

Northeast Asia Economic Cooperation: Japan's Perspective
(Summary of Comments)

The Evolving WTO Regime and Regional Economic Cooperation
Implication for Northeast Asia
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1. Introduction

I am very much honored to be here as a discussant with many other distinguished speakers and guests. I am currently a coordinator for a trilateral joint research project among Korea, China and Japan entitled “Trilateral Trade and Investment after China's Entry into the WTO”² and am also conducting various studies about Northeast or East Asia Economic Cooperation including “Proposition on the Comprehensive Vision for Development of Northeast Asia”, “Environment and Energy Cooperation in Northeast Asia”, etc. The above involvement in various studies about Northeast Asia Economic Cooperation is the reason that I have been invited here. However, I have to confess that I am not familiar with international economic laws, including the legal issues of the WTO and FTA. So I would like to limit my comments upon the presented papers to the economic and social aspects.

At the moment of my writing this short note, I have already received 2 papers for discussion. One is “Economic Partnership and Free Trade Agreements in East Asia – Japan's Experiment in the Framework of the WTO- “ by Prof. Mitsuo Matsushita and the other is “Korea's FTA Policy: Focusing on Bilateral FTAs between Chile and Japan” by Dr. Inkyo Cheong.

¹ National Institute for Research Advancement, an independent policy research institute: www.nira.go.jp

² “Report and Policy Recommendations on Strengthening Trade Relations between China, Japan and Korea” November 2001, Trilateral Joint Research by DRC of China, NIRA of Japan and KIEP of Korea, executive summary of which is attached in appendix. The full text is also available in the above mentioned web sight.

2. Summary of presented papers and issues for discussion

Prof. Matsushita's paper is composed of 2 parts, namely a review of recent developments toward FTA in Japan and East Asia, and a legal analysis of EPA and FTA with the framework of the WTO. In the first part he emphasizes the importance of exerting some discipline on proliferating FTAs, particularly since the 1990's so that they do not undermine the WTO system. He then concludes the recent catalysts of the of the EPA/FTA comes from both inside and outside of the region. Forces from outside the region are the failures of the WTO Ministerial Conference in Seattle and a strengthening regionalism including the expansion of the EU into Eastern Europe before 2010, and the move toward FTAA in America. One internal force is the emergence of China as a trade power and her effects on neighboring countries. After this background analysis he moves to case-by-case analyses of the Singapore/Japan EPA/FTA, which concluded in January of this year, and then of proposals for Korea/Japan EPA/FTA agreement, for which the joint study group has just started their discussions. His explanation is clear about the relationships between EPA and FTA and useful to understand Japan's recent move toward regional cooperation with a wider-scoped EPA/FTA-type cooperation scheme. I am very much interested in Japan's recent move toward regional expansion of EPA/FTA talks in East Asia, so I would like to describe later my hypothesis regarding the economic background of Japan's FTA policies.

Part 2 of his paper is a legal analysis of EPA and FTA in the framework of the WTO. He shows that there remain many unsettled points and vague areas in interpretation about FTA's consistency with the WTO framework. His appeal for clearer rules regarding the relationship between WTO disciplines and FTAs sounds quite reasonable and important. Further comments on these legal issues are, however, outside of my purview.

Dr. Inkyo Cheong's paper also provides us with a very clear bird's-eye view of Korea's FTA policy, especially regarding her first FTA with Chile. He evaluates FTAs more positively than Prof. Matsushita. He posits Korea's reasons to decide to pursue FTAs as the Asian Financial Crisis and Korea's transformative policy toward becoming "an opening trading country" as well. Besides these reasons, however, Korea's stance on FTAs sounds very much like Japan's. Both of us are pursuing regional economic cooperation within the framework of the WTO, in line with the growing presence of other regional groups including the EU, NAFTA and AFTA. It seems to me that we both have tried, as honest students in the WTO School, to stick to the multilateral system as

much as possible. Yet we have noticed the illusion of a perfect multilateral trading system and have started to look for more realistic approaches to gain the fruits of economic liberalization.

He explains in detail the reason that Korea has selected Chile as her first FTA partner in detail. Why did Korea select Chile as her first partner for a FTA, while Japan selected Singapore? That is one interesting issue for discussion in this session. I would like to invite all the participants to discuss this point later.

He raises many interesting points with regard to possible Korea-Japan FTA. There are political and historical obstacles; a sort of similarity in production function, which is leading to fierce competition between Korea and Japan. I would like to touch upon this issue later.

Dr. Inkyo Cheong analyses the economic aspects of the Korea-Japan FTA in many interesting ways including: export similarity index (ESI), revealed comparative advantage (RCA), terms of trade and CGE model analysis. It is very interesting to see that an excellent economist like Dr. Inkyo Cheong tends to support FTAs based upon those various economic analyses that show positive welfare effects to the economies, while a prominent lawyer like Prof. Matsushita tends to be cautious regarding FTAs. How to integrate legal aspects and economic aspects in the evaluation of FTAs is a final point I would like to raise after examining these 2 excellent papers.

3. Changing regime in East Asian Economic Development

When we think further about the background of Japan's and East Asia's recent move toward regional arrangements, I would like to emphasize the importance of a changing regime in East Asian Economic Development, which has occurred particularly since the Asian Financial Crisis and China's emergence as a future super power in East Asia.

Looking back the Japan's post WWII economic development, Japan had long enjoyed a situation (until mid 1980's), where we had industrialized first in Asia and continuously maintained competitive advantage over neighboring Asian countries. We enjoyed favorable Terms of Trade in our industrial products and therefore we were able to improve our standard of living rapidly, in spite of some domestic economic sectors that remained uncompetitive.

Of course some Asian countries, that is to say, Asian NIEs have gradually caught up to Japan in terms of industrialization, especially since the 1970's. However, there still remained plenty of room for Japan to develop mass production of manufactured goods with higher values than those manufactured in Asian NIEs. In addition, Japan was able

to export capital goods and materials to those countries. The world market led by the U.S. still had room to swallow those Asian manufactured goods. At this stage Japan was satisfied with the GATT-IMF system of the time.

Then the first change of regime in East Asian Economic Development came in the mid 1980's, when the U.S. manufacturing industries hollowed out and the trade imbalance hit the limit between the U.S. and Japan. The Plaza agreement in Nov. 1985 was the highlight of the change. Japan and Asian NIEs were forced to move their production base from their home countries to less developed countries with lower production costs. The most favored destinations of FDI at that time were ASEAN 5 nations, especially Thailand and Malaysia. FDI brought a windfall of capital and technology, which were surely needed for industrialization.

At that time East Asian Development led by Japan, followed by Asian NIEs and then ASEAN countries was described by the analogy of "Flying Geese Development". Japan produces high-tech and higher value-added manufactured goods while ASEAN countries produce low-tech and low-value added goods. NIEs fall in between. If NIEs and ASEAN climb one rung up the ladder of development, Japan moved up one step too. In that way the flying geese formation did not change its shape. At that stage the people in East Asia started to give importance to regional cooperation schemes like APEC. Although trade liberalization in the region was within the scope of cooperation, more emphasis was placed on Macroeconomic policy dialogue, ODA for developing countries and various types of economic cooperation.

Japan was still happy with her final product markets in the U.S. and Europe, labor incentive production bases and capital goods markets in ASEAN. Japan provided ASEAN with infrastructure financed through soft loans and manufacturing plants and equipment through FDI. So that Japan was not overly eager to arrange regional trade at that time.

In the wake of NAFTA, ASEAN started to fear losing FDI from developed countries (including Japan) to Mexico, and decided to form a FTA within ASEAN, namely AFTA. AFTA mainly aimed at gaining scale as a market and a manufacturing base, where electronics and automobile multinational companies could better use the scattered production network throughout ASEAN more strategically and with better division of labor. Therefore AFTA is believed to be good for Japanese multinationals heavily invested in ASEAN, although Japan is not a member of ASEAN.

This rather happy situation for Japan even out of world regionalism has finally come to an end, since China has come into the center of the scene of East Asian Economic Development. The above mentioned flying geese development model has changed its

shape dramatically with the inclusion of China. Vast population in China and continuing supply of quality workers at low wages has brought down the prices of mass-produced manufactured goods, especially electric and electronic goods and appliances, with which Japan has kept her competitive edge. China's rapid technological progress is going to deprive Japan of its ability to keep away from the following forces.

Under such circumstances, Japan can no longer live outside of regionalism that is prevailing globally. First of all Japan has to strengthen her manufacturing network constructed among NIEs and ASEAN countries, and also has to compete with globally competitive forces in China. Singapore has strategic importance as the center of the ASEAN manufacturing network. I understand this is additional (to all the reasons pointed by 2 speakers already) and one of the most important economic reasons why Japan has selected Singapore as the first EPA/FTA partner.

In addition, China has accelerated toward integrating with ASEAN economies and has agreed with ASEAN to start the negotiations for the creation of a FTA within 10 years. It is my understanding that this movement has pushed Japan to speed up her proposal of EPA/FTA with ASEAN countries. Since then Japan has already decided to start to study the issue with Thailand. The first meeting will likely start soon in Bangkok.

Korea- Japan EPA/FTA study has the same background as above, in my understanding. As Dr. Inkyo Cheong correctly pointed out, Japan and Korea are in the same boat after having dropped from a rather successful and peacefully flying geese group and now have to face much fierce competition in the world. Japan and Korea are now backed into the corner of the ring and have to combine our full strength to keep up with the global competition. Prof. Bhagwati's contention would best apply to Korea-Japan EPA/FTA case. Our industrial structures are similar and most of the competing industries between the 2 nations are capital-intensive ones with great scale merit. Although the necessary adjustments in integration are intense and hard to endure, the final gains would be bigger than usual. Especially Japan would be able to get further momentum for restructuring by integrating with Korea, which has been outpacing Japan in terms of restructuring since the Asian Financial Crisis.

As both of the speakers touched upon political and historical problems, which have been blocking the closer integration of both countries, there are many non-economic elements affecting their relations. However I observe that mutual understanding is advancing quickly between the two nations, especially through such occasions as the co-hosted FIFA World Cup Korea-Japan. I sincerely hope EPA/FTA between Korea and Japan will materialize in the near future and it will further advance mutual

understanding and friendship between the two countries.

In this context I would like to inform you that NIRA has also conducted a project to develop Japanese language videotext in Korea in order to deepen cultural exchange between Korea and Japan.

4. Why Chile for Korea and Singapore for Japan as the first FTA partner

I understand there are both similarities and differences between the above two cases.

Regarding the similarities, I can point to: small share of trade, good experience in FTAs, small competition, distance, member of regional FTA, advanced in liberalization, developing country, etc.

Regarding the differences, Singapore is located in East Asia and is a strategic center in Southeast Asia while Chile is located in Latin America. Singapore scarcely has an agricultural sector, which is the most sensitive sector for FTA in Japan, while Chile has some fruits as part of their export products

Japan seems to be more sensitive about agricultural sectors than Korea and Korea seems to be more interested in the Latin American Economy than Japan. Both Korea and Japan preferred an experienced partner, trying to avoid severe impact on domestic economies for the first trial.

5. Emerging China is providing opportunities

Although I stressed the importance of the changing regime in East Asia Economic Development since the emergence of China as a new regional power in the market economy, I don't mean merely that China is threatening Japan as a competitor.

Recently, Japanese consumers have been enjoying value for price import products from China. First retailing caused the YUNIKURO boom in the past couple of years in Japan. Daiso, which is well known as 100-yen consumer good shop, also has been supplied mostly from China.

On the other hand some industries are suffering from fierce competition with Chinese products and are fighting for survival. However we have to recognize that it is the natural course of a market economy and the real reason for fast productivity development therein. In order to enjoy the fruits of it we have to endure fierce restructuring.

We should have more positive thinking upon the emerging new power. There are exceptional invest opportunities in the burgeoning economy. Actually Japan's direct

investment into China has been increasing rapidly and therefore Japan's capital goods export into China has been increasing too. Extremely low return for capital in the domestic market and continuing saving's surplus could be compensated for capital outflow from Japan to China and rich investment opportunities in China before the aging Japan's population becomes critical.

China will even provide us with new chances to counter the hollow out of local industries and employment opportunities. For example the number of new rich Chinese is increasing and there will be great opportunities for ailing Japanese ski resorts and hot springs to attract them as new tourists. If those people can visit Japan more easily they may wish to buy resort houses in rural areas.

6. Importance of Northeast Asia Regional Cooperation and some key issues

According to a Business Survey conducted by NIRA during last two years regarding trade and investment environment among China, Korea and Japan, Japanese enterprises are looking for closer regional cooperation and stronger integration in the future among the 3 countries.

Of course there are pro's and con's in regional trade liberalization. Even within the region there are simultaneously losers and beneficiaries. Sometimes the losers have stronger political power than the general beneficiaries; especially if the benefits for the consumers are spread wide but with little per capita gain.

As I touched upon in section 2, there are clear differences between lawyers' and economists' evaluations of FTAs. Even if economists calculated positive welfare effects from a FTA, lawyers will check its consistency with the WTO rules and judge on it from discipline.

From an economic point of view, if total welfare is improving in a FTA then that FTA should be judged positively. Of course in order to sum up all of the countries' welfares, we have to use the evaluation function. Then the results depend on a certain value upon evaluation function, and therefore judgment can't be free from a certain value. Pareto improving condition would be difficult to hold because of the nature of regional preference in FTAs. In this sense from an economic point of view there seem to remain many issues to be studied further regarding the evaluation methods used for FTAs.

Finally I would like to point out some key issues for Northeast Asia Regional Cooperation. Trade liberalization is of course at the core for an EPA/FTA arrangement in the region. However, economic integration is composed of many elements, that is to

say, free investment in the region, free transfer of capital, visa waivers, proper protection of intellectual property rights, comprehensive regional development master plan, efficient infrastructure development, standardized environmental protection, etc.

All of these things are vehicles to promote the best allocation of resources according to the natural conditions, without being hindered by artificial borders. I sincerely hope all of these issues will be seriously studied among those concerned and the best way and timing arranged for mutually beneficial regional cooperation in the Northeast Asia. Northeast Asia is far behind other major regions in its progress towards regional integration, but to the contrary the region still holds one the biggest potential in the world.

APPENDIX

Executive Summary

Report and Policy Recommendations on Strengthening Trade Relations between China, Japan and Korea

Following the initiative of President Kim Dae-jung, late Prime Minister Keizo Obuchi and Prime Minister Zhu Rongji, who agreed upon trilateral joint research on economic cooperation between China, Japan and Korea at the historic Manila Meeting in November 1999, the joint research was formally launched by three representative institutes, Development Research Center (DRC) of China, National Institute for Research Advancement (NIRA) of Japan and Korea Institute for International Economic Policy (KIEP), in November 2000.

The three institutes agreed to conduct a series of joint research projects on economic cooperation among the three countries. The first joint project began with the joint research on trilateral trade cooperation and investment. This research is for a period of two years, of which the first year is devoted to trade with a focus on trade facilitation issues and the second year will be devoted to investment issues.

In order to find the real trade barriers and propose concrete measures to overcome them, the three institutes conducted a survey of the firms of their own country that are engaged in trade with the two neighboring countries, using the same questionnaire. They also co-organized an international symposium and three workshops, in which the contents of ongoing research were discussed.

This report aims to provide the leaders of the three countries with some concrete short-term trade facilitation measures between the three countries as well as some policy proposals that could contribute to strengthening their trade relations in the long run.

This report will be followed by a more comprehensive report next year on trade and investment between China, Japan and Korea. In the following years, the joint research will also cover specific sectoral cooperation issues such as, information technology, energy, environment cooperation, etc.

We hereby recommend the following:

1. Policy Measures Directly Linked to Trade Facilitation

Communication Channels of Laws and Regulations

In order to avoid misunderstandings, delays and additional costs, the three governments must notify each other about their legislation and/or revision of laws, regulations and standards as well as the implementation procedures related to trade, as soon as they are decided by relevant bodies.

Training System for Customs, Inspection and Quarantine Institutions

Creation of a training program for people who are engaged in customs, inspection and quarantine institutions to simplify inspection and quarantine procedures and to harmonize the standards of the three countries.

Establishment of Trade Dispute Early Warning System

To establish a trade dispute early warning system in each country and consultation mechanism among the three countries so as to reduce unnecessary trade frictions between the three countries.

Improve Business People Mobility

To further promote business activities and facilitate commercial personnel mobility, the authorities should consider the establishment of visa waivers system for business people who are recommended by each government, along with simplification of visa application procedures and shortening of application time.

2. Policy Measures with Broader Implications

Annual Economic Ministers Meetings

In order to have healthy economic and trade development among the three countries, and further discuss and implement trade facilitation measures described above, as well as other important economic issues, a mechanism of annual meeting of Economic Ministers of the three countries must be established.

Tripartite Dialogue

With a view to building a comprehensive dialogue mechanism on trade and other economic issues between the three countries, it would be desirable to set up a tripartite forum including academia, business people and government officials.

Inviting business community and government officials to the Beijing symposium next year can be a step nearer to dialogue mechanism building.

In addition, the existing bilateral communication channel at the governmental level, such as vice economic minister's meeting, may be extended to communication channel among the three countries for dialogue on broader economic issues.