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**East Asian Regionalism and Japanese Business Strategy<sup>1</sup>**

**By**  
**Ippei Yamazawa**

**1 . Overview of East Asian Economies**

The international community started recognizing East Asia as an economic zone in the late 1980s. At that time, while Korea and ASEAN countries were achieving miraculous high economic growth, China was succeeding in its open economic policies and also starting to show good economic performance. In the first half of that period, Japan enjoyed 5% economic growth and drove economic growth in Asia, but collapse of the bubble economy led her to long-term its economic stagnation.

East Asian economies are characterized by economic development dynamism. Figure 1 shows the population and GDP per capita in East Asian economies. While they vary greatly in their population size, they also have a tremendous gap in per capita income from some \$200 in Myanmar to \$37,000 in Japan. Korea ranks 5th and has a GDP per capita at about \$10,000. This shows a gap in their economic development stages, which in turn represents the gap from when they started their economic growth. Japan started its modern economic growth in 1885. NIEs (i.e., Hong Kong, Taiwan,

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<sup>1</sup> The author conducted a lecture tour with Toshihiko Kinoshita and C.H.Kwan and benefited from discussions at Chulalongkorn University (Thailand), Tianjin Nankai University (China) and Yonsei University (Korea) in September in the 2003 “Japan in Asia” project of Japan Forum on International Relations. This paper is abridged and updated version of our joint report (Yamazawa, Kinoshita and Kwan 2003), focusing on the author’s contribution.

Korea and Singapore) started their export-oriented economic growth in the 1960s, while some leading ASEAN economies (Thailand, Malaysia, the Philippines and Indonesia) started to follow the same path in the 1970s. China launched its open economic policies in the early 1980s to turn its socialistic planned economic regime into a market-oriented economy, while Indochina CLMV economies also executed similar policies in the 1990s. All the East Asian economies enjoyed high economic growth for ten years after 1987. Japan also achieved a moderate 4%-5% economic growth for the first five years. The World Bank report called this the "East Asian Miracle."

East Asian countries achieved their economic growth mainly through the industrialization process in which labor-intensive light manufacturing industries came first, followed by capital- or technological-intensive metal, chemical and machine industries. This type of industrialization first occurred in leading Asian countries and, then, in other follower economies. This phenomenon is also known as "flying geese" economic development. This means that East Asian economies have successfully kept pace with globalization.

On the other hand, the 1997-98 Asian currency and financial crises led to temporary stalemate in their high economic growth. Except for China and Hong Kong, East Asian currencies suffered tremendous devaluation against the US dollar. Their exchange rates are still hovering at 20%-70% lower than immediately before the crises. Even Korea is still suffering some 30% lower currency value than in the pre-crisis era and hasn't yet restored its GDP on a US dollar basis (Figure 2). This means there has been 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.

China's economic growth, as well as rapid progress in its corporate activities since the late 1990s has not only stimulated other East Asian economies, but also generated insecure feeling and posed threats among East Asian countries. As most East Asian policymakers are expecting China to play the role of engine for East Asian economies, they are trying to leverage China for their own economic recovery. However, because some enterprises or industries are facing direct competition with Chinese products, they feel insecure about powerful China and are starting to strongly call for import

restrictions and other safeguard measures on Chinese products. This is what happens in East Asian economies in the globalization era.

During recovery from the currency crisis, East Asian countries also started seeking regional integration. Policymakers proposed a variety of bilateral FTAs as well as regional integration concepts, such as China-ASEAN, Japan-ASEAN, and ASEAN+3. Some of the East Asian governments have negotiated and actually entered into such FTAs. Many economists agree that East Asian economies will see obstacles in the short run but will form their own economic zone in the middle or long run. Will it become the third economic area like the European Union or the FTAA (Free Trade Area of the Americas)? What is an effective economic system required to form an East Asian economic area?

This paper first examines recent economic growth in ASEAN countries, Korea, China and Japan as well as their policies to address globalization. Then, the paper analyzes recent regional integration trends in East Asia and also discusses the proper path and effective economic systems for forming the East Asian economic community.

## **2 . Policies for Globalization in ASEAN Countries**

ASEAN countries and Korea have led the way in miraculous economic growth and also contributed to forming the East Asian economic area. Although ASEAN countries and Korea both suffered from significantly negative impacts from the 1997-98 currency/financial crisis, they have made are making full efforts to revitalize their economies. Actually, most of them have entered into a new orbit of autonomous economic growth. This section briefly explains how these countries have been working on economic recovery.

### **ASEAN's recovery path**

Although ASEAN countries (original members unless otherwise stipulated) have largely overcome their currency crises and started to enjoy economic recoveries again, significant problems and confusions still remain. ASEAN economies have faced oil crises and many other problems since the 1970s, but they have flexibly managed to overcome these problems and always yielded better economic performance than other

developing countries in the world. In a word, ASEAN countries used to be winners in the world. However, 1997 was the turning point. The World Bank used to highly evaluate East Asian economies as a success model, but the currency and financial crises inflicted heavy damage, and the international community suddenly labeled their performance as a bad example. Although these economies had not necessarily shown most ideal macroeconomic performance by that time, nobody predicted the growing risks for economic crisis in the region. While investors suddenly lost their confidence and speculatively withdrew significant investments, ASEAN governments (Thailand and Indonesia) and Korea failed to conduct proper countermeasures and had no choice but to ask the IMF for help. The international community should have understood at an earlier stage that the crisis stemmed from systemic weaknesses of the current international economic and financial regimes, rather than blaming ASEAN governments. However, many Western influential mass media reported the simple criticism that the currency and financial crises in East Asia were mainly attributable to the too close relationship between political and economic communities ("crony capitalism") or, in other words, poor political/business governance in East Asia. Such criticism was proved not to the point after a while, but by then, it was too late to restore investors' confidence in the region. Similar crises also occurred in Argentina and Russia at later dates.

After accepting requests for support, the IMF conducted various "structural reforms" to eliminate "crony capitalism" based on traditional recognition that significant current deficits would result in currency speculation. However, these reforms delayed economic recovery and yielded more embarrassing problems. Later, the IMF itself acknowledged that its economic measures had errors.

Since China had placed severe restriction on capital transactions, the country didn't suffer from such negative impacts. Malaysia, which restricted capital transactions after the crisis and implemented different policies from the IMF, has only suffered a marginal crisis setback. Korea made full efforts to conduct domestic economic reforms, which were more than the IMF had expected. As a result, Korea successfully got back on the right track for economic recovery. Thailand also struggled with the crisis, but its political stability and ongoing business-friendly policies successfully attracted the largest mount of FDI among ASEAN nations and significantly improved its

macroeconomic performance.

Indonesia saw the most severe negative impacts from the currency crisis. The Suharto Administration strongly opposed the IMF's reform agenda but finally collapsed. Indonesia's becoming a democratic nation was like a blessing from above. Most Indonesian people support the present democratic regime, which is rather a welcome change for us. On the other hand, this also resulted in a weaker economy and the delayed formation of a new economic regime. These negative impacts have led to an unnecessary power game between the central and local governments and discouraged foreign firms from direct investments. Because Indonesia will have general and presidential elections in 2004, we can expect to see hot political debate in the nation.

As mentioned above, ASEAN nations have significantly different political and economic conditions. However, even though they have conflicting interests with one another, it is time for ASEAN nations to cooperate with one another. They also face the difficult problem of how to properly deal with new ASEAN member states: CLVM nations.

### **Strengthening intra-ASEAN cooperation**

When the currency and financial crises occurred in these economies, Japan quickly offered a significant amount of financial support, correctly identified defects in the IMF reform agenda and provided proper warnings. Japan also offered new types of support programs to Asian nations. As one of these programs, Japan tried to establish the "Asia Monetary Fund," but strong opposition from the United States prevented its formation. On the other hand, Asian economies successfully launched the Chiang Mai Initiative under the "ASEAN+3" framework. "ASEAN+3" nations also started their own plan to issue local-currency-dominated Asian Bonds in order to utilize Asian private savings for investments in Asian nations.

In addition, most Japanese experts agree that the nation should import more products from ASEAN nations as long as Japanese products face no direct competition with ASEAN products. Thailand exports rice, rubber and shrimp, while Vietnam exports rice and coffee. If Japan imports them and exports its comparative advantage products to these nations, both sides will mutually gain benefits from trade. It is also

important that Japan provides CLMV nations with market access to its domestic market because CLMV nations have comparative advantage in agricultural products.

ASEAN nations are making full endeavors to attract foreign direct investments. All economists agree that Thailand is the most successful in this regard. Indonesia, which has the largest GDP in the ASEAN region, also recognizes foreign direct investment is important in general terms because the Indonesian President has advocated this year as the "2003 Investment Year." However, the country is less business-friendly than China or other ASEAN economies, as terror and political instability are unfavorable to foreign businesses, and labor legislation excessively protects workers. The Philippines is also politically less stable and has weaker infrastructure than Thailand or Malaysia. ASEAN nations suffer from two problems: Many labor-intensive products made in ASEAN are facing direct competition with Chinese products; and, generally speaking, ASEAN nations have no specific strategy to compete with China, which has a larger domestic market and better infrastructure, and attracts excellent human resources more easily. This is because ASEAN nations are not successfully sharing their common interests.

ASEAN nations must form alliance among themselves and attach more importance to technology that will generate niche products that are better than Chinese products. They also need to implement proper policies that will mitigate possible exchange rate fluctuations. Although the currency crisis didn't directly result from "crony capitalism," ASEAN nations must bear in mind that respecting business contracts, protecting intellectual property rights and providing due access to fair trial are important factors in foreign firms' investment decision-making process. The international community expects Japan to beef up intellectual support in these fields and to give a helping hand to ASEAN's prosperity in the 21st Century.

### **3 Korea's reform efforts**

No economist could have correctly predicted that the 1997-98 currency crisis would have such severe negative impacts on Korea. The crisis had adverse effects on Korean Won only in November 1997, four months after its outbreak. Similar to ASEAN currencies, short-term capital flight pushed down the Won value by 50% at the maximum. The Korean government asked the IMF for help and accepted strict

adjustment measures, which in turn led to more severe socio-economic stagnation. As Korean people had firm determination for economic reconstruction, President Kim Dae-jung conducted various radical structural reforms.

First of all, Seoul reorganized its domestic corporate structures, including chaebols. The government required private corporations to cut off loss-making operations that had been excessively expanded during Korea's high economic growth era. Seoul achieved grand bargains between labor unions and chaebols, encouraged chaebols to swap over their business operations and implemented capital structure improvement plans, including foreign capital participation and credit-debit swaps. This reform led to Daewoo's bankruptcy and divided up Hyundai and the SK Group. Second, the government reinforced Korean financial institutions. After reorganizing government-affiliated banks that had granted excessive bad loans under instructions from the government or the central bank, Seoul newly established the Financial Supervisory Committee to make banks more efficient and transparent. Third, the government created safety nets for workers or micro enterprises adversely affected by the corporate and banking reforms. Excluding corporate employees in chaebols or government-affiliated enterprises, irregular workers account for half of the total workers in Korea. Korea needs to eliminate such dual-structured labor markets.

These radical structural reforms have rapidly improved the macroeconomic performance. Korea enjoyed economic growth at 10.9% in 1999 and at 9.3% in 2000. Although the collapse of the US IT bubbles pushed down the Korean economic growth rate to 3.1% in 2001, the economy started to enjoy 6.3% economic growth in 2002. Although the savings rate and investment rate are still lower than in the pre-crisis era (34%-37%, and 33%-35%, respectively), these rates took an upturn to 29%-37% and 26%-28%, respectively, and restored healthy economic fundamentals. The Korean Won value has also recovered and is now at 30% down from the pre-crisis era.

This year, although new President Roh Moo-hyun took office this year and aims at "participatory government" and "business hub in Northeast Asia," Korea faces serious economic problems. With the deteriorated economy, labor unions are engaging in strike action to oppose the sale of government-affiliated banks and the reorganization of national railways. These movements have posed obstacles for further structural reforms. In October 2003, in the middle of heightened political anxiety caused by his

aid's suspected misconduct, President Roh proposed a national referendum for the confidence of his administration in December. It is worried that it may further slow down the Korean reform efforts.

#### **4. Rising China and Its Impacts on Neighbors**

During the 1997-98 Asian currency crisis, China successfully avoided economic stagnation. Thanks to strict foreign exchange controls, China did not suffer serious short-term capital flight, despite repeated rumors about the possibility of a devaluation of the Chinese Yuan against the US dollar. In this way, China has enjoyed high economic growth for more than 20 years. Recently, China has started to pay more attention to equality, rather than simply focusing on efficiency as in the past in formulating its development strategy. The rising Chinese economy poses challenges for Japan but provides economic opportunities as well. If these two nations successfully compensate for each other's weaknesses and make the best use of each other's strengths, there will be a "win-win game" situation.

##### **Challenges for building a *xiaokang* (well-off) society**

Since the reform and door opening process started in the late 1970s, China has seen high economic growth at about 9% a year and significantly improved its living standards mainly in coastal provinces. With its industrial power rising, China is attracting attention as "the world's factory." However, competition has become keener as globalization and the transition to a market economy proceed, and the low efficiency at state-owned enterprises has become more and more apparent, aggravating the bad-debt problem facing state-owned banks. On the other hand, various discriminations on loans to private corporations have posed obstacles to further economic growth. In addition, there has been a larger income gap between the rich and the poor. Rising unemployment and low income for farmers are destabilizing Chinese society, resulting in weaker private demands and promoting deflation.

Aiming at eliminating such imbalances and achieving stable and sustainable growth, Beijing is now aiming at building an "all-round *xiaokang* society." "*Xiaokang*"



originally means "somewhat affluent life," and Deng Xiaoping made it the goal of China's modernization when market-opening reforms were started. To this end, the government aimed at doubling China's real GDP in 1990 from the 1980 level to satisfy basic subsistence and also at redoubling it in 2000 to achieve "*xiaokang*." The government also aimed at increasing GDP per capita and catching up with mid-income-level countries before the middle of the 21st Century to achieve higher living standards and complete China's modernization. The Communist Party National Congress in autumn 2002 confirmed that the Chinese economy had basically achieved the first stage of *xiaokang*. The Conference set out a new goal to build an "all-round well-off society" and to maintain 7.2% annual economic growth until 2020 in order to quadruple GDP from the 2000 level.

The new target, "all-round well-being," means a more comfortable life and more equal income distribution than in the present "initial stage of *xiaokang*" (Figure 3). Although the national average has reached the "initial stage of *xiaokang*," not all Chinese citizens have attained it. Even in 2000, some 30 million people, including some urban residents, were still living below the subsistence level. While a considerable number of Chinese citizens who have solved the subsistence problem have not reached the "*xiaokang*" level yet. To achieve the "all-round well-off society," the government has to accelerate development in the central and western provinces as well as rural areas so that all of China's 1.3 billion people can benefit from modernization.

Judging from the experience of foreign countries that have already achieved the all-round *xiaokang* society, China needs to build a fair and competitive market, rule of law, a democratic government, a proper system to protect private property, and a social security system. While political reform is the most difficult task among these challenges, even the Communist Party leaders understand that this is inevitable. In 2000, then General Secretary Jiang Zemin announced the "Theory of Three Represents." According to this theory, the Communist Party represents advanced productive forces, advanced culture and the fundamental interests of the majority of the people. Based on this theory, in his speech at the Party's 80th Anniversary in July 2001, he officially accepted capitalists as Communist Party members. In this manner, changes in economic base are paving the way for reforms in the superstructure.

### **Aiming at a Win-Win Game in Japan-China relationship**

As Japan has been suffering from long-term economic stagnation, more and more Japanese people are feeling the threat of China that has seen reforms progressing steadily and enjoying economic development. However, there is still a significant gap in industrial power between Japan and China. In this sense, Japan and China have a complementary relationship, rather than a competitive one. Although some Japanese products face competition with Chinese products in international markets, they account for only 16% of Japan's total exports to the United States, for example (Figure 4). This contrasts sharply with the much higher degree of competition between the ASEAN countries and China. For example, more than 80% of products made in Indonesia, compete with China in the US market. Complementary between Japan and China should mean a "win-win game" that benefits both countries.

The complementary relationship here has two meanings: China's strengths are Japanese weaknesses; and, on the contrary, China's weaknesses are Japan's strengths. China's strengths lie in its fast expanding market, particularly in such areas as housing, automobile and distribution, and in its competitiveness in labor-intensive products, thanks to its low wage level. On the other hand, China is weak in technology and has serious environmental problems. Japanese firms tend to focus upon China's strengths when doing business with China, but they should have stronger confidence in their own.

For example, the Japanese media has changed its tune regarding China's position from "the world's factory" to the "world's market" after China's entry to the WTO. In line with this, Japanese firms used to regard China as the production base for their exports, but they have started focusing on selling more products in China. Since the Japanese and Chinese economies complement each other in many ways, there should be a variety of successful business models. Individual firms should avoid paying excessive attention to market sentiments and prepare their China business strategies, fully recognizing their own strengths and weaknesses and those of their Chinese business partners.

In doing so, they need to correctly understand whether Japan or China has the market advantage and production advantage in the products or industries concerned.

The wage level in China is much lower than in Japan, but it does not necessarily mean that China is able to manufacture every product at cheaper costs than Japan. Under the current circumstances, China does not have first class brands or technologies and must depend on low wages to gain competitive edge. In contrast, Japan is still internationally competitive in its technology-intensive products. Although China is seeing rapidly higher income levels, it is still a developing country with a GDP per capita at some \$1,000 and must have different consumer behavior from those of industrialized countries. As this shows, the answer to the question of whether China is a "factory" or a "market" will naturally differ from one industry to another.

With China's economy rising, Japanese firms need to reconsider their business strategies, and the Japanese government must also redefine its industrial policies. In doing so, Japanese firms and the Japanese government are hesitating between a positive attitude that looks at China as an opportunity and a negative one that looks at China as a threat.

By taking a positive attitude toward China's rapid economic growth, Japanese firms should transfer their less competitive operations overseas while at the same time redirect more resources into promising operations. Shifting declining industries to China will leave Japan new room to develop a more sophisticated industrial structure. In this process, the Japanese economy will regain its competitive edge.

In contrast, by taking a negative attitude, Japan's less competitive industries leverage their political advantage to lobby for protection from Chinese imports. Policymakers and entrepreneurs are asserting the "China Threat" as a useful excuse for hiding their own faults. If Japan tries to further delay its reform efforts by diverting people's attentions from the essence, the resultant costs will not come cheap.

## **5. Structural Reforms in Japan**

### **Signs for recovery from a decade-long stagnation**

Japan has been suffering from long-term economic stagnation for more than 10 years, because the country has seen a matured economy, aged population with declining birthrate as well as its export industry's rapid overseas investment due to

trade frictions and quick yen appreciation in the late 1980s, and the post-1991 "bubble economy" after-effects (i.e., a large amount of bad debts resulting from a sharp drop in stock/land prices).

On the other hand, there are some good signs for recovery both from microeconomic and macroeconomic perspectives. In FY 2002, many firms recorded the record-high profits. They began to expand domestic equipment investment and to increase R&D. The fact that many firms began to regain confidence is very good news for the future. Intellectual property-wise, Japan ranked the second only next to the United States, exceeding Germany in number of obtaining international patents. Net international revenues on royalty and fees of Japanese firms have turned to be positive. As of March-end 2003, non-performing loans of major Japanese banks reduced by 15.5% to the rate of 7.2% from 8.1% at September-end 2002. New businesses have increased in the arenas of electric/electronic related industries, welfare for the aged and software. As far as IT is concerned, the usage of high-speed/super high-speed broadband has risen considerably; 2.5 fold of applicants of ADSL connection in the past one year. Personnel-dispatching and child-care businesses could increase sizably due to deregulation.

In its August 2003 monthly report, the Japanese government upwardly revised its economic forecast, recognizing that higher stock prices and better US business performance had improved domestic production activities and also led to favorable employment conditions. Its November report conveys that real GDP growth rate in July – September reached 2.2 % on an annual basis after the 3.5% growth in April – June. The Japanese economy has already continued positive growth for seven consecutive quarters. However, GDP deflator has continued to fall over five years.

Japan's economic stagnation for these ten years (i.e., the so-called "Lost Decade") has comprised a dual crisis both from macroeconomic and microeconomic perspectives. From the microeconomic viewpoint, Majority of Japanese firms used to exclusively focus on competition for market share, but such a traditional business model is no longer effective. Both the government and Japanese firms undoubtedly need to find a new framework suitable for the globalization era. This means that Japan needs to significantly change its traditional "success model.". For instance, corporate efforts to aim at becoming 'Only One' not 'Number One' in use of high level technology will

be the right way. Importance of corporate governance would not be too exaggerated in this context. Tens of Japanese firms have seemingly attained the international standard from such aspects. We should be careful, however, about the widening U.S.'s twin deficits which might well give further uprising trend of yen exchange rate, having reached as high level as ¥110 per U.S. Dollar, given the disapproval attitude of G-7 against the intervention in the foreign exchange market. It may damage again Japanese economy which narrowly came up to the recovery level.

### **Substantive systemic reforms and corporate structural transformations**

Japanese people are well aware that international affairs around Japan have changed drastically in the post-Cold War era and that no reform at this moment would deteriorate the existing excessive capacity and redundant employment. Stagnant domestic demand and continuous deflation are attributable to such domestic factors. Cheap Chinese products have partly accelerated the problem. However, the inflow of such cheaper products would normally result in better terms of trade for Japan due to income effect.

Unfortunately, structural reforms will require much time in Japan's post-war political arena where powerful leadership is difficult to exercise. Briefly, the political decision-making process plays a vital role in upgrading government policies and reducing subsequent high cost economy. In this sense, Japanese people should try, albeit democratically, to amend the political system in order to legislate proper policies. By doing so, the Japanese political system will be more rule-based and improve its transparency.

With recent changes in corporate structures as well as requests from private corporations, the Japanese government has been making efforts to revitalize Japan's socio-economy and also implementing institutional/regulatory reforms in succession. In June 2002, the CEEP (Council on Economic and Fiscal Policy) adopted a structural reform plan that calls for reforms on tax structure and government expenditures, including public infrastructure, social security and local government's firm revenue sources. Although there have been particularly hot debates on postal service and highway construction, the future direction has already become clear. In April 2003, the

Diet passed legislations for revitalizing domestic industries and establishing structural reform special zones. In particular, the latter bill is attracting attention because this would defy the stagnant economy. Japan needs to revitalize its economy by making full efforts to execute these structural reforms as soon as possible. If successful, Japan will be able to play more important roles in Asia.

### **Overseas presence of Japanese firms**

Many Japanese firms, especially auto and auto-related industries and electric/electronic industries, have actively expanded their business operations overseas since the mid 1980s. With significant changes at home and abroad, they are redefining role-sharing in East Asia. Although Japanese firms put in more money to expand their businesses in North America rather than in Asia (except for 2002 when the September 11 attacks had significant adverse effects), such investments aim at expanding their own production/sales bases for addressing local demands in North America. In this sense, this will not yield directly significant impacts on the Japanese and Asian economies.

However, it should be noted that many Japanese firms enjoy significant resources from their direct investment in North America for their huge R&D activities . Incidentally, since Japan's industrial structure and comparative advantage are complementary with those of China or ASEAN, successful leverage of such a complementary relationship will lead to a Win-Win situation. In this sense, ASEAN and China are both main partners for Japan. While Japanese firms further expand their business operation in China, they are actively reorganizing or strengthening their existing networks in ASEAN as well adjusting themselves toward the integrated ASEAN market (AFTA). Due to the recent SARS outbreak, Japanese firms have recognized anew that diversified production bases are extremely important. This means that they should and will not put all eggs in a single basket (China).

## **6. Toward East Asian Community**

### **Regionalism in the context of globalization**

East Asian economies are struggling for undertaking structural reform addressing globalization individually. Either fast or slow in their implementation, they are all annoyed at adjustment difficulty. But they are headed at large in the right direction. On the other hand, regionalism is gaining popularity in East Asia. Do they not contradict with each other? Are the globalization efforts not impeded by the increasing regionalism?

The regionalism while addressing 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 state governments need to attract foreign and domestic firms within their borders to maintain economic prosperity. To attract corporations, they must provide business-friendly environments, which will require various deregulation efforts. While worldwide deregulation is the most ideal, it is politically difficult. Therefore, regionalism provides an alternative solution: Neighboring countries agree to open their markets and ease their regulations among themselves. This trend became apparent in Western Europe at the end of the 1950s and became widespread worldwide in the 1990s. East Asia didn't see formal regional integration because the market economies and socialistic economies long divided up the region. However, regionalism became apparent in East Asia in the late 1990s. It should also be noted that the 1997-98 Asian crisis forced East Asian countries to recognize the necessity for regional cooperation.

Although the WTO Doha Round started last year, regionalism is gaining popularity rather than getting weaker. Since worldwide liberalization is the best solution but usually poses significant challenges, regionalism is normally regarded as the second best. But it is gaining popularity 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 that mutually opens up their markets and eases regulations within the group, an outsider country fearing discriminatory treatments will thus join the group or form a different group. Undeniably, the effects of competitive liberalization partly contributed to worldwide proliferation of regionalism

in the 1990s. In September 2003, at Cancun Mexico, the WTO ministerial meeting failed to conclude its mid-term review of the Doha Round negotiation, which will accelerate this preference for regionalism.

There are various proposals for regional integration, such as bilateral FTA, multilateral FTA and the East Asian Economic Community that covers whole of East Asia. As one of the bilateral FTAs in East Asia, Japan and Singapore signed their bilateral FTA in early 2003. South Korea and Chile reportedly agreed to sign their bilateral FTA. Japan and Mexico will soon start their FTA negotiation. In addition, policymakers are considering Japan-South Korea FTA, Japan-Thailand FTA, Japan-Philippines FTA and Japan-Malaysia FTA. As a multilateral FTA, ASEAN countries formed AFTA. China also started FTA negotiation with ASEAN, and Japan has also asked ASEAN for FTA negotiation. Obviously, competitive liberalization is a driving force for these regional integration. Although Japan used to attach exclusive importance to GATT-WTO global negotiation, the country is now paying due attention to the Japan-South Korea FTA in 1998. Japan knows the effects of competitive liberalization and will get left behind if it continues to exclusively focus on the WTO.

Since the FTA eliminates tariffs and non-tariff barriers among member states while maintaining them against outsiders, non-member states have criticized that imports from member countries would replace those from non-member states. GATT Article 24 allows FTA as a transitive measure for worldwide free trade as long as the FTA effectively encompasses every field, avoids higher obstacles to non-members and eliminates tariffs among member states within 10 years. However, recently, more and more countries have been practically negotiating comprehensive FTA that would also mutually recognize member countries' systems and rules, protect intellectual property rights and liberalize foreign investments. A good example is the Japan-Singapore economic alliance agreement that was signed in early 2002. Under such comprehensive FTA, trade creation will exceed the trade diversion effect. In addition to the trade liberalization effect, such comprehensive FTA will ease domestic regulations and also modify common structural deficiencies in East Asian economies. Such drastic reform is difficult because it will face strong opposition from certain vested interest groups. The regionalism is a pragmatic approach for addressing globalization in East Asia.



## **China- Japan Rivalry in approach to ASEAN**

What is the future of East Asia, if we recognize FTA as a practical approach? Will East Asia achieve economic prosperity as one of three poles like Europe and America? East Asian policymakers are considering bilateral and multilateral FTAs as well as FTA that would cover the whole of East Asia. In particular, seeking competitive liberalization, China and Japan are both urging ASEAN to conclude FTA. When the ASEAN+3 summit was held in Phnom Penh last November, China signed the comprehensive economic cooperation framework agreement with ASEAN after a one-year long negotiation. China also announced that it would sign FTA in 2010-2015. When China joined the WTO last fall, the country promised ASEAN countries to open its domestic market for eight agricultural product categories in the earlier stage, such as fresh vegetables, fruit and ornamental plants. At the ASEAN + 3 Summit in Bali in October 2003, China installed its liberalization package with Thailand and announced the promotion of 'strategic partnership with ASEAN'. Japan also agreed on starting Japan-ASEAN Comprehensive Economic Partnership with ASEAN but the Japanese media expressed their concern about getting behind China in approaching to ASEAN.

On the contrary, Japan need not to worry about getting behind China.. Japan and ASEAN have already had close economic ties for more than 30 years. Japan- ASEAN trade far exceeds the China-ASEAN trade both in value and trade intensity (Tables 1 and 2) and major Japanese firms have already established business network with in ASEAN. However, the traditional Japan-ASEAN relationship was composed of bilateral relationship between Japan and individual ASEAN members. Unlike traditional bilateral economic cooperation between Japan and ASEAN, the Japan-ASEAN comprehensive economic partnership agreement aims at economic integration between Japan and the unified ASEAN market. (Institute of Developing Economies, 2003)

If AFTA is successful, ASEAN will form the single market. If Japan signs FTA with the unified ASEAN, Japanese firms and ASEAN corporations will both benefit from newly emerging business opportunities. Expecting AFTA to be successfully formed this year, many firms, mainly Japanese corporations, are establishing their ASEAN-wide business networks. It will require smooth distribution and telecommunication among ASEAN countries. To realize this, ASEAN countries

certainly need to ease custom procedures, liberalize transportation/telecommunication services and create more coherent rules of origins and standard certification. The comprehensive economic alliance is a new type of FTA that will address these challenges (Fig. 5 and 6)

Japan also has its own problems. Liberalization of agricultural product markets are delayed because Japanese farmers have excessively powerful political influence and are strongly opposing such liberalization. However, many Japanese understand that Japan and ASEAN will both benefit from opening up agricultural product markets. Some ASEAN countries are interested in expanding their labor immigration opportunities to Japan. Although labor movement is politically difficult for many countries, Japan will undoubtedly accept labor inflow from foreign countries due to its low birthrate and aging population. Japan has already been working on smoother labor movements by mutually recognizing foreign country's engineer tests. Japan mutually recognizes IT engineer certificates with Myanmar, the Philippines, Singapore, Thailand and Vietnam. Japan should beef up these efforts more smoothly. As FTA acts as an experimental apparatus to liberalize the domestic market on a limited scale, Japanese people need to form a consensus to achieve FTA as soon as possible.

### **Difficulties on the '+3' side**

Although both Japan and China are asking ASEAN to sign an FTA, neither Japan nor China is proposing a Japan-China FTA. At the time of ASEAN+3 Summit in Bari, top political leaders of China, Japan and Korea jointly announced that trilateral cooperation among Japan, China and Korea would be promoted, but only experts are conducting research on this matter (Trilateral Joint Research, 2003).

The Japan-Korea economic alliance, a part of such trilateral alliance, is also facing difficulties. The Japan-Korea FTA aims at dynamically nursing globally competitive firms and push up their productivities and reduce costs by intensifying competition between Japanese and Korean firms, involving strategic alliance among them, and inviting European and American firms. Only comprehensive FTA can address these challenges. However, Seoul opposes such FTA because they fear possibly expanded trade deficits to Japan, stronger competitiveness of Japanese firms and emotional distrust of Japan. Seoul demanded that Japan implement "Pre-FTA measures" to

eliminate the emotional distrust. These measures include a smoother visa granting process and more Narita-Seoul airline flights. Japan implemented all of these measures before the 2002 Soccer World Cup. While business people and government officials tend to support the Japan-Korea FTA, strong opposition still remains at the public level. Both governments are not so willing to have FTA negotiation. Both Japan and Korea need to make efforts to make progress. As these two countries are actively working on structural reforms to address globalization, they recognize that the creation of an integrated market is one of their top priorities. Without it, these two economies cannot survive in the globalization era. (Yamazawa, 2001)

It is desirable to involve ASEAN+3 countries, Hong Kong and Taiwan in the future in forming the East Asian community. By doing so, East Asian economies will form their own economic zone comparable to American continents and Europe. It is economically viable to form an East Asian economic zone. However, economic disparity among Japan, Korea and China, difference in economic regimes, lack of experience in regional economic integration as well as negative after effects from the early 20th Century have prevented successful formation of the East Asian economic community. We have no choice but to try everything possible, such as bilateral or multilateral schemes. However, if the region has China-ASEAN FTA only, the region will suffer from trade diversion effects. East Asia should aim at the East Asian Economic Community as its ultimate goal, while making parallel efforts to form bilateral and multilateral FTA. (Yamazawa, 2003)

## **7. Toward East Asian Economic System**

Many East Asian economists agree that the region will form its own economic zone in the middle or long run. Large economic disparity will still prevail among Japan, Korea, China and ASEAN countries, but such disparity will yield complementary role sharing and also contribute to economic integration in the region. East Asia will become one of the world's most powerful economic areas like the American and European economic zones. The region will be more of an open economic zone that has active trade, investment relations and capital flow with other regions because of individual economies' high trade and investment dependence with outside. If East Asia is economically integrated, its constituent countries will share a common economic

system. What is a proper common economic system for East Asia? Even the experts have yet to reach consensus on such an economic system. I would like to conclude this paper by briefly explaining my ideas on the East Asian common economic system.<sup>3</sup>

As already mentioned earlier, every country and corporation is seeking globalization. Without it, they cannot maintain their international competitiveness or survive in the global competitive market. In the globalization era, efficiency is the most important factor, and corporation-based economic liberalism will 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. 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 standard as it is. They feel that the Anglo-American standard has alien components that are different from East Asian economic systems as well as its traditional, social and cultural backgrounds and human relationships. Americanization spread all over the world after WWII and made us think in ways that differed from our traditional philosophy. The Anglo-American standard is closely connected with democracy, which though far from being the ideal, is however a stable political system. Democracy has led to a high-level of material prosperity. However, the Anglo-American standard also has negative aspect because it places the highest priority on economic merits and tends to lock up economic inequality. It also embraces individualism and dilutes Asian traditional family ties.

Unlike a revolution that leads to the sudden adoption of a new constitution, we will gradually form our new economic system in East Asia. Since we will gradually transform our current systems into globalization-compatible economic systems, our present systems, corporate structures and employment practices will partly survive, rather than totally disappearing. As each of the East Asian economies has its own system, East Asia will embrace more heterogeneous systems and institutions than those in American continents or in Europe. In this sense, we have to pay due attention to diversity in East Asia. However, our new standard should yield sufficient efficiency to

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compete with the Anglo-American model. It must have maximum flexibility for coexistence and also generate minimum homogeneity that will not prevent East Asian economic integration.<sup>2</sup>

There is a term, "Asian value," which expresses the identity of East Asia. It sometimes allows derogation from the basic rule and also means flexibility. If we use it as an excuse to avoid addressing globalization, the result will yield dangerous effects. We must 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, observe other country's reforms and mutually understand their difficulties and outcomes. Without such honest efforts, we will not be able to form the East Asian Community.

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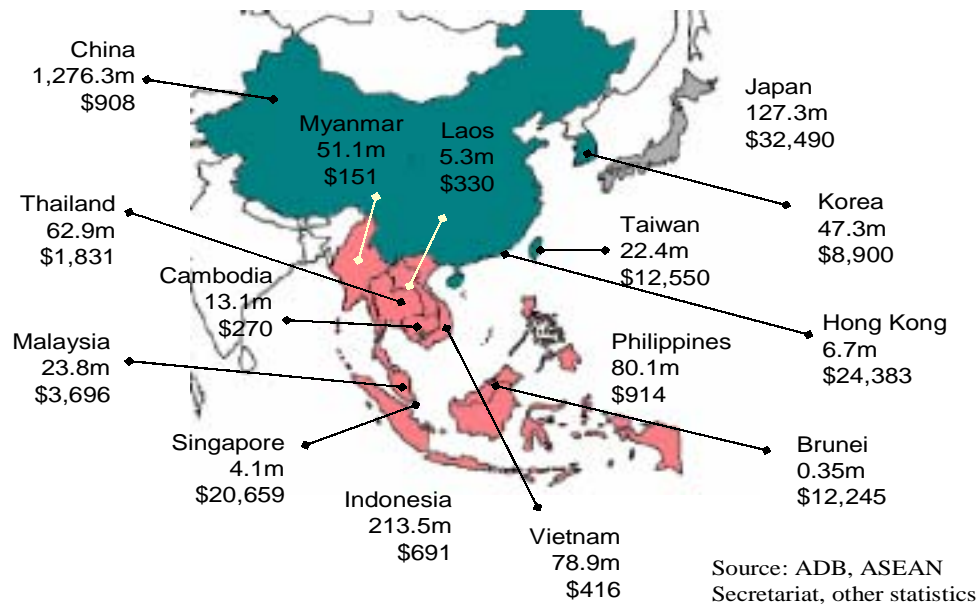
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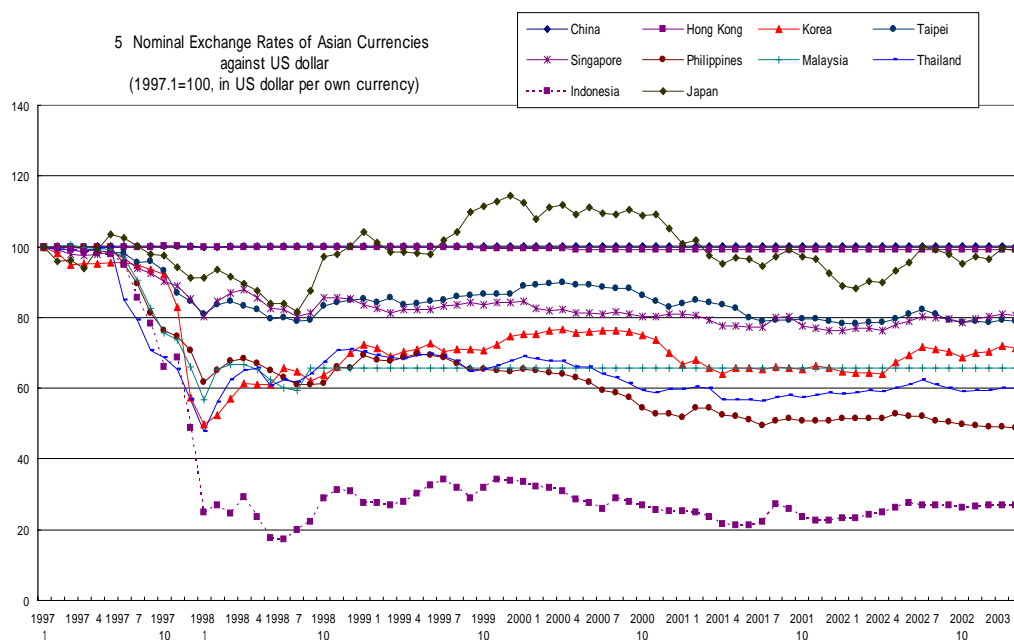
<sup>2</sup> Some participants stressed the need for assimilating closely to the Anglo-American standard at our seminars in Thailand and Korea.

## Figures & Tables

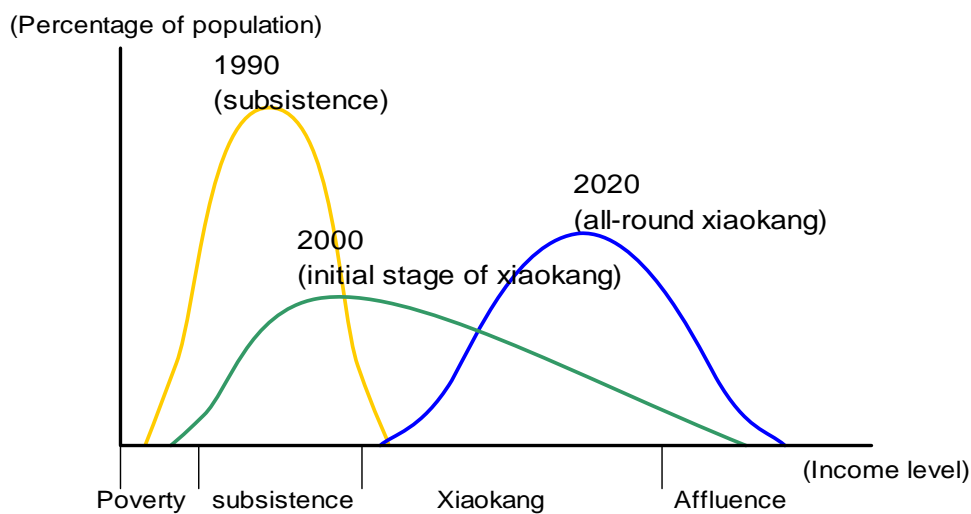
**【Figure 1】 Map of East Asia: Population and GDP per capita (US\$) in 2001**



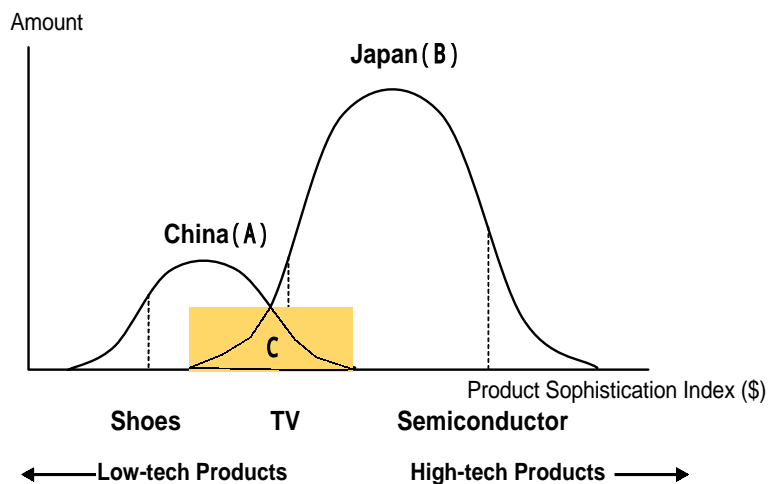
**【Figure 2】 Nominal Exchange Rates of Asian Currencies against US dollar (1997.1=100, in US dollar per own currency)**



**【Figure 3】 The Path to an All-Round XiaoKang Society**

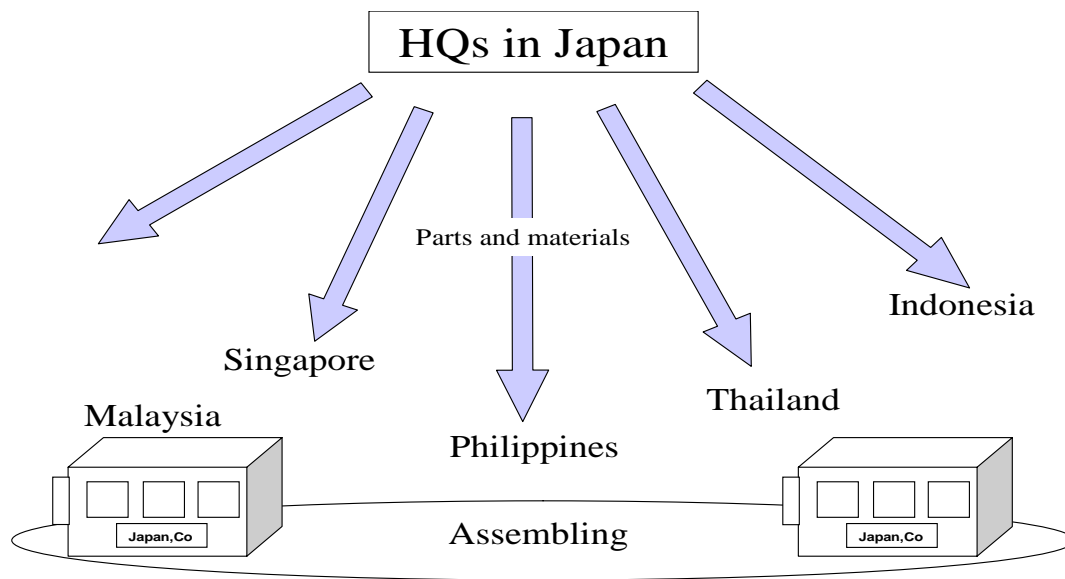


**【Figure 4】 Competition Between China and Japan :  
Degree of Overlap in Industrial Exports**

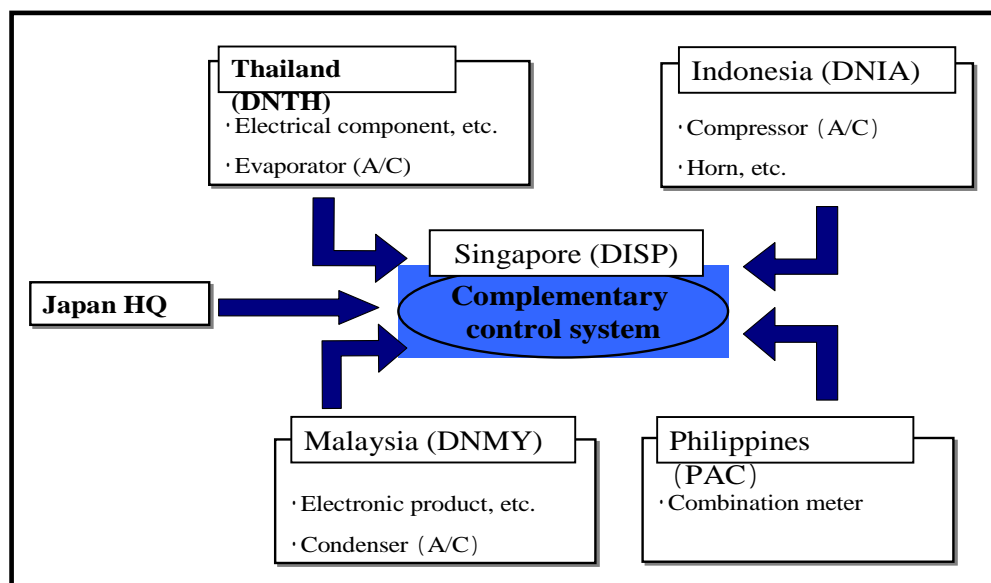


Source: Both Figures 3 and 4 are borrowed from C.H.Kwan. Refer to Yamazawa, Kinoshita, and Kwan (2003) for details.

【Figure 5】 Traditional Procurement System



【Figure 6】 Complementary System – DENSO Co., Ltd.



Source: Institute of Developing Economies (2003)



**【Table 1】 Trade Flow within East Asia (Million US\$ )**

Export		Japan	Korea	China	ASEAN
Japan	1990		18,574	6,145	32,066
	2000		31,828	30,356	68,186
Korea	1990	12,638		585	5,215
	2000	20,466		18,455	20,033
China	1990	9,327	2,268		3,493
	2000	41,654	12,799		16,633
ASEAN	1990	27,000	5,122	2,268	27,500
	2000	55,945	18,171	16,179	93,075

**【Table 2】 Trade Intensity between the Four**

Export		Japan	Korea	China	ASEAN
Japan	1990		3.08	1.29	2.33
	2000		2.64	1.91	2.52
Korea	1990	2.75		0.54	1.68
	2000	2.22		3.22	2.06
China	1990	1.99	1.62		1.1
	2000	3.13	2.04		1.18
ASEAN	1990	2.77	1.77	0.99	4.17
	2000	2.49	1.72	1.16	3.92