

C EPEA: Japan's New Regional Cooperation Initiative in East Asia

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Uncertain Economic Prospects for East Asia

East Asia has achieved high economic growth after recovering rapidly from the economic crisis of the late 1990s. One of the important drivers of rapid economic growth is expansion of foreign trade and foreign direct investment (FDI), which interacted to form a trade-FDI nexus. Indeed, the formation of the trade-FDI nexus in East Asia reflects the construction of regional production and distribution networks for many products, particularly machinery. Behind the rapid expansion of foreign trade and FDI were the buoyant global economy and liberalization of foreign trade and FDI policies by East Asian countries.

Recently East Asian countries have started to experience deceleration in their economic growth and the prospects of their economic growth are not so optimistic. The current deceleration stems largely from external factors, which include a slowdown in the United States' economy and sharp rises in oil and food prices. It should be remembered that the oil and food price surge is partly attributable to rapid economic growth of Asian countries such as China and India, as their demand for oil and food has risen substantially with a rise in income.

In addition to these rather short-term and external problems noted above, East Asian countries face various internal and structural problems, which have to be overcome in order for them to achieve further economic prosperity. They include barriers to trade and FDI, widening income gaps between and among the countries as well as within the countries in East Asia, environmental and energy problems, underdevelopment of infrastructure, lack of well-functioning institutions, and shortage of human resources, among others. To overcome these structural bottlenecks, regional cooperation is expected to play an important and effective role. The importance of regional cooperation in trade and FDI has heightened because of the collapse of the World Trade Organization's Doha Round of trade negotiations last July.

Regional Cooperation in East Asia

In the post-WWII period, Europe has been the leader in regional cooperation. Europe established the European Coal and Steel Community (ECSC) in 1951 to form unified markets for coal and steel, two most important products for economic activities at that time. Since then Europe has made enormous progress, which includes the establishment of a customs union (EEC) and a common market (EC), toward its unification (EU), culminating in the introduction of a common currency, the euro, in 1999. The original members of the ECSC included six West European countries, and the membership in the process of European integration increased to 27 in 2007. Compared with Europe, regional cooperation in other parts of the world has been slow and shallow. In North America, the United States took an initiative to form a free trade agreement with Canada and Mexico, the North

American Free Trade Agreement, in 1994, under which tariffs on imports from member countries have been removed. An attempt has been made to unify North and South American markets, but so far it has not been successful.

East Asia has been lagging behind Europe and North America in regional cooperation. East Asia began to have discussions on the need for regional cooperation to deal with the economic crisis in the late 1990s. Until then, the Association of Southeast Asian Nations (ASEAN), which was formed in 1967, was the only exception. In 1997 the first ASEAN+3 (China, Japan and South Korea) leaders' meeting was held. This meeting was planned as part of the 30th anniversary of ASEAN, but it turned out to be an important meeting to discuss the problems caused by the economic crisis.

The ASEAN+3 framework has produced a large number of regional cooperation projects. One of the most important achievements so far may be the implementation of the Chiang-Mai Initiative, whose objective is to deal with the shortage of foreign exchange, a major cause of the crisis. The ASEAN+3 summit recognized the need for regional cooperation in a number of areas, including economic, political and social spheres, to achieve peace and prosperity.

One of the important agenda items for regional cooperation, which has emerged through the discussions, is the establishment of a region-wide free trade agreement, or East Asia Free Trade Agreement (EAFTA). So far, a large number of free trade agreements have been established, negotiated and studied in East Asia. However, except for the ASEAN Free Trade Area (AFTA), all FTAs in East Asia are bilateral or "minilateral," meaning FTAs involving a subset of East Asian countries, resulting in a web of FTAs to complicate the trading system. Minilateral FTAs in East Asia have been set up with ASEAN playing a central role. Indeed, five ASEAN+1 FTAs (ASEAN+China, +Korea, +Japan, +India and +Australia/New Zealand) are likely to be completed by early 2009. To overcome the problems stemming from complicated trading systems, an EAFTA was proposed. An Expert Group was set up to study the feasibility of EAFTA and its work is under way.

The first East Asia Summit (EAS), involving leaders of ASEAN+3+3 (India, Australia and New Zealand), was held in 2005. The long-term objective of the EAS is to build an East Asian community. Since the inception of the EAS framework, Japan has played an active role in pursuing regional cooperation. Japan has led two important initiatives. One is the proposition of a Comprehensive Economic Partnership Agreement in East Asia (CEPEA), and the other is the establishment of the Economic Research Institute for ASEAN and East Asia (ERIA), both of which will be discussed below. In May 2008, Japan's Ministry of Economy, Trade and Industry (METI) proposed the idea of an Asian Economic and Environmental Community, which places importance on environmental issues in addition to economic issues. This proposition may be considered as an extension of CEPEA.

CEPEA: The Impacts & Obstacles

A CEPEA study group was set up and began its work in June 2007 after having an endorsement by the EAS leaders. The group submitted a report and recommendations to the ASEAN+6 economic ministers in August 2008. The study group argues that the objectives of CEPEA are to contribute to deepening economic integration in the region and to help narrow development gaps.

To achieve these objectives, the study group proposes CEPEA include programs on three themes – economic cooperation; trade and FDI facilitation; and trade and FDI liberalization. Economic cooperation includes various subjects such as improvement of infrastructure and human resource development, while a facilitation program includes improvement of customs procedures, protection of intellectual property rights and others. These three programs are also adopted in the Asia-Pacific Economic Cooperation (APEC) forum and EAFTA. Indeed, these are called “three pillars” of APEC. The difference between CEPEA on the one hand and APEC and EAFTA on the other hand is the order of priority. Recognizing the importance of narrowing development gaps between the member countries, CEPEA places priority of the three programs in the descending order as cooperation, facilitation and liberalization, whereas the reverse order is adopted by both APEC and EAFTA. It should be added that the report proposes special programs to deal with the issues related to the environment and energy, and information and communication technology.

Expected economic impacts of CEPEA were examined by using an economic model in the report (*Table*). According to its simulation results, the East Asian countries will benefit from CEPEA as they can expect their combined GDP to increase by 2.11%. This increase is greater than the cases for EAFTA or five ASEAN+1 FTAs (five minilaterals). The importance of economic cooperation can be observed by comparing the results from Simulation 1 (trade facilitation and liberalization) with those from Simulation 2 (trade facilitation and liberalization, and economic cooperation). GDP growth rates of developing members will be increased substantially when economic cooperation is included in the program.

Despite the expected positive economic impacts of CEPEA, this concept is likely to face obstacles. The most difficult is likely to be the opposition to trade and FDI liberalization from potentially and negatively impacted groups. Specifically, import and FDI-competing industries or non-competitive industries will oppose liberalization because it would put competitive pressures on them. These industries vary depending on the countries. For example, agriculture is a non-competitive sector in Japan and South Korea, while high technology industries such as automobiles are such a sector in China, India and other developing countries. It should be noted that protection of the high-tech sector by developing countries may be justified based on the infant industry protection argument, while protection of agriculture by resource-poor countries is difficult to justify.

Japan's Role in Regional Cooperation

The Japanese economy is currently faced with various unfavorable developments. Japan's population is declining and rapidly aging, resulting in declining economic dynamism. Government debt is accumulating to a record-high level to put an economic burden on future generations. To successfully deal with these problems and to brighten prospects, the Japanese economy has to improve the use of its resources, that is, labor and capital, and attract capable human

TABLE
Effects of CEPEA on GDP(%)

	EAFTA (ASEAN+3)		(ASEAN+1)x5	CEPEA (ASEAN+6)	
	Sim.1	Sim.2	Sim.1	Sim.1	Sim.2
Japan	0.44	0.44	0.10	0.54	0.54
China	1.66	4.72	0.20	1.77	4.84
South Korea	3.56	3.55	0.20	3.72	3.71
Indonesia	1.74	3.94	1.00	1.94	4.14
Malaysia	5.83	8.62	3.30	6.21	9.00
Philippines	3.94	6.28	2.20	4.18	6.52
Singapore	4.22	4.24	2.30	4.40	4.42
Thailand	4.49	7.02	2.80	4.78	7.32
Vietnam	7.08	9.67	5.00	7.33	9.92
Other Southeast Asia	0.88	2.91	0.50	0.92	2.95
Australia	-0.09	-0.09	0.20	1.35	1.35
New Zealand	-0.06	-0.06	0.10	1.87	1.87
India	-0.10	-0.10	0.50	1.30	3.45
Hong Kong	0.00	0.00	0.00	-0.01	-0.01
Taiwan	-0.08	-0.08	0.00	-0.10	-0.10
NAFTA	-0.01	-0.01	0.00	-0.01	-0.01
EU15	-0.01	-0.01	0.00	-0.01	-0.01
Rest of the World	-0.06	-0.06	0.00	-0.08	-0.08
ASEAN	3.60	5.67	2.14	3.83	5.89
ASEAN+3	1.18	1.93	0.30	1.30	2.05
ASEAN+6	1.02	1.68	0.31	1.30	2.11
World	0.22	0.38	0.06	0.28	0.47

Note: Simulations 1-2 are as follows:

Sim.1: Trade liberalization and facilitation

Sim.2: Trade liberalization, facilitation and economic cooperation

Shaded areas indicate FTA members.

Source: CEPEA Report

resources and FDI. It is also important for Japan to assist the rest of East Asia to achieve high economic growth and to expand the relationship with rapidly growing East Asian countries. Looking at Japan's future this way, one should understand the importance of the successful implementation of regional cooperation programs within the framework of CEPEA for Japan. It should be quickly noted that CEPEA is also important for East Asia because it would promote its economic growth.

Japan has contributed substantially toward regional cooperation in East Asia through various ways, including technical assistance such as the preparation of the CEPEA report and the establishment of ERIA, whose goal is to become an East Asian version of the Organization for Economic Cooperation and Development (OECD). These efforts will undoubtedly prove to become important contributions to regional cooperation. However, Japan is also expected to contribute to regional cooperation by opening up its market to products from the rest of East Asia. A case in point is the opening up of its agriculture market as part of CEPEA. Immediate market opening would cause serious damage to Japan's agriculture, but gradual opening combined with appropriate structural reform would not only reduce the adjustment cost but also improve competitiveness of the agriculture sector. What is needed is careful formulation and implementation of appropriate policies and the political leadership to carry out the necessary tasks. **JS**

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