

Regional Economic Integration — Where Are We Going?

By Kazumasa Kusaka

At the end of January, we heard US President Barack Obama highlight in his State of the Union address the fact that export growth had accounted for one-third of US GDP growth and that 98% of exporters are small businesses. For Japan, GDP growth may well depend on FTA negotiations, which are the core of Abenomics' third arrow — a “growth strategy”. However, the US administration is reported to be facing a struggle to sell the benefits of FTAs to Congress in this election year. Fast track negotiating authority — now called “trade promotion authority” — is essential for leaders in risking their own political capital in such negotiations. With fast track negotiating authority, the US Congress can approve or disapprove but cannot amend; therefore foreign leaders need not worry about the risk of renegotiation. It was this authority that made the complex and difficult negotiations of the Uruguay Round and the NAFTA possible.

It is rather paradoxical that the conclusion of such negotiations needs a political environment of economic growth to alleviate some of the pain while economic growth needs an increase in trade and investment which the negotiations can deliver.

What is happening in the real world? Cross-border supply chains have been expanding. Bilateral trade statistics do not reveal the entire picture and bilateral specialists or country desk officers fail to grasp the true picture. From the perspective of Washington, the United States has recorded an almost \$2 billion deficit in iPhone trade with China, but as a WTO-IDE-JETRO report indicates, when measured on a value-added basis, China's contribution to the deficit is only 4% while component-manufacturing countries contribute significantly.

According to the report, in the 1980s regional production networks consisted of bilateral relationships between Japan and an Asian producing country, but this changed to multipolar networks around 2000 with the US, China and Japan serving as the center. Now China plays the central role. A global supply chain has emerged and trade patterns have changed dramatically. Institutional arrangements, such as the GATT, GATTS, WTO and bilateral FTAs are years behind in terms of the need to change, and are increasingly losing relevance to the real needs of the economy and the private sector.

Japan's efforts in the trade policy area are aimed at catching up with reality. Both the Regional Comprehensive Economic Partnership (RCEP) and the Trans-Pacific Partnership (TPP) are important for the region, not only in terms of their geographical dimension but also in terms of the coverage of investment, intellectual property rights, and trade in services.

Against such economic realities, Abenomics is providing FTAs with a third arrow to achieve increases in productivity and correspondingly higher wages through structural reforms, to be accelerated both by the FTA negotiations themselves and trade and investment that should accompany them. FTAs are not simply aimed at increased overseas demand; what matters more is the dynamics that the negotiations and trade create.

A healthy Japanese economy will contribute to robust economic growth in the region. But more importantly, the mindset of the Japanese private sector and public sector has changed from being inward-looking to looking more towards the Asia-Pacific region. This change in attitude and psychology will lead to a new situation in which Japan, in both its public and private aspects, together with like-minded countries, will assume a bigger role in providing public goods in this region.

What is driving this economic integration? As we know, intra-regional trade in Asia is comparable to that of the European Union. This happened before FTAs were agreed and well before tariffs had been removed. The major driving force was foreign direct investment, and this was driven by the private sector. This trend accelerates when businesses become aware of the launch of FTA negotiations and perceive them as an opportunity for improvement in the business and investment environment in the countries concerned. This indicates that the perception or awareness of business opportunities is key, and the confidence built is then translated into a private sector vote of confidence.

This year marks APEC's 25th birthday in Beijing. The APEC process started with the objective of removing barriers for this region's sustainable growth. In the beginning, the challenge was how to feed the region's growth by securing oil, gas and coal as well as financing power plant investment. But some institutional arrangements which were effective in fostering growth in regional economies may now have outgrown themselves and rather be functioning as constraints. This is exactly the reason why we tackle trade and investment liberalization as the core of our action agenda in APEC and FTAs.

It is time for us to go back to the spirit of APEC in managing both the economic risks of emerging economies and geopolitical risks.

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