

How to Integrate Regional Economy in East Asia



Author Ke Long

By KE Long

The major nations China and Japan have had a hard time overcoming their diplomatic row in the aftermath of the crisis involving the disputed Senkaku Islands (Diaoyu in Chinese) in this region. Japan is involved in territory problems in Northeast Asia not only with China but also with South Korea and Russia. It is difficult to overcome such problems because all parties insist on the ownership of territory regarding islands between Japan and its three neighbors – China, South Korea and Russia. These territory problems have presented Japan with difficulties in rebuilding confidence with the neighbors.

It is unusual that the prime ministers of Japan and China did not meet each other during their stay in New York. The Chinese government is concerned about domestic nationalism because such nationalism could shift towards anti-government activities.

The economic and industrial map in East Asia has had a makeover in the last 20 years. The Chinese economy has grown to have the second largest GDP in the world. The US and European economies in particular are still stuck in recession because of the financial crisis since 2007. China has emerged the most hopeful driving force of the global economy. Economic interdependence between China and Japan has also become very strong. China is a critical external trade partner for Japan; Japan is the most important supplier of high technology to China. We therefore hope that the two major neighbors can come together to strengthen regional cooperation.

Rethinking Role of Regional Powers

Most will likely agree that East Asia needs strong leadership to create a regional common market and strengthen regional cooperation. But this goal is difficult to realize when China and Japan “see different dreams in the same bed,” as is the current situation. It is a tragedy for Asia that its two leading nations struggle against each other. They need to build trust and establish a hotline as a mechanism for overcoming various difficulties.

China is rising as a regional superpower and will have a growing impact on the world economy and diplomacy. The Chinese government recently announced that it will increase its quota share in the IMF. Although China is not a member of the G-8, it has been a main player in global society. When reevaluating the kind of role China will play in global society, I think that we need to integrate the major country into global organizations like the OECD in order to play under the same rule.

Here we also need to clarify the role China wants to play in the region and in the world. For example, the Chinese government is endeavoring to internationalize the renminbi, a challenge to the global currency system. We have become accustomed to the present system based on the US dollar. Although there is still a long way to go for China to internationalize the renminbi, it will greatly influence

the world economy when it realizes its goal.

What can we do in the coming stage to integrate China into global organizations? First, we need to encourage China to reform its political and other domestic systems and enhance transparency. I want to emphasize that every nation must play under the same rules. This is the first condition for regionalization and globalization.

When looking at the history of cooperation in East Asia, we find that the ASEAN countries took advantage in the 1970s and 1980s. Japan strengthened its relationship with ASEAN by pumping ODA and FDI into ASEAN countries. Japan had a close relationship with ASEAN 10 years ago, but it was shocked when ASEAN didn't vote for Japan's permanent membership on the UN Security Council. How to rebuild a close relationship with ASEAN is therefore problematic for Japan. Japan and ASEAN were the two big regional powers in East Asia.

In the early 1980s, however, China started to open its doors and reform its economic system, and has grown into a regional superpower. And China has strengthened its relationships with ASEAN countries, particularly after entering the WTO in 2001. Former Premier Zhu Rongji called on ASEAN to establish a bilateral FTA by 2010, and China promised to open its markets, including agriculture, to ASEAN. In doing so, China gained ASEAN's trust. No doubt both China and Japan saw each other as rivals in terms of establishing close relationships with ASEAN. Both regional superpowers want to gain an upper hand in the region. This is basically not bad news for Asia: such competition helps open markets in East Asia. But now it is time for Japan and China to build a close relationship. This is the meaning of the proposal by former Japanese Prime Minister Yukio Hatoyama to establish an East Asian Community. Actually, we now have three regional powers in the region: Japan, China and ASEAN.

Confirm Possibility of FTA

In global society we have the WTO to improve and guarantee free trade, but this kind of multilateral framework is not functioning well to ensure free and transparent international trade. Many bilateral free trade frameworks have been suggested in the past two decades to increase free trade and strengthen industrial competition, some of which have been realized. The most powerful free trade framework is the European Union (EU), which not only provides a free trade mechanism but also has a regional common currency. European countries had to come a long way to work together, but they finally realized their goal to create a free market regionally. As the second largest free trade framework in North America, NAFTA is also quite significant. The United States, Canada and Mexico, the three member countries, have strong complementary industrial structures.

In 1997, we experienced the Asian currency crisis. The lesson from this crisis is that we cannot expect to sustain economic devel-

opment by depending on exports to the United States and Europe. To realize sustainable and stable economic development, we need to create regional economic cooperation and establish a regional FTA.

It is significant for our region to establish an FTA in order to strengthen industrial competition. In the past four to five decades, Asia has emerged as a global manufacturing center, but we are not yet a world market. Asia's economic development is based on a simple export expansion model. Specifically, this model encourages the flow of FDI into the region, establishes many factories to produce labor-intensive consumer goods such as toys and shoes, and exports these goods to the United States and Europe. Asian emerging economies increased their dollar-based assets through this development model. As a result, most Asian countries upgraded their industrial structures and enhanced their manufacturing competitive strength.

But these days Asian emerging economies are facing new problems concerning industrial overcapacity. Even Japan has lacked efficient policies to overcome such problems. The past couple of decades are now called the "lost 20 years." How can the challenges of deflation and overcapacity be overcome? The only efficient solution is to look for an expanding market, and in the meantime reallocate the capacities domestically and regionally.

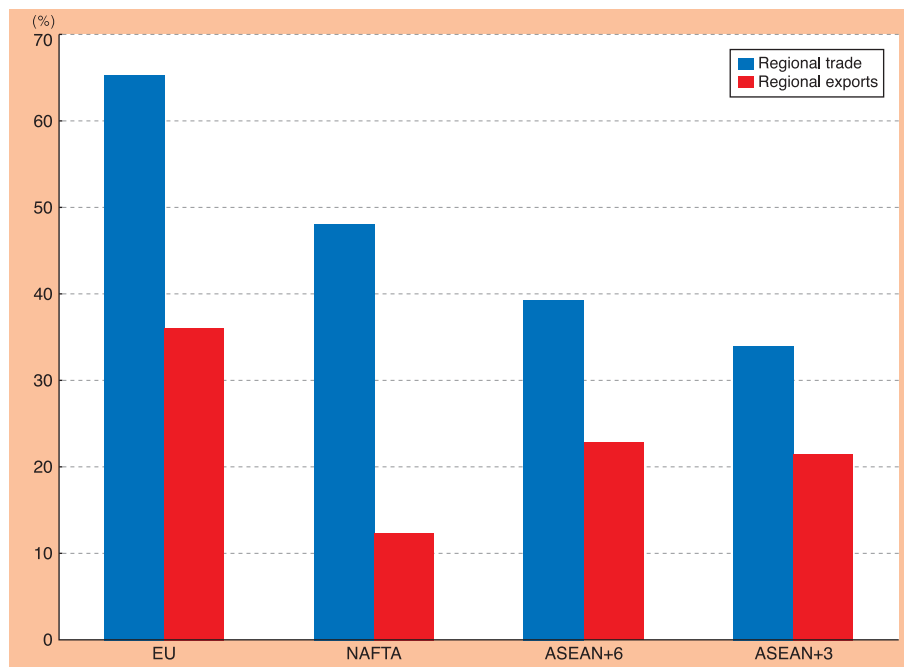
When Zhu Rongji called on ASEAN leaders to sign an FTA with China and promised to open agriculture and other markets 10 years ago, ASEAN leaders clearly changed their attitude and agreed to sign the agreement. From this case we know that we took the first step. Now it is time to embark on a second step.

Stop Argument about ASEAN+3 or +6

China and Japan cannot be expected to work together when they see each other as rivals. China has risen to become a superpower. The three regional powers including ASEAN need to create a platform to discuss how to overcome regional difficulties.

We will face many challenges such as how to sustain economic development and create a framework for economic cooperation, including financial cooperation. The lesson of the 1997 Asian currency crisis is to create a function to protect our financial system. Since then, East Asian countries have created a multi-currency swap agreement, the so-called Chiang Mai Initiative, to supply foreign currency

Share of regional trade/exports in world total



Source: Development Research Center (DRC), China

liquidity in the case of emergencies. We are also discussing how to rebuild the Asian bond market regionally.

We remain mired in the recession that began three years ago because of the financial crisis. The crisis started from the United States and impacted on European countries and the rest of the world. We must create our regional common market as soon as possible. This is the background behind the necessity for creating an FTA in the region. But now China and Japan are arguing about issues surrounding the FTA, such as the kind of FTA to be created and how many countries will participate in the framework. It seems Japan wants to create an FTA including ASEAN (10) and another six countries, while China wants the FTA to be limited to ASEAN and Japan, China and South Korea. The key point here is whether to allow the United States to participate in the framework.

This problem is not about the framework of an FTA, but rather concerns leadership. Personally I think it is pointless to argue about members such as who can participate and who cannot. The critical point is to make clear which framework is more feasible for the nations in the region. The goal to sign the agreement could be divided into two or three steps. Here the most important point is to have a clear timetable, while clarifying the concept of the FTA is also necessary.

Every country in the region must recognize the need to cooperate and do more to open markets under a regional FTA framework. This must be a plus-sum game.

JS

Ke Long is senior fellow, Economic Research Center, Fujitsu Research Institute.