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ECONOMIC INTEGRATION IN EAST ASIA
AND ITS IMPLICATIONS FOR JAPAN AND THE UNITED STATES

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**Panel I: Economic Integration in East Asia
and Its Implications for the U.S. and Japan**

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Panel I: Economic Integration in East Asia and Its Implications for the U.S. and Japan

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MR. KOBAYASHI: Thank you very much, Mr. Yabunaka. We would now like to begin the first panel, “Economic Integration in East Asia and its Implications for the United States and Japan.” I would like to introduce the panelists. This is Syujiro Urata, Professor of Economics at Waseda University and an alumnus of the Graduate School of Asia Pacific Studies. He will be serving as a panelist as well as the moderator. Next to Professor Urata are Dr. Lim Wonhyuk of the Korea Economic Institute and Dr. Takashi Shiraishi, who is Vice President and Professor at the National Graduate Institute for Policy Studies. From the Brookings Institution, Dr. Richard Bush, Senior Fellow and Director of CNAPS. Lastly, Dr. Chu Shulong, a current CNAPS Visiting Fellow from China.

SYUJIRO URATA: Ladies and Gentlemen, this is Panel One. As the program says, we are going to discuss “Economic Integration in East Asia and its Implications on the U.S. and Japan.” I am the moderator and a panelist. First of all, as the moderator I must fulfill my duty; after that, I will ask the panelists to speak. At the very end, if there is anything that I should add, I will make my remarks as a panelist.

Vice Chairman Yonekura of Keidanren and Deputy Foreign Minister Yabunaka have already spoken; what I am going to say may overlap with previous speakers. In any case, very briefly I would like to talk about the progress of East Asian economic integration as well as the implications for the U.S. and Japan.

In East Asia, what is the state of affairs regarding economic integration? Within the region of East Asia, trade is becoming very important. To be more concrete, intraregional trade, that is, trade among East Asian countries, occupies more than 50 percent of all trade of East Asian countries. In Japan this number is often cited. Using this number, a lot of people say that economic integration is making progress in East Asia. Why are we experiencing this phenomenon? Up until the late 1990s, because of a market mechanism, regional integration advanced. I think that was the usual interpretation. Let me be more specific. In East Asia, Japanese companies, American companies, and other multinationals made direct investment very vigorously. They made direct investments in East Asia, and a production and logistics system were established. As a result, in the region of East Asia, the production and logistics network enhanced the trade dependency on intraregional trade. That is the usual interpretation. As I said earlier on, market mechanisms led this integration. People often say that it is a market-driven regionalization.

The backdrop to regionalization of this nature is that the trade policies and investment policies were liberalized in many of the East Asian countries. However, at this moment in time, as Mr. Yonekura and Mr. Yabunaka mentioned, infrastructure has not been completed within the region of East Asia.. Trade investment policy may be liberalized, but still there are many obstacles and hindrances remaining. Market-driven regionalization did create progress, but after 1997, especially after the financial crisis in East Asia, institutions were built up. So this type of regionalization is called institution-driven regionalization. To be more specific, many bilateral and multilateral FTAs were

concluded. Some ideas floated around regarding regional FTAs, but as of now, official agreements for East Asian institutions have not been completed.

Why do we have those bilateral and multilateral institutions? For one reason, trade liberalization at the World Trade Organization (WTO) has been delayed. The U.S. and other countries in various regions are concluding FTAs and Regional Trade Agreements (RTAs). In response to such moves, East Asian countries became interested in FTAs and EPAs. Another important factor is that in 1997, the financial crisis hit Asia. Because of the crisis, countries were devastated. They came to realize that regional cooperation is needed in order to avert the recurrence of such crises. I think this is the second reason for the vigorous institution-building.

In various countries of East Asia, it is almost as though a competition exists to complete several FTAs—China, Korea, Japan, ASEAN countries. Of course, this session would like to focus on the U.S. and Japan.

There is the KORUS FTA. They have come to a general line of agreement. Negotiations have concluded, and what remains is the approval of both parliaments. Across the Pacific Ocean, FTAs are being built. This reality has been a very important influence on the course of FTA-building in East Asia.

Next I would like to briefly review the U.S.-Japan economic relationship. In the global economy, what are the positions of both the U.S. and Japan? Looking at the numbers of 2004, the U.S. occupied 29 percent of the world's GDP, whereas the Japanese occupied 11 percent. Putting them together, the U.S.-Japan economies comprised 40 percent of the whole world. Looking at the bilateral economic relationship, especially for the Japan, the U.S. is very important. In the concrete domain of trade, the U.S. is Japan's largest export market; regarding imports, China is the largest country from which we import, and the U.S. is the second largest. The U.S. is the largest country for direct investment, and the largest country from which investment comes to Japan.

On the other hand, what is Japan to the U.S.? Regarding trade, Japan is the third largest export market and the fourth largest import market. How about investment? Investment in the United States is of course very important, and Japan is the second largest country from which investment comes. But the view from Japan is that Japan itself is not a major investment destination. Concretely speaking, only 3.6 percent of U.S. investment comes to Japan as direct investment. I will give you the numbers very briefly. I talked about the importance of the bilateral relationship, citing some numbers, but qualitatively the importance of the U.S.-Japan relationship can be emphasized. The tax treaty, the investment guarantee agreement, the social security agreement, are a few in a multitude of agreements were concluded between the two countries at the June 2001 summit meeting, the U.S.-Japanese Economic Partnership Agreement. Under this banner, dialogue continues between the two countries.

Very briefly I talked about regional integration in East Asia, as well as economic relations between Japan and the United States. That information could be used as your

reference in our discussion. Now we will go to the panel discussion. The panelists will speak about the economic integration in East Asia and its impact on the U.S. and Japan. However, if possible, I would like them to address the following two points in their remarks. First of all, the process of economic integration in East Asia is expanding very rapidly. As such, what kind of impact will it have on the U.S.-Japanese economic relationship? The second question I would like our panelists to discuss is this. As institutional economic integration is making progress in East Asia by means of FTAs, what is the desirable state of affairs for the economic relationship between Japan and the United States? Here I am talking about institutions. Regarding this notion of an U.S.-Japan FTA, what are the views of the panelists? Two speakers on this panel are from China and Korea, so the U.S.-Japan economic relationship will not be the only focus. These panelists can also talk about economic integration in East Asia and its relationship with the United States.

First we will hear from Dr. Lim Wonhyuk of Korea. Please take the floor.

WONHYUK LIM: Thank you for the introduction. It is my pleasure to give a presentation at Keidanren.

I would like to speak about economic integration in East Asia and the KORUS FTA, the recently concluded free trade agreement between Korea and the United States. I picked the KORUS FTA because I think it is representative of the evolution of discussions on economic integration in East Asia. In my talk I will split time evenly between economic integration in East Asia and the KORUS FTA. First let me give a brief historical overview of economic integration in East Asia. I think it can be divided into three phases: before the 1990s, during the 1990s, and after the 1990s.

After 1945 and before the 1990s, there were political constraints on economic integration in East Asia. There was the Cold War between the United States and the Soviet Union, so there was a natural limit to how much economic integration Asian countries could pursue. At the time, a lot of countries in East Asia pursued export-oriented industrialization and the focus was more on global economic integration rather than on regional integration. Countries such as Korea, Singapore, and others pursued export-oriented industrialization targeting overseas markets in extra-regional countries like the United States and European countries, so at the time the focus was more on globalization than regional integration. As Professor Urata mentioned, especially since the 1980s there has been a formation and expansion of international production networks, thanks largely to Japanese multinationals in Southeast Asia.

During the 1990s, my view shifted toward a greater emphasis on regional integration. Some factors contributed to this new trend. There was the removal of political constraints on economic integration after the end of the Cold War, so transition economies like China and Vietnam became viable partners for economic cooperation in the region. There was also a search for defensive regionalism in East Asia in response to NAFTA and the E.U., and a key factor during this decade was the resurgence of China. There was a search for a multilateral arrangement designed to minimize the risks

associated with the shifting balance of power. The idea was to put China within a larger framework of multilateral cooperation so that a shifting balance of power can be contained, or so that the risks associated with the shifting balance could be contained. As Professor Urata mentioned, there was also the 1997 Asian economic crisis, and interestingly there was a sense of regional identity that gave further impetus to regional integration. Based on international relations theory, this had more to do with constructivism than liberalism or realism. After the crisis, there was a collective sense of regional identity in East Asia, and institutions like ASEAN Plus Three really began to take off. This left the question of where the United States fit within this larger framework.

This is a fairly famous picture of President Suharto of Indonesia signing the International Monetary Fund (IMF) agreement while Michel Camdessus, the Director of the IMF, kind of looks on with his arms folded. In 1997 there was, in my view, a sense of humiliation among East Asian countries, and that gave impetus to this new sense of regional identity and for some time much progress was made in multilateral institutions like ASEAN Plus Three. I would also add that relations among Northeast Asian countries—China, Japan, and Korea—were fairly good in this period. President Kim Dae-jung of Korea and Prime Minister Keizo Obuchi of Japan made a new declaration for a partnership for the 21st century. Korea-Japan relations were more cordial than ever before and there was the genuine sense that efforts toward an East Asian economic community were being made.

Looking back, it seems that was a narrow window of opportunity. I do not want to be definitive, but it seems to me that this narrow window of opportunity has largely closed, and after the 1990s, what we have had is this uneasy coexistence of cold politics and hot economics. There is a continuation of market-driven economic integration, and trade and investment are expanding in East Asia—not only among countries in East Asia, but also thanks to efforts on the part of multinationals from extra-regional countries. At the same time, international relations began to take an increasing order of importance in this more recent period, and the key factor has been the rise of China and what to do about it.

As I mentioned, in the 1990s, there were efforts on the part of East Asian countries to put the rise of China within the larger framework of multilateral cooperation in East Asia, but by the beginning of the 2000s, China had become so big, it was more realistic to talk about what China was going to do and how nations would respond to what China was doing, rather than try to control China's rise. In addition, there was a marked deterioration in relations between China and Japan, and Japan and Korea as well, and the China-Japan-U.S. triangle became of much greater importance in this latter decade. The emergence of historical issues like Yasukuni Shrine and the [inaudible] controversies also poisoned the atmosphere for serious trade negotiations. Evolution of Korea's FTA strategy greatly paralleled the larger evolution of discussions on economic integration in East Asia.

Korea initially had a two-pronged approach. On the one hand, Korea pursued exploratory FTAs, so it signed free trade agreements with small countries that posed little risk to Korea's agricultural sector—countries like Chile, Singapore, and the European Free Trade Association (EFTA), made up of Iceland, Lichtenstein, Switzerland and Norway. These became natural partners during this exploratory stage. At the same time, Korea also tried to promote free trade agreements with select members of NAFTA and the E.U., countries like Canada, because it was thought that countries like the United States and the E.U. as a whole were too big for Korea to handle. It seemed easier for Korea to first deal with countries like Canada to get its feet wet, so to speak, and then move on to larger free trade agreements. That constituted one of the prongs of Korea's initial FTA strategy.

The second component was regional FTAs with strategic implications toward the building of an East Asian economic community. Korea-Japan FTA negotiations started in earnest in 2003, and there was also discussion about signing an FTA with China and also with ASEAN countries. This two-pronged approach lasted approximately until the end of 2004, when talks with Japan broke down and also FTA negotiations with China and ASEAN made only limited progress.

As we all know, historical and political factors played an important role in limiting the progress of FTA negotiations and, as a result, Korea began to seek new directions in its FTA strategy. There was an abrupt change in direction in 2005. In fact, it raised a lot of questions about the Korean government's motives in instituting this change because until 2003-2004, when research institutions conducted studies on the economic merits of free trade agreements, it was usually the case that China was viewed as the most desirable partner in terms of economic merits because its average tariff rate was relatively high and Korean manufacturers could benefit greatly by having preferential access to China. At the same time, the Chinese were beginning to say it would consider the sensitive nature of Korea's vulnerable sectors in agriculture, etc. So on economic merits alone, there was a lot of talk about signing free trade agreements with China in addition to Japan and ASEAN countries. What happened in 2003 and 2004 was that Korea-U.S. relations deteriorated quite a bit. Much of it had to do with rhetoric, in my view—things like a “balancer” in Northeast Asia and President Roh making some anti-American remarks as well. So although signing a free trade agreement with China might be economically sensible, it was viewed as political suicide, given the alliance relationship with the United States. Instead of concentrating on exploratory FTAs and regional FTAs with a strategic component, the Korean government made an abrupt change and decided to go for an FTA with the United States. In fact, Korea and the United States signed a deal just last month, which wound up being a very comprehensive FTA, and Korea is now pursuing FTA negotiations with the European Union. So instead of focusing on exploratory FTAs and regional FTAs, Korea switched to extra-regional FTAs rather abruptly; it remains to be seen what Korea's next step is going to be.

Since my time is limited, I going to show just a couple of graphs. This shows Korea's bilateral trade with the United States, Japan, and China. Korea normalized

relations with China in 1992, and as the black line shows, Korea's bilateral trade with China soared over the past decade-and-a-half.

So what does the KORUS FTA mean for regional integration in East Asia and for U.S.-Japan relations? Some observers contend that the KORUS FTA would create a domino effect that, due to trade divergence, will instigate an increasing call for a Japan-U.S. FTA, but in my view, the risks of trade divergence for Japan need to be weighted against the adjustment costs in vulnerable sectors. In fact, now I am sure how serious this trade divergence effect is going to be due to the KORUS FTA because the U.S. tariff rate, on average, is quite low, and Japan is producing many products within the United States, for instance automobiles. On the other hand, there is the chance that the KORUS FTA might create an impetus toward a domino effect in the political direction. A China-Korea FTA or a Japan-Korea FTA might receive a boost due to the conclusion of the KORUS FTA.

As I mentioned at the outset, KORUS FTA might mean that the old vision of an East Asian free trade area has now largely faded. There is continuing concern over the China-U.S. rivalry and the China-Japan rivalry, and, as Mr. Yabunaka mentioned, there is always controversy over the scope of membership. It seems to me that these days, the big question is whether to include India, Australia, and New Zealand; that is, to really expand the notion of East Asia.

At the same time, economic integration is going to continue and it is going to be largely-market driven, so this uneasy coexistence of cold politics and hot economics is likely to continue in the near future, even after the signing of the KORUS FTA. Thank you.

MR. URATA: Thank you very much. Next I would like to call upon Mr. Takahashi Shiraishi, Vice President and Professor at the National Graduate Institute for Policy Studies.

TAKAHASHI SHIRAISHI: Thank you very much. Takahashi Shiraishi is my name. I am not an economist. Regarding FTA and EPA, we have with us Dr. Urata, who is the foremost authority here in Japan, so I will not directly address this topic.

In general I want to talk about the U.S.-Japan alliance and East Asian integration, which I believe are not mutually exclusive or contradictory. In other words, the U.S.-Japan alliance, or having the United States as a hub and having a security pact between let's say Japan and Korea on a bilateral basis and characterize that as the hubs and spoke with the U.S. at the center. Such a security system is the foundation of order here in East Asia. In terms of security, East Asian economic integration is really based upon this foundation. It has an open character, and the United States will continue to be a very important trading partner in the midst of this East Asian integration. If that is how we perceive these two issues, I certainly have no opposing views.

Today I am going to share with you more of a long-term perspective. Can we say these same things for the long-term? When I think about this matter, I realize some very interesting points. [This study](#) was published by the Japanese Economic Research Center a few months ago. This relates to the long-term forecast for the world economy, the purchasing and power parity in 2000. Based on that, what will be the individual country and regional GDP based on the purchasing power parity in the year 2000? Citing figures, per se, does not really mean much, so if we look at Japan as the basis, what will this issue look like? That is how I want to interpret these numbers.

The Japan Economic Research Center provided its long-term forecast. In 2020 the Chinese economy will be four times the scale of the Japanese economy; in 2030 it will be five times the Japanese economy; in 2040 it will be six times the scale of the Japanese economy; and in 2050 it will be seven times—or very close to it. From 2020 until 2040, the Chinese economy will actually be slightly larger than the scale of the U.S. economy. In 2050, because of the difference in population growth, the size of the U.S. economy will actually surpass once again the size of the Chinese economy. As for India, in 2020 it will be 1.5 times the scale of the Japanese economy, and in 2050 it will be four times as large, comparable to the economy of the E.U. As for Asia, it will be 1.8 times the size of Japan's economy in 2020. That is the long-term forecast.

This is simply a long-term forecast based on purchasing power parity. Is this the best yardstick by which to measure the potential of the national economy? Of course this gives rise to various discussions. Maybe we should also focus on other factors, such as military strength. We can not say that the purchasing power parity only equals the power of the country.

However, if relative sizes of the economies were to shift on such a substantial basis, then significant growth can take place in the next forty years. So many of these countries with that type of forebearing in mind will be acting out. Of course, the emergence of China has been talked about on various fronts because of these factors.

Having said that, let me make a few points. This is perhaps a given, but if the distribution of power among Asian countries were to shift in such a dramatic fashion, then the order will have to shift as well. What order will ultimately emerge? We do not know that yet, but we do know that this shift in the East Asian order will be revolutionary. Will it totally collapse the current order and reconstruct a totally different order? I do not think that will be the case. I believe the current order will change in a very stable fashion and will actually evolve, will be more of an evolutionary nature. That is more desirable. Once again, how can we accurately predict the long term with regard to managing the order of East Asia? I believe this question is very important. There is only one response, and that is to maintain the U.S.-Japan alliance. If we combine the U.S. and Japanese economies from 2020 until 2040 based on the purchasing power parity, even though the Chinese economy will be larger than the U.S. economy, the combination will still continue to exceed the size of the Chinese economy

One other thing. It has been said that by the year 2050 the Chinese economy will be seven times the size of the Japanese economy. It is important to note that the Chinese economy is not a closed economy. On the contrary, Chinese trade dependence is already 80 percent. In that regard, inclusive of Japan and the United States, all of these countries' dependence on trade will actually increase and mutual independence will evolve further. If that is the case, then each of these countries and regions will have stakes in seeing a stable evolution of order. From that perspective, especially under Mr. Abe, the Japanese government is making efforts to at least adopt a fairly rational policy aside from the question of whether they really have a long term basis. Let me explain what I mean.

First, Japan wants to see further evolution in the U.S.-Japan alliance. That is what Mr. Abe has been saying. In that regard, the U.S.-Japan alliance must be maintained for the long term. I believe that is the message that the current government is sending out. Based on the Asia Gateway Initiative, the government is also trying to open Japan to the rest of the world, inclusive of Asia; they are trying to promote EPAs; and the government is also trying to contribute to the creation of a stable order here in East Asia. In terms of EPA and the promotion of regional economic integration, I believe this will actually raise the stakes in maintaining long term stable evolution of the order here in East Asia and Asia.

So if we adopt this perspective, if we consider both U.S.-Japan relations and the promotion of economic integration, the United States will have even greater stakes in the economy in East Asia. One necessity is to have an FTA between Japan and the United States. As I recall, even before Mr. Abe became the Prime Minister he was promoting a Japan-U.S. FTA. We must develop a study of an U.S.-Japan FTA. Also, we have ASEAN Plus Three and ASEAN Plus Six, but having Asia as a framework for the basis of a coordinating mechanism in Asia.

In one sense, that may not be totally a happy situation for the United States. In the 1990s this initiative garnered a great deal of attention and interest. However, it seems to have lost steam after the Asian financial crisis. How can we reinvent this mechanism that is APEC? I believe this is another challenge.

MR. URATA: Thank you very much. Next I would like to call on Dr. Richard Bush, Senior Fellow and Director of the Center for Northern Asian Policy Studies at the Brookings Institution.

RICHARD BUSH: I would also like to echo the thanks that were conveyed by President Strobe Talbott to the Keizai Koho Center for their outstanding efforts to put on this conference. We are deeply grateful to them.

I am honored to speak to this distinguished audience today. I don't believe I am qualified to speak on the topic of economic integration in East Asia. I am not simply being polite because I am in Japan, I just think I'm not really very qualified, but I can draw on the views of some people I respect.

It will not be news to this audience that Asian countries are working on an accelerating basis to create an institutional basis for the dynamic and deepening economic and business interdependence that has emerged within East Asia. For example, in January, economic ministers from the sixteen member countries of the East Asia Summit agreed to start an experts' study on a Japan-proposed free-trade area among their nations at an early date—a Japan-proposed free-trade agreement. At the same time, leaders of Japan, China, and South Korea agreed to conclude a trilateral FTA at an early date.

On May 4, economic ministers from Japan and the members of ASEAN reached an agreement on basic terms for an economic partnership agreement and plan to sign the agreement at a November summit. The next day, finance chiefs from thirteen Asian countries, the ASEAN Plus Three, agreed to launch a multilateral currency-swap scheme by pulling funds from their foreign exchange reserves to better protect their economies from financial crises. So there is a lot of activity, and the issue for me, as the American on the panel, is to address the implications for the United States.

It is clear that Asian economic regionalism is getting America's attention. President Bush pushed his competing idea of a free-trade area of the Asia Pacific at last year's APEC meeting in Hanoi. It is my understanding that there have been three types of arguments or rationales in favor of East Asian regionalism of all types. The first is functional, that regionalism is a way of deepening functional cooperation to manage an increasingly interdependent regional economy and the political forces that accompany it. The second type of argument is identity. That is, regionalism is a reflection and amplifier of an underlying regional identity or consciousness either of positive values or a negative sense of victimization. The third type of argument is regionalism as a collective weight, a joint call to action for increasing East Asian power in the world, and, for some countries in the region, for a counterbalance to the United States. A variant of this argument is that East Asian regionalism is an effective strategy to shape China to play a constructive role in the region. I will come back to these three rationales in a minute.

When American officials talk about East Asian regional integration they tend to make the following points. Number one, although Washington does not view exclusively Asian institutions and meetings as bad for its interests, it wants to ensure the strongest possible U.S. engagement in the region. Number two, the strategic and economic geography through which Asia can best build on its success is through trans-Pacific partnerships and institutions, not trans-Asian ones. Number three, if multilateralism developed in Asia is done in a way that pits one organization against another or one group against another, neither Asia nor the world benefits. Number four, regional and trans-Pacific forums should place more emphasis on outcomes and less on process alone. By tackling issues, institutions build confidence and maximize the benefits of coordinated collective action. And finally, free-trade arrangements are good as long as they are not trade diverting.

I can appreciate the logic behind this rather defensive stance. There is nothing wrong with any of these points, but I think they lack a certain realism. I, for one, do not see why the United States should get nervous about regionalism that springs from a desire

to express an Asian identity. I believe we should recognize that East Asian regionalism is an objective and strong reality and I think we should welcome it rather than resist it. I can fully understand the identity motivation behind the holding of an East Asia Summit. It should be no surprise that Asian identity should be a basis for Asian regional activity, and I am glad to see that the Bush administration is now considering signing the ASEAN Treaty of Amity and Cooperation so that in response to Asian wishes it might participate in future East Asia summits.

Similarly, to the extent that East Asian regionalism is caused by a desire to balance against the United States, there may be reasons for that desire and there may be countermeasures that Washington can take to do reduce or remove the impulse to balance. In my view, it is quite sophisticated to use regionalism to shape the rise of China. I hope it works.

It is when we come to the functional side of regionalism that I become puzzled. The reason for economic regionalism is simple enough. Transnational production networks have emerged in East Asia characterized by fragmented and modularized manufacturing processes, falling transportation costs, and production management simplified by the IT revolution. This regionalization of production has in turn driven the demand for a reduction in transaction costs; hence, bottom-up economic integration is propelling top-down state-led institution building in the form of FTAs and EPAs. The companies represented in this room understand this far better than I do because you do it every day.

Some friends in Asia say that Americans should not worry about this institution-building because it's focused on functional issues, and who can argue with that? The main reason to argue a little with it is that functions are not necessarily geographically defined, so some of the supply chains of which Asian production networks are a part often start in the United States and end up in the United States. They are not bound by geography at all. Their production aspect may be in Asia, but the total supply chain is not, so East Asian-only FTAs may not be economically justified. Moreover, even if the United States were not a factor, the functional argument doesn't necessarily hold. For Taiwan is very much a part of these functional networks, and the last time I checked, Taiwan is in Asia, but it is being excluded from regional economic arrangements because of the political objections of one party.

Finally, there are other functions such as environmental protection that are increasingly global in nature and will need global cooperation for their solution. Obviously there is a lot that can be done on a regional basis and that is good, but there may be global solutions as well.

A bigger question is the nature of the economic regionalism that is occurring and what it means for the East Asian economy. On the flight to Tokyo I read a very interesting paper written by Richard Baldwin of the University of Geneva that he did for the Asian Development Bank. He pinpoints the complexity of what he calls East Asia's "noodle bowl syndrome," not spaghetti bowl syndrome, but noodle bowl syndrome, a

muddle of bilateral FTA deals as opposed to true regionalism. He points out that even the ASEAN PRC FTA is really ten separate and different trade agreements, the ASEAN FTA is really forty-five different deals, and the discrimination that these arrangements imply has really yet to kick in. Once it does, things will get really complicated.

Baldwin notes two other dangers of this messy situation. First of all, the mandates of these FTAs have yet to be bound in the WTO and so are not irreversible. Second, the institutions needed to quickly resolve disputes and to prevent them from upsetting delicate region-wide time-sensitive production networks are weak or nonexistent. In brief, whereas economic regionalism was supposed to make life simpler for the corporations that do such a good job at sustaining the economic miracle of East Asia, the reality of competitive FTAs and EPAs may be making it more difficult, and once these FTAs are fully implemented, it may make it even more difficult. So I agree with the spirit of Vice Chairman Yonekura's remarks that these arrangements should be as multilateral and as high quality as possible, but we will have to see.

Therefore, if economic functionalism is not genuine without the United States, and if the economic regionalism that has occurred and will occur is not necessarily facilitating continued business integration in East Asia, then there is some logic behind President Bush's proposals for a free-trade agreement of the Asia Pacific. The leading private American advocate of a free-trade agreement of the Asia Pacific is Fred Bergsten, the President of the Peterson Institute for International Economics. He believes it would foster a gigantic liberalization of trade more than any current initiative, it would address the problem of the proliferation of bilateral and sub-regional preferential trade arrangements in East Asia, the noodle bowl problem, it would be a boost for APEC, and it would perhaps help jumpstart the Doha Round.

Bergsten's argument makes a lot of economic sense. Whether it will work politically is another question. The prospects for the renewal of the President's trade promotion authority seem brighter this month which is a precondition for any such proposal. Perhaps a convergence is possible between an FTA for the Asia Pacific and ASEAN Plus Three and ASEAN Plus Six, but the goal should be a more open business-friendly trade arrangement and not a more complicated noodle bowl.

But I think what is really important is Bergsten's point, the Doha Round, and the future of the global trading system, which is an important asset for the U.S.-Japan relationship. If East Asian economic regionalism is going to have a beneficial impact, the region's economic integration should be embedded in global economic integration. Starting an FTAAP may be the way to do that, but since it will take a long time to bring that to a conclusion, a decision to start is probably not a strong enough signal for a Doha Round. What is needed instead, I think, is joint action by the world's three leading trading nations, the United States, China, and Japan, to create a sense of urgency that Doha must succeed for the International trading system to thrive. Thank you very much.

MR. URATA: Thank you very much. We will go to the last panelist, Dr. Chu Shulong, from Tsinghua University. The floor is yours.

SHULONG CHU: Thank you. I am grateful for today's opportunity provided by the Keizai Koho Center and Brookings's Center for Northeast Asian Policy Studies.

I am also going to talk about economic integration. As we have watched Asian economic development in the past half-century, we have seen that the ranking order of economic growth has not changed fundamentally; that is, East Asia has continued to grow faster than most other parts in the world. Although it has been slower in the past 10 years, Asia still has an annual growth rate of 5, 6, or 7 percent. When we look at these developments, however, we can see some structural changes. When we look at economic relations, we have tended to look 20 years into the past. When we talk of Asian economic integration, we have tended to talk of integration with the United States and European trade investment, and later, in the 1980s with Japan. However, the greater portion of Asian exports and economic integration occur within the economies of Asia. Therefore, when we talk about economics or economic integration in Asia, we must acknowledge that at least half of this activity takes place within Asia. This is inter-Asia trade, inter-Asian economic relations. When we check the data on investment in Asian economics; you see that Japan, China, and Hong Kong comprise at least half of integration. That is the new trend of the past 15 years, in contrast to 50 years ago. This is a real structural change of economic relations and a structural change in regional integration.

We have some specific evidence. News media are now reporting that Japan and China are becoming the largest trade partners of more and more Asian countries. Ten years ago the largest trading partners of most Asian countries were the United States or the European Union. But now East Asian or ASEAN countries have become major trade partners with one another, and, as other panelists have already stated, interregional trade is quickly becoming a large part of Asian economies. I have read statistics suggesting that about 6 percent of Asian trade is with other Asian countries. Hardware integration has become institutional and software integration has also grown quickly in Asia. When we worked on Asian affairs 17 or 20 years ago it had no history, no sense of multilateralism. Now we hear people say that Asia has too many multilateral processes, and it is too complicated.

A couple years ago we heard criticism about the multilateral processes—that they were without any meaningful direction, but now we see Asian countries that are negotiating by means of FTAs or EPAs. These are not talk shops; there is real integration taking place. The East Asia Summit and ASEAN Plus Three, as well as other institution- and community-building meetings, have become acceptable concepts of Asian leadership for ordinary citizens.

Let me next talk about integration. I don't see any major negative impacts on Japan from hardware and software integration, because Japan itself is a major part of that process. Japan used to be the leader of Asian economic integration and trade investment and multilateralism, but in the 1990s Japan did not play a large role because its own economy was not so strong. I think Japan will resume the leading role for Asian economic integration in both hardware and software. In investment and trade, Japan is

still a major part of regional integration and the institutionalization of FTAs, EPAs, and the East Asia Summit. So I don't think Japan has been left out or weakened by regional integration.

Certainly Japan no longer monopolizes the role as the leader of Asian economic integration. China is increasingly sharing the leading role, and certainly there are some differences between Japan and China that create competition. I think it's a natural process, and it's not bad. We may have different priorities or preferences, but we have the same common interests and similar goals to promote regional integration and community building. I see that multilateralism, including economics, might create a channel to promote Japanese and Chinese relations and new roles in Asia, now and in the future.

As for the U.S., I think its economic role in Asia has been declining slightly in the last 5 to 10 years because of Asian economic integration. The evidence is that the U.S. is no longer the largest trading partner for Asian countries including ASEAN countries. However, I think the U.S. role is still important. When you look at other countries' economies trade as a part of the U.S. market, it is still a large portion. Secondly, the U.S. is still the major buyer of most products manufactured by Asian economies. Also, the U.S. is still a major source of market technology, technological innovation, and management skills for Asian economies. The quality of the U.S. role in Asian economics has not been declining.

I think American institutions are being challenged, as Richard Bush already mentioned, and that sooner or later there will be Asian institutions that will not include the U.S. I see that as inevitable, natural, and normal. Everywhere else in the world—the Middle East, Africa, the European Union, there are some multilateral institutions of which the U.S. is not a member. I don't think the U.S. business community should worry because regardless of whether the U.S. is a member of some future Asian institutions, U.S. influence will always be there, in matters of economy, security, politics, and culture. No matter whether it's a member, its influence is there. The U.S. is not a E.U. member, but U.S. influence in European economics is as strong as ever.

This concludes my analysis of Asian integration. I think countries such as Japan, China, and India may one day reach the level of influence that America has in Asia, but it is hard for any of them to go beyond America's economic, cultural, and political influence. It has become a win-win game; it is no longer a zero-sum game. I think this is the ethos of globalization and integration today. Thank you.

MR. URATA: Thank you very much. We have all heard the remarks of four panelists. They spoke on the theme of economic integration in East Asia and its implications for the U.S. and Japan, and they discussed that relationship up against the backdrop of economic integration.

I would like to make brief remarks as a panelist and not as the moderator. Professor Shiraishi spoke about international politics, security, and political dimensions. He focused on those elements and the importance of the U.S.-Japanese relationship. I, for

one, would like to talk about the importance of the U.S.-Japanese relationship from the perspective of economics, which is my field. Furthermore, I would like to talk about prospects and the need for having a U.S.-Japan FTA.

This morning Mr. Yonekura, Vice Chairman of Keidanren, said that Keidanren is coming up with a proposal for concluding a U.S.-Japan FTA. As Professor Shiraishi mentioned, the positioning of the Japanese economy has been lessened, weakened, and faces prospects of a smaller population and a positioning that will be further weakened. In this context, I think the Japanese economy's competitiveness can be maintained, and maintaining competitiveness is very important. I will be more specific.

When considering the scale of an economy, population looms large. Population is very relevant. If Japan's population does not increase, I think it will be rather difficult for us to maintain the strong position of the Japanese economy; however, living standards and competitiveness can still be maintained. Existing resources—the land, labor, and capital—must be utilized in the most efficient way. So the key is an efficient use of the factors of production. In order to use factors of production effectively and efficiently, we need external competitive pressure and we need to build appropriate institutions within Japan. In order to realize those two objectives, an FTA is needed, especially with a developed country. An FTA with the U.S. will be very important.

From that perspective, I am of the opinion that between Japan and the United States, the FTA must be concluded so that two nations, the U.S. and Japan, can lead the global economic system. We can play an important role in building a global system. To paraphrase, the WTO is an institution for rules of trade, but regarding business activities, we need more than just rules of trade. We also need principles of competition that are not discussed at the WTO. These themes are necessary as well. Those are also economic systems. Such institutions and systems can be built between Japan and the United States, which in turn will make an enormous contribution to the benefit of the global economy. For the aforementioned reasoning, Japan should positively negotiate an FTA with the United States and we should make a positive approach to the United States. We should upgrade the level of study regarding an FTA with the U.S.

Because we have only 20 minutes left, there is one last question that I would like to ask the panelists, after which the floor will be opened to questions. Here is my question: The KORUS negotiations have been completed and they are very well poised for concluding an FTA between Korea and the U.S. Regarding the U.S.-Japan FTA, once it is made, supposing it is made, how will it be received by the rest of the Asian countries? To be more concrete, on the one hand we have the notion or movement in the direction of an East Asian community. The countermovement, a U.S.-Japan FTA, will have an effect of dampening that enthusiasm; it's going to be the role of a dampening blanket. One question is, what is the impact of the KORUS agreement on the building of an East Asian community? Sure, there are cooperative measures involved, but do you think that becomes the water poured over the fire of the East Asian community? This is the other question to be answered. It's a very specific question, but I will give 2 or 3

minutes to each panelist. Can you respond to my question in the same order? We will start with Dr. Lim, and then we will go to Dr. Shiraishi, Dr. Bush, and Dr. Chu.

MR. LIM: As I mentioned in my presentation, my point was that the causality is from the disenchantment with the East Asian community-building efforts to KORUS FTA, not the other way around. I would argue that, because of the simmering rivalry between China and Japan, for the foreseeable future it is quite unlikely we are going to have an effective multilateral mechanism for fostering economic cooperation in East Asia. So what's likely to happen is a shift toward bilateralism. It is already happening. So China and Japan individually would negotiate FTAs with Korea or ASEAN countries and so on and that prospect brings up the possibility of the “spaghetti bowl” effect or the “noodle bowl” effect, as Richard mentioned.

Actually, I'm not so concerned about the noodle bowl effect. If economic logic has the final say due to complicated rules of origin, regulations, and so on, countries might work out an arrangement where this noodle bowl effect would be dealt with in the end. So bilaterals would open the way for further institutional economic integration, and when things get complicated, there might be an impetus for trying a more multilateral approach.

In addition, I would like to add that if advanced industrial countries are serious about the Doha Development Round, the thing to do is to try and strike a bargain with developing countries. Where developing countries would benefit from a reduction in subsidies to agriculture and so on, and advanced industrial countries would benefit from a reduction in tariffs in developing countries. I think focusing on other arrangements like a free trade area for the Asia Pacific and so on actually takes momentum away from the Doha Development Round and it is more important for advanced industrial countries to address the concerns of developing countries and promote multilateralism directly.

MR. URATA: Thank you very much. As a point of confirmation, your comment means that developed countries such as the U.S. and Japan should not conclude an FTA. Am I right in interpreting your comment as such?

MR. LIM: I think the East Asian economic community-building has been already dampened and if there is a U.S.-Japan FTA, it could work in a beneficial way in that there was continuing concern on the part of the United States about being excluded from East Asia. With the KORUS FTA and the U.S.-Japan FTA, the U.S. would have a fairly steady anchor in East Asia. So the building of an East Asian economic community can proceed after bilateral agreements between Japan and the United States are made.

MR. SHIRAISHI: Thank you. Let's begin with the East Asian community. What is important here is that we all talk about the East Asia community, we all use the term East Asia community, but then what does East Asia community entail? No one knows what type of community we want to build. And it's not just that. For example, in January the second East Asia Summit took place. If you will recall that discussion back in January—if we can be clear in the creation of the charter that, yes, indeed ASEAN integration

was progressing, but even then, even ASEAN countries don't really have the willingness to create something that is akin or similar to the E.U.

What is taking place in Asia in terms of integration is not like the E.U. It is far less intrusive in nature, which has been created on a network basis. Aside from the question of whether an East Asian community could be built, that is irrelevant. Under the guise or under the excuse of creating an East Asian community, various activities are taking place. As a matter of fact, in terms of economic integration, various mechanisms and institutions are being created. There was talk about the spaghetti bowl or the noodle bowl effect, but in essence, that type of institution-building is taking place, which in itself is quite important. So regardless of whether we have a U.S.-Japan FTA, this trend will continue in East Asia.

Let us assume that we do have a U.S.-Japan FTA. If that is achieved, one of the obstacles to Japan signing FTAs and EPAs are domestic issues. Unless we overcome these difficult obstacles domestically, we cannot sign any FTA or EPA. Once we have an FTA between Japan and the United States, from the regional perspective, EPAs and FTAs will perhaps have lost their effectiveness as a tool for bringing about integration. So I personally believe an FTA between Japan and the United States is critical. We believe that this FTA would actually raise the stakes for the United States to be involved in the Asian region. At the same time, from the long-term perspective, if we want to pursue economic integration in this region, I think we need perhaps an alternative policy instrument to replace the FTA and EPA. That is my impression.

MR. URATA: Dr. Bush?

MR. BUSH: Thank you very much. I would like to associate myself with Dr. Lim's comments; Dr. Lim really knows what he's talking about. I think that the East Asia community idea has a life of its own, if only for identity reasons, and on that basis it will continue, and should be something that the United States should be comfortable with. Thank you.

MR. URATA: Thank you very much. Dr. Chu?

MR. CHU: On Japan-U.S. free trade, it depends on the goal or purpose of a bilateral FTA. The goal, as we usually understand it, is to promote, enhance, and increase economic ties, trade, and investment. I think that is the goal for a trade arrangement between Japan and the U.S., which would be good for the two countries and others, including China. And, as some sectors of Japan's economy are not as open as America's, there will be more benefits to the Americans.

China does not fear any bilateral FTAs because the country has become quite confident in international trade and economic relations, just as more than 10 years ago when—now it turns out China benefited from NAFTA.

Beyond economics, I see limited benefits in bilateral FTAs between major economic countries. The benefit is going to be marginal because the two countries' economies already have been highly integrated. My perception is, if the U.S. and China engage in FTA talks, I think China can benefit very little because we are already close to \$300 billion in trade each year. How much can we improve? Yes, it's good, it's positive, but I think also it's marginal in its significance.

MR. URATA: Thank you very much. Now we exactly have 10 more minutes. We would like to use it for a Q and A session with the people in the audience. If you have a question, please raise your hand and identify yourself by stating your name and affiliation. Are there any questions from the floor? Sorry, time is limited. Be very succinct.

MR. MAKINAWA: Makinawa is my name. Mr. Talbott and Mr. Bush, thank you very much. I was once with the Brookings Institution.

Comparing an E.U.-centered Europe and a China-centered East Asia, Japan is almost like a pendulum, very vulnerable. Professor Shiraishi suggested revamping APEC—in my opinion, that is very important. Eighty years ago Sun Yat-sen talked about pan-Asianism and Occidentalism—that we shouldn't be the underdog of Europe, but we should be the leader of the Orient. Now the royal road of the Orient is economic cooperation, am I correct? Mr. Shiraishi, can you respond?

MR. SHIRAISHI: This was totally unexpected. I'm not sure how I should respond to this question. But I think it's not merely economic cooperation. It might include economic cooperation, but it might have somewhat of a horizontal nature, cooperation based on the principle of equality, as I would imagine, and also maintaining a stable order. If that is the case, I think Sun Yat-sen probably would have advocated such a philosophy. The historical contexts of today compared to 1920 are totally different, as you can imagine, so it would be very difficult to say one way or the other in a very clear-cut fashion.

I am a very pragmatic person, so if we were to use the analogy of Sun Yat-sen I think we would have to exclude that from the current context. What we need is to have stable change and stable development, which I believe is the royal road for East Asia and for the world. I think that's how we should see it.

MR. URATA: Thank you very much. Are there any other questions from the audience?

FRANK CHING: I'm Frank Ching. I'm a columnist from Hong Kong. Actually, I have a question for you, Professor Urata. You mentioned several times that the Japanese population is declining. Why doesn't Japan do something about this decline? Why don't you welcome immigrants? That seems to be what most other countries do when faced with the same problem.

MR. URATA: I never expected a question would come to me. As you say, yes, in my writings I talk about immigration, but before immigration occurs I think we have to do something about foreign workers. We should accept more foreign workers, and on that extension, I think there should be a debate on immigration. Whenever we have that kind of discussion, however, whenever I state this view of mine, there are strong opposing opinions.

One opposing argument goes like this. In the labor force we have Japanese women, and the labor participation rate of women could still rise. But my personal view is, as I said, that the Japanese economy has to be revitalized and one effective means would be accepting foreign workers in an orderly fashion. So with the caveat of being orderly, foreign immigrants should be accepted.

MR. SHIRAISHI: Yes, let me add to that. Prime Minister Abe is heading the Committee on the Asia Gateway Initiative. Just last week it happened to compile its final report. I'm afraid the English version is not yet available, but in that report, although they do not talk about immigration policy per se, they talk about the exchange student program; also, they focus on having more Asian exchange students in Japan. Those exchange students could eventually work in Japan, so on a de facto basis, perhaps this is an immigration policy. This Gateway Initiative Conference actually compelled the recommendation, which on a de facto basis can lead the way for immigration. I actually share the same view, so on a gradual basis the Japanese government is actually beginning to take action in this direction. That being said, we must note various internal social oppositions that were mentioned by Dr. Urata. This is an issue which requires caution because it could be that somewhere down the road, some unexpected obstacle emerges,, so we must be very careful in pursuing this. I believe that is the position of the current administration.

MR. URATA: Did he answer your question? If you are satisfied, maybe we can entertain one last question.

PAUL HSU: I am Paul Hsu from Taiwan. I think all over the world there is one phenomenon that helps revitalize each country's economy, that is, to encourage entrepreneurship, to encourage small- and medium-sized industry. I have talked to some of my Japanese students in Taiwan and they said that it is very difficult for young people to start a business in Japan. My question is, have you considered that there should be more effort? I don't know the answer. I'm only asking the question of whether there is the proper environment to encourage more start-up companies in order to help official growth of the Japanese economy in addition to the continued growth of big corporations.

MR. URATA: Is the question for me? I think Professor Shiraishi will supplement my remarks. It goes without saying that the future has to be bright, to be hopeful; of course, those people will start their businesses. For a decade or so, up until now, Japanese economic growth was very stagnant and we experienced long years of recession. Only in the recent past has the Japanese economy recovered. In addition to this economic recovery, the rate of start-up companies is increasing. The entire economic mood is

important, so in this context it's being improved in Japan. Venture capital companies, so-called NGOs, Taiwanese or American, may come from the U.S. or Taiwan to help Japanese people start businesses. Those venture capital firms and NGOs have not grown so much in Japan.

There is perhaps an institutional problem of providing funds; I often hear this story, but it's not only that. When you start a business, of course it's a risky business, but typically the first couple of years are in the red, and, after some time, usually the company will become profitable. That's the classic pattern of a start-up entrepreneurship. Past deficits can be accumulated, but once you become profitable, these deficits will be offset and the taxes levied. Then it becomes advantageous for start-up entrepreneurs. However, our institution does not work in that way, so several institutional problems could be approached and overcome. Many Small- and Medium-Sized Enterprise (SME) owners and entrepreneurs tell me of this problem.

To go back to where I started, when there is an upswing in the economic mood, there is a better environment for start-up companies in Japan, but there are still obstacles remaining in the Japanese business scene. That's where we are now.

Just one word of impression about this panel discussion and then I would like to close the session. The theme of this session is "Economic Integration in East Asia and its Implications for the U.S. and Japan." As I said many times, I am very interested in FTAs because I believe it is positive for Japan. At the WTO, liberalization efforts continue. We also have APEC, another forum in which many countries participate, so we have liberalization cooperation in various fora. The multilateral scene is very important. I don't negate that. But when there is little progress from multilateral scenes. Bilateral FTAs could be regarded as an impetus, way of giving a push. To that end, we must build FTAs.

In today's discussion regarding the possibility of a U.S.-Japan FTA, a lot of people spoke, and in my interpretation, many said that they were not against an FTA between the two countries. I think there were some people who were quite positive about U.S.-Japanese FTAs. So I would like to say that in many different forms, not just between the U.S. and Japan, the FTA must be studied. We must consider how we can revive APEC and how we can jumpstart WTO negotiations. We should have a multitude of research, fora, and symposia just like this one. I would like to conclude this session with those words.

MR. KOYABASHI: Thank you very much. We would like to thank our panelists for their very constructive presentations and contributions. We would also like to show appreciation to the members of the audience for their patience, and with this we would like to conclude the first panel for the session entitled "Economic Integration in East Asia and its Implications on the United States and Japan." Thank you very much. We will conclude and take a lunch break at this juncture. We will resume at 1:30.

[Recess]