

IDE APEC STUDY CENTER
Working Paper Series 03/04 – No. 1

**Japan and the East Asian Economies:
Prospects and Retrospects in the Early Twenty-First Century**

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MARCH 2004

APEC STUDY CENTER
INSTITUTE OF DEVELOPING ECONOMIES, JETRO

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I. East Asia as an Engine of Growth

This paper aims to review the major trends that have emerged in East Asia and the surrounding Asia-Pacific region since the latter half of the 1980s and to give prospects for the first two decades of the twenty-first century. It is appropriate to include these two decades in the paper's scope because the year 2020 is often targeted in the development plans of some East Asian economies, and the Bogor Goals established by the Asia-Pacific Economic Cooperation forum in 1994 set the deadline for free trade and investment in the region at 2020 for developing economies. In this section I will give an overview of this report.

The globalization of corporate activities was a major trend during the past two decades, and governments of all nation-states responded to this development. Governments of developed economies tended to accommodate the trend, taking advantage of the globalization of business to boost their economic growth. Governments of some developing economies followed suit and succeeded in achieving economic development. East Asian economies are mostly in this group, and the region achieved 6%–10% growth during the decade following 1987, which was appraised as the “East Asian Miracle” in a World Bank report (1993). These nations were met with a currency crisis in 1997–98, however, and some of them suffered from rapid outflows of short-term funds that dealt a serious setback to their economic growth.

East Asian developing economies have recovered from the setback sooner than anticipated, though, and regional integration has gained momentum among them in the recovery process. Their governments have sought economic cooperation with neighboring economies in order to avoid a recurrence of the crisis, first in the form of currency cooperation and then in various forms of regional trade agreements. Japan and China have emerged as active participants in these moves. Japan was not seriously affected by the currency crisis, but played an active role in providing rescue funds and arranging financial cooperation. China also avoided the setback, and has enjoyed continued high growth, becoming a dynamic engine of the regional economy. A variety of bilateral free trade areas have been proposed, as well as regional integration concepts, such as those involving China and the Association of Southeast Asian Nations, Japan and ASEAN, and ASEAN + 3, the Southeast Asian group plus China, Japan, and Korea.

Some East Asian governments have negotiated and actually entered into such FTAs.

Many economists agree that the East Asian economies will see obstacles to integration in the short run but will form their own economic zone, an “East Asian economic community,” over the mid- to long term. Will East Asia become a major area of economic integration like the European Union or the Free Trade Area of the Americas? If so, what kind of economic system will be required to form a viable integrated economic zone in East Asia?

At the same time, East Asia—specifically, ASEAN + 3—is a part of a greater concept of regional cooperation, APEC, and was a strong engine of growth in this broader grouping before the crisis. What has happened to APEC? Are we seeing a paradigm shift from APEC to ASEAN + 3? APEC has not yet come to an end and should be utilized for the steady development of East Asia.

Links with the rest of East Asia have become indispensable for Japan to survive the globalization challenge in the twenty-first century. Japan should continue pursuing initiatives in East Asian regionalism to strengthen these links. It should not seek to position an East Asian bloc against the European Union and FTAA, but rather offer guidance to its neighbors under the banner of “open regionalism,” making use of Asian dynamism for the sake of the global economy. We have to fix this tendency toward an insular East Asian community in the first two decades of this century.

China’s economic growth and the rapid progress in its corporate activities since the late 1990s have not only stimulated other East Asian economies, but have also generated insecurity among East Asian nations that feel threatened by China’s growth. As most East Asian policymakers are expecting China to play the role of an East Asian economic engine, they are trying to leverage Chinese growth for their own economic recoveries. However, because some enterprises and industries face direct competition from Chinese products, some policymakers feel insecure about the prospect of a powerful China and are starting to lobby for import restrictions and other safeguard measures on Chinese products. Such phenomena are a characteristic of East Asian economies in the globalization era.

This is the outline of my review; the following sections will elaborate on its major elements. First I will review the East Asian miracle and the crisis that struck the region, and I will identify the underlying forces of East Asian dynamism. I will then

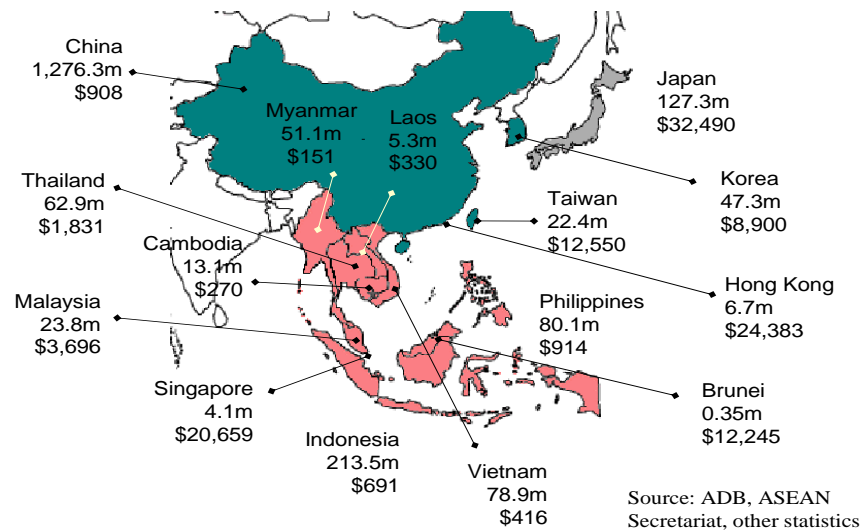
examine the emerging regionalism in East Asia and characterize the motives of its major actors, ASEAN, China, Korea, and Japan. Next I will analyze the rivalry between the two prime movers, China and Japan, and explore how to guide them toward the common goal of an East Asian community. I will go on to discuss APEC, both its successes and failures in the past, and how to utilize it for East Asian integration. The last section will conclude this review with suggestions for Japan's expected leadership role.

II. The East Asian Miracle

The international community began to recognize East Asia as a distinct economic zone in the late 1980s. At that time, Korea and the various ASEAN nations were achieving "miraculous" levels of economic growth, and China's economic performance was improving thanks to its more open economic policies. In the first half of the 1980s, Japan enjoyed 5% economic growth and drove growth in Asia, but the collapse of Japan's so-called bubble economy led to a period of long-term economic stagnation.

The East Asian economies are characterized by dynamic economic development. Figure 1 shows the population and GDP per capita in these economies. These economies vary greatly not only in population size, but also in per capita income, from a low of some \$200 in Myanmar to a high of \$37,000 in Japan. Korea ranks fifth, with a GDP per capita of about \$10,000.

【Figure 1】 Map of East Asia: Population and GDP per capita (US\$) in 2001



The gap in per capita GDP results from the fact that these nations are in different stages of economic development, which have resulted from differences in the timing of the various countries' beginning of economic growth. For example, Japan started its modern economic growth in 1885. In contrast, the NIEs, or newly industrialized economies (Hong Kong, Korea, Singapore, and Taiwan), started their export-oriented economic growth in the 1960s, while some leading ASEAN economies (Indonesia, Malaysia, the Philippines, and Thailand) started to follow the same path in the 1970s. It was not until the early 1980s that China launched its open economic policies in an effort to turn its planned socialist economy into a market-oriented economy, while the economies in Indochina—Cambodia, Laos, Myanmar, and Vietnam—implemented similar policies in the 1990s. In the decade following 1987, all of the East Asian economies enjoyed high economic growth, and for the five years following 1987, Japan also achieved a moderate 4%–5% economic growth. In its 1993 report on the East Asian economies, the World Bank called this phenomenon the “East Asian Miracle.”

The growth performance of the East Asian developing economies during the 10 years until 1997 was remarkable. The four NIEs achieved high growth of 8%–10% and

the members of ASEAN listed above (the entire group at that time, with the exception of Singapore and Brunei) achieved 6%–8% growth. Japan’s growth rate had almost halved from 10% before the oil shocks of the 1970s to the 4%–5% level thereafter, but was still the highest among the developed economies. In the early 1990s, while the world economy suffered from slow growth, Asian NIEs maintained 7.1%–7.3% growth and East Asia excluding Japan maintained 6.7% growth.

A Concentration of Rapid Growth

Why were so many rapidly growing economies concentrated in East Asia? The World Bank’s East Asian Miracle Project of the early 1990s examined this issue and pinpointed a number of factors contributing to the rapid growth of the East Asian economies: trade orientation, industrial policy, development finance, macroeconomic discipline, Confucian work ethics, and so on. Each of these factors explains the success of high growth of some East Asian economies, but not all of them. The World Bank tried to give a synthesized explanation of all these factors. However, I would like here to focus on a missing factor, geographical proximity. It is not enough to note simply that these fast-growing economies are located in the same area. We must realize that the high growth rates of the East Asian economies are interrelated, and that this dynamic interdependence supports the high growth of all economies in this region.

The East Asian nations achieved economic growth mainly through an industrialization process characterized by the growth of labor-intensive light manufacturing industries, which were then followed by capital- or technology-intensive metal, chemical, and machine industries. This type of industrialization first occurred in the leading Asian nations and then in other follower economies. This phenomenon is also known as “flying geese” industrial development, because one economy led the way for the whole flock. As a result of this industrial development, the East Asian economies have successfully kept pace with globalization (Yamazawa et al. 1993).

Japan drove the economic growth of East Asia during the second half of the 1980s, and this helped the Asian economies recover from their setback in the mid-1980s. Prices of petroleum and other primary products reached their peaks in 1980–82 after the second oil shock and declined sharply thereafter. Malaysia, Singapore, and Indonesia experienced serious declines in their economic growth rates, even showing zero growth, as their export earnings decreased in 1984–86. However, they recovered strongly toward

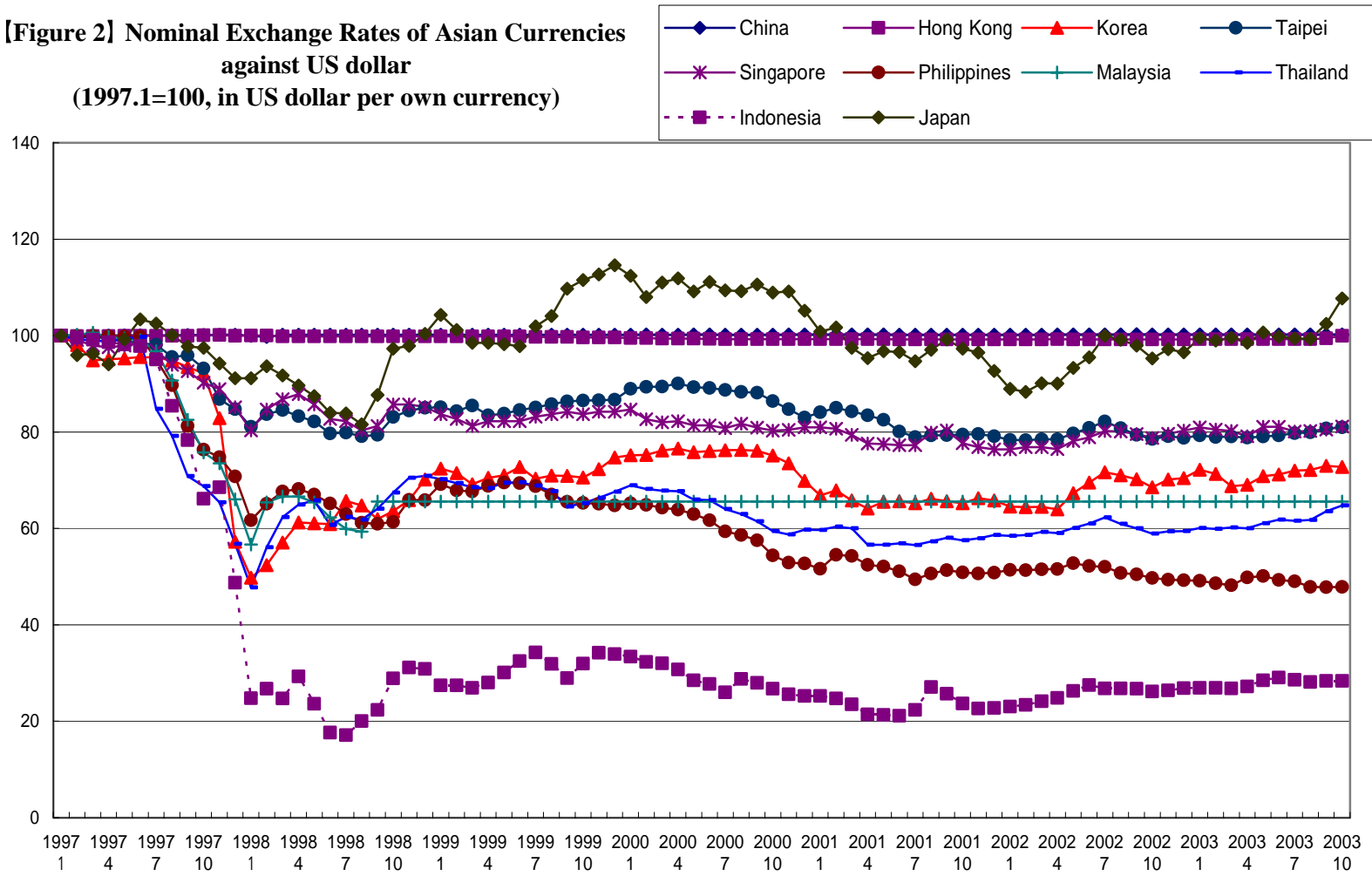
the late 1980s and continued growing rapidly through the 1990s until the currency crisis started.

The Japanese economy grew at around 3% during the first half of the 1980s but enjoyed 4%–6% growth in 1987–91. This was preceded by the accumulation of the twin deficits in the United States, aggravated trade conflicts between the United States and Japan, and the 1985 Plaza agreement on multiple currency alignment. The yen-dollar rate doubled from ¥265 to ¥138 per dollar in two years then leveled off. Japanese domestic production quickly became less competitive on the world market and its exports decreased. The Japanese government boosted domestic demand through expansionary monetary and fiscal policies. The high growth of the 1987–91 period was contributed wholly by domestic demand, offsetting the decrease in foreign demand. Imports increased and the current account surplus more than halved from the record-high ¥13 trillion (\$94 billion) marked in 1987–90. Japanese automobile and electronic manufacturers moved their production capacity abroad to North America, Western Europe, and East Asia. East Asia's exports to Japan doubled between 1986 and 1991, with the value of these exports for the period amounting to \$342 billion. East Asia also received \$28 billion in Japanese direct investment in 1986–90.

III. The Asian Financial Crisis

The Asian currency and financial crises in 1997–98 dealt a temporary setback to the region's high economic growth, though. Except for those of China and Hong Kong, East Asian currencies suffered severe devaluations against the US dollar. The exchange rates for these currencies are still between 20% and 70% lower than immediately before the crises. Even Korea's currency remains some 30% lower than in the pre-crisis era and Korea's GDP in US dollar terms has yet to return to its pre-crisis level (Fig. 2). This points to a failure to keep pace with globalization. Although Korea started an upturn in 1999 on a macroeconomic basis, fragile financial institutions and opaque corporate governance still remain, requiring reforms in the future.

**[Figure 2] Nominal Exchange Rates of Asian Currencies
against US dollar
(1997.1=100, in US dollar per own currency)**



Structural Deficiencies Remain

East Asian economies have recovered from the financial crisis of 1997–98, but their structural deficiencies have yet to be amended. The foundation of these deficiencies lies in the weak economic systems of the countries themselves—the vulnerability of financial systems, the immaturity of corporate governance, and the lack of transparency in the market systems, for instance. Their financial systems developed noncompetitively under governmental protection, while unsound government-business relationships were at times aggravated by paternalistic industrial policies. These sorts of structural deficiencies were concealed during the miraculous growth of East Asia but were revealed all at once by the 1997–98 crisis. They needed to be corrected in order to prevent a resurgence of the crisis.

The need for structural reform was shared by transition economies as well. China and Vietnam, under tight regulation, were able to avoid the detrimental effects of the crisis and enjoy continued high growth, but they share the same structural deficiencies. China's recent accession to the World Trade Organization both encourages Chinese firms to globalize their activities and increases the difficulty of adjusting their systems and practices to the market economy. Whether they resume a steady growth path will depend on their success in their reform efforts.

Financial systems of East Asian economies are crippled by a few common impediments. They all suffer from accumulated nonperforming loans, which tend to cause a serious credit crunch in the real economy sector. Badly regulated financial sectors tend to bear unsustainably high risks, inducing great vulnerability in national economies. Increased interdependence between East Asian economies, brought about through steady expansion of trade and investment, has been accompanied by rapid financial integration in terms of increased flows of foreign capital across money and capital markets in the region. Before the Asian crisis the dollar peg and capital-account liberalization supported this integration process. Financial cooperation had started to facilitate this integration, but did not work in time to prevent the crisis. The affected nations' recoveries from the Asian crisis have basically depended on the efforts of each country.

Japan in the Time of Crisis

Where did Japan stand in the Asian currency and economic crisis, and what role did it play in overcoming it? Basically, the Japanese tended to regard the Asian crisis as “a fire in someone else’s house.” They were heavily engaged in dealing with their own domestic problems, such as reviving the Japanese economy from its stagnation following the bursting of the bubble economy and implementing the six big structural reform programs proposed by then Prime Minister Ryutaro Hashimoto. Japan did, however, perceive correctly that the crisis was hitting a major destination for its products and investment, and it moved quickly to rescue the ASEAN economies. Being the world’s biggest creditor nation, with ¥100 trillion in overseas assets (equivalent to \$710 billion, and around 20% of its GDP), and equipped with its exchange reserves of \$218 billion (as of the end of 1996), Japan provided \$37 billion in rescue funds to Thailand, Korea, and Indonesia, much bigger than such funds from any other single nation.

However, it was toward the end of 1997, when the yen’s depreciation accelerated, that the Japanese came to realize how severely the crisis was affecting them. First, the yen had depreciated in advance of other Asian currencies. Its value dropped by 26% between the second quarter of 1995 and July 1997, which, together with the 33% devaluation of China’s yuan in the first quarter of 1994, caused the overvaluation of other Asian currencies. Second, the Japanese economy shares with other Asian economies major deficiencies in economic structure and performance, such as a weak financial system and protected, noncompetitive primary and tertiary sectors. Although Japan is free from the constraint of foreign exchange reserves, the postponed settlement of nonperforming loans has made banks reluctant to extend loans even to sound debtors, aggravating deflationary pressure in the nation. Third, its stagnant domestic demand and low GDP growth did not help the recovery of the Asian economies as a whole.

Financial Cooperation in the Region

Nevertheless, some regional financial cooperation has been implemented to support the fragile financial systems of ASEAN members. The Japan-ASEAN Comprehensive Economic Partnership, proposed in 2002 and scheduled for realization over the course of a decade, is likely to incorporate this financial cooperation into its

framework. Immediately after the outbreak of the crisis Japan proposed an Asian Monetary Fund, but it was abortive because of objections from the United States and China. In November 1998, the deputy finance ministers of APEC members agreed to the Manila Framework, which was supported by the APEC Leaders' Declaration in Kuala Lumpur later that year. This framework authorized the expansion of a loan system to prevent the spread of the crisis and strengthen the region's financial supervisory systems.

At the APEC economic leaders' meeting that year Finance Minister Kiichi Miyazawa announced the New Miyazawa Initiative, a Japanese plan to give \$30 billion in support to the crisis-hit economies. In September 2000 the APEC finance ministers met in Bandar Seri Begawan and reviewed APEC's activities on financial cooperation during the preceding year, which included the Voluntary Action Plan for promoting freer and more stable capital flows, the development of domestic bond markets, steps to address the issue of how to manage bank failures, an initiative for the training of financial regulators, the strengthening of corporate governance, creating sound insolvency law, an initiative on fighting financial crimes, and the increased use of electronic financial transaction systems. In addition, the ASEAN + 3 nations met in Chiang Mai, Thailand, in May 2001 and reached agreement on currency swaps to provide against the recurrence of a similar crisis. The agreement is designed to supplement emergency loans from the IMF and World Bank by improving regional cooperation. In late February 2003 the finance ministers of ASEAN + 3 agreed to cooperate in the nurturing of an Asian bond market. Japan has proposed to establish jointly with other members an Asian Guarantee Organization to warrant bonds issued by regional firms. This move aims to encourage regional firms to secure long-term funds in their own currencies and reduce their dependence on dollar-denominated funding.

On the other hand, there has not been much visible progress toward a stable exchange-rate regime. While most of the Asian currencies have been floated, rate movements seem to require further efforts for stabilization. Regional currencies have stabilized at depreciated levels compared to their precrisis levels. The Indonesian rupiah has depreciated roughly by 75%, the Philippine peso by 50%, Thailand's baht by 45%, Malaysia's ringgit by 35%, the Korean won by 30%, and the Singaporean and Taiwanese dollars by 20%. The depreciation of Asian currencies has certainly helped

East Asian exports to the US market and contributed to these economies' quick recovery from the crisis. Nevertheless, I am concerned that under the current float regime, separately managed by individual monetary authorities, another speculative run on an Asian currency may incur a contagion to neighboring currencies and trigger competitive devaluations, thus resulting in another Asian crisis.

Some form of regionwide currency arrangement seems to be needed to assure traders and investors about exchange rate stability in the region. De facto dollar pegs have proved inadequate given the diversified trade patterns, greater capital mobility, and inadequate monetary policies in the region's countries. There is no guarantee that currency board arrangements will escape from the same drawbacks that affect pegged regimes. Free-float regimes, meanwhile, have their own costs of possible excessive volatility and free-riding risks. Some form of managed exchange-rate system with a market basket peg seems to meet the needs of the region. Such a system needs to be combined with some form of currency cooperation among the dollar, euro, and yen.

IV. Emerging Regionalism

East Asian regionalism has become a popular topic of discussion at international conferences, and diverse views have been expressed on it by both pros and cons. It is often asked whether the EU type of regional integration is feasible in East Asia. It is obvious that East Asian economies are not yet mature enough to adopt the EU type of integration. Nevertheless they wish to carry out regional cooperation in some form. Some also argue that the regional integration movements—which had been viewed as the second-best method of achieving liberalization when the WTO did not work well—should have been stopped when the WTO's Doha Development Agenda was launched in November 2001. But the momentum for seeking closer regional cooperation in East Asia has not decelerated.

A more productive approach is to identify the region's need for closer cooperation, give a clear vision of East Asian regionalism, and guide arguments and official consultations in a manner consistent with open regionalism. This and the following sections focus on this issue.

The 1990 EAEC Proposal

The proposal of the East Asian Free Trade Area appeared in the headlines in November 2000, when it was tabled at the ASEAN + 3 Summit by Singaporean Prime Minister Goh Chok Tong. However, it had been preceded by Malaysian Prime Minister Mahathir Mohamed's proposal of an East Asian Economic Caucus strikingly similar in geographical coverage to the 2000 concept, which came in December 1990—soon after the failure to conclude the Uruguay round of negotiations of the General Agreement on Tariffs and Trade.

The EAEC proposal met with fierce objections from US Secretary of State James Baker, and neither China nor Japan followed up with support for the plan. Prime Minister Goh's more recent proposal, however, was made in response to a call from Chinese President Jiang Zemin for the inking of an FTA between China and the ASEAN members. Japan and South Korea also came on board, and the nations agreed to launch a joint study toward the realization of this plan. This reflects an environment in which regionalism can take root much more easily than 10 years earlier.

Global Regionalization

Regionalization is currently in fashion around the world. During the last decade we witnessed the global prevalence of regional trading arrangements. RTAs are exempted from the GATT/WTO rule of nondiscrimination, and the global trade body must be notified whenever they are concluded. Since 1947, when the GATT process was launched, 214 RTAs have been reported and 120 of them are still effective. Of the 120 effective RTAs 88 were concluded after 1990, and 60 of these were concluded from 1995 to 2000.

Regionalization under globalization is not a paradox. Globalization means that corporations, people, and money freely move across borders, helped by sophisticated communication and transportation technologies. In the globalization era, nation-states need to attract foreign and domestic firms to set up shop within their borders to maintain economic prosperity. To attract corporations, they must provide business-friendly environments, which requires various deregulation efforts. While worldwide deregulation is ideal, it is politically difficult. Therefore, regionalism provides an alternative solution: Under regionalism, neighboring nations agree to open their markets

and ease their regulations among themselves.

Although the WTO Doha Round started in 2002, regionalism is gaining momentum rather than getting weaker. Though worldwide liberalization poses significant challenges, it is the best solution, and regionalism is normally regarded as the second-best solution. But it is gaining momentum because policymakers see advantages in regionalism itself. This advantage is called “competitive liberalization,” which means that, if a certain number of economies form a group and reciprocally open up their markets and ease regulations within it, outside nations that fear discriminatory treatment will have an incentive to join the group or form different free trade groups. Undeniably, the effects of competitive liberalization contributed to the worldwide spread of regionalism in the 1990s.

There are various proposals for regionalization in East Asia, such as bilateral FTAs, multilateral FTAs, and a proposed East Asian Economic Community that would cover all of East Asia. With respect to bilateral FTAs, several have already been consummated or are under contemplation. For example, Japan and Singapore signed a bilateral FTA in early 2003, South Korea and Chile have reportedly agreed upon a bilateral FTA, and Japan and Mexico are negotiating an FTA. In addition, policymakers are considering a Japan–South Korea FTA, a Japan-Thailand FTA, and a Japan-Philippines FTA. As for multilateral FTAs, the ASEAN nations have formed AFTA, the ASEAN Free Trade Area, China has begun FTA negotiation with ASEAN, and Japan has also proposed free trade negotiations with ASEAN. Obviously, competitive liberalization is a driving force behind such regionalization moves. Although Japan used to attach exclusive importance to GATT/WTO global negotiation, it is now paying due attention to the bilateral FTAs mentioned above. Japan understands the effects of competitive liberalization and sees that it will be left behind if it continues to focus exclusively on the WTO.

Regionalism in East Asia

The most advanced region in terms of this integration is Europe. The 15 member countries of the European Community have evolved into the European Union with its integrated currency. Negotiations are now underway for the participation of eight additional members from Eastern Europe. The North American Free Trade Agreement between the United States and Canada was expanded to include Mexico, and

is in the process of expanding further to include Chile. Agreement has been reached among 34 countries in North, Central, and South America to negotiate the Free Trade Agreement of the Americas (FTAA), which will take effect in 2005.¹

Regionalism has also emerged in East Asia. The then six members of ASEAN started moves toward AFTA in 1992, and this scheme is now in the process of expansion with the inclusion in ASEAN of Vietnam, Laos, Cambodia, and Myanmar. Among the ASEAN members, Singapore has been particularly active. It has already signed free-trade agreements with New Zealand and Japan, and is negotiating a similar agreement with United States. Japan and Korea have traditionally emphasized multilateralism, but over the past three years there have been news reports of free trade agreements under consideration between Japan and Korea, Japan and Mexico, and Korea and Chile. And a network of currency swap agreements is being formed among the ASEAN + 3 members.

The proposal of an East Asian Free Trade Area mentioned above came in the middle of this increased momentum for regional cooperation in East Asia. Furthermore, subregional groupings of different combinations for FTAs or closer economic cooperation are going on among the ASEAN + 3 members. Nowadays there are plenty of opportunities—such as APEC, ASEAN + 3, and Asian Development Bank meetings—for leaders and ministers of East Asian economies to discuss strengthening cooperation. The ASEAN + 3 Economic Ministers' Meeting in Bandar Seri Begawan on September 13–15, 2002, provided the most recent occasion to promote the China-ASEAN and Japan-ASEAN FTAs. Chinese and ASEAN leaders had agreed in November 2001 to form an FTA within 10 years. At this meeting their economic ministers added an “early harvest” implementation of reduced tariffs on hundreds of items in eight agricultural sectors within the 2004–06 period. A framework agreement incorporating these steps was signed by their leaders at a summit meeting in November 2002. Meanwhile, the economic ministers of Japan and ASEAN agreed to conclude an Economic Partnership Agreement including an FTA within 10 years and to start negotiations toward this in 2003. The Korean economic minister has also spoken of his efforts to explore the possibility of forming a FTA with ASEAN members.

China, Japan, and Korea have started consultations on ways to strengthen

¹ This process will be strongly supported by the Trade Promotion Authority Act, which was enacted by the US Congress in early August 2002.

regional cooperation among themselves. Based on the proposal by Korean President Kim Dae-jung at the three nations' summit meeting in Manila in November 1999, three research institutes representing the countries started a joint study on ways to promote trade and investment facilitation among the three in January 2000.²

We should note, however, that East Asia has been slow to come around to the global fashion for regionalism. However, East Asian economies have already achieved close trade relationships among themselves. Table 1 gives trade intensity indexes between East Asian economies and economic groups as well as for North America, Oceania, and Europe for 1980–2000. If a country's export trade is proportional to its imports, or vice versa, its trade intensity index is unity. Very high trade intensity values exceeding 5 are recorded between China and Korea, Taiwan, and Hong Kong, within the original six members of ASEAN, and within Oceania (between Australia and New Zealand). Between East Asian economies and economic groups we see high intensity values above 2. Oceania maintains high intensity values with the East Asian economies, reflecting that region's exports of resource products. On the other hand, North America shows an intraregional trade intensity of 2, while its trade intensity with East Asia is 1.5 at most. Europe has a low trade intensity of 0.3–0.4 vis-à-vis other regions, while its intraregional trade intensity has increased from 1.4 to 1.8. Even without a formal agreement, East Asia has achieved a degree of market-driven integration.

² This resulted in the "Report and Joint Policy Recommendations on Strengthening Economic Cooperation among China, Japan, and Korea" issued in November 2001.

Table 1 Index of Trade Intensity in Asia Pacific: 1980, 1990, 2000

	Japan	KR,TW,HK	ASEAN6	China	N America	Oceania	EC12(+3)
Japan							
1980	-	3.72	4.59	3.90	1.66	2.47	0.36
1990	-	2.63	2.33	1.29	1.73	1.93	0.44
2000	-	2.71	2.52	1.91	1.43	1.67	0.46
KR,TW,HK							
1980	1.53	1.81	2.68	2.19	1.91	1.89	0.46
1990	1.73	1.38	1.68	5.85	1.54	0.83	0.33
2000	1.73	1.60	1.07	5.32	0.78	0.90	0.41
ASEAN6							
1980	4.22	2.18	5.68	0.97	1.03	2.26	0.32
1990	2.77	1.71	4.17	0.99	1.06	1.54	0.36
2000	2.49	1.87	3.92	1.16	0.88	2.20	0.41
China							
1980	3.40	7.57	2.97	-	0.46	1.23	0.39
1990	1.99	6.41	1.10	-	0.61	0.66	0.24
2000	3.13	3.45	1.18	-	1.00	1.25	0.43
N America							
1980	1.22	1.34	1.01	1.57	2.04	1.43	0.59
1990	1.47	1.13	0.76	0.68	2.05	1.32	0.47
2000	1.10	0.52	0.70	0.46	2.10	1.02	0.42
Oceania							
1980	3.17	1.70	2.37	3.40	0.78	5.13	0.39
1990	3.43	1.87	2.12	1.30	0.67	5.21	0.32
2000	3.53	2.05	2.27	1.58	0.54	6.71	0.34
EC12							
1980	0.14	0.27	0.34	0.35	0.40	0.59	1.44
1995	0.35	0.34	0.35	0.33	0.41	0.59	1.64
(EC15)2000	0.34	0.29	0.28	0.31	0.46	0.60	1.74

Source: UN, Commodity Trade Statistics, individual years.

Note: Trade intensity index is calculated by the formula of $lij = (X_{ij}/X_i)/(X_{.j}/X_{..})$

Regionalism as a Pragmatic Approach

The idea of current RTAs is that neighboring countries should cooperate to liberalize trade and investment and should reform and integrate domestic systems. It would be better if these liberalization efforts were made on a global scale, such as through WTO negotiations, but few can wait for the 144 members of the WTO to reach an agreement, so countries rush towards the achievable goal of achieving regional economic integration with their neighbors.

On the other hand, criticism is heard against the FTA initiatives based on their inconsistency with multilateral liberalization. This criticism is correct in theory because an FTA incurs a trade-diverting effect on nonmember countries. It is based on the negative static effects of the elimination of tariffs and nontariff measures between members resulting from the formation of an FTA. Many economists, however, admit these negative effects are likely to be more than offset by the positive dynamic effects of intensified competition, economies of greater scale, promotion of investment, and technology flows. Furthermore, the criticism addresses the conventional concept of FTAs defined by Article XXIV of GATT more than 50 years ago, focusing on the elimination of tariffs. Many of the current FTA initiatives aim to pursue the dynamic effects mentioned above through greater coverage of areas including investment and services, rules of origin, harmonization of rules and standards, intellectual property rights, and dispute settlement mechanisms, as well as tariffs and nontariff measures. This has been shown in the “new age FTAs” mentioned by Singaporean Prime Minister Goh Chok Tong. This approach provides a new type of regional integration, different from conventional free trade areas, which minimizes discrimination against nonmembers and is strengthened by trade facilitation and ecotech, or economic and technical cooperation (Yamazawa 2000).

Warnings Against East Asian Regionalism

Nevertheless, some observers warn against regionalization in East Asia. They contend that new bilateral FTAs are inconsistent with the Bogor goals, may erode APEC’s fragile efforts for liberalization, and will impede liberalization efforts under the WTO. These people state that an East Asian free trade bloc will become so inward-looking that it will discriminate against non-East Asian members of APEC and thus stimulate similar regional groupings in other regions, especially in North and South America, and APEC will fall apart into Free Trade Area of the Americas and the East Asian bloc (Yamazawa 2000).

However, this reflects fear of imaginary threats and a bit of overreaction, while neglecting the region’s need for closer cooperation. East Asian economies are latecomers in terms of RTA initiatives. As a matter of fact there are only five East Asian economies—China, Hong Kong, and Taiwan as well as Japan and Korea—which have not formed FTAs either bilaterally or plurally. Here the move toward regionalism is

never an aggressive one but no more than a pragmatic approach within the scope of competitive liberalization. Furthermore, these regional grouping proposals differ in their feasibility in the near future. Singapore and Mexico have been quick in realizing their FTA initiatives. FTAs between Singapore and New Zealand and between Mexico and the EU were concluded in 2001, and the Singapore-Japan FTA in early 2002. Korea has already been negotiating a FTA with Chile for two years. The Japan-Mexico FTA may come in the near future. However, the Japan-Korea FTA will take more time for preparation. ASEAN members other than Singapore seem to be cautious about going far beyond their currently ongoing AFTA liberalizations. We have a long way to go to an East Asian FTA.

Since FTAs eliminate tariffs and nontariff barriers among member states while maintaining them against outsiders, nonmember states have complained that imports from member nations will replace those from nonmember states. GATT Article XXIV permits members to enter into FTAs as transitional measures toward worldwide free trade as long as the FTAs effectively encompass every field, avoid higher obstacles to nonmembers, and eliminate tariffs among member states within 10 years. Recently, more and more nations have been negotiating comprehensive FTAs that would also mutually recognize member nations' systems and rules, protect intellectual property rights, and liberalize foreign investment. A good example is the Japan-Singapore economic partnership agreement that was signed in early 2002. Under a comprehensive FTA like this one, signatories can expect trade creation to exceed the trade diversion effect. In addition to the trade liberalization effect, such an FTA can be expected to reduce domestic regulations and alleviate common structural deficiencies in member economies. However, such drastic reform may be difficult to attain because it will face strong opposition from certain vested interest groups.

Cooperation to Revitalize East Asia

East Asian economies need these dynamic effects to revitalize their economies. They had enjoyed a decade-long period of "miraculous growth" before it was stopped by the financial crisis in 1997–98. Their macro economies have recovered more quickly than had been anticipated since 1999, but their structural deficiencies have remained uncorrected. Liberalization momentum heightened during the miraculous growth has tended to decrease in many economies, and a return to steady growth cannot be secured

today through liberalization and structural reform efforts. As the nations come to share an understanding of these problems and strengthen regional cooperation toward an FTA, liberalization and structural reform will be secured through the dynamic effects of the FTA in individual economies. This agreement should be a “new age FTA” incorporating a wide variety of measures rather than a traditional one. The shared recognition of this need underlies the increased momentum of East Asian regionalism.

It cannot be denied that momentum toward liberalization diminished in some ASEAN economies after the currency crisis. In addition, China, Taiwan, and Vietnam have to adjust their legal systems in line with their WTO accession. And Japan and Korea require revitalization of their economies. All East Asian economies need to intensify their efforts toward liberalization, facilitation, and structural reform. They all realize the necessity of these efforts, and in a world where economic matters moved according to textbook rules they would do so voluntarily. However, the reality of political economy means that these efforts will meet severe resistance from vested interest groups at home, which have benefited from the current economic and social systems and object to any attempt to change them.

Liberalization and structural reform basically depend on self-help efforts, but it is a fact that reforms tend to make little headway due to the resistance from entrenched domestic interests. Here we should remember why our predecessors established GATT. The GATT was created as an international mechanism under which countries could jointly pursue liberalization. Resistance to liberalization in import sectors is counteracted by support for liberalization in export sectors, and a framework of international liberalization commitments is created to move the process forward.

Joint Promotion of Structural Reform

Joint international implementation will also be effective in structural reforms. It will be helpful in this context to provide guidance in the form of success stories from other countries. The structural adjustment lending offered by the World Bank and IMF already play this role. However, when international institutions encourage structural reforms in specific countries, they may not be in line with the circumstances of the country or region and may create an impression within the recipient country that it has been “forced” to make reforms. By contrast, the mediation of a regional cooperation organization may be able to induce structural reforms in ways that are better suited to

the specific conditions of the region. APEC ecotech plays this role in some aspects.

So we rely on closer regional cooperation for joint promotion of liberalization, facilitation, and structural reform. There are two reasons for this joint promotion. First, this approach allows us to better utilize external commitments to our neighbors and peer pressure to break through the vested interest groups' resistance. Second, our companies operate across national borders and concerted efforts are needed to suggest the best practices or to encourage the implementation of minimum standards at least. This latter point suggests that East Asian cooperation is good for outside companies and other APEC members as well.

The dynamic effects of an FTA are realized only through structural changes to the status quo, and they inevitably meet strong resistance from vested interest groups. Such an agreement can succeed only by breaking these groups' resistance, which is also the case with WTO liberalizations. In this respect forming a FTA serves as a laboratory for breaking through domestic resistance and thus contributes to the preparation for liberalization under a broader framework such as APEC or the WTO.

Regional cooperation also helps East Asian economies to efficiently implement environmental protection and to secure supplies of food and energy, taking advantage of the complementary positions of Japan and the Asian NIEs with other regional members. Successful integration in East Asia will also intensify competition, however, and will inevitably cause trade disputes between members. A network for closer cooperation is required to resolve disputes and implement industrial cooperation in time for early settlement.

China's Dynamic Advancement

Furthermore, the emerging instability in East Asia brought about by the recent advances of the Chinese economy and Chinese firms has also bolstered the case for East Asian cooperation. It cannot be denied that there exists a feeling of unease and a sense of threat throughout East Asia in response to China's advancement (Dhume and Lawrence 2002). Although the majority view is that China's dynamism is a strong engine of Asian development and that other economies will benefit from it, there may emerge persistent requests for restrictive measures against China by sectors and firms directly competing with the nation. Closer cooperation is needed in order to prevent these protective moves and to enable all East Asia to benefit from China's dynamic growth.

Subregional Group Cooperation

While the RTAs are officially promoted by central governments, there exist subregional cooperation groups (often called subregional economic zones, or SREZs) including provincial governments neighboring each other across national borders. They are the Growth Triangle of Singapore, Riau Islands of Indonesia and Johor Bahru of Malaysia; the South China Economic Zone of Hong Kong, Guangdong, Fujian, and Taiwan; the Yellow Sea city groups of China, Korea and Japan (Qingdao, Tianjin, Talian, Puzan, Inchon, Kitakushu, and Fukuoka); and the Northeast Asian Economic Conference Group consisting of China, Korea, Japan, Russia, and Mongolia. Each SREZ forms a natural economic territory across national border in which neighborhood trade is activated. Provincial governments are inspired by the intensified movements of commodities, money, and personnel between neighboring provinces across national borders, and they intervene either actively or passively to further facilitate these movements. These SREZs are active in East Asia, where formal integration has lagged in spite of rapid market-driven integration.

V. Japan's Approach to East Asian Regionalism

A Changing Commercial Policy Stance

After 1997–98 Japan adjusted its commercial policy stance to a pragmatic one allowing a wider choice of policy tools, including various forms of RTAs. Japan, more than many other countries, used to show strong attachment to the traditional multilateral approach to trade relations. But with the regionalist trend gaining ground around the world and the increased pressure of competitive liberalization, it had to leave its options open. Without a flexible approach to regionalism, Japan could well end up tying its own hands in the diplomatic sphere (Yamazawa 2001b).

In 1997 the Japan External Trade Organization (JETRO), a public corporation subordinate to the Ministry of Economy, Trade, and Industry, started a joint study with the Mexican Ministry of Commerce on the feasibility of a Japan-Mexico FTA. It responded to Japanese firms' concern about being discriminated against in Mexico compared with American and European firms as a result of NAFTA and the EU-Mexico FTA. In 1999–2000, the JETRO Institute of Developing Economies conducted a joint

study with KIEP, the Korean Institute of International Economic Policy, on a Japan-Korea FTA (Yamazawa 2001a). The IDE-KIEP reports highlighted the dynamic effects to be achieved through the integration of the two markets.³

In 2000 Japan and Singapore conducted a joint official study on a FTA between the two countries, which was followed by intergovernmental negotiations in 2001. The Japan-Singapore Economic Partnership Agreement was concluded by the two nations' prime ministers in January 2002. It conforms to Prime Minister Goh Chok Tong's "new age FTA" concept and incorporates facilitation and ecotech elements as well as the elimination of tariffs and nontariff measures. Singapore is to eliminate all tariffs, while Japan will eliminate 98 percent of its tariffs on manufactured products but exclude some sensitive agricultural products. Services trade is to be liberalized 90 percent by Singapore and 86 percent by Japan. Agreements on investment, mutual recognition of procedures, the movement of professionals, and intellectual property rights are also included. The scope for economic partnership is extended so as to cover IT technology, human resource development, trade and investment promotion, small and medium enterprises, tourism, electronic trade, and document exchange. Prime Minister Koizumi made it clear in his January 14, 2002, speech in Singapore that Japan was willing to conclude similar economic partnership agreements with other ASEAN members in working out a Japan-ASEAN FTA.

Japan-China Rivalry in Their Approach to ASEAN

China and Japan are now negotiating FTAs with ASEAN. When the ASEAN + 3 summit was held in Phnom Penh in November 2002, China signed a comprehensive economic cooperation framework agreement with ASEAN, concluding a year-long round of negotiations. China also announced that it would sign an FTA with ASEAN between 2010 and 2015. Moreover, when China joined the WTO in 2002, it promised ASEAN that it would open its domestic markets in eight agricultural product categories, such as fresh vegetables, fruit, and ornamental plants, before such an FTA was reached.

Japan has already had close economic ties with ASEAN for more than 30 years. Trade intensity between Japan and ASEAN has already risen to as high as 2.5, while

³ The Japanese and Mexican governments have been negotiating an FTA since 2000. The Japanese and Korean governments took the additional step of following up the initial study by a joint business forum in 2001, in order to observe the public acceptance of this proposal in both countries. They finally started official negotiations in December 2003.

China-ASEAN trade was still at around 1.1 (Table 1). Unlike traditional bilateral economic cooperation between Japan and ASEAN members, the Japan-ASEAN Comprehensive Economic Partnership agreement aims at economic integration between Japan and the unified ASEAN market. If AFTA is successful, the ASEAN economies will form a single market. If Japan signs an FTA with a unified ASEAN, Japanese firms and ASEAN corporations will both benefit from newly emerging business opportunities. Expecting AFTA to be implemented this year, many firms, mainly Japanese corporations, are working to establish ASEAN-wide business networks. However, such networks will require smooth distribution and telecommunications services between ASEAN countries. For this to be possible, the ASEAN countries need to ease custom procedures, liberalize transportation and telecommunications services, and create more coherent rules of origins and certification standards. The comprehensive economic partnership is a new type of FTA that will address these challenges. At the time of the ASEAN + 3 Summit in October 2003 Japan and ASEAN agreed to negotiate a FTA within a 10-year framework.⁴

Obstacles to integration exist in Japan's domestic markets as well. Liberalization of agricultural product markets takes time because Japanese farmers possess disproportionate political power and seek to use that power to oppose liberalization. However, many Japanese economists understand that Japan and ASEAN will both benefit from opening up agricultural product markets.

In addition, some ASEAN countries want Japan to liberalize its immigration policies for workers. Although labor movement is politically difficult for many countries, Japan will undoubtedly have to accept labor inflows from foreign countries due to its low birthrate and aging population. Japan has already been working on smoother labor movements by awarding reciprocal recognition to engineers licensed by certain other countries. For example, Japan extends reciprocal recognition to IT engineers certified in Myanmar, the Philippines, Singapore, Thailand, and Vietnam. Japan will continue to increase the number of foreign-awarded licenses that it recognizes. While the limited experiment of liberalization under existing FTAs is playing out, the Japanese public should accept the need for further liberalization of

⁴ The underlying logic for the Japan-ASEAN Comprehensive Economic Partnership agreement was proposed jointly by JARIM, a group of the JETRO Institute of Developing Economies and 10 ASEAN research institutes, in IDE 2003.

domestic markets through additional FTAs in the future.

FTAs Help Revitalize Japan

Japan's change in its policy stance also responds to the need to utilize East Asian dynamism in order to sustain the growth of its matured economy. The relationship between Japan and East Asia has undergone fundamental changes in the last 10 years. A decade ago, Japan stood out as a leader of the "flying geese" in Asian development. It provided assistance for development in other East Asian countries much as a father would treat his sons. Now the sons have grown strong and the father has matured and entered old age. Japan still has money and technology, but it has lost its vigor for new growth and has little stomach for bold reforms. Not only must it live in harmony with its sons, it must also survive in a globalized world.

The East Asian region is the home base for the Japanese economy. Ever since the appreciation of the yen in the late 1980s, Japanese companies have been moving out of Japan and establishing business networks throughout the region. This continued even during the prolonged domestic slump of the 1990s. It is important for Japanese companies and the Japanese economy that East Asian countries and regions move forward with structural reforms and return to the path of steady economic growth. The keys to this are the promotion of trade and investment liberalization, the reinforcement of market competition functions, and the resolution of remaining structural problems. This requires support for capacity building, and economic cooperation will be vital in this.

The Japanese economy has been slow to write off defaulted credits and strengthen corporate governance, and has very little room to comment on liberalization and structural reform in its neighbors. However, Japanese companies will not be able to survive just inside Japan. They must make effective use of the business networks they have built up across borders in East Asia. For this to develop into a vigorous and vibrant section of the globalized economy, East Asia as a whole must continue to liberalize and make structural reforms. This must move forward, whether in the form of bilateral FTAs, East Asian regional cooperation, APEC cooperation, or WTO liberalization. It is a vital policy objective, on par with domestic liberalization and reform efforts.

Japan's Changing Industrial Structure

Japan is now implementing a variety of reform in public institutions and regulations and its industrial and firm structures are undergoing drastic changes. This reform is partly being stimulated by dynamic changes in China and ASEAN, but also by feedback to the changes in those two areas in the form of accelerated and adjusted performance of Japanese firms. The Japan-ASEAN Comprehensive Economic Partnership has to be designed so that the dynamic interaction of these changes can be taken into consideration.

Industrial adjustment should not be overwhelmed by short-term conflict over interest. On the Japanese side, agriculture is currently seen as the biggest barrier. Rather than worrying about how to exclude it from FTA talks, the nation should be working on this issue positively. Let me raise one example. In 1993 Japan's rice crop decreased 26% from regular years due to cold weather, and emergency imports of 263,000 tons of rice were conducted for 1993–94. Of this amount, 42% was from China, 30% was from Thailand, and 21% was from the United States. After that, the crop returned to the normal harvest amount and rice imports were reduced to minimum-access levels. However, according to agricultural experts, there is a big probability that Japan will need to rely on substantial amounts of rice from imports every year within the next 5 to 10 years. This is because the farmers, many of whom are already aging, are facing difficulty in passing on their jobs to such a degree that regular crops will decrease. In this case, from where would Japan import?

Would it be fine to rely on the United States or Australia, which have problems relating to water shortages? Would it not be natural to rely on East Asian countries that are close, in the same monsoon area, and manage rice cropping through small, family-run farms? If this is the case, then Japan should actively advise East Asian countries on agricultural management by promoting such issues as the nonuse of excessive agricultural chemicals and genetically modified seeds, offering solutions to water shortages, and securing safe agricultural imports, rather than simply saying that “importing rice should not permitted.” A comprehensive FTA is the framework that could make this type of industrial cooperation possible. Rather than leaving agricultural imports as a taboo and obstructing an FTA, we should make use of an FTA and seek ways of sustainable reliance on agricultural imports in the longer term. Securing safe

and stable food imports should be the essential goal of the East Asian economic community. I would like to hope for wisdom and wise decisions from the government and the public of Japan.

VI. Towards East Asian Community

Although both Japan and China are seeking FTAs with ASEAN, neither Tokyo nor Beijing has proposed a Japan-China FTA. Top political leaders agree that trilateral cooperation among Japan, China, and Korea would be desirable, but only scholars have explored this issue. The Japan-Korea economic alliance, a part of such a trilateral alliance, is also facing difficulty. The Japan-Korea FTA aims to nurture the development of globally competitive firms by increasing productivity and reducing costs through intensive competition between Japanese and Korean firms in some areas, creating strategic alliances among them in other areas, and inviting European and American firms to participate. Only a comprehensive FTA between Japan and Korea can address these challenges.

However, Korea opposes such a comprehensive FTA not only because it fears expanding trade deficits with Japan and stronger competition from Japanese firms, but also because historical distrust of Japan still exists in Korea. As a result, Korea has demanded that Japan implement certain “pre-FTA” measures to raise levels of trust. These measures include a smoother visa-granting process and more Tokyo-Seoul airline shuttle flights. Japan implemented all of these measures before the 2002 World Cup soccer finals. While businesspeople and government officials tend to support the Japan-Korea FTA, strong opposition still remains on the Korean side. Because of political pressures, neither government is aggressively pursuing comprehensive FTA negotiations. However, Japan and Korea both need to work toward making progress in this area. Indeed, both countries recognize that the creation of an integrated market is a top priority, as evidenced by the fact that both countries are actively working on structural reforms to address globalization. Without economic integration, neither of these two economies can survive in the globalization era (Yamazawa 2001a).

In forming an East Asian economic community, it will be essential to involve the ASEAN + 3 countries, Hong Kong, and Taiwan in the future. Only by doing so can

the East Asian economies form an economic zone comparable to North America and the European Union. Though an East Asian economic zone would be viable in my belief, economic disparities among Japan, Korea, and China, differences in economic systems, a lack of experience in regional economic integration, and residual distrust from events of the past century have prevented the successful formation of a regional economic community. However, success in the era of globalization will require that the countries of East Asia make every reasonable effort to achieve successful economic integration, such as bilateral and multilateral integration schemes. However, East Asia should attempt to avoid a situation in which the region has only a China-ASEAN FTA, because, in such a situation, the region will suffer adversely from trade-diversion effects. For this reason as well, all of East Asia should aim at an East Asian Economic Community as its ultimate goal, while making interim efforts to form bilateral and multilateral FTAs.

Many East Asian economists agree that in the mid- to long-term the region will form its own economic zone. Large economic disparities will still prevail among Japan, Korea, China, and the ASEAN nations, but such disparities will allow complementary role sharing and also contribute to economic integration in the region. If such integration is achieved, East Asia, like North America and the European Union, will become one of the world's most powerful economic areas. Economic integration will result in a more open economic zone characterized by active trade, investment relations, and capital flows with other regions. If East Asia is economically integrated, its constituent nations will share a common economic system. But what common economic system would be appropriate for East Asia? Even the experts have yet to reach consensus on such a system. I would like to conclude this paper by briefly explaining our ideas about an appropriate economic system for an integrated East Asia.

As already mentioned, countries and corporations around the globe are seeking to globalize themselves. Without these efforts, they cannot maintain international competitiveness or survive in the global marketplace. In the globalization era, efficiency is the most important factor, and corporation-based economic liberalism appears poised to prevail. Corporations will seek to maximize their profits and behave in accordance with the so-called Anglo-American standard, which requires a high level of transparency, openness, and accountability. At an international conference held in Korea recently, a Korean economist living in the United States asserted that an American-type approach

would be necessary to correct insufficient Korean reform efforts. Will East Asia also embrace the Anglo-American standard in the globalization era?

While acknowledging the importance of dealing with globalization, many East Asian economists hope that East Asia will not adopt the Anglo-American model as it is. They feel that the Anglo-American standard has alien components that are incompatible with East Asia's economic systems, traditions, societies, cultures, and ideals about human relationships. The American ideas that gained popularity throughout the world in the years after World War II forced us to think in ways that differed from our traditional philosophies. The Anglo-American model is closely connected with democracy, which though far from being the ideal, is a stable political system that has often led to a high degree of material prosperity. However, the Anglo-American model also has a negative side that tends to place the highest priority on economic merit and reinforces economic inequalities among people. It also embraces individualism and dilutes the traditional family relationships that prevail in Asia.

The formation of a new, integrated economic system in East Asia will result from evolution, not revolution. Because the transformation toward an economic system that is compatible with a globalized world economy will be gradual, many parts of our present systems, corporate structures, and employment practices will survive, rather than totally disappear. Because each East Asian economy has its own system, East Asia will likely embrace more heterogeneous systems and institutions than those in the Americas or Europe. In this sense, we have to pay due attention to diversity in East Asia. However, any new East Asian standard must yield sufficient efficiency to compete with the Anglo-American model. It must have maximum flexibility to allow for the coexistence of the various East Asian systems, yet still generate the minimum homogeneity necessary to allow for a competitive, coherent East Asian economic system.

There is a term, "Asian values," which is used to express the distinct identity of East Asia. Reference to "Asian values" can be used cynically to avoid compliance with so-called international norms, but it can also be used positively to allow for flexibility. If we use references to "Asian values" as an excuse to avoid addressing globalization, the result will be dangerous. We must, therefore, all make efforts to establish an effective East Asian economic system in the next 10–20 years. In doing so,

it is necessary to conduct reforms on our own, to observe other nations' reforms, and to work together to understand their difficulties and outcomes. Without sincere efforts toward these ends, we will not be able to form the much-needed East Asian community.

VII. Can APEC Achieve the Bogor Goals?

APEC's 2003 Bangkok Meeting

APEC now formally incorporates 21 economies surrounding the Pacific Ocean, including Australia, New Zealand, Chile, Peru, Mexico, the United States, Canada, and Russia in addition to the East Asian economies. In 2003 Thailand hosted ministerial and leaders' meetings in Bangkok on October 18–23. The ministerial meeting reviewed a variety of economic cooperation arrangements under the common theme of “A World of Differences: Partnership for the Future” and announced plans to pursue further liberalization of trade and investment, border measures, concerted promotion of domestic reforms behind borders, economic and technical cooperation in capacity building, and the strengthening of financial systems. The leaders' meeting also focused on counterterrorism and security issues and delivered the “APEC Leaders' Declaration on Health and Security.”⁵

Counterterrorism and security have received more emphasis at APEC under the initiative of the United States. While Asian members also pay much attention to these matters, they seem to be more concerned about economic issues, focusing on steady recovery from the setbacks caused by the 1997–98 crisis. Their economic growth has become self-sustaining, recently based more on domestic demand than on exports. The higher priority on economic growth by East Asians needs to be apprehended more by Americans.

Ambitious Commitments in Bogor

APEC gained its biggest momentum during the years 1993–96. APEC made a modest start in 1989 with an annual meeting of foreign and trade ministers of 12 member economies, focusing mainly on economic cooperation. Its momentum increased in the following decade. The leaders' meeting was initiated in Seattle in 1993,

⁵ Both the leaders' declaration and the joint ministerial statement are available on the website of the APEC Secretariat <www.apecsec.org.sg>.

the ambitious Bogor Declaration was delivered by Indonesian President Suharto in 1994, the guide lines embodied in the Osaka Action Agenda were adopted in 1995, and the Manila Action Plan, designed to implement this agenda, was jointly prepared in 1996. At Bogor, the APEC leaders committed themselves to achieving “free and open trade in the region” by 2010 or 2020, with 2010 being the deadline for developed members and 2020 for the rest of the APEC members. This seemed to open up great potential for Asia Pacific cooperation. What has happened to this ambitious declaration?

APEC has a unique modality of implementing liberalization. This is described as “concerted unilateral liberalization.” That is to say, individual member governments unilaterally announce their own liberalization and facilitation programs and implement them in accordance with their domestic rules. However, individual APEC members closely watch each other’s liberalization programs and their implementation. They then feel obliged to prepare liberalization programs as sweeping as those of their neighbors. They are subsequently encouraged to implement what they have committed to. APEC thus relies upon “peer pressure” to urge all members to join the liberalization process. This modality has been criticized as “unassertive” in comparison with the Western approach of negotiating (as in GATT and the WTO) liberalization agreements which are legally binding, so that the signatories will be punished and suffer sanctions if they fail to implement their commitments. At the initial stage, however, this legalistic approach could not be accepted by Asian members.

However, APEC’s momentum turned downward in 1997. The Individual Action Plans, individual members’ unilateral liberalization programs based on the Manila Action Plan, did not go far beyond their Uruguay Round commitments. Another liberalization program that was proposed in 1997 to supplement the IAPs, Early Voluntary Sectoral Liberalization, actually failed to be realized because of the conflict between major participants in 1998.⁶ The crisis in 1997–98 hit the East Asian economies, a leading APEC group with high growth potential, and APEC finance ministers were not at all prepared to defend member economies against such currency disturbances. Domestic resistance tended to decelerate liberalization efforts in these crisis-hit economies. The WTO Ministerial Meeting in Seattle failed to launch the new millennium round negotiations in December 1999. Although APEC leaders endorsed the

⁶ Detailed analyses of both the implementation of the IAPs and the failure of EVSL are available in Yamazawa and Urata 2000.

importance of the new WTO round, their trade ministers could not agree on a specific agenda for the negotiations due to conflicts of interest between APEC member economies.

A Paradigm Shift from APEC to ASEAN + 3?

Ten years have passed since the Bogor Declaration and its first deadline of 2010 is approaching. President Suharto and other leaders have already left the scene. What has happened to their ambitious commitment? Quite a few Asian governments seem to have abandoned APEC and to be looking instead to ASEAN + 3 or other forms of subregional groupings.

However, the pessimistic views about APEC that we hear occasionally nowadays are overly affected by poorly focused expectations that ignore the true capabilities of APEC. The recent poor performance of APEC in the area of liberalization has certainly revealed that APEC is not a negotiating body and cannot accomplish much alone in the liberalization area. Hadi Soesastro of the Center for Strategic and International Studies in Jakarta has proposed a change from “V-APEC” (voluntary) to “B-APEC” (binding) so that APEC can go beyond unilateral liberalization. In the meantime, though, APEC can still contribute to liberalization under WTO by acting as a catalyst.

Strengthening IAP Peer Review

APEC officials, that is, government officials working on APEC matters in individual member economies, have not yet given up the idea of progressing towards the Bogor Goals. The APEC Senior Officials Meeting has been conducting peer reviews of individual members' IAPs on a voluntary basis since 1999 so as to encourage their progress toward the Bogor Goals. At the Shanghai APEC meeting in 2001, Japan subsequently proposed to strengthen this peer review process by covering all member IAPs on schedule so as to urge individual member economies to make further efforts to achieve the goals. Under this process, an IAP review team formed by senior officials of other member economies, the APEC Secretariat, and a consultant expert for each member's IAP interviews APEC officials of the member economy under review and drafts reports on their assessment of the economy's progress toward the Bogor Goals.

The report is submitted for open discussion at a senior officials meeting. The

IAPs of Mexico and Japan were thus “peer reviewed” in 2002, those of Australia, Canada, and Thailand were reviewed at the SOM in February 2003, and those of Hong Kong (China), Korea, and New Zealand were reviewed in August 2003. It is planned to cover Chile, China, Peru, Singapore, Taipei, and the United States in 2004 and the remaining seven member economies by the first SOM in 2005, completing a mid-term stock-taking within 2005 on overall progress towards meeting the Bogor Goals.

Private-sector economists in member economies have been invited to participate in this strengthened peer review process as consultant experts. I participated in the peer review team for Australia, drafted its original report, presented it at the SOM, and witnessed the peer review process last year. All completed peer review reports are available on the APEC Secretariat’s website. My assessment describes Australia as actively pursuing the Bogor Goals while remaining constrained by its unique domestic circumstances. Australia is cautious in its approach to quarantine and sanitary and phytosanitary (SPS) measures in order to maintain the natural plant and animal endowments of an isolated continent. Australia has maintained its traditional federalism, which means that legislative and regulatory responsibility for such issues as government procurement, investment, and certain services sectors are split between the commonwealth and the state/territory governments. Foreign companies and investors find this system difficult to negotiate.

Peer review reports are lenient to developing member economies in general, understanding their adjustment difficulties and encouraging them to liberalize by steps. After all, APEC’s IAP peer review differs from the WTO’s trade policy review. TPR indicates departures from an economy’s trade and investment policy from WTO rules and urges the economy to remove the gaps.⁷ On the other hand, APEC’s IAPs contain each economy’s liberalization and facilitation efforts, reflecting its unique domestic conditions, and do not mandate their quick harmonization. Both the Bogor Goals and the Osaka Action Agenda contain ambiguities and flexibility, some deliberate and some unintentional. APEC’s modality is not to redefine the terms strictly and to decide who will pass and who will fail, but to encourage as many members as possible to continue their efforts to reach the Bogor Goals. This is the fundamental objective of the IAP peer review. The Bogor Goals will help APEC members to achieve free and open trade in the region.

⁷ Each member country’s trade policy is reviewed by the WTO Secretariat every four years and the results made available on the WTO website <www.wto.org/english/tratop_e/tpr_e/tpr_e.htm>.

Trade Facilitation and Coordinated Capacity Building

As regards facilitation areas like customs procedures, standards and conformance, and business visas, the prospect of achieving the Bogor Goals is much brighter thanks to the Collective Action Plans implemented jointly by member economies. CAPs set detailed targets for harmonization among member economies: Mutual Recognition Agreements on conformity assessment of food products and electronic equipment standards, harmonized system conventions and paperless customs clearance in customs procedures, and APEC Business Travel Cards to facilitate business trips.

Several member economies are implementing the APEC Trade Facilitation Action Plan in order to quantify the benefits of various trade facilitation measures. This will help to ensure that APEC meets the leaders' target of reducing business transaction costs by 5% by 2006. On the other hand, the United States has been introducing stricter inspection measures for airline passengers and ship cargos to prevent terrorist attacks and is insisting that other APEC members follow suit. These strengthened counterterrorism measures will tend to increase transaction costs.

APEC will also benefit developing member economies through a variety of ecotech measures: human resource development, capacity building for knowledge-based economies, strengthening domestic financial systems, supporting small and medium enterprises, environmental protection, human security, and so on.

APEC Helps East Asian Regionalism

Facilitation and ecotech measures cannot be provided properly within regional cooperation groups consisting of only developing economies. This is a clear advantage of APEC, which encompasses both developing and developed economies. ASEAN + 3, with its major members all belonging to APEC, should maintain close contact with APEC and take advantage of these benefits.

It will be difficult to change the voluntarism of APEC and introduce compulsory action by persuading all 21 members. However, APEC ministers have acknowledged the important role of "pathfinder initiatives" that allow economies that are ready to initiate and implement the cooperative arrangements to proceed to do so, while those that are not yet ready to participate may join at a later date. These pathfinder

initiatives have already started in areas such as APEC policies on trade and the digital economy, the Digital Piracy Initiative, and the APEC Sectoral Food Mutual Recognition Arrangement. They first establish the best practices in selected areas among prepared members and encourage other members to participate. These pathfinder initiatives will help the V-APEC to transform itself to a more effective B-APEC.

VIII. Japan's Leadership Expected

So much for my review of Japan and the East Asian economies in the past two decades and the future prospects for the current trend of their regionalization in the context of globalization, in which the economic rationale suggests a move toward an East Asian Economic Community.

This is the most promising route for Japan to survive global competition. Japan still has capital and technology but has lost the dynamism of growth. It has to take advantage of the dynamism of its neighbors. This is also consistent with the economic rationale mentioned above and gives a clear vision for Japan to realize it.⁸ It should not be a closed trade bloc against the European Union or the FTAA but should be consistent with open regionalism of the APEC type, allowing individual member economies to continue their traditional trade investment ties with partners outside the region. This vision has come to be shared widely by economists in the region.

However, there is no guarantee that the economic rationale of the East Asian Economic Community will be realized without deliberate efforts by members. Japan and China are expected to take the initiative in guiding other members toward this common goal. It is a pity to hear talk in Japan of rivalry against China's advancement and the threat of China's dynamic growth even though Chinese leaders and economists have started recently to call upon Japan for joint leadership toward the goal. China's dynamism should be utilized for the sake of East Asian growth and Japanese capital and technology should be combined with it. Other East Asian economies seem to understand that the two countries can collaborate toward this goal by playing different roles.

The style of the Japanese political leaders sometimes invites comments by its

⁸ The East Asian Free Business Zone highlighted at the JETRO symposium in Tokyo in November 2003 perfectly fits this economic rationale.

neighbors. The strong leadership often taken by the United States neither fits Japan nor helps do away with the mistrust of Japan still held by the populaces of her neighbors. Peter Drysdale of Australian National University once suggested that a different style of international leadership fits Japan, namely “leadership from behind.” I did not welcome his description then, but this description does convey an important element of Japanese leadership. One example is the attention paid by Japan to CLMV—Cambodia, Laos, Myanmar, and Vietnam—in its proposal for a Japan-ASEAN Comprehensive Economic Partnership through JARIM, the research group mentioned earlier. These new members of ASEAN do not welcome the integration of Japan with ASEAN as a whole but prefer to deal with Japan bilaterally and get ODA for their economic development. Japan has recently decreased its ODA to the original ASEAN members and China, but continues providing it to the CLMV nations so that they can overcome the handicap of being late starters. The JARIM report also recommended that ODA should be combined with other ASEAN members’ assistance to new members. Another example is Japan’s active participation in APEC’s ecotech and facilitation programs for the sake of developing members.

This type of leadership may not give a clear, visible image, but it will inevitably be needed to support the group. I hope our East Asian neighbors will acknowledge this unique Japanese leadership style and encourage Japanese commitments within the region.

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