

## East Asian Regionalism and the ASEAN-Japan Economic Partnership

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Individually and collectively, the member countries of the Association of Southeast Asian Nations (ASEAN) are facing tough economic challenges. First, they need to find a way of ensuring that the ASEAN economies experience a robust and sustainable recovery. The financial crisis and subsequent severe economic downturn of 1997–1998 were followed, in turn, by a sharp recovery in 1999–2000, a sharp downturn in 2001, and a tentative recovery in 2002. For the ASEAN member states that are so heavily dependant on exports and foreign direct investment (FDI), robust and sustainable economic recovery depends on buoyant export demand and investment inflows. Countries that have tried to stimulate domestic demand through government pump priming have met with some success, as in the case of Malaysia and Thailand, but they now face rising fiscal deficits.

Second, there is a need to manage globalization and the emergence of China and India as economic powerhouses. ASEAN member states have benefited from the globalization of trade, but have been hard hit by the downside of financial globalization. While there was widespread acceptance of trade globalization during the economic miracle years, increasingly the benefits and costs of globalization are being questioned in the aftermath of the financial crisis that has highlighted the urgent need for social safety nets to protect economically vulnerable members of society. Countries are searching for an appropriate policy mix that enables them to maximize the gains derived from globalization while limiting its downside. China and India are rapidly becoming economic powerhouses. The

economic rise of China is forcing ASEAN to become more competitive in terms of production, exports, and attracting FDI; its rise, together with that of India, will force the smaller regional economies to undergo major structural adjustments.

Third, ASEAN member states should accelerate and deepen their collective economic integration. The key factors in economic competitiveness are product innovation and production costs. Most ASEAN economies are having difficulty achieving sufficient product innovation to capture regional or global niche markets. Only the more advanced member economies, such as Singapore and Malaysia and, to a lesser extent, Thailand, have the financial and human resources to shift to a knowledge-based economy. Mainly, ASEAN member states are improving production efficiency and costs through economies of scale and by improving factory production. An integrated ASEAN market of over 500 million would make possible economies of scale and the rationalization of production according to each member's competitive and comparative advantages. At the ASEAN Summit in October 2003, the ASEAN states agreed to hasten and deepen economic integration with the formation of the ASEAN Economic Community.

While ASEAN is entering into free trade agreements with its major trading partners in order to improve market access for its exports, attract FDI, and promote infrastructure development, human resources, and private enterprise, it must remain committed to its own internal integration as well as to the multilateral trading system embedded in the World Trade Organization (WTO).

## East Asian Regionalism

Regionalism is well developed in Europe, where the European Union (EU) has progressively developed and its membership extends to the countries of central and eastern Europe. Regionalism is also well developed in the Americas, where there is the North American Free Trade Area (NAFTA) and various groupings in Latin America, as well as the forthcoming Free Trade Area of the Americas (FTAA) that is expected to be in place by 2005. In contrast, the sense of regionalism is a relatively recent development in East Asia.

In recent years, East Asia has seen a growing number of regional, sub-regional, and bilateral regional economic agreements negotiated or under

study and negotiation. Until the mid-1990s, the regionalization of East Asian economies was entirely in response to and determined by market forces: investors, producers, importers, and exporters. This has led to the rapid growth of intraregional trade and investment, as well as of regional production networks. There has appeared to be little interest in institutionalized regionalism among the Northeast Asian economies, beset as they have been by geopolitical and ideological conflicts, Japan's strong advocacy of multilateralism, partnerships with the United States, and China's preoccupation with its internal economic development.

Regionalism in Southeast Asia began with the 1967 formation of ASEAN, more as a political cooperation grouping than as a trade bloc. During the 1990s, the Southeast Asian ideological divide drew to a close simultaneously with the cold war, and ASEAN extended its membership to Cambodia, Laos, Myanmar, and Vietnam.

It was also during the 1990s that ASEAN moved to establish the ASEAN Free Trade Area (AFTA), ASEAN Framework Agreement on Services (AFAS), and ASEAN Investment Area (AIA). Since 1997, exploratory studies and negotiations have been ongoing regarding various regional trading arrangements (RTAs) in East Asia. The ASEAN + 3 (China, Japan, and South Korea) initiative, focusing on monetary and financial cooperation rather than the traditional trade and investment liberalization, developed from the need for financial cooperation in the wake of the Asian financial crisis. More trade-focused forums are the ASEAN-China Comprehensive Economic Cooperation (CEC), proposed by China in 2001, the ASEAN-Japan Comprehensive Economic Partnership (CEP) proposed by Japan in 2002, and the ASEAN-South Korea Free Trade Agreement being proposed by South Korea. There are also bilateral pacts emerging in East Asia involving China, Hong Kong, Japan, South Korea, Malaysia, the Philippines, Singapore, and Thailand, as well as pacts involving countries outside the region, such as the ASEAN-Closer Economic Relations (CER) pact with Australia and New Zealand, the ASEAN-U.S. and ASEAN-India groupings, in addition to bilateral agreements involving individual ASEAN countries and Australia, New Zealand, the United States, Canada, Mexico, Chile, the EFTA (European Free Trade Area), Bahrain, India, and Sri Lanka. A domino effect is becoming evident, as an increasing number of countries jump into RTAs for fear of being left out or marginalized.

Various economic and political factors have contributed to this emerging regionalism in East Asia. There has been a defensive response to the rise of regionalism elsewhere and disappointment with the WTO and the

Asia-Pacific Economic Cooperation (APEC) forum. First, RTAs have proliferated in North and South America and Europe, which has caused East Asian exports to be increasingly discriminated against in these markets and which have led to increased flows of FDI to these RTAs to take advantage of tariff preferences and benefit from economies of scale in production for the larger integrated markets.

Second, the WTO process of multilateral negotiations is arduously slow. It will be recalled that the Uruguay Round took seven years to complete, and the Doha Development Round was only launched in December 2001 after many obstacles. The collapse of the Doha negotiations in Cancun in September 2003 further highlighted the difficulties faced in WTO negotiations.

Third, APEC was established on the principles of open regionalism and voluntarism. The goal of the 1994 Bogor Declaration that free and open trade and investment would be attained by 2010 in the case of industrialized countries and 2020 in the case of developing economies was a cause of hope that APEC would become a free trade and investment zone. However, progress has been very slow, as demonstrated by the failure to agree on the Early Voluntary Sectoral Liberalization (EVSL) initiative.

The environment for economic cooperation in East Asia has also been improving. First, following the decades of cold war–related divisions in East Asia, political barriers have tumbled, paving the way for improved economic relations. Second, during the two decades up to the mid-1990s, the region experienced an economic miracle, and intra-regional trade and investment grew rapidly and spontaneously, driven by market forces. Japanese FDI and its production networks played an important role in integrating the economies of the region, while the unilateral trade and investment liberalization of several of the region's economies boosted intra-regional trade and investment. As China and the ASEAN economies in transition—Cambodia, Laos, Myanmar, and Vietnam—undertook market-opening and economic reforms, the way was opened for even greater economic interaction. Third, the 1997–1998 Asian financial crisis proved a turning point, heightening the awareness of a shared destiny and clearly demonstrating the degree to which East Asian economies are interdependent, as well as the need for regional cooperation in the wake of disappointing responses from the United States, European Union, and the International Monetary Fund (IMF). The Crisis brought Southeast Asia and Northeast Asia closer together under the ASEAN + 3 initiative.

The term regional trading arrangement has become increasingly inappropriate to describe the recent economic cooperation arrangements. First,

they cut across geographical regions, reaching beyond East Asia to North and South America, Europe, the Middle East, Australia, and New Zealand. Second, many of these agreements go beyond the traditional FTAs that focus on trade and investment liberalization and which are in the domain of the WTO. They are WTO-plus agreements, in that they include trade and investment facilitation as well as economic and technical cooperation. Hence these economic agreements have adopted new terminology, such as the terms comprehensive economic partnership (as in Japan-Singapore CEP and ASEAN-Japan CEP) and comprehensive economic cooperation (as in ASEAN-China CEC). The theoretical literature on free trade areas and customs unions focuses on the trade-creation and trade-diversion effects. The existing empirical studies that attempted to model the effects of RTAs have focused on the results of tariff removals, and have failed to capture the broader and dynamic effects of new-age RTAs.

The proliferation of RTAs has given rise to some concerns in the academic and policy-making communities that regionalism and bilateralism could overshadow and undermine multilateralism and the WTO. More specifically, critics of RTAs argue that they undermine the GATT-WTO principle of non-discrimination, and are stumbling blocs to the WTO's process of multilateral trade and investment liberalization.

It is premature to pass general judgment that the East Asian RTAs are stumbling blocs rather than building blocs without careful examination of the empirical evidence. Much depends on the countries' intent in forming and joining RTAs and in the design of the specific RTAs. First, there is no evidence that the East Asian economies engaging in RTAs are doing so as substitutes for the WTO process. For example, Singapore is an active participant in RTAs, and is also one of the strongest advocates of the WTO process and the Doha Development Round. It is conceivable, of course, that for the small and less developed economies with limited financial and human resources, RTA negotiations could divert resources that might otherwise be allocated to the Doha negotiations. Second, many of the countries participating in RTAs have declared that they are prepared to accelerate the pace and scope of trade and investment liberalization with like-minded economies. It should not be forgotten that it was the formation of APEC that pressured the European Union to compromise and contributed to the successful conclusion of the Uruguay Round.

Some economies are also using RTAs to pressure and consolidate domestic economic reforms. RTAs represent a half-way house between multilateralism and nationalism and could serve to keep multilateralism alive.

Third, to the extent that the RTAs normally cover sectors, areas, and issues beyond the current scope of the WTO, they are WTO-plus agreements that could facilitate the incorporation of these sectors, areas, and issues into subsequent WTO negotiations. However, it is recognized that WTO discipline and rules pertaining to RTAs have been lax and that stricter discipline and rules are called for. Specifically, Article XXIV of the General Agreement on Tariffs and Trade (GATT) provides unsatisfactory control and discipline concerning the principles of nondiscriminatory and national treatment.

Increasingly, countries are simultaneously participating in several and often-overlapping regional, subregional, and bilateral RTAs, giving rise to the spaghetti-bowl and hub-and-spoke effects. The spaghetti-bowl effect arises when various RTAs contain inconsistent and varying rules relating to origin, technical standards, and conformity requirements, as well as varying treatments of sensitive sectors. The information and transaction costs of businesses that export multiple products to multiple RTAs are thus increased, raising the question of how these multiple rules and standards might eventually be consolidated into an East Asian FTA—that is currently being mooted. Ideally, a common framework and common principles of regional and bilateral FTAs should have been developed under the aegis of the WTO before RTAs proliferated around the world and in East Asia. This would have ensured consistency among WTO member states, emphasized the liberalization and building-bloc effects of RTAs, and minimized the trade-diversion and spaghetti-bowl effects.

Critics argue that, with regard to the hub-and-spoke effect, RTAs will favor the hub over the spokes. Thus, where a country or group of countries (the hub) has signed RTAs with many countries (the spokes), each additional pact will give the hub added preferential access to another partner market while diluting the benefits of access to its own domestic market. It should be noted, however, that initially the United States and European Union were singled out as hubs, but, as more East Asian countries—notably ASEAN, Japan, South Korea, Singapore, and Thailand—signed on to several FTAs, they in turn became secondary hubs. As more countries enter into multiple RTAs, the first-mover advantages of the primary and secondary hubs become diluted.

## The Rise of China, Emergence of India

China is the second-largest economy in East Asia after Japan. While its meteoric economic growth over the past two decades and its recent accession to the WTO pose severe problems of adjustment and competitiveness for other East Asian economies, China can certainly serve as a second growth engine for East Asia, particularly since the Japanese economy remains stagnant.

China is seeking closer economic and political relations with Southeast Asia. At the ASEAN-China Summit in November 2000, Chinese Premier Zhu Rongji proposed deepening economic cooperation. An ASEAN-China Expert Group was established and in November 2001 submitted a report, *Forging Closer ASEAN-China Economic Relations in the Twenty-First Century*. The report proposes the establishment of an ASEAN-China FTA within ten years; wide-ranging trade and investment facilitation measures; technical assistance and capacity building; and expanded cooperation in areas such as finance, tourism, agriculture and forestry, human resources development, small and medium-sized enterprise development, industrial cooperation, intellectual property protection, environment protection, as well as energy and subregional development.

The November 2001 ASEAN-China Summit gave the green light for negotiations to commence. The ASEAN-China Framework Agreement on Comprehensive Economic Cooperation was signed in November 2002, providing for the creation of an ASEAN-China FTA within ten years. Tariff negotiations are to be completed by 2004 and implementation is to start in 2005. In addition, China offered a so-called early-harvest package to liberalize trade, mainly in agricultural products, with implementation scheduled for January 2004. Also discussed were liberalization of, and cooperation in, trade in services and investment, as well as cooperation in other economic areas. In addition, China offered special and differential treatment for Cambodia, Laos, and Myanmar in recognition of their development difficulties, and agreed to the write off of their debts. At the October 2003 ASEAN-China Summit, it was agreed to strengthen cooperation in five priority areas, namely, politics, economy, social affairs, security, and regional and international issues.

The economies of China and ASEAN are at similar stages of economic development and an FTA could qualify under the WTO enabling clause for developing countries (as was the case for AFTA) rather than Article XXIV. Resource-abundant ASEAN member states would be major

suppliers to China of energy, raw materials, and food. However, China and ASEAN have similar export structures in labor-intensive manufactures and, since China has lower production costs, ASEAN's competitiveness will be increasingly challenged in domestic and third-country markets. ASEAN's ability to attract FDI is also challenged by China's huge domestic market potential and its success as a low-cost export platform. According to the *World Investment Report 2003*, in 2002 China received FDI inflows of US\$53 billion, representing 63 percent of the total FDI flow to developing East Asian states, while inflows into ASEAN totaled only US\$14 billion. To meet the China challenge as well as to maximize the benefits of an ASEAN-China economic partnership, the ASEAN region will have to accelerate and deepen its own internal market integration, so as to improve its export and investment competitiveness through economies of scale, industrial upgrading, and rationalized production.

India's very credible economic performance over the past decade has, to a degree, been overshadowed by China's accomplishments. However, the Indian economy is now attracting more global, regional, and investor attention as India continues with its economic reforms. India is also increasingly looking eastward to East Asia. ASEAN-India economic relations grew rapidly after India became an ASEAN Dialogue Partner. The first ASEAN-India Summit took place in November 2002. The ASEAN-India Framework Agreement on Comprehensive Economic Cooperation was signed in October 2003, aimed at strengthening and enhancing cooperation in trade and investment and other areas. It provides for the establishment of an ASEAN-India Regional Trade and Investment Area (RTIA) that incorporates an FTA in goods, services, and investment; an early harvest program; and special and differential treatment for the CLMV countries (Cambodia, Laos, Myanmar, and Vietnam). India also proposed cooperation in the areas of agriculture, biotechnology, human resource development, and agro processing.

## Japan's Changed Response to RTAs

Until recently, Japan has been committed to multilateralism, unlike the European Union and the United States. However, rising regionalism in the Americas and Europe, together with a decade of economic stagnation, have eroded Japan's economic power, competitiveness, and confidence in relying on multilateralism to attain its economic goals.



In 1997, in response to Japanese corporate concern regarding discrimination in the Mexican market arising from NAFTA and the EU-Mexico FTA, the Japan External Trade Organization (JETRO) embarked on a joint study with Mexico on the feasibility of a Japan-Mexico FTA. In 1999, JETRO-IDE (Institute of Developing Economies) embarked on a joint study with the Korean Institute of International Economic Policy (KIEP) on a Japan-South Korea FTA, and official FTA-related negotiations commenced in 2002. In the meantime, Japan signed an economic partnership agreement with Singapore in January 2002, representing Japan's first departure from multilateralism.

Japan's Task Force on Foreign Relations, in its report to Prime Minister Koizumi Jun'ichiro in November 2002, recommends that Japan's economic strategy be defined by a closer partnership with ASEAN, to serve as a counterbalance to the emerging economic presence of China. This should be further bolstered by FTAs with South Korea and, in the medium term, Taiwan. Japan's Ministry of Foreign Affairs established an FTA-EPA (economic partnership agreement) unit with the objective of boosting organizational strength to handle the growing number of free trade and economic partnership agreements.

## Japan-Singapore Economic Partnership Agreement

Japan and Singapore share many economic and strategic interests and work closely in several regional and international fora. The Japan-Singapore Economic Partnership Agreement (JSEPA) grew out of a discussion held in December 1999 between the late Japanese Prime Minister Obuchi Keizo and Singapore Prime Minister Goh Chok Tong. Negotiations started in October 2000, following the positive assessments and recommendations of the *Japan-Singapore Joint Study Group Report*. The JSEPA agreement was signed in January 2002 and implemented in November 2002. The speed with which it was concluded and implemented—far faster than the Japan-Mexico and Japan-South Korea initiatives—reflects the strong bilateral political and economic ties and strong economic complementarity of the two countries, and particularly the fact that Singapore does not have agricultural exports (other than orchids and tropical fish) to threaten Japanese farmers.

The JSEPA contains the traditional FTA features of bilateral preferential market access for goods and services, as well as new age features of trade and investment facilitation and ecotech elements.

On trade liberalization in goods, tariff concessions go beyond what each party has committed to the WTO. Tariff elimination covers 98.5 percent of the bilateral trade in goods. Singapore will eliminate tariffs on all imports from Japan, while Japan will eliminate tariffs on 94 percent of its imports from Singapore. Japanese exporters will not gain much from preferential market access in goods, as Singapore has already applied multi-lateral zero-tariffs on all goods except a limited range of alcoholic beverages. But Singapore expects to benefit significantly from exports to Japan of electronic goods and petrochemicals. Agriculture has proved a thorny issue, and Singapore has failed to secure zero-tariff market access for its orchids and tropical fish. The rules of origin for manufactured products are based on substantial transformation and 60 percent of the selling price, with all the value added in Singapore and Japan included. Both countries have adopted mutual recognition of electrical, electronics, and telecommunications products; they recognize each other's test results and accept each other's certificates of conformity as issued by the designated authorities.

For liberalization of trade in services, some 90 percent of the services trade will be liberalized by Singapore and 86 percent by Japan, with both countries going beyond their WTO commitments. Unlike the goods sectors, Singapore's services sectors have not been fully liberalized under the WTO. Japanese businesses are given preferential market access and national treatment and are also subject to domestic regulations and disciplines. In particular, the commitments will expand bilateral trade in financial services and in e-commerce. Both governments plan to establish a Joint Committee on Broadcasting to exchange views and information on broadcasting policy issues and newly emerging broadcasting services, and to sign a Common Statement of Policy to encourage audiovisual cooperation in film, television, and the video industry. A Joint Committee on Tourism will cooperate on the expansion of tourism.

Investment liberalization is not a key feature of the JSEPA since Singapore already has an open investment regime and does not impose performance requirements. However, the JSEPA provides national treatment for Japanese investors well ahead of the ASEAN Investment Area time schedule and is expected to boost Japanese FDI into Singapore.

The JSEPA also includes trade and investment facilitation. Both countries will cooperate in promoting trade and investment activities by private enterprises through cooperation between JETRO and International Enterprise Singapore (the former Trade Development Board), and between

Nippon Export and Investment Insurance (NEXI) and Export Credit Insurance Corporation of Singapore (ECICS). The JSEPA contains provisions for investment promotion and investment protection such as national treatment, prohibition of performance requirements, free transfers of investment-related funds, expropriation and compensation, and access to investor-state dispute settlement specifications. It facilitates the movement of business visitors, intra-corporation transferees, investors, and engineers. There is cooperation in the protection of intellectual property rights covering patents, trade secrets and related rights, and foreign patent laws.

Provisions on government procurement have threshold values that are lower than those imposed by the WTO's Government Procurement Agreement. Both governments are also committed to controlling anticompetitive practices in the telecommunications and energy sectors, using notification, exchange of information, and technical assistance. A dispute settlement mechanism has been negotiated, to ensure that differences arising from the implementation of the JSEPA can be dealt with in a predictable, efficient, and effective framework.

The JSEPA has included several ecotech features. In science and technology, the JSEPA will establish a formal intergovernmental joint committee to identify areas in which cooperation might be of mutual benefit. In human resources development, several existing bilateral programs are to be placed under the JSEPA to enhance cooperation, including the Japan-Singapore Partnership Programme for the 21st Century, Japan-Singapore Joint Training Programme, University Exchange Programme, and Exchange of Attachment of Government Officials. On the development of small and medium-sized enterprises (SMEs), three areas of cooperation have been identified, namely, the promotion of business alliances between Singaporean and Japanese SMEs through business matching; the development of one-stop information services to help Singaporean and Japanese SMEs mutually establish operations; and the establishment by JETRO of a Business Support Centre in Singapore.

The JSEPA has been billed as a catalyst and model for similar cooperation agreements between Japan and the other ASEAN member states. However, some ASEAN scholars are skeptical about the JSEPA's relevance for the less-developed ASEAN states that have significant agricultural sectors and exports. Furthermore, less-developed ASEAN economies are reluctant to prematurely open up their services sectors to Japanese competition and would seem to be in greater need of Japanese development assistance than market-opening competition.

## The ASEAN-Japan Comprehensive Economic Partnership

Immediately after signing the JSEPA in Singapore in January 2002, Japanese Prime Minister Koizumi proposed that an ASEAN-Japan Comprehensive Economic Partnership (AJCEP) be set up. No specifics were given at the time, and the proposal was seen as a rushed response to the ASEAN-China FTA proposal announced by Chinese Premier Zhu Rongji in November 2001. At an economic ministers meeting in September 2002, an ASEAN-Japan Closer Economic Partnership Expert Group was established and submitted a report recommending immediate steps to realize a framework for the AJCEP, including elements of a possible FTA.

At the ASEAN-Japan Summit held in Phnom Penh in November 2002, Koizumi indicated that Japan would adopt a two-track approach, involving a comprehensive economic partnership agreement with ASEAN as a group, and bilateral pacts with individual ASEAN countries. The ASEAN-Japan Framework Agreement for Comprehensive Economic Partnership was signed at the ASEAN-Japan Summit in October 2003. This is parallel to ongoing bilateral negotiations on economic partnership agreements (EPAs) between Japan and Thailand, Malaysia, and the Philippines.

Objectives of the AJCEP are to strengthen ASEAN-Japan economic integration; enhance their mutual competitiveness in the world market; progressively liberalize and facilitate trade in goods and services and a transparent and liberal investment regime; explore new areas and develop appropriate measures for further cooperation and integration; and facilitate the more effective economic integration of CLMV countries and bridge the development gap in ASEAN.

The AJCEP Agreement will be negotiated between Japan and ASEAN as a group, taking into account completed and ongoing bilateral EPA negotiations between Japan and individual ASEAN states. There will be no renegotiation of existing bilateral agreements. All schedules of trade and investment liberalization concessions under bilateral EPAs will be annexed to the AJCEP Agreement.

The AJCEP negotiations on trade and services liberalization will begin in 2004 and focus on the basic principles of rules of origin, customs classification, and collection and analysis of trade and customs data. Negotiations on progressive elimination of tariffs and non-tariff barriers on trade in goods will cover substantially all trade in goods. On trade in services, negotiations aim at the progressive elimination of substantially

all discrimination and/or prohibition of new or more discriminatory measures, expansion in the depth and scope of services liberalization, facilitation of entry and temporary movement of business people, and enhanced cooperation in services to improve efficiency and competitiveness. On investment promotion, the focus is on creating a liberal and competitive environment, strengthening cooperation in investment, facilitating investment and improving transparency of investment rules and regulations, and providing for the protection of investors and investments.

The ASEAN-Japan FTA will cover substantially all trade, and negotiations include rules of origin, rules governing tariff reduction or elimination, nontariff measures, and trade remedy measures. Liberalization of trade in services will include progressive elimination of substantially all discrimination between ASEAN and Japan, expansion in depth and scope of liberalization of trade in services, facilitation of entry and temporary movement of business people, and enhanced cooperation in services to improve efficiency and competitiveness.

Consultations on the liberalization of trade and investment under the AJCEP will begin in 2004 and negotiations begin in 2005. Implementation of AJCEP, including elements of a possible FTA, should be completed by 2012, with due account to the economic levels and sensitive sectors in each country, including an additional five-year time frame for the CLMV countries.

The Framework Agreement on the AJCEP provides measures for immediate implementation, including technical assistance for and capacity building in ASEAN, trade and investment promotion and facilitation measures, trade and investment policy dialogue and business sector dialogue, measures to facilitate the mobility of business people, and exchange and compilation of customs tariff and bilateral trade statistics. It also covers programs on facilitation and cooperation, including trade-related procedures, business environment, intellectual property rights, energy, information and communication technology, human resource development, SMEs, tourism, transportation and logistics, standards and conformity, and mutual recognition arrangements.

There are several reasons for formalizing the ASEAN-Japan economic partnership. First, extensive economic relations that encompass trade, investment, and technical and development assistance have grown in recent decades. Japan served as an economic growth engine for ASEAN, a market, a source of investment and technology, and a source of development and technical assistance. In 2001, ASEAN exported goods and services to

the value of US\$48.3 billion to Japan, and imported US\$53.3 billion worth from Japan, accounting for 13.0 percent of ASEAN's total exports and 17.1 percent of ASEAN's total imports. Cumulatively, Japan's FDI in ASEAN in the 1990–2001 period reached US\$63.7 billion, accounting for 9.7 percent of Japan's total outward FDI and 18 percent of ASEAN's inward FDI. Japan is also the largest provider of technical and development assistance to the less-developed members of ASEAN. During the 1997–1998 Asian financial crisis, Japan also provided crucial official financial assistance.

Second, ASEAN and Japan both have a desire to consolidate and expand their dynamic relationship that has been set back by the Asian financial crisis, Japan's continuing economic stagnation, and the growing attraction of China. An ASEAN-Japan FTA would bring about growth in trade, GDP, employment, and economies of scale, as well as spur on structural reform. An FTA would have a combined population and market of 590 million (11 percent of the world market), a combined GDP of US\$4.9 trillion (18 percent of the world total), and it would be larger in terms of economic size than the ASEAN-China FTA. An expert group report highlights the results using a GTAP database model to simulate the effects of an ASEAN-Japan FTA with zero tariffs. It shows that by 2020, ASEAN's exports to Japan will have grown US\$20.6 billion, or 44.2 percent above the 1997 base, while Japan's exports to ASEAN will increase US\$20.0 billion, or 27.5 percent. Rates of return on investment will rise in both ASEAN and Japan, encouraging capital and technology flows which, in turn, will boost domestic productivity. By 2020, ASEAN's GDP should rise 1.99 percent and Japan's 0.07 percent. The model has not factored in other aspects of the CEP, including liberalization of services and investments.

Japanese scholars and officials are quick to point out that Japan's advanced and resource-scarce economy largely complements ASEAN economies, while China and ASEAN are at similar levels of economic development and compete in many areas of manufacturing, particularly in labor-intensive industries. Furthermore, Japanese FDI stock in manufacturing in ASEAN member states is more than three times the size of its FDI stock in China. A priori, an ASEAN-Japan FTA is likely to confer more benefits on ASEAN than an ASEAN-China FTA, given the extensive existing economic relations and the high degree of economic complementarity. However, China has a huge population and consumer base, and a very dynamic economy, so demand for ASEAN raw materials, manufactures, and services (tourism in particular) is expected to grow

very rapidly. A look at a number of issues pertaining to the ASEAN-Japan partnership agreements follows.

### Addressing ASEAN Diversity

The diversity in economic levels and in industrial competitiveness among the ASEAN-10 has hindered the pace of ASEAN trade liberalization and the early attainment of an integrated single market. This same diversity will make it difficult to achieve an ASEAN-wide economic agreement with other countries. So far, only China has signaled its intent to negotiate an FTA with the whole of ASEAN, while Japan has signaled a two-track approach. The United States has also indicated that it will take the bilateral track and negotiate with individual countries. It has already concluded a bilateral FTA with Singapore, scheduled for implementation in January 2004.

Japan's approach of bilateral FTAs with individual ASEAN countries will provide the flexibility necessary to include only countries that are ready to liberalize trade and investment, and to design FTAs to suit particular circumstances. However, such an approach also has the danger of undermining ASEAN solidarity and collective strength and enabling Japan to pick the terms and content of each bilateral agreement. It raises the hub-and-spokes issue as Japan (the hub) deals with ASEAN-10 (the spokes) and fails to promote ASEAN as a single, integrated market for Japanese investors.

It is very necessary to ensure that Japan's two-track strategy to promote the AJCEP and bilateral FTAs moves in tandem. Effective trade and investment liberalization hinges on parallel development of facilitation measures, such as customs procedures, standards and conformity, intellectual property rights, and capacity building to strengthen the competitiveness of the less-developed economies. It is also crucial that, by singling out only some economies for bilateral agreements, Japan should not exacerbate the existing economic divide between the more and the less advanced ASEAN economies. Under the AJCEP common framework, Japan can institutionalize and accelerate its technical and development assistance to the less developed members of ASEAN, and its efforts could be combined with the human and physical resources and experience of ASEAN-6.

## Maximizing the Investment Effects

Japanese investments in ASEAN declined after the start of the Asian financial crisis and have yet to regain their previous peak. There are various explanations: a worsened investment climate in ASEAN resulting from the economic slowdown and reduced political and social stability; Japan's continuing economic stagnation and the reduced financial ability of Japanese corporations to engage in outward investments; and the growing attraction of China as an investment destination.

It is hoped that the AJCEP would lead to a new boom in Japanese investments in ASEAN. First, Japanese corporations will have to increasingly seek offshore production to remain internationally competitive, because of the high costs in Japan and the ageing and shrinking Japanese population and labor force. Japanese corporations will not wish to put all their investment eggs in the China basket and ASEAN offers a reliable and competitive alternative. Japanese companies have worked closely with ASEAN governments and companies for several decades to produce for host, home, and third-country markets, and have contributed to the creation of production networks, growth of supporting industries, and development of human resources.

The investment environment in ASEAN for Japanese business is expected to improve as trade and investment are liberalized and facilitation measures are put in place, such as Japanese corporations receiving national treatment. ASEAN has a market of over 500 million consumers, which will enable Japanese manufacturers to enjoy economies of scale and regional divisions of labor to maximize the comparative and competitive advantages of individual ASEAN states. The less-developed ASEAN countries can still compete with China on a cost basis, while the more advanced ASEAN countries are engaged in industrial restructuring to develop new comparative and competitive advantages in technology and knowledge-based industries and services. Singapore, Malaysia, and Thailand are the most advanced in this process.

If investment is to flourish, ASEAN must speed up the pace at which it is realizing a single, integrated ASEAN market so that regional production networks can be set up and specialization encouraged along the supply chain. Tariff reductions under AFTA will have to be speeded up with a view to attaining the zero-tariff goal as soon as possible and providing comprehensive sectoral coverage that includes agriculture and other sensitive sectors. Many policy and institutional non-tariff barriers shall have



to come down, including cumbersome customs procedures, varying product standards and conformity requirements, as well as barriers in the form of different transportation and logistics systems. As an integrated market, ASEAN will be better able to compete with China. It is noteworthy that at the Ninth ASEAN Summit in October 2003, the political leaders of ASEAN agreed to the creation of an ASEAN Economic Community.

## Liberalizing Agricultural Trade

Agriculture remains a major activity in a number of ASEAN countries. Agriculture accounts for 15 percent of GDP in the Philippines and Indonesia, and more than 45 percent in Cambodia, Laos, and Myanmar. Agriculture represents more than 10 percent of exports for Thailand, Indonesia, and Cambodia, and more than 25 percent for Myanmar, Laos, and Vietnam. Among the ASEAN countries, Thailand and Vietnam are large exporters of rice, Thailand is a major exporter of rubber and seafood, and Vietnam of coffee. Growth in agricultural exports to Japan would be an important source of growth for several ASEAN members states, particularly Cambodia, Laos, Myanmar, and Vietnam. Japan is the largest market for ASEAN agricultural exports.

While seeking better market access abroad, many ASEAN countries continue to maintain tight restrictions on agricultural imports and are slow in bringing agriculture within the ambit of AFTA's tariff reductions and eliminations. In the early-harvest package of the ASEAN-China economic cooperation program, involving mainly agricultural products, some ASEAN countries have demonstrated their reluctance to open up their agricultural markets. Nipon Poapongsakorn (2003) argues that ASEAN needs development programs to allow inefficient farmers to switch to other activities, social protection schemes for poor and vulnerable farmers, and the capacity to produce and export safe foods in accordance with sanitary and phyto-sanitary standards.

Japan is a very high-cost producer of rice and other foodstuffs, yet agricultural imports into Japan remain tightly restricted despite severe criticism by WTO members and those developing countries that are heavily dependent on agricultural exports. It is commonly argued that the government has been unable to push for agricultural liberalization because the ruling political party is dependent on rural votes. However, young Japanese are increasingly reluctant to follow in the footsteps of their parents

and become farmers, so that preserving rural employment and the rural way of life no longer appears to be the critical issue it once was. But, more significantly, Japanese consumers have remained passive despite the high prices they have to pay for rice and other foodstuffs. Nipon argues that Japan needs to de-emphasize its defensive strategy of food security because Japanese people have the wealth to meet food-security requirements, and advocates a more direct and less costly way of achieving national food security.

Given the sensitivity of agriculture in Japanese politics and economics, and the fact that several ASEAN countries are highly competitive exporters of agricultural products, this sector may pose a formidable obstacle in bilateral FTA negotiations. It should be noted that in the bilateral negotiations between Japan and Singapore on the JSEPA, the exports of orchids and tropical fish by Singapore proved a stumbling block that prevented JSEPA from being an FTA that is comprehensive in sectoral coverage and inclusive of agriculture.

## Conclusion

The future of ASEAN-Japan economic relations needs to be assessed in the context of three factors. First, one should consider the background of how economic relations have developed between Japan and ASEAN countries since the 1960s in the areas of trade in goods and services, FDI, and the development of production networks, and technical and development assistance in broad-ranging areas.

Second, one should look at the current challenges posed by the economic rise of China. Competition from China is a growing reality for Japan and ASEAN. Unbridled economic rivalry would be disastrous for regional peace, stability, and prosperity, so Japan and ASEAN will have to manage their economic relations and competitiveness vis-à-vis China in such a way as will result in a win-win outcome.

Third, future ASEAN-Japan economic relations shall have to be considered in the context of East Asian regionalism. The rise of East Asian economic regionalism is both an opportunity and a challenge for ASEAN. In terms of opportunity, ASEAN countries will belong to a larger economic grouping and enjoy not only wider market access, but greater international clout, as well as greater regional peace and order. However, a key consideration is whether East Asian regionalism will strengthen or

weaken ASEAN solidarity and cohesiveness. ASEAN was very concerned over the future and robustness of its regional grouping when APEC was first mooted. As it turned out, ASEAN has not been undermined by the parallel existence of APEC. ASEAN's current weakness is of its own making, due to its inability to restore peace and order in countries in the region, or to achieve the political will to strengthen and deepen ASEAN economic integration.

Whether ASEAN would be strengthened by an East Asian economic community will depend on whether ASEAN has realized its own economic integration before becoming part of the larger East Asian Community. This community could improve ASEAN economic efficiency and competitiveness; strengthen ASEAN as a market, a producer, an exporter, and an investment destination; and ensure ASEAN cohesiveness in a broad East Asian economic context.

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