

# **Beyond FTAs: Strategies for Asian Integration**

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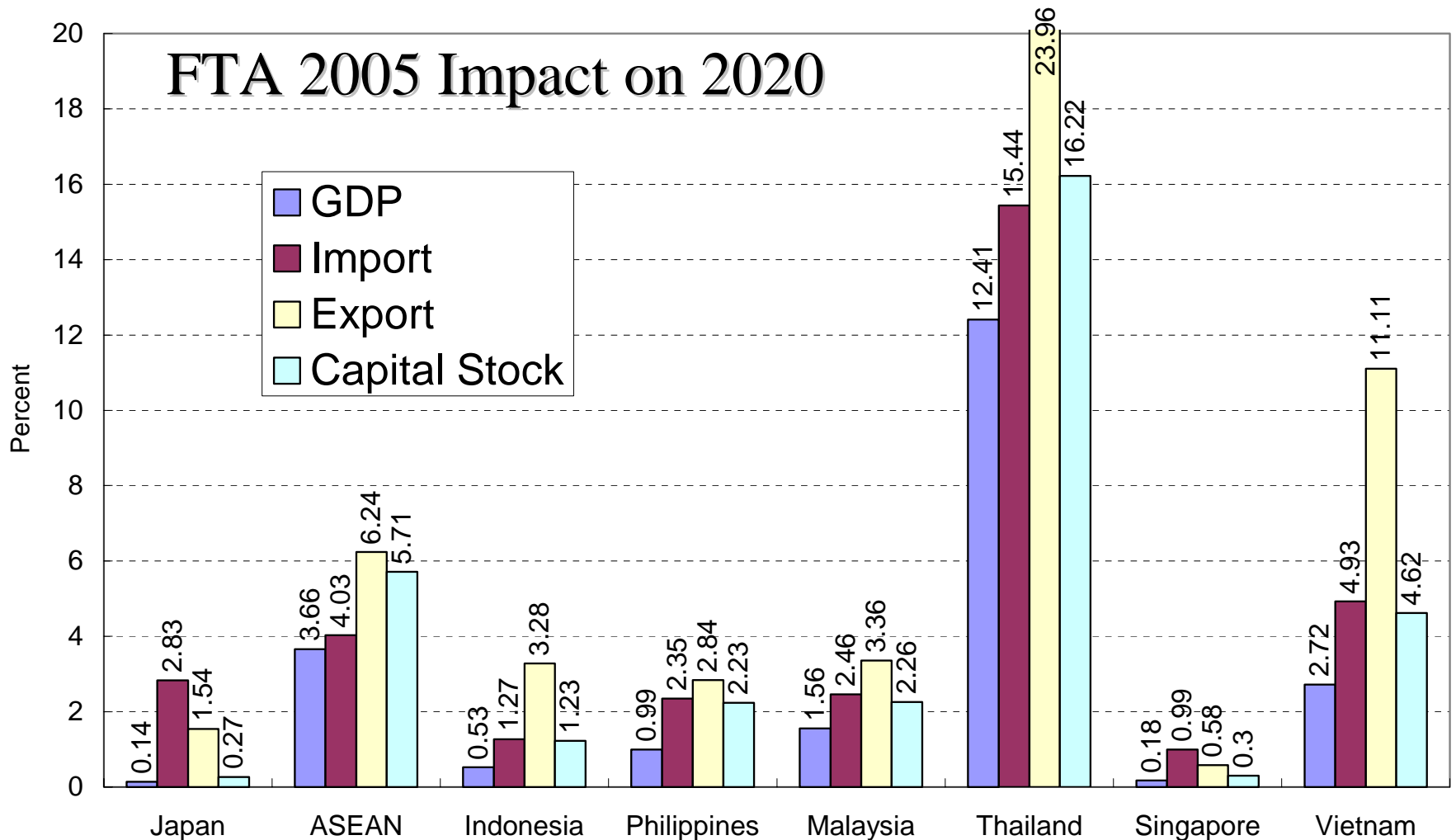
# Outline

- Regional FTAs are Insufficient
  - Trade++ EPAs are the way to go
- Regional EPAs need to trade Economic against Political Gains
  - Market Access against Structural Reforms
- ASEAN+3 EPAs should start with a focus on one Sector
  - Targeting Financial Reform

# Japan Neglected Regional FTA Strategies

- Japan had little Interest in Regional FTAs because
  - For Major Countries FTAs are a Waste of Time and Money
    - Trade Diversion
    - Rules of Origin become Overlapping and Confuse Trade Partners
  - WTO requires the inclusion of all trade for Regional FTAs
  - FTAs are a Strategy for the Small and Weak
- East Asia is a particularly Problematic Case because
  - Japanese products account for the Highest Percentage of Trade, but Final Demand depended on the U.S.
  - East Asia has the Highest Tariffs, but trade includes Japan's most Protected and Competitive Products
- From a Trading Point of View
  - WTO is the Way to GO

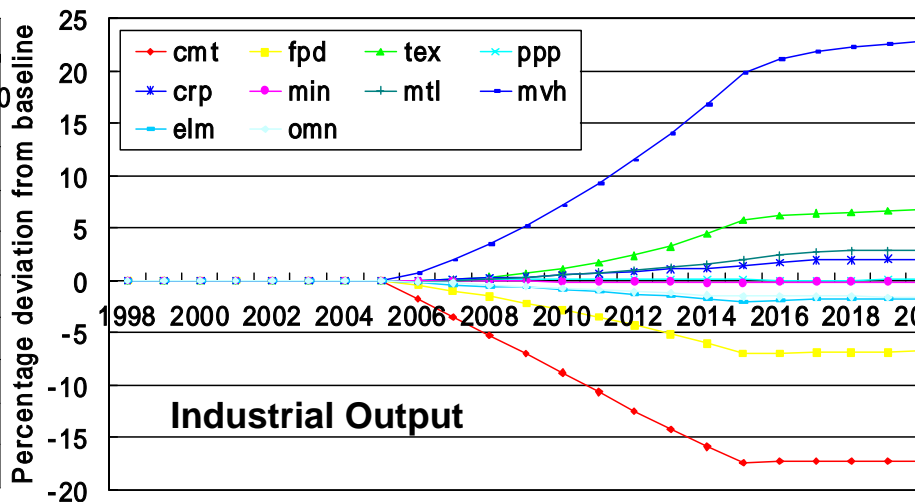
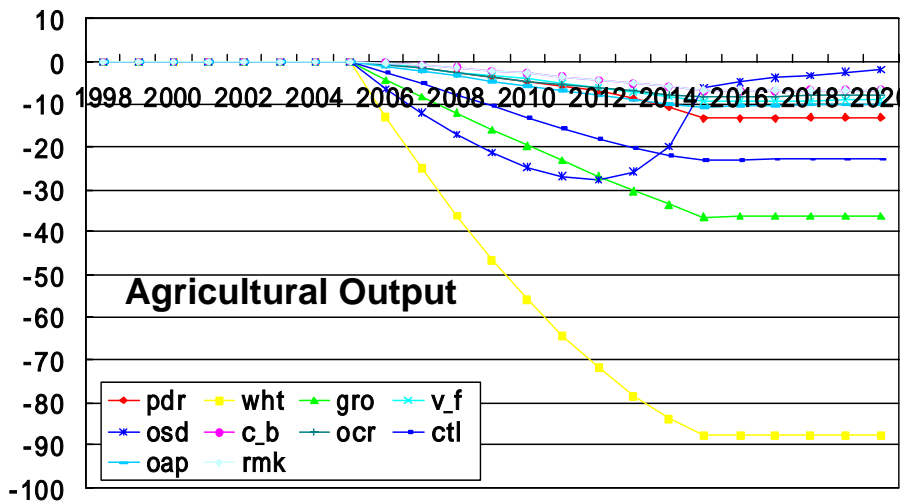
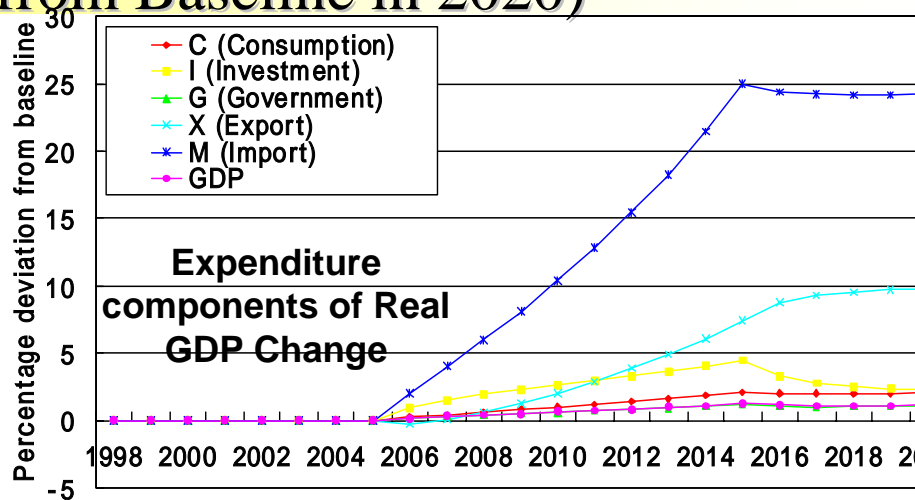
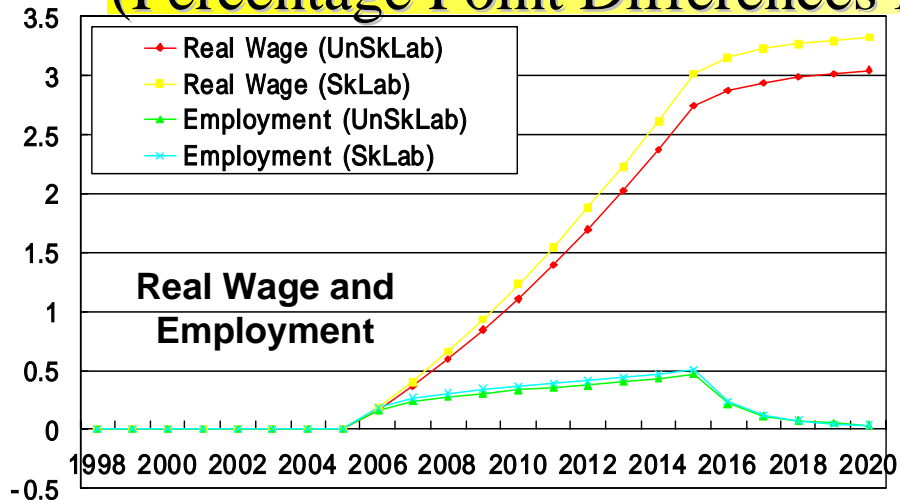
# ASEAN FTA has Limited Impact on Japan ...



Note: Percentage Point Differences from Baseline. Baseline Scenario is based a Dynamic GTAP Applied General Equilibrium Model simulation with a data set of 1997.

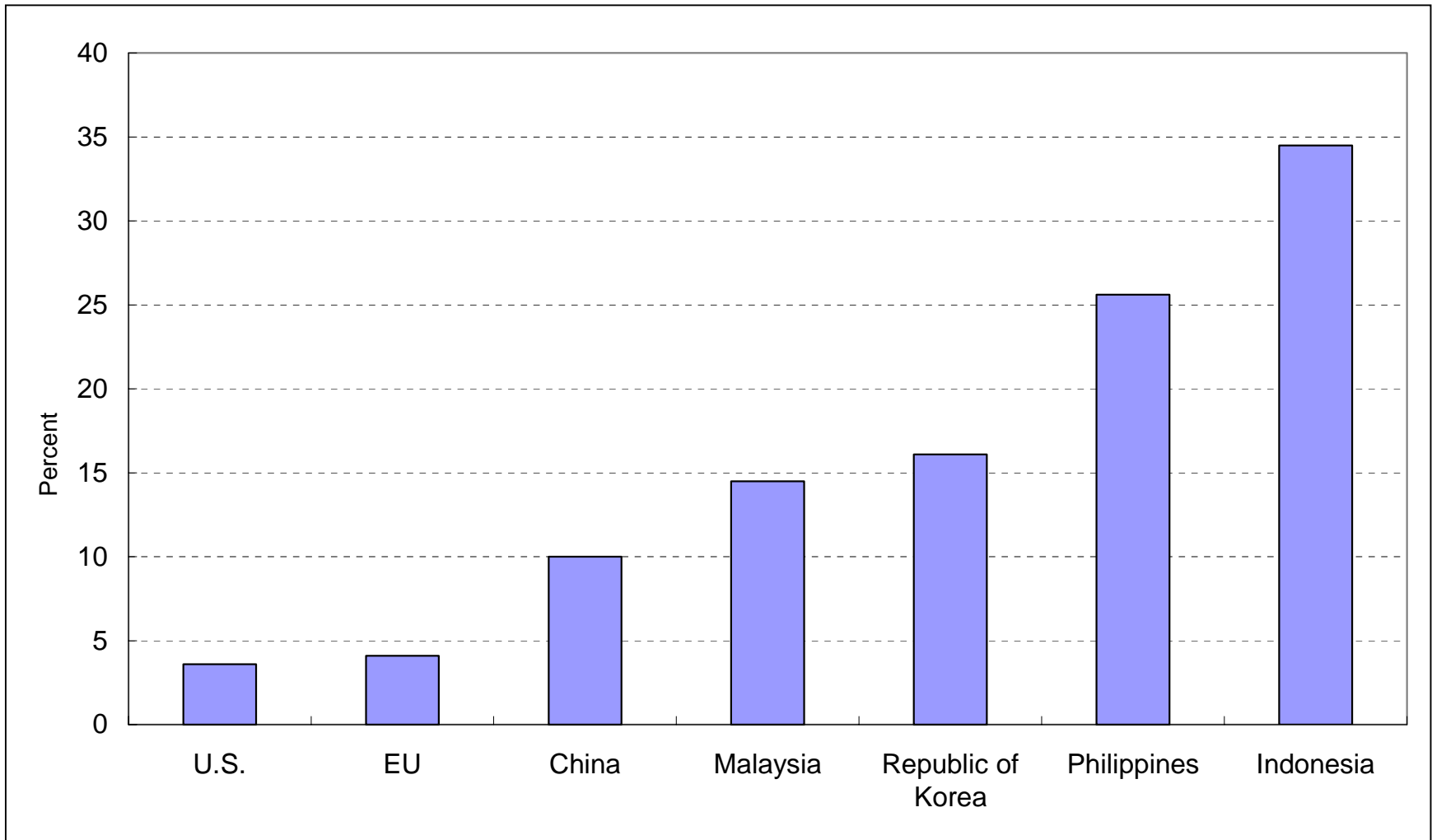
# ... but some Inconvenient Effects ...

(Percentage Point Differences from Baseline in 2020)

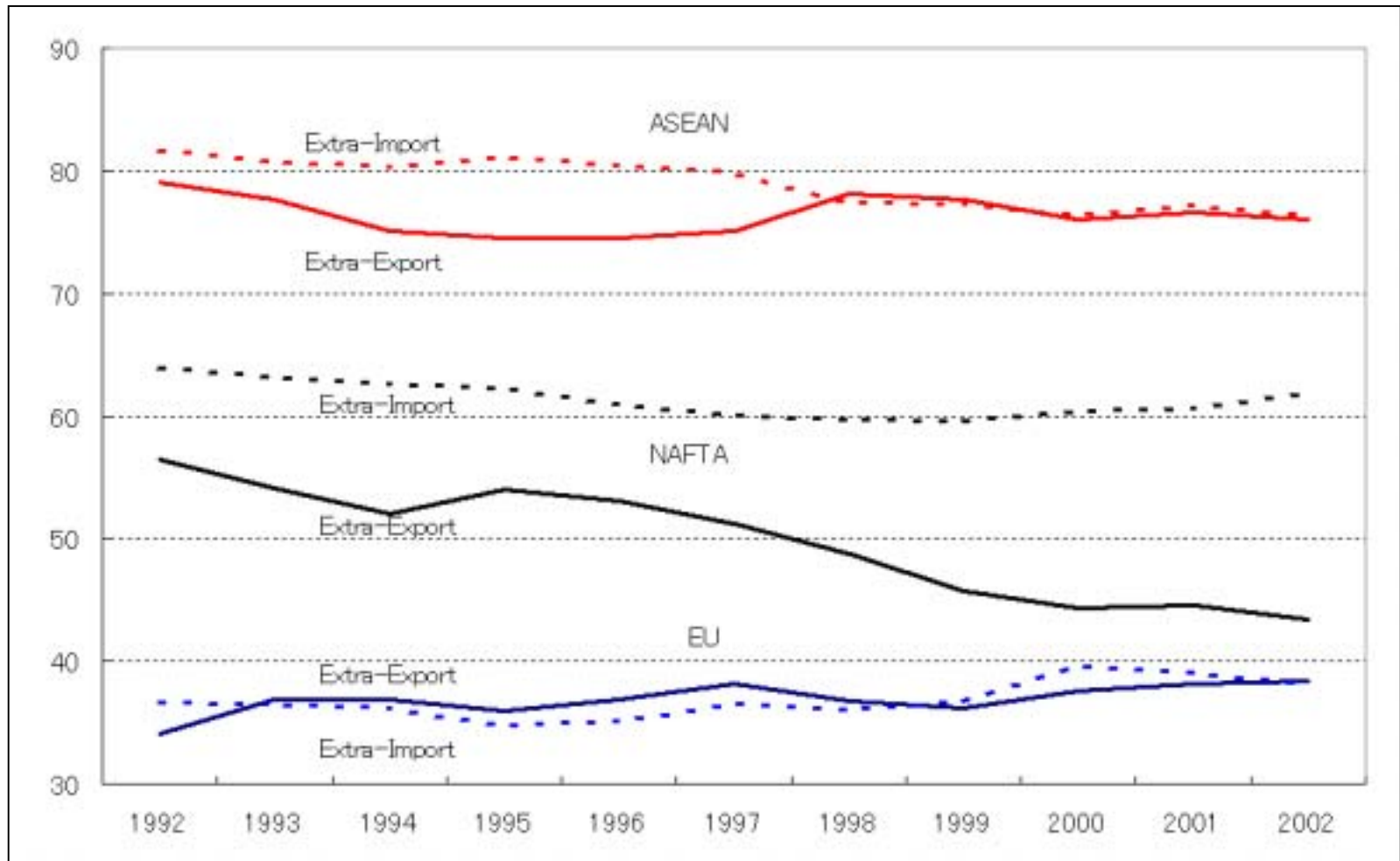


Note: pdr = Paddy Rice; wht = Wheat; gro = Cereal Grains; v\_f = Vegetable, Fruits, Nurts; osd = Oil Seeds; c\_b = Sugar Cane, Beet; ocr = Other Products, Fibers; ctl = Cattle, Sheep, Goats, Horse; OAP = Other Animal Products, Wool; rmk = Raw Milk; cmt = Meat Products; fpd = Foot products; tex = Textile; ppp = Paper, Publishing; crp = Chemical, Rubber, Plastic; min = Mineral, Cement; mtl = Metal; mvh = Transport equipment; elm = Electrical Machinery; omn = Other Manuf. Source: © FRI 2004. Simulations by Hiroshi Hamasaki.

# ... although (because?) Tariffs in Asia are High ...



# ... because (and therefore?) Intra-ASEAN Trade Depends on External Demand



Note: Exports and Imports as Percent of total Export/Import.

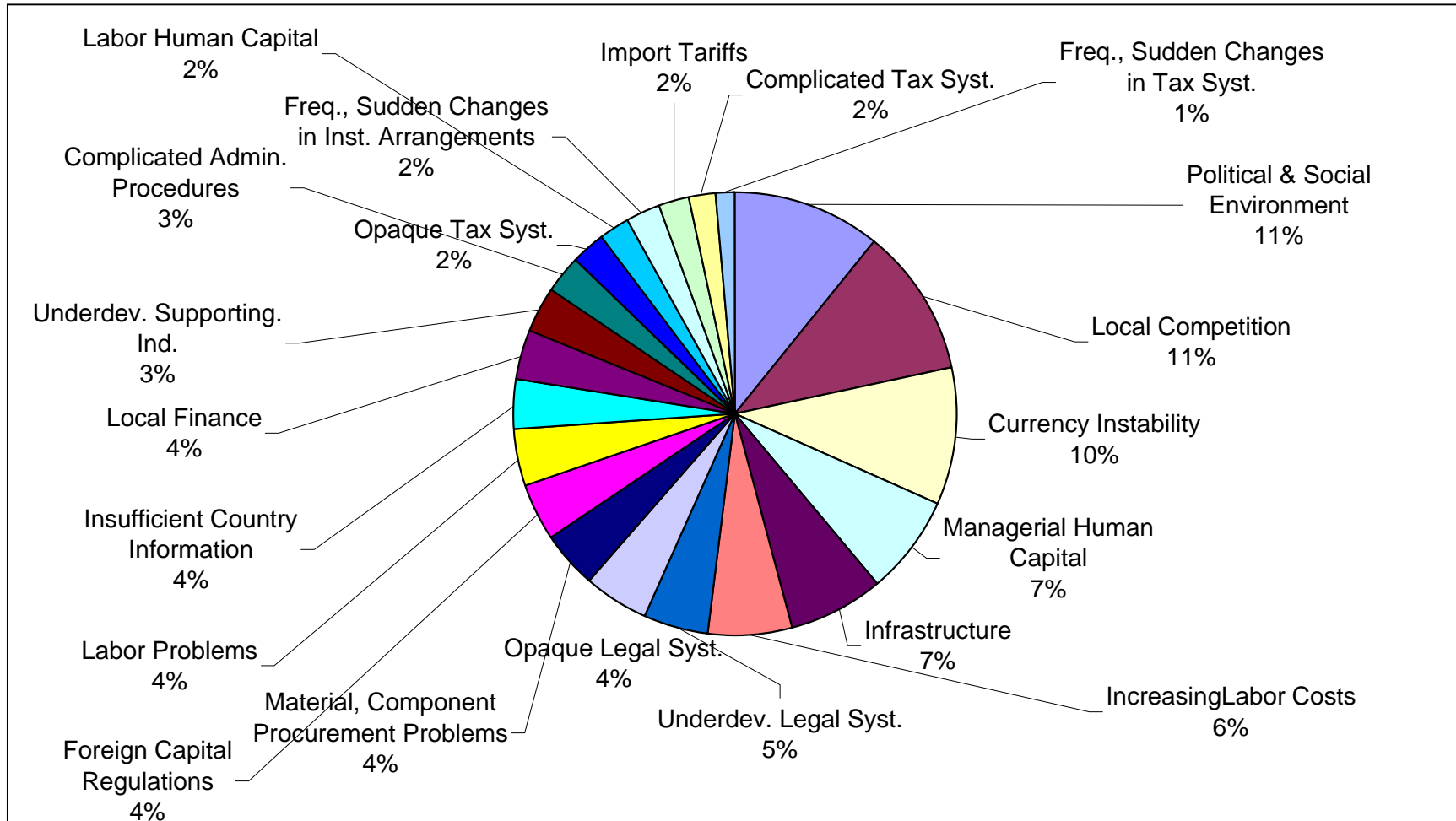
Source: © FRI 2004. Data from METI (2004): External Trade.

# But Today, Globalization requires Regional Stability and Development

- Growing Capital Flows and International Markets
  - Restrict National Macroeconomic Autonomy
  - Act as International Rating Agencies
  - Have caused Regional Crisis Contagion
- FDI and Transnational Corporations (TNC)
  - Demand Intellectual Property Rights (IPR), Standardization, e-Commerce, Education & Training
  - Need advanced (Financial) Services
  - Depend on Cross-Border Stability for Vertical Production Networks

# Political & Economic Instability have become the Main Problems for Japan's Corporations in Asia

Questionnaire: Problems of Japanese Manufacturing FDI Destinations in Asia



Note: Survey of Japanese corporations with at least three foreign affiliates, of which at least one in manufacturing (812 firms with 508 valid replies).

Source: © FRI 2004. Data from Marugami (2003) - 2002 Nendo Kaigai Chokusetsu Toshi Ankeeto Chosa Kekka Hokoku - Dai 14kai, Journal of the Research Institute for Development and Finance, Vol. 14, p. 4-82.

# Regional EPAs therefore Target the Consequences of Globalization

- EPAs focus on “Plus-Plus” Issues beyond Trade
  - The Japan-Singapore EPA is a Show Case of FDI Interests
- EPAs are Tools for Developed Countries
  - Developing Countries target Trade and ODA
- EPAs can be Tools for North-South-South Cooperation
  - Unilateral FTA in exchange for Institution Building
- EPAs allow to “Take-them-one-by-one”
  - To enter NAFTA, Mexico had to sign Environmental and Labor Standards
- EPAs work as Tools for “Gaiatsu”
  - International Institutions can break Domestic Deadlocks on Structural Reforms

# EPA Example: Japan-Singapore Agreement

## Trade++ Issues

### ● “New-Age Economic Partnerships”

- Mutual Recognition Procedures
- Rules of Origin
- Intellectual Property Rights (IPR)
- E-Trade
- Investment Facilitation
- Service Sector Liberalization beyond WTO
- Financial Services
- Human Resources Development
- Science and Technology
- Small and Medium Enterprises
- ICT & Broadcasting

### ● But the Agreement became only possible because Singapore

- Has no Agriculture
- Is a Developed Country
- Is a Super-Trader (Trade-GDP Ratio beyond 200%)
- Is a Regional FDI Hub
- Is a forerunner in Asian “Structural Reforms” and “Internationalization”

### ➤ **In Contrast: ASEAN Developing Countries remain focused on Trade and Cheap Finance**

# Most ASEAN+3 Strategic Plans beyond FTAs focus only on one problem: Finance

- Chiang Mai Initiative (CMI; 2000)
  - Network of ASEAN and Bilateral Swaps to Counterweight disruptive Capital Flows and Stabilize Currencies
  - Allows to reduce USD Reserves
  - Introduced no Surveillance System
  - Cures only the Effect (Liquidity Crisis), not the Cause (Credibility Crisis)
  - Sets Stretch Targets (Exchange Rate Stability)
  - Either too small and IMF-dependent or too risky for Japan as a Lender of Last Resort
- Asian Monetary Fund (2000)
  - Could provide Surveillance for CMI
  - Specific Focus on East-Asia's Banking-based Financial Systems
  - Costly Overlap with IMF, Depends on Japan-Finance, Questionable Credibility and Representation
- Asian Currency System
  - Pegging East Asian Currencies to a Basket of Yen-Dollar-Euro to stabilize Exchange Rates
  - Countries are likely unable to control Real Appreciations by Targeting Inflation and Implementing Structural Reforms
  - Depends on an Extension of CMI with Surveillance Mechanisms
- Asian Monetary Union (1999/2004)
  - Requires Open (Capital) Markets and Political Integration
- **Most of these plans are either Ineffectual or Unrealistic**

# Even the most Market-based ASEAN+3 Financial Strategy has Many Problems

- Asian Bond Market
  - Improves the Liquidity of East Asian Bond Markets by increasing their Size
  - Develops reliable Clearing, Payment and Settlement Systems
  - Avoids Regulatory Races to the Bottom
  - Implementation Depends on Dismantling of Capital Controls
  - Increases Exchange Rate Volatility through Capital Flows
  - Asian Bond Funds (ABF) for Currency Reserves Investment unlikely to increase Demand for Risk Bonds
  - Demand depends on Sound Regulation, Transparency, Investor Protection, Macroeconomic Stability
  - Supply of Investment-Grade Corporate Bonds only improves through Upgrading of Accounting Standards, Corporate Governance, Local Rating Agencies
  - Requires an Asian FSA
  - Requires comprehensive Structural (Financial) Reforms

# The Search for an Appropriate Strategy

- Theory

- Scenarios that Target the Consequences of Globalization (Increasing Capital Flows and Regionalization)

- Empirics

- EU Case Study

- Implementation

- Practical, Stepwise Approaches with Visible Effects

# The Search for an Appropriate Strategy

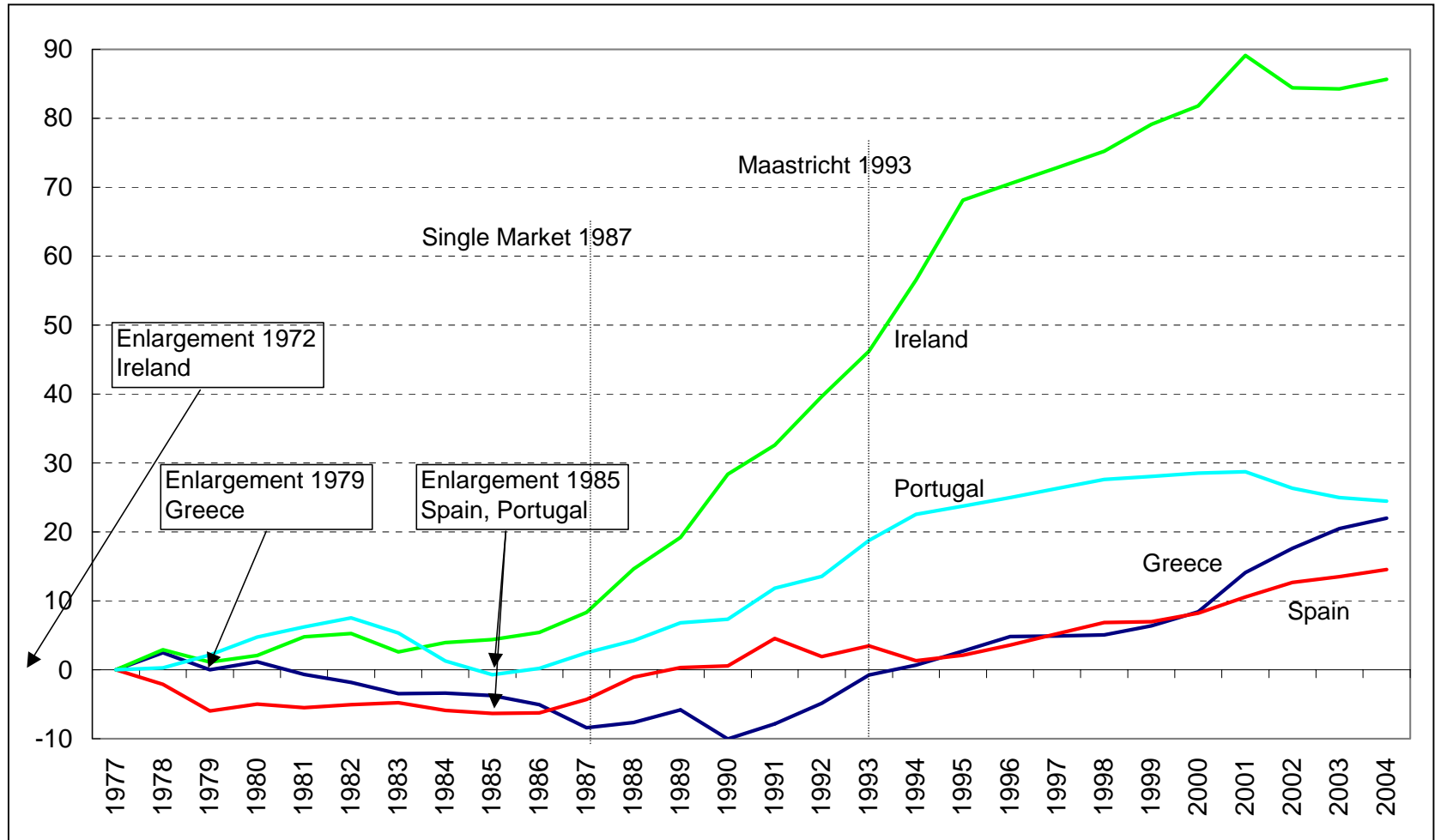
➤ EU Case Study

# EU before 1993: Trade and Harmonization

- The EU started in 1951 with
  - Political Commitment for Cooperation
  - A key-sector, the European Coal and Steel Community (ECSC)
  - French Control of Germany's Weapons, and German Economic Liberation
- Until the Treaty of Maastricht (1992) European policy focused on
  - Trade
  - Agriculture
  - Harmonization of Standards
  - Regulatory Reform
- With the completion of the Common Market (1993) it achieved the
  - Scrapping of 60 million customs and tax formalities
  - Development of a (de-)regulatory package of about 80,000 pages
  - Harmonization of some 100,000 national standards
- **But in the 80s, it was not widely regarded as a success because**
  - Growth remained below expectations and unemployment high
  - Institutions seemed remote, wrongly focused (CAP), and poorly controlled
  - Globalization (Capital Flows) started to dominated Trade and Economic Policy

# Trade & Harmonization had only Limited Impact on EU Growth Rates

## Accession Country Performance of Ireland, Greece, Spain and Portugal

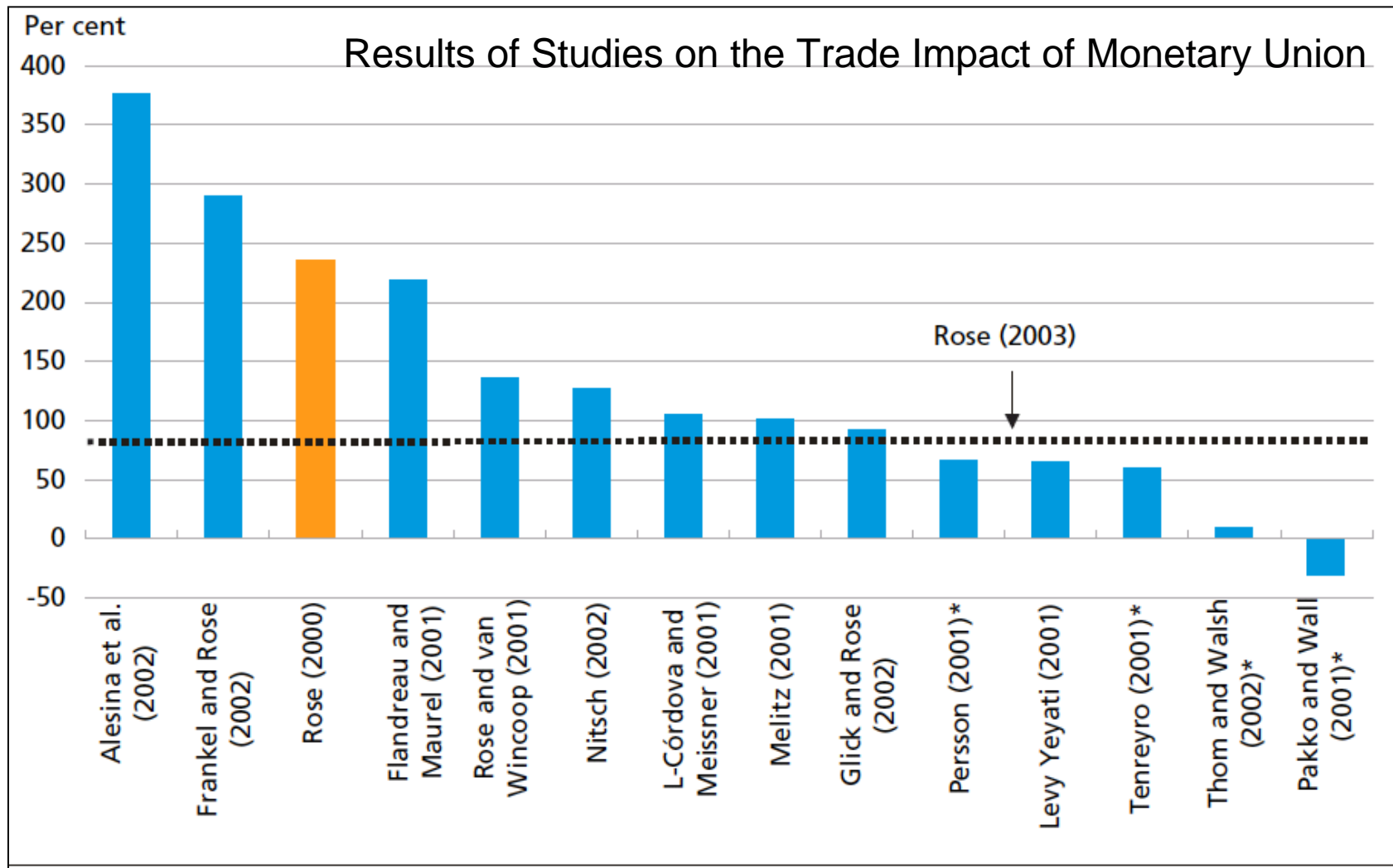


# EU after 1993: Economic Policy Coordination

- Globalization changed the Integration Focus
  - From Trade and Harmonization
  - To Competition and Economic Policy Coordination
- Regulatory Competition and Diversity
  - Mutual Recognition of Standards
  - “Subsidiarity Principle”
- Competition Policy
  - Monopoly Control
  - Benchmarking, Peer Review
- Economic Policy Coordination
  - Maastricht Criteria
  - Common Monetary and Exchange Rate Policy
  - Limits for Budgets and Fiscal Policies (“Stability and Growth Pact”)
- Regional Institution Building
  - EU Structural Funds
  - ODA for Institution Building and North-South-South Cooperation



# ...and a Surprisingly Strong Impact on Trade



Note: \* states that the estimated effect is not statistically significant.

出典: Pedersen (2004).

## Result: The EU offers...

- ... No Blue Print for Asia...
  - Strong Commitment for Political Integration
  - Major Integration Steps developed before Globalization
  - Integration Process was not Linear

# Result: But the EU offers...

## ● ...important Lessons for Cooperation Policies

- Trade Integration is only a necessary but insufficient First Step
- Harmonization faces Costs and Limits
- Political Commitment of Core-Partners for EPA++ is Vital
- Starting with a Core-Sector (EU: steel & coal) helps to develop Policies and Institutions “as you go”
- International Institutions can break Domestic Deadlocks on Structural Reforms
- International Institution cannot Guide Structural Reforms
- Structural and Development Policies need to focus on Market Incentives and Regional Institution Building
- Globalization requires a strong Focus on Stable Macroeconomic Policies and Transparent Markets
- Fixed Exchange Rate Regimes are Insufficient Coordination and Enforcement Mechanisms
- Currency Unions work as a strong Coordination and Enforcement Mechanisms, but require Political Integration
- Financial Integration faces strong Resistance in banking-based economies
- Political Integration Stalls at Fiscal Integration
- Regionalization and Devolution is the way to go

## Result:

### EU Integration Lessons for Current Asian Plans

- Political Commitment of Core-Partners for EPA++ is Vital
- International Institutions can break Domestic Deadlocks on Structural Reforms
- Starting with a Core-Sector (EU: steel & coal) helps to develop Policies and Institutions “as you go”
- Harmonization faces Costs and Limits
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- Fixed Exchange Rate Regimes are Insufficient Coordination and Enforcement Mechanisms
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# The Search for an Appropriate Strategy

➤ A Practical Approach

# Implementation:

## Integrated ASEAN+3 FTA and Financial Strategies

- Trade

- Free Market Access for ASEAN Emerging Market Members
- Limited Trade++ Issues (IPR, Investor Protection)
- Upgrading the ASEAN Secretariat for Monitoring

- Finance

- Structured Banking Reform and Financial Market Capacity Building
- Sequencing for Dismantling of Capital Controls
- Founding an ASEAN+3 FSA


# Implementation: Japan's ASEAN+3 Strategy

- Prepare Domestically
  - Unilateral Liberalizations
  - Structural Reforms in Agriculture and Finance
  - Reform of ODA Policy towards Regional Institution and Capacity Building
- Continue to Promote WTO Regionally for Broad Trade Gains
- Promote Regional EPAs
  - Trade Japan Market Access against Trade++ Issues
  - Support for “Global” not “Japanese” Standards
  - Focus on Competition vs. Harmonization
- Support ASEAN Regional Structures and Institutions
  - North-South-South Integration
  - Support for Financial Market Development
  - ASEAN Secretariat for Monitoring FTA and Preparing Trade++ Integration
- Aim for ASEAN+3 Institution Building Agreements with China and South Korea
  - Intergovernmental Council of Vice-Ministers in Seoul
  - Secretariat in Jakarta
  - FSA in Singapore
  - Dispute Settlement Office in Bangkok
  - Structural Integration Fund Office at ADB in Manila

# The Search for an Appropriate Strategy

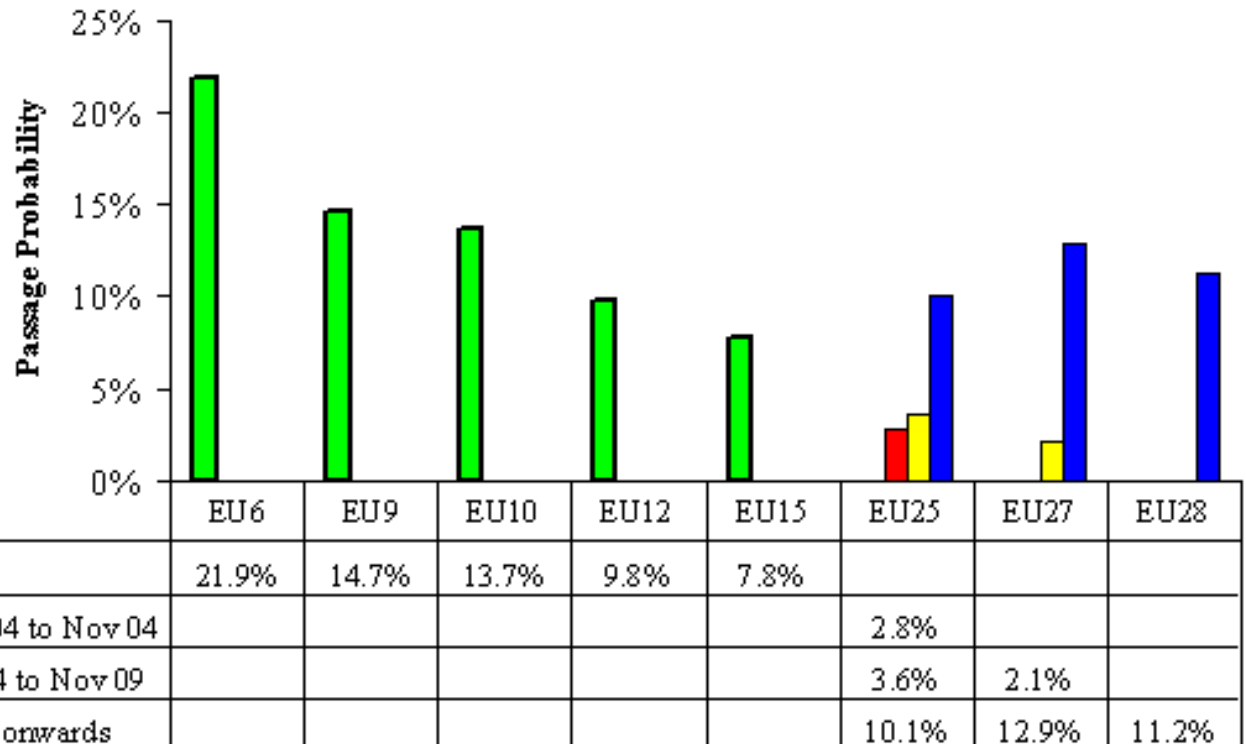
## ➤ Appendix: EU Lessons

# Appendix: EPA Institutional Development

- The EU effectiveness depends on the
    - Council (of Ministers)
    - Commission
    - Court of Justice
    - Parliament
    - Committee of Regions
- Initiation & Importance
- 
- As a driving force of initiatives and procedures, the role of the Commission is outstanding

# Appendix: Council Voting Power Problems

## Probability of Bill Approvals in the EU Council (based on the Banzhaf Index)

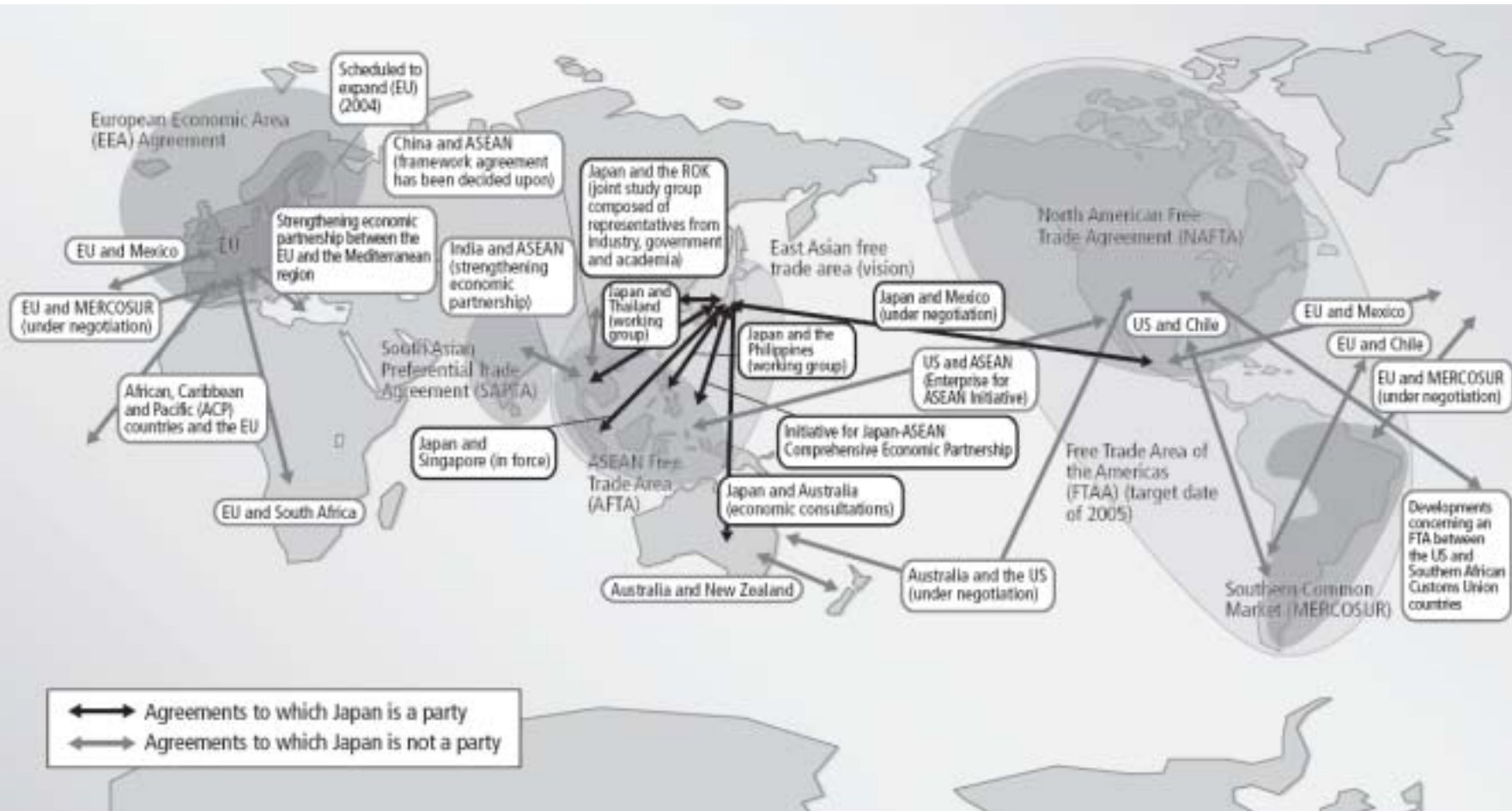


Notes: The figures show the “passage probability” which measures the likelihood that a randomly selected issue would pass in the Council of Ministers. Source: Authors’ calculations.

# The Search for an Appropriate Strategy

## ➤ Appendix: Japan's EPA Steps

# Appendix: FTA, EPA, and Japan's Partnerships



Source: MOFA (2003): Diplomatic Blue Book – Realizing the Prosperity of the International Community.

# Appendix: Why Singapore First?

- **Because:**

- **WTO: Singapore has no Agriculture**
- **Singapore is a Developed Country**
- **Singapore is a Super-Trader (Trade-GDP Ratio beyond 200%)**
- **Singapore is a Regional FDI Hub**
- **Singapore is a forerunner in Asian “Structural Reforms” and “Internationalization”**
- **Practicing “New-Age Economic Partnerships”**
  - **Facilitation of Investment**
  - **Financial Services**
  - **ICT**
  - **Science and Technology**
  - **Human Resources Development**
  - **Small and Medium Enterprises**
  - **Broadcasting**

# Appendix: Why Mexico Next?

- **Because:**

- **Mexico has little Rice**
- **Practicing Meat Negotiations**
- **Everybody has an FTA with Mexico**
- **Regional Orientation of Japanese Transnational Companies (TNC) in the U.S.**
- **Practicing Regional FTAs Outside of WTO**

# The Search for an Appropriate Strategy

## ➤ Appendix: ODA as Instrument

# Appendix: The Role of ODA in Regional Integration

- **ODA can be an Important Tool for**

- **Building Social Infrastructure**
- **Developing Institutional Capacity**
- **Technical Cooperation and Harmonization**
- **Regional Integration Beyond Borders**
- **Supporting Supra-National Institutions (ASEAN)**

- **Japan's ODA Charter I.1 asks for**

- **“...Japan's ODA ... to contribute to the peace and development of the international community, and thereby to help ensure Japan's own security and prosperity.**

# Appendix: Japan's ODA – Old Style (...2002)

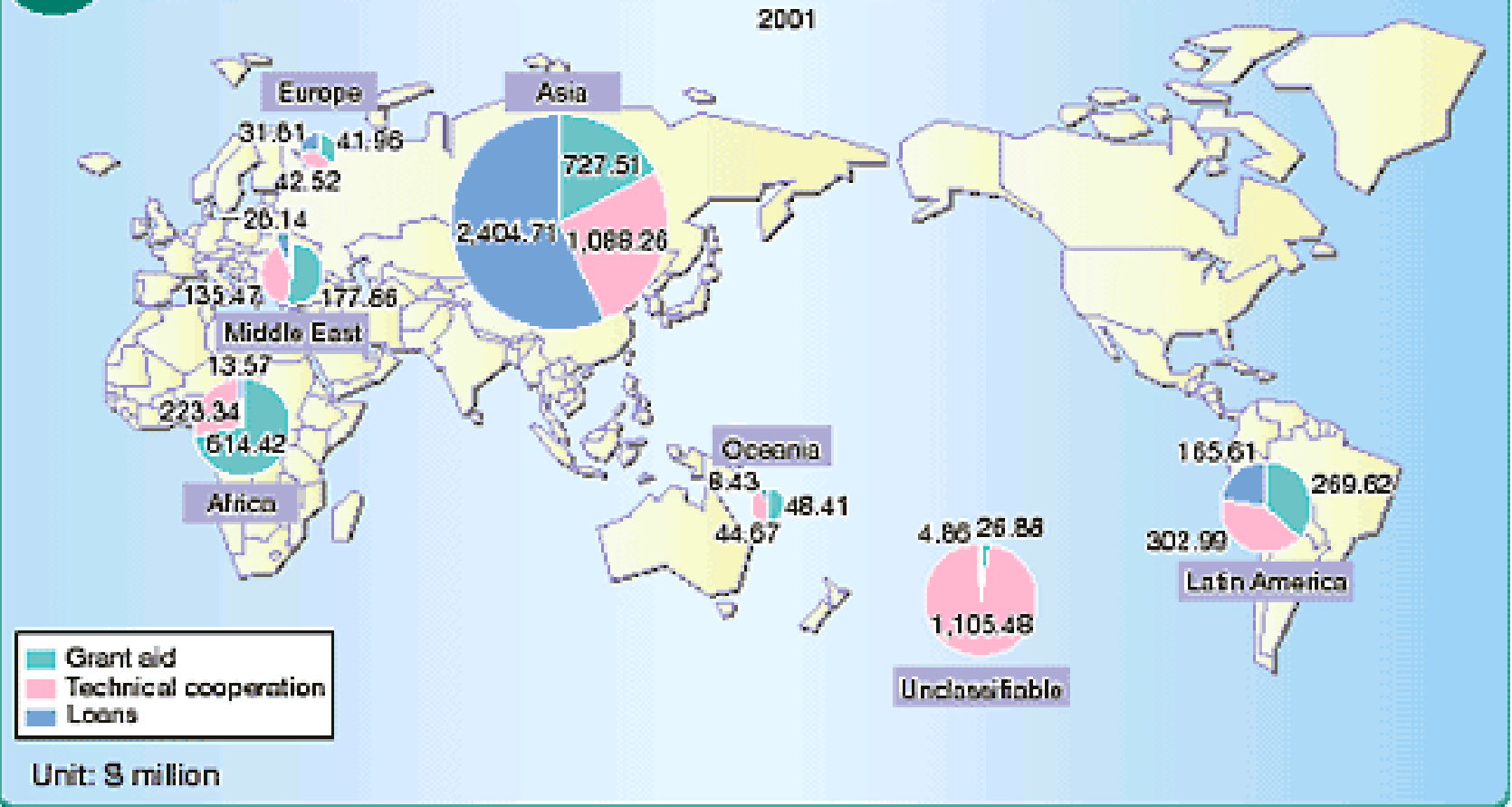
- **Japan's ODA was**

- **Focused on Asia**
- **Substantial, it Pushed Up GDP of Thailand by 1.8% and Malaysia by 5.4% over the last 20 years**
- **Focused on Economic Infrastructure**
- **Focused on Loans, not Grants or Tech. Coop.**
- **Non-Interventionist, with Little Conditionality and Dialog**
- **Fractured between Ministries**
- **A “Badly Managed 50-Billion-Dollar-Business”**  
(Motohide Yoshikawa, Deputy Director-General, Economic Cooperation Bureau, MOFA, Feb. 25, 2003)
- **Ineffectual as a Policy Tool**
- **Ranked Last of 21 OECD countries by the Center for Global Development**

# Appendix: Japan's ODA – Regional Distribution

Chart I-11

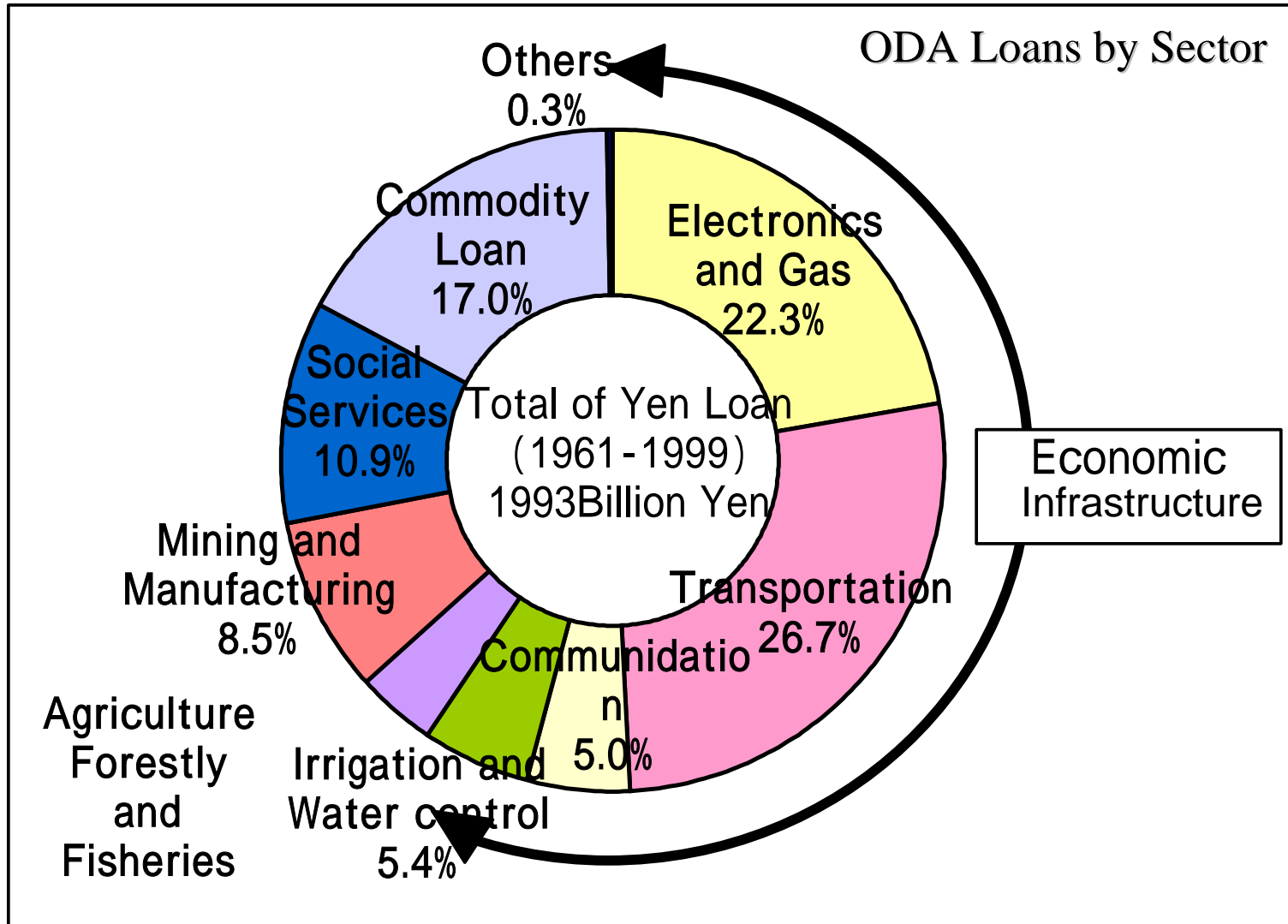
Distribution of Japan's Bilateral ODA by Region 2001



# Appendix: Japan's ODA – Organizational Responsibilities of Ministries and Functions

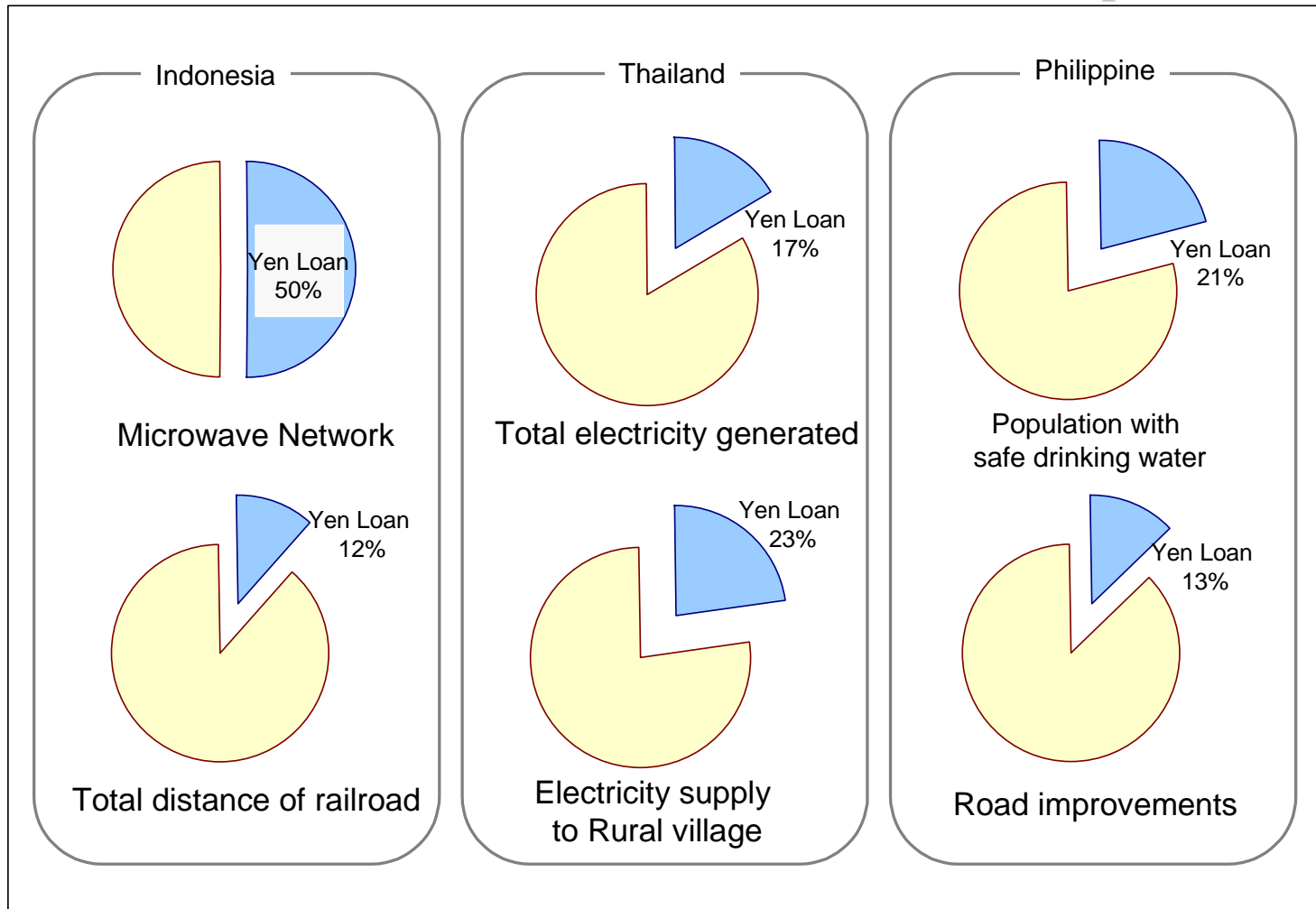


# Appendix: Japan's ODA – Focus on Economic Infrastructure



# Appendix: Japan's ODA to SE Asia – Impact on Economic Infrastructure

## ODA Contribution Ratio to Infrastructure Development



# Appendix: Japan's "New Age" ODA (2003 ...)

- Japan's ODA turns to
  - ASEAN4 (Indonesia, Malaysia, Philippines, Thai) Priority Regions
    - 59% of Asia Aid
  - Country Strategy Approach (from Instruments)
  - Program-Based Aid (from Project-Based)
  - Social Infrastructure, Human Resources, Institution Building, Local Community Capacity Building (from Economic Infrastructure)
    - Intellectual Property Rights, Standardization, ITC, Student Exchange, Research
- Bureaucratic Integration
  - Strategy: MOFA, Economic Cooperation Bureau
  - Implementation: JICA, JBIC