistic at the time, but Kojima and a group of enlightened intellectuals from Japan, the U.S., Canada, Australia, and New Zealand formed the intellectual thinking group called the Pacific Trade and Development Conference (PAFTAD). Encouraged and supported strongly by the late Saburo Okita, one time foreign minister of Japan, the group then met every year to exchange ideas on how these five advanced countries should pursue integration. I occasionally participated in the annual meetings of PAFTAD and assisted in bringing scholars from developing East and Southeast Asian countries into the group in the mid-1970s. The effort of PAFTAD along with other initiatives such as the Pacific Basin Economic Council (PBEC) eventually led to the formation of the Pacific Economic Cooperation Conference (PECC) in 1980, which included participation by government officials from the region for the first time, *albeit* in an informal capacity. This event consisted of a tripartite group consisting of scholars, businesspeople, and government officials. In retrospect, though the activities of PAFTAD, PBEC, and the PECC were basically non-governmental, it was these early efforts which led to the formation of the

Asia-Pacific Economic Cooperation (APEC), the first official organization in the region to focus on economic issues.

A. The first half of the 1990s: APEC

During the first half of the 1990s, three major developments occurred that would come to shape the nature of today's Asian integration. As I mentioned earlier, AFTA was established in 1992. Second, there was a key proposal by Prime Minister Mahathir of Malaysia in December 1990 to form an East Asian Economic Grouping (EAEG), which was quickly renamed (to have a milder tone) the "East Asian Economic Caucus" (EAEC) at the ASEAN Fourth Summit in Singapore. The membership consisted of the current members of the ASEAN Plus Three group, namely ASEAN countries, China, Korea, and Japan (APT). It was opposed by the United States, which feared that such an agreement might lead to a discriminatory trading bloc. Japan, concerned by the objection of the United States, was relatively silent and ambivalent about the matter. Concurrently, an Australian proposal to create an Asia-Pacific cooperative forum was launched in 1989 and which would become APEC. In fact, at the initial planning stages of APEC, Australia, its main proponent, did not extend an invitation to the United States. However, after much pressure from the U.S. (and help from Japan), it was included in the grouping. Subsequently, APEC became the main vehicle for transpacific economic cooperation and the pursuit of U.S. trade policy concerns in the region through 1996.

In 1993, when the U.S. was hosting the annual APEC meeting, President Clinton elevated the meeting to an informal summit of heads of state. In 1994, the annual APEC meeting in Bogor was a major event as countries agreed to the liberalization goal of free

trade and investment in the region by 2010 for developed countries and 2020 for developing countries. It should be noted, however, that this was not meant to lead to a “free trade area”, but rather “open trade and investment in the region”. The subtle difference in these two phrases tends to obscure the vast differences in the implications of each.

APEC has brought together 22 leaders from economies in the region, including Chile, Peru, and Russia, along with East Asian countries and NAFTA members and has provided a forum for dialogue in the region. However, the APEC approach is based on the voluntary liberalization efforts of individual member countries on a MFN basis, unlike the systematic and discriminatory integration approach like what can be found in the EU or NAFTA. Therefore, the countries have been promoting trade and investment facilitation among APEC countries but the framework lacks enforceability (and, arguably, political sustainability). Furthermore, all concessions made are extended to non-members, a process known as “open-regionalism”. Some feel that the insistence on the principle of open regionalism, championed by Australia and supported by Canada and many other APEC members, led to growing U.S. disenchantment with the magnitude and pace of liberalization in APEC.

B. The Second Half of the 1990s: From APEC to ASEAN Plus Three

In the latter half of the 1990s, there were a few events that shifted the focus of Asian integration to East Asia. Though overshadowed by the broader coverage of APEC, the idea of ASEAN Plus Three implied in the EAEC did not fade away. On the contrary, it began to grow in substance. Strangely, the initiative came from ASEAN’s effort to

expand economic cooperation with the EU, but the EU's desire to deal with East Asian countries in addition to ASEAN led to ASEAN asking China, South Korea, and Japan to participate. The first Asia-Europe Meeting (ASEM) was held in Bangkok in March of 1996, and officials from ASEAN and East Asia met with EU representatives—a format which was regularized and has continued twice a year since. Even though the initial impetus for these meetings was economic cooperation with the EU, the significance for East Asian regionalism lies in that these meetings brought officials from ASEAN, China, South Korea, and Japan together, to discuss issues of economic cooperation. These meetings culminated in 1997, in an informal summit of ASEAN Plus Three heads of state in Kuala Lumpur.

Even more significantly, the Asian Financial Crisis of 1997 and 1998 strengthened the move toward East Asian economic integration. The crisis began in Thailand with the Baht's devaluation and the exodus of foreign capital—which in turn quickly spread to other Asian countries. In turn, the contagion of the crisis illuminated the economic interdependence of Asian countries, as well as the region's potential exposure to extra-regional shocks.

Most Asian countries also believed that the IMF's solution to the Asian Financial Crisis was not the most appropriate. The IMF recognized that the nature of government spending and macroeconomic policies was different from that which took place in Latin America. For example, many Asian countries had a budget surplus when the Crisis occurred, which is unlike what has happened in various Latin American economic crises. However, the IMF insisted upon solutions which were more or less the same as used in the Latin American case, e.g., that the currency collapse and capital flight could be

combated by keeping interest rates high and shoring up budget surpluses to be used to recapitalize banks later on. Also, Asian countries were disappointed when the United States was not more forthcoming with assistance especially to Thailand (which had a special Treaty of Amity with it), even though it was aggressive in assisting Mexico during the Peso Crisis of December 1994. It is arguably this absence of swift support from the United States and even the IMF that caused Asian countries to begin looking for alternative means of defense from international crises.

Both Asia's business climate and culture played a role in the failure of IMF intervention, as well. The dependence of Asian business on bank finance left companies vulnerable to high interest rates, a component of the standard IMF policy package. Furthermore, strong links among firms, from South Korea's *chaebol* to industrial groups in Indonesia and the Philippines, combined with weak or non-existent bankruptcy laws to ensure that general economic stagnation would be the result--rather than just isolated bankruptcies--as the strong aided the weak until they became weak as well. Finally, the IMF ignored the fragility of the political and social system in Indonesia. The abrupt end of crucial subsidies on basic needs touched off riots and disorder, whose economic costs far exceeded any possible budgetary savings, to say nothing of the huge social costs.

It turns out that APEC was not effective at all in managing the crisis nor preventing it from happening. But being an informal organization, APEC was not designed to deal with financial crisis. Moreover, while it was the Asia-Pacific *Economic Cooperation* organization, its focus had been on the real side of the economy, not finance. Yet dissatisfaction with the crisis response from outside the region touched off many discussions in the various formal and informal regional fora.

The original Miyazawa plan initiated by Japan to create an Asian Monetary Fund to supplement the IMF, which was originally opposed by the IMF and the United States, eventually led to the establishment of a currency swap arrangement among East Asian countries during the annual meeting of the Asian Development Bank in May 2000. It would be known as the Chiang Mai Agreement.

However, financial integration in general is a very complicated process. Usually it occurs well into the process of regional integration, as is indicated in the case of the EU and the creation of the euro, which was only possible after decades of a customs union and a common market. Because the benefits of monetary cooperation are less clear—particularly in the Asian case, since exchange rate stability among Asian countries is of limited value for the many countries that trade heavily outside the region—and the political benefits no doubt are far less than in the EU case, countries have begun to focus more on FTAs, at least as a first step.

The lack of influence of APEC in the Asian Financial Crisis has served to solidify East Asia's move towards the establishment of the APT. The current spate of agreements however, have not been extended APT-wide, but have come more from ASEAN to individual countries. For example, the completion of the China-ASEAN joint FTA study in the summer of 2001 prompted Japan to quickly initiate a study of its own with ASEAN. One month later, at the 2001 APT meeting in November, ASEAN and China announced their intention to negotiate a free trade area within 10 years.

C. The Flying Geese Pattern in Question

China's enthusiasm for pushing regional free trade seems somewhat suitable in that the PRC has experienced a continually high growth rate and an increase in the inflow foreign investment, while the rest of East Asia and Southeast Asian countries have experienced a more checkered pattern of recovery from the Asian Financial Crisis in 1997-98 and the bursting of the IT bubble in late-2000. It is also consistent with China's WTO accession, and the associated on-going economic and policy adjustments. ASEAN countries have seen a continued (at least relative) decline in foreign direct investment and the total flow of foreign capital, and while these countries have maintained a high level of savings, domestic investment has fallen off substantially. These shifts raise some interesting questions regarding the orderly pattern of economic development which has characterized the last thirty years preceding the Asian Crisis.

In the 1970s, NIEs such as South Korea and Taiwan began to achieve rapid growth by adopting outward looking and export-oriented economic policies. This was followed in the 1980s by ASEAN's and China's success in implementing similar policies. During this time, a systematic transition from labor-intensive industries such as textiles and light industries, to capital-intensive industries such as steel and chemicals, existed throughout the more developed countries in East and Southeast Asia. For Japan, this period consisted of a smooth industrial transition, which shifted labor-intensive enterprises to other countries and stimulated capital, skill, and technology intensive industries domestically. Through the synergy and order of this system, the NIEs in Asia began to catch-up with the Japanese economy, and the economies of ASEAN countries

and China began to draw nearer to that of those NIEs. This phenomenon was dubbed the “Flying Geese” pattern of development, in which Japan led the flock and facilitated economic development by a continued inflow of foreign investment and ODA into these countries, including the transfer of technology, management styles, and industrial organization.

The interruption of this pattern could be a result of a number of factors. First, a host of domestic structural adjustment problems stifled the Japanese economy which has since suffered a decade-long recession. Whether she can emerge from this predicament is still unclear—though at present there are positive signs--and may greatly depend on whether new technology-intensive sectors can be developed while existing ones are transferred to other Asian countries. Part of Japan’s challenge today is to improve productivity in its service sectors, which have long been ignored by policymakers in favor of manufacturing.

Second, the tier immediately behind Japan in the flying geese pattern, Singapore and Hong Kong, are simply not large enough to continue to pull the more populous countries following them.

Third, there is a possibility that the aforementioned shift of foreign investment to China, the country’s sheer size, and the demonstration of her enormous potential in factory production, may lead to China becoming the central absorber of industrial goods in Asia, thereby taking up the leadership position in East Asia. Yet China, despite its amazing growth performance, is many years away from giving up its competitive advantage in labor-intensive manufactures and becoming a major investor in poorer countries in South and Southeast Asia. In any case, the uncertain future of leadership in

the Flying Geese pattern, and the question of whether the Flying Geese pattern still holds applicability in general, illuminates the critical juncture that East and Southeast Asian countries face.

V. Japan-Singapore Economic Partnership Agreement

The JSEPA agreement between Japan and Singapore is the first FTA that Japan has negotiated and signed, and perhaps certain features can serve as a model for accomplishing future pacts moving towards region-wide free trade with other Asian countries. Thus I would like to discuss it in some detail. It was initially proposed by Prime Minister Goh Chok Tong of Singapore to Prime Minister Obuchi in December 1999. They adopted a unique joint-study approach, launched in January 2001 with a team of representatives from business and academia, as well as government officials. The study led to an affirmative recommendation in September 2000 to Prime Minister Mori. Following this, negotiations proceeded and in January 2002, it was signed by Prime Minister Koizumi and took effect in November of that year. It was an agreement completed rather quickly, in that it took only a little more than two years. An interesting contrast lies in the fact that this accomplishment occurred during the term of one Prime Minister in Singapore, and three in Japan. Also, the aforementioned joint-study group approach proved to be a viable method of coming to an agreement.

A. The Nature of the Japanese-Singapore Economic Partnership Agreement (JSEPA)

JSEPA is a high-level and comprehensive agreement, as it involves not only trade and investment liberalization but also includes investment and business facilitation, as

well as the use of information technology, a Mutual Recognition Agreement (MRA), entry visa relaxation, and other notable features such as intellectual property rights, competition policies, and government procurements.

Under this agreement, 98% of traded items from Singapore will enter Japan duty-free, and Singapore, in the context of generally low trade barriers to all countries, will eliminate several tariffs on Japanese imports of particular interest to Japan, such as beer on which Singapore levies a 10% tariff. In the area of services, in contrast to the trade sector, Singapore has more barriers than Japan. Under the WTO's General Agreement on Trade and Services (GATS), services are divided into 155 items. Japan already liberalized 102 under the GATS, and under JSEPA an additional 32 were liberalized. So instead of 66% of the total items, 86% will be liberalized together. In the case of Singapore, there were already 62 items liberalized; this agreement saw 77 more liberalized, to a total of 139. Expanding from 40% to 90% signaled a great compromise on Singapore's part. For Japan, finance, the medical profession, and social work rules were relaxed. For Singapore, electronics communication, education, and environment limits were reduced.

As a whole, such agreements in general go far beyond what is stipulated by the WTO. They bring to the forefront globalization and technological advancement as the two key components of modern economic growth. Such agreements contribute to business and industrial strength and indicate the importance of recognizing what other countries can offer in the area of cost, quality, and human-resource development. Thus, FTAs allow countries to take advantage of the individual strengths of other countries in a

wide range of areas, such as technology, human and natural resources, marketing skills, and market size. This is the foundation of JSEPA.

B. Why Singapore?

Why this Japanese focus on Singapore, rather than negotiating with other countries such as Mexico and South Korea first? Singapore and Japan's levels of development are very similar. They have similar *per capita* income (approximately \$25,000 U.S., at PPP rate) and both have fairly highly-developed IT and conventional infrastructures. Compared to other countries the economic systems are market orientated—thus the framework for doing business is similar.

In addition, Singapore's small agriculture industry and large trade dependence made negotiations easy for Japan to open its market to Singaporean goods. Trade is the lifeblood of Singapore. The combined trade value of exports and imports exceed its GDP by a factor of three. To some extent, it is the easy way out for Japan because there is no agriculture with which to compete. In fact, Japan is said to have offered to bind the tariff rates on certain agricultural commodities, which have already been reduced to zero under the Uruguay round of the WTO (GATT allows binding as a form of concession).

The quantitative economic impact is not going to be large since Singapore is basically a duty-free economy and the size of trade affected is relatively small. However, it has great implications for Japan in the sense of implicit structural adjustment. In this broader sense, it is clear that what we are seeing is not just trade liberalization, but an agreement which extends beyond the elimination of tariffs by encompassing investment and the harmonizing of regulatory systems of Japan and Singapore. In line with an

increasing number of agreements recently arising out of the WTO, Japan's agreements within the framework of JSEPA will encourage the elimination or relaxation of various Japanese regulations and the redress of high-cost factors, which will in turn stimulate domestic industries and bring about greater efficiency and competitiveness—in the end benefiting Japanese consumers.

But JSEPA alone is not enough to produce macroeconomic and microeconomic change. Agreements similar to JSEPA must be sought out and actualized with other countries—most notably ASEAN and others. Of course, many larger complications remain. Specifically, the major hurdle of an FTA with ASEAN is the complication of liberalizing agriculture. This is not just a problem for Japan; almost all FTAs have various difficulties in dealing with agriculture, including U.S.-based agreements. Often, many have allowed for a degree of flexibility in this sector, such as giving longer periods of time with which to achieve liberalization, and taking more of a package approach to reaching consensus on reductions rather than dealing with individual items. Japan should use its strengths to overcome these obstacles. For instance, with the high level of technological advancement that Japan has, further applied innovation might produce new products such as organic farming and health-related products. To achieve possibilities like this, Japan must make internal structural adjustments.

Pursuing FTAs with other countries could become the driving force for the long-awaited resurgence of the Japanese economy domestically as well as regionally, for through these agreements Japan can force necessary structural changes which will benefit her in the long-run. Japan has been contributing to Asia through trade, investment, and ODA, and in the meantime, other countries have emerged as strong competitors. Again,

China has taken somewhat of a strategic stance on the issue, moving rapidly to secure an economic advantage as soon as possible, and ASEAN sees China in the ascendancy and Japan in the decline.

The China-ASEAN Early Harvest Program negotiations could see certain items liberalized as early as 2004, and an FTA completed by or before 2010. The rapid development of FTAs sprouting in the region, often with ASEAN countries and China as partners, suggest that if Japan does not continue with FTA negotiations, it could not only miss an important opportunity but could actually be strongly disadvantaged.

Trade agreements alone cannot bring about fundamental changes in the Japanese economy. As an analogy, consider the proliferation of FTAs pursued by Latin American countries in the 1970s. These agreements led to very little additional trade, and hence little structural adjustment or economic growth. Only after substantial unilateral liberalization in the 1980s did these agreements start to flourish. A fundamental change in the mindset of the national leaders was required. While Japan, of course, is far more open and economically advanced than any Latin American country, a no less fundamental change in mindset may be required to set off the forces of restructuring and growth.

VI. ASEAN's Future

Not only did Singapore make a good starting point from which Japan could begin to negotiate FTAs but, frustrated by ASEAN's economic regression, Singapore's trade-dependent economy has been actively seeking other trading partners outside of this grouping such as the United States, Australia, and New Zealand. This raises some

important issues regarding ASEAN in general, and whether it can continue to be an effective regional organization despite its deficiencies in dealing with the Asian Financial Crisis.

After the Asian Crisis, ASEAN has been struggling with its very identity. The ending of the Asian miracle of high growth and the revelation that the region is much more inter-dependent than initially thought has brought to light ASEAN's structural weaknesses and in some ways has undermined its credibility as an effective institution in dealing with these issues.

In the past, ASEAN has thrived upon bringing together Southeast Asian countries in an informal capacity despite their differences in culture, economic structure, economic development, and language barriers to name a few. The organization's commitment to non-interference seemed to be effective in contributing to these successes but its loose, voluntary nature has resulted in the underdevelopment of formal institutions.

For example, although ASEAN countries have increased the staff and empowered the head of the ASEAN Secretariat with ministerial (rather than mere ambassadorial) rank, it pales in comparison to the size, scope, and degree of authority of the European Commission. With the establishment of AFTA, ASEAN is beginning to move towards other areas of cooperation and its loose structure based on consensus and voluntary agreements is beginning to give way to more legally binding statutes. A number of efforts have been made to strengthen the organization, such as the ASEAN Vision 2020, in 1997 and, ultimately, the AEC.

The goals outlined at this event were specified in more concrete terms through the Hanoi Plan of Action in 1998, which aimed to accelerate the AFTA process. As far as

tariff liberalization is concerned, ASEAN has completed this agreement. Approximately 95% of intra-ASEAN trade tariffs have been lowered to 5% or less, and they have agreed to reach 0% for the ASEAN Six by 2010 and the new members by 2015. The Hanoi Plan also called for: the launching of the ASEAN Industrial Area Program in order to attract foreign investment and prevent its diversion; liberalized trade and services which will increase ASEAN's intra-investment; and strengthened the ASEAN Secretariat (for example the number of staff was increased from 64 to 99). In 1998, they established the ASEAN surveillance process and in 1999.

While these efforts should be applauded, much more needs to be done to address the larger issues still nagging the organization. Relying more on voluntary participation and less on legally-binding agreements, some concessions made under the AFTA have already been retracted as in the case of Malaysia's automobile industry. In the area of AFTA Plus, they have not been very quick with investment liberalization, services, banking, transportation, intellectual property rights and so forth. There is no official judiciary to oversee dispute settlements, as with NAFTA; thus, this process is more like peer review rather than peer oversight. The establishment of the ASEAN Surveillance Process is important in this respect, in that its purpose is to stabilize regional economies by providing an early-warning system and assisting the trouble spots. To do this effectively, countries must provide economic data on macroeconomics, exchange rates, etc.—but ASEAN's lack of a compulsory backbone has allowed Malaysia and Singapore to withhold certain data that they deem confidential.

It is clear that ASEAN is going to have to take some painful next steps to transform its institutions into an AEC if it wants to be more relevant as a regional

grouping. Its consensus-building framework worked well in the past, but now that the AFTA has been established, it needs a much deeper, statutes- based integration if it is to be effective.

Not only must the grouping extend deeper; its trade scope must widen. The majority of ASEAN's members are very trade/export oriented and have been industrializing rapidly. Exports comprise about 40% of Indonesia's GDP and over 100% for Malaysia and Singapore and the share of exports which are manufactured goods are more than 75% for Malaysia and Thailand and more than 50% for Indonesia and the Philippines. The majority of these exports are directed towards advanced countries. ASEAN's exports to Japan are 13% of ASEAN's total exports now, though this is a decline from over 20% in the mid-1980's. On the other hand, Japan's exports to ASEAN rose from about 7% in the mid-1980's to 13% today. Japan has become more dependent on ASEAN and the reverse seems to hold for ASEAN.

Intra-ASEAN exports rose from 18% in 1985 to 22% in 2000 and intra-ASEAN imports rose from 16% in 1985 to 22% in 2000, but over the last several years it has remained fairly constant. Though these figures have increased, they are part of the sharp rise in trade amongst developing Asian countries in general as intra-Asian trade between China, South Korea, and Taiwan has been rising. For example, exports of intra-Asian trade as a percent of total trade of developing Asian countries rose from 21% in 1985 to 36% in 2000. In other words, trade among East Asia's developing countries as a whole has increased much faster than the increase in intra-ASEAN trade, in part because income growth in those countries has well exceeded the world average and trade barriers have declined. Hence, there is a high degree of *de facto* integration in East Asia with growing

intra-regional trade, investment, and other economic activities. This creates the incentive and need for institutions to foster interdependence and avoid conflicts. In this case, opening up to Asian-wide integration will allow the group to become deeper institutionally and wider in the scope of its trade.

VII. A Stepping-Stone to Wider Regionalism

In May 2001, Robert Scollay and John Gilbert published a study of the economic effects of various possible trade blocs, including a number of possible Japanese arrangements, using a Computational General Equilibrium (CGE) model. In general, they find that Japan—and Asia in general—would be better off with free trade under the WTO or an APEC-wide agreement. However, free trade under the WTO would be far more ambitious than what is currently on the table at Doha, and the Bogor vision of APEC continues to be a long way off, should it arrive. The subregional agreements tend to be more realistic, so it is interesting to see what the effects would be. For example, within Asia, a Japan-Singapore FTA would not increase Japan's GDP, a disappointing observation. A Japan-South Korea FTA which excluded agriculture (which is most likely) would lead to an increase in Japanese welfare of 0.04%, whereas a Japan-South Korea-China arrangement would increase it by 0.25%. An FTA arrangement within the context of APT would lead to an increase in Japan's GDP of 0.34%. Outside the region, a Japan-Mexico FTA would increase Japanese welfare by 0.01% and a Japan-Chile arrangement would actually cause Japanese GDP to decrease by 0.04%, in general because of competition in the agricultural sector. Finally, an APEC-wide agreement that

is based on “open regionalism” would lead to a 0.68 percent increase in Japanese GDP, whereas global free trade would raise the gains even somewhat higher to 0.98%.

It should be noted that while these effects do not appear large—less than one percent of GDP in the most optimistic scenario does not seem to be a great selling point for the WTO—I want to stress that the CGE model that they use is very conservative and measures the welfare effect based only on the trade impact of FTAs. Therefore, many of the more important effects of these arrangements, for example, the effect on foreign direct investment, technology transfer, economies of scale, and a more competitive microeconomic environment, are excluded. Studies of other groupings have shown that inclusion of such effects can increase the welfare effects many fold. The value of this sort of CGE exercise is more in terms of ordering which arrangements are best, rather than sheer numerical interpretation. The economic effects of these arrangements could, indeed, be substantial. This study makes an important point, in that bilateral FTA agreements should be promoted as a stepping-stone rather than a stumbling block to wider regional trading arrangements such as APEC.

Looking with an eye towards the future and beyond this region, I would like to stress that Japan’s pursuit of FTAs in general should be undertaken with prudence and foresight. Free-trade agreements combine both elements of freer trade and more protection. Not only can they create more trade among members but they also can result in the diversion of trade away from non-members. Therefore, integration is often supported by both the free trader and the protectionist. Many studies indicate a negative impact of various policy innovations in the EU and NAFTA on Asian exports. Furthermore, some studies show the diversion of investment away from Asia has been

even larger than the diversion of trade. Ideally, East Asian regionalism can both foster trade within, while protecting itself from the negative impacts of outside agreements, but that is not the only possible outcome. Thus a blind pursuit of regional trade agreements can only answer one side of the question, as it neglects the WTO and APEC, which stand as necessary links to the rest of the world. Japan must be careful not to follow the temptation of instituting a closed regional integration effort, as the WTO and APEC are important organizations through which existing trade links with countries like the United States can be improved.

Where does APEC stand now and can “open-regionalism” be pursued with bilateral agreements simultaneously? As I stated earlier, confidence in APEC has declined. Since the Financial Crisis, the ambitious “Bogor Vision” goals of free trade and investment in the region appear to be on hold. More recently however, the United States seems to be able to play a larger role in the organization; President Bush now has (“fast track”) Trade Promotion Authority which allows him more leverage to act; however his promotion of the Free Trade Area of the Americas seems to be faltering; and all this has caused a shift in U.S. trade policy. In this, through an Enterprise for ASEAN initiative, the U.S. is seeking to negotiate both bilateral and regional free trade arrangements with Southeast Asian countries (similar to a study called ASEAN-U.S. Initiative (AUI), in which some of us were involved nearly 15 years ago).

The recently heightened interest of the United States in Southeast Asian trade and development might provide a ‘jumpstart’ to greater Asia-Pacific regionalism, and help revitalize APEC as the most prominent official organization bridging the Asia-Pacific to date.

For Japan, in addition to maintaining a prominent role in APEC, she should also continue active participation in the Doha round of the WTO. Through this, multilateral liberalization is fostered and can have a great impact on reducing any negative effects of regional integration. As Professor Ippei Yamazawa points out, if FTAs are pursued only when the WTO liberalization is facing difficulties, FTAs can easily become inward looking and discriminatory against nonmembers. To avoid such a situation, it is essential to promote a regional approach parallel to the WTO and APEC.

A. The Role of ICSEAD

In concluding, I would like to draw the link between the role of firms like ICSEAD and these larger processes. As this paper posits, in addition to bilateral FTAs between Japan and other Asian countries causing the necessary structural adjustments to stimulate growth, they can also contribute to raising the clout of the East Asian agenda in regional negotiations, and culminate in the endgame of promoting “open regionalism” in general. ICSEAD is unique, in that it is an institution focusing on economic analysis of East Asian countries and has produced many excellent and engaging researchers. Their strong links to researchers and technical institutions in other Asian countries are invaluable in maintaining open lines of communication and collaboration throughout the region in general.

One lesson I have gleaned while working in Asia, and also at the ADB, is that all projects funded by ADB or other development institutions--whether it is building factories, roads and schools, general infrastructure development, or environmental protection—require feasibility studies and appraisal reports. In my experience,

inabilities of local researchers to conduct such studies, at least to the specifications of the international donors, is one of the weakest areas for developing countries. Thus they often require the help of foreign consulting firms in the form of research, and often it is the firms that have conducted the feasibility reports that tend to receive the final business contract in implementing the project. These groups can play a major role in providing the technical information on East Asian countries, which is useful for decision-making, and trade and investment on the part of Japanese firms. In the future, I hope that firms will continue to use the invaluable work ICSEAD has produced in its contribution to Kitakyushu, as I believe cutting-edge work like this will prove to be an integral contribution to the realization of these larger goals.

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