

The Impact of Economic Development of East Asia, Including China, on Japan

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A Preview

- ◆ The Rise of China and the Rest of East Asia
- ◆ Increasing Economic Interdependence within East Asia
- ◆ Japan and the Rest of East Asia: Complementarity or Competition?
- ◆ An East Asian Free Trade Area/Economic Community: The Role of Japan

East Asian Economies: ASEAN + 3 (including Hong Kong, Macau & Taiwan)

- ◆ ASEAN (Association of Southeast Asian Nations)—Brunei, Indonesia, Khmer Republic, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam
- ◆ + 3 (China, Japan, South Korea)
- ◆ + Chinese Economic Areas (Hong Kong, Macau and Taiwan)

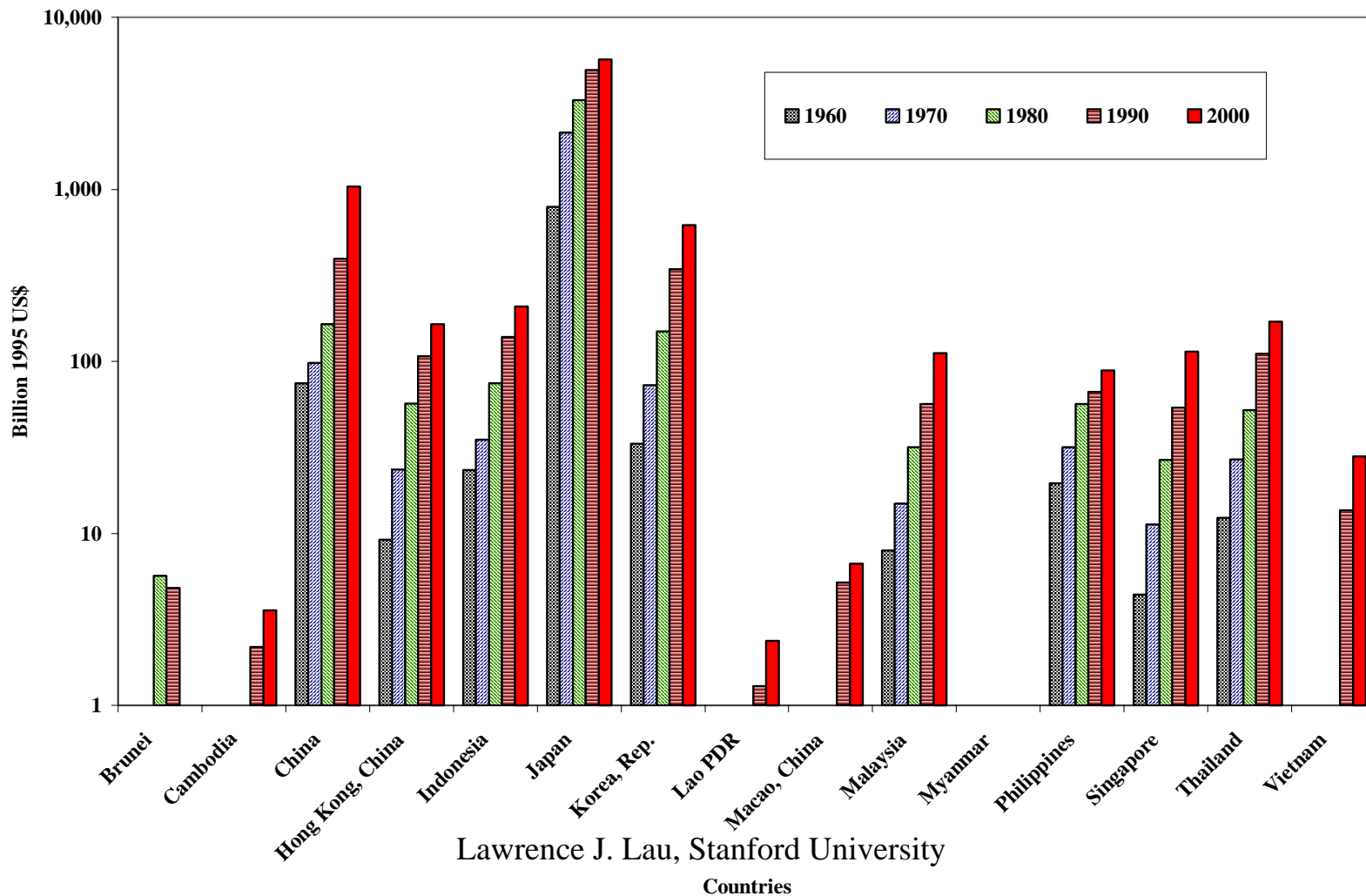
The Levels of Real GDP and Real GDP per Capita in East Asian Economies

- ◆ In 1960, the GDP of ASEAN + 3 was approximately 40% of US GDP, with Japan contributing more than 80% of total East Asian GDP, followed by China (Mainland only), with not quite 8%.
- ◆ In 2000, the GDP of ASEAN + 3 was approximately 75% of US GDP, with Japan contributing more than 60% of total GDP, followed by China (Mainland only), which contributed somewhat more than 15%.
- ◆ South Korea, and Hong Kong, Macau, and Taiwan combined, each contributed between 5% and 10%.
- ◆ Thus, ASEAN + 3 is also comparable to the Zone Euro in terms of the order of magnitude of its GDP.
- ◆ Japan also leads in GDP per capita among East Asian economies, with almost US\$50,000 in 2000 (at market exchange rates), followed by Singapore at US\$30,000. In contrast, Mainland China's GDP per capita was less than US\$900 in 2000.
- ◆ These figures and percentages are sensitive to the exchange rates used for the conversion, but the general conclusions that (1) The contribution of the rest of East Asia to total GDP has increased significantly and (2) Japan remains the leading economy within East Asia in both aggregate and per capita terms are inescapable.

Real GDP of East Asian Economies

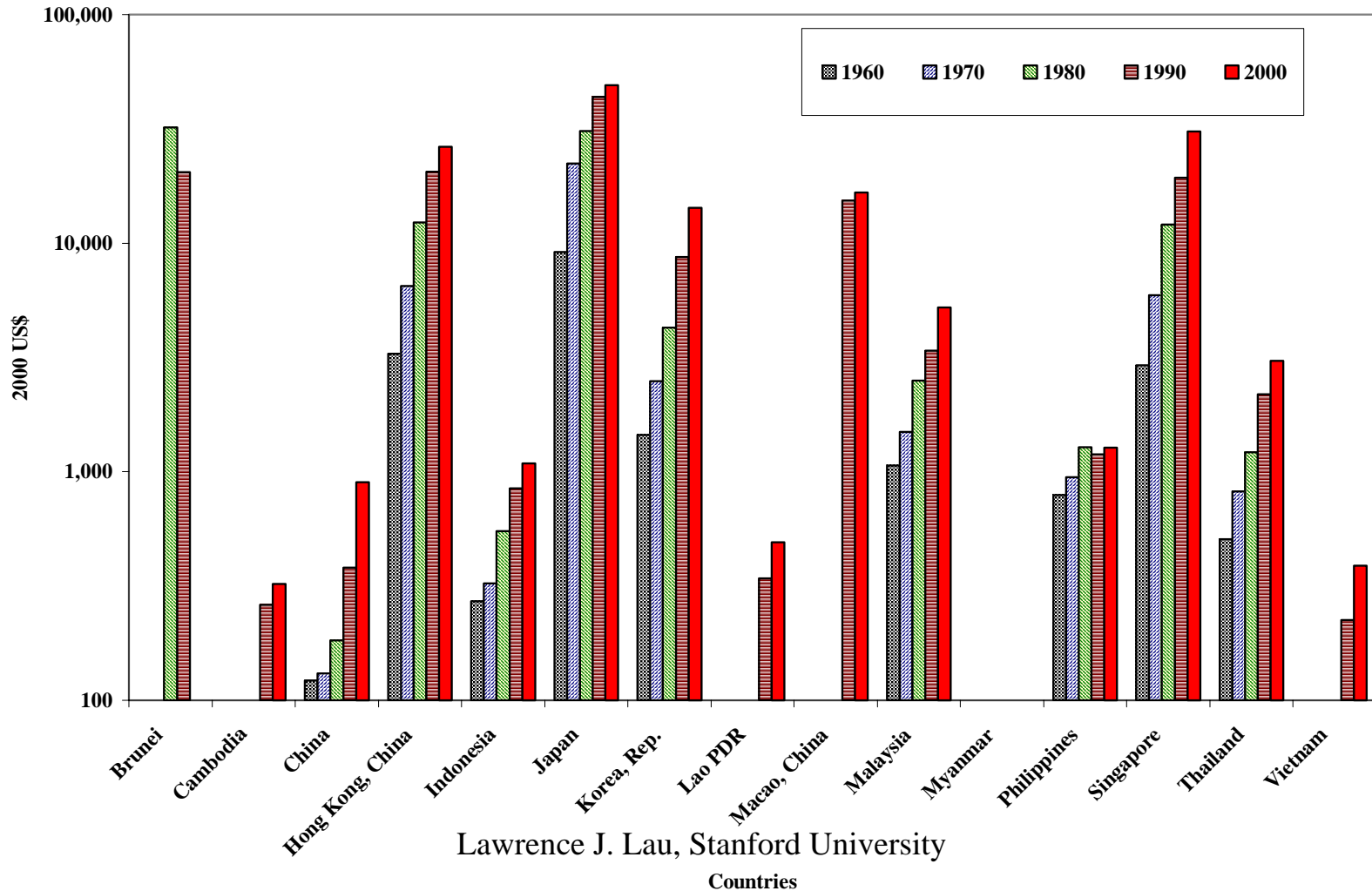
Billion 1995 US\$

Figure 2.1: Real GDP of East Asian Economies, Billion 1995 US\$



Real GDP per Capita of East Asian Economies, 2000 US\$

Figure 2.2: Real GDP per Capita of East Asian Economies, 2000 US\$

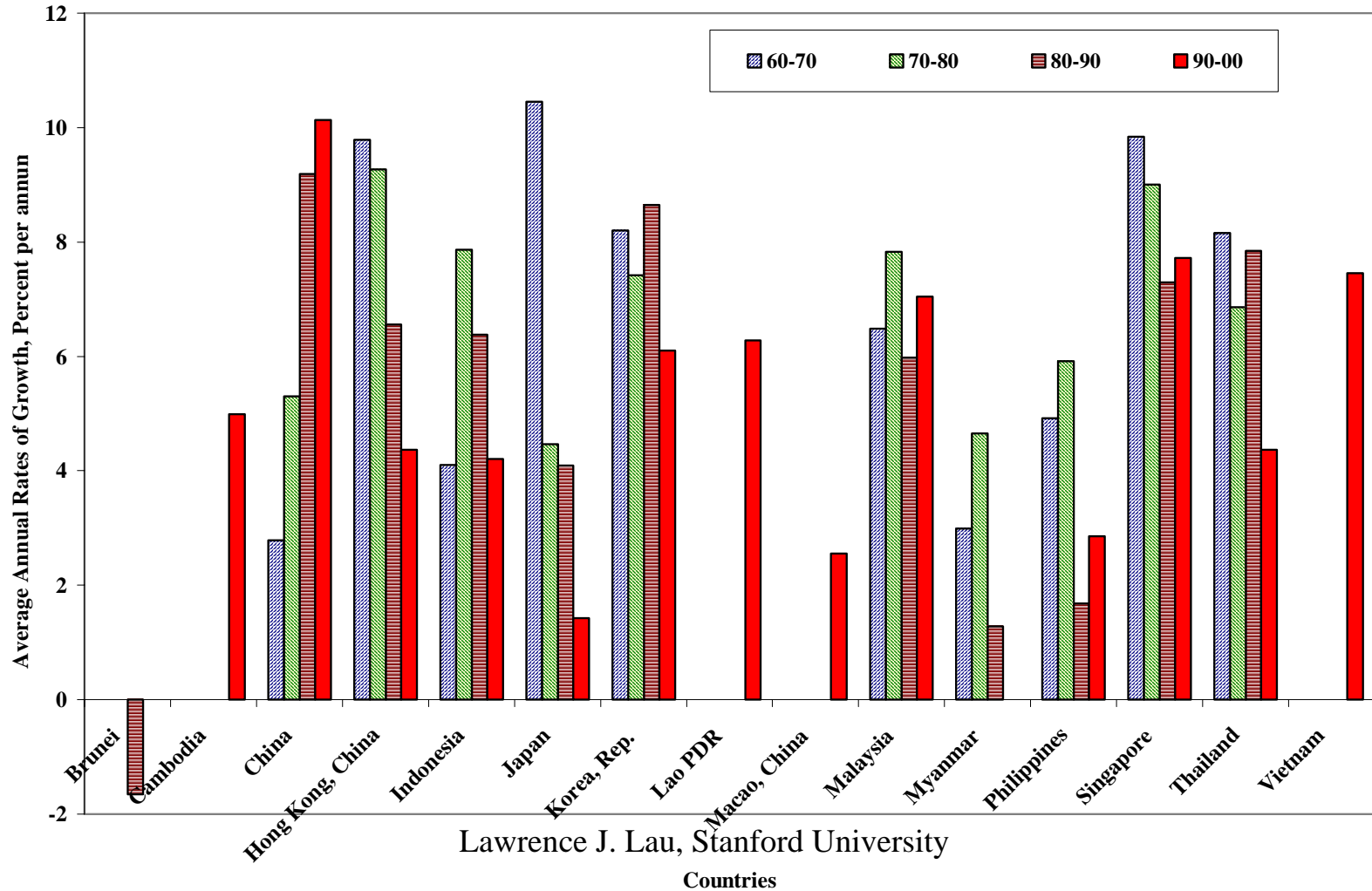


The Rates of Growth of Real GDP in East Asian Economies

- ◆ Japan achieved an average annual rate of growth of real GDP in excess of 10 percent during the decade of 1960-1970 (in fact, between 1955 and 1975). However, due to the two oil shocks, the average annual rates of growth in the two subsequent decades declined significantly to less than 5%. And since 1990 the average annual rate of growth has been below 2%.
- ◆ The rest of East Asia, with the exceptions of Brunei, Macau, Myanmar and the Philippines, have been able to grow significantly faster than Japan in the decades of the 1980s and 1990s, despite the considerable slowdown in the Japanese economy during the past decade. In particular, China was able to achieve an average annual rate of growth of almost 10% over the past two decades, a performance comparable to that of Japan between 1955 and 1972).
- ◆ Notwithstanding the East Asian currency crisis of 1997-1998, the other East Asian economies, with the aforementioned exceptions, still achieved respectable average annual rates of growth ranging between 4% and 8%.

Average Annual Rates of Growth of Real GDP of East Asian Economies

Figure 2.3: Rates of Growth of Real GDP, East Asian Economies, Selected Periods



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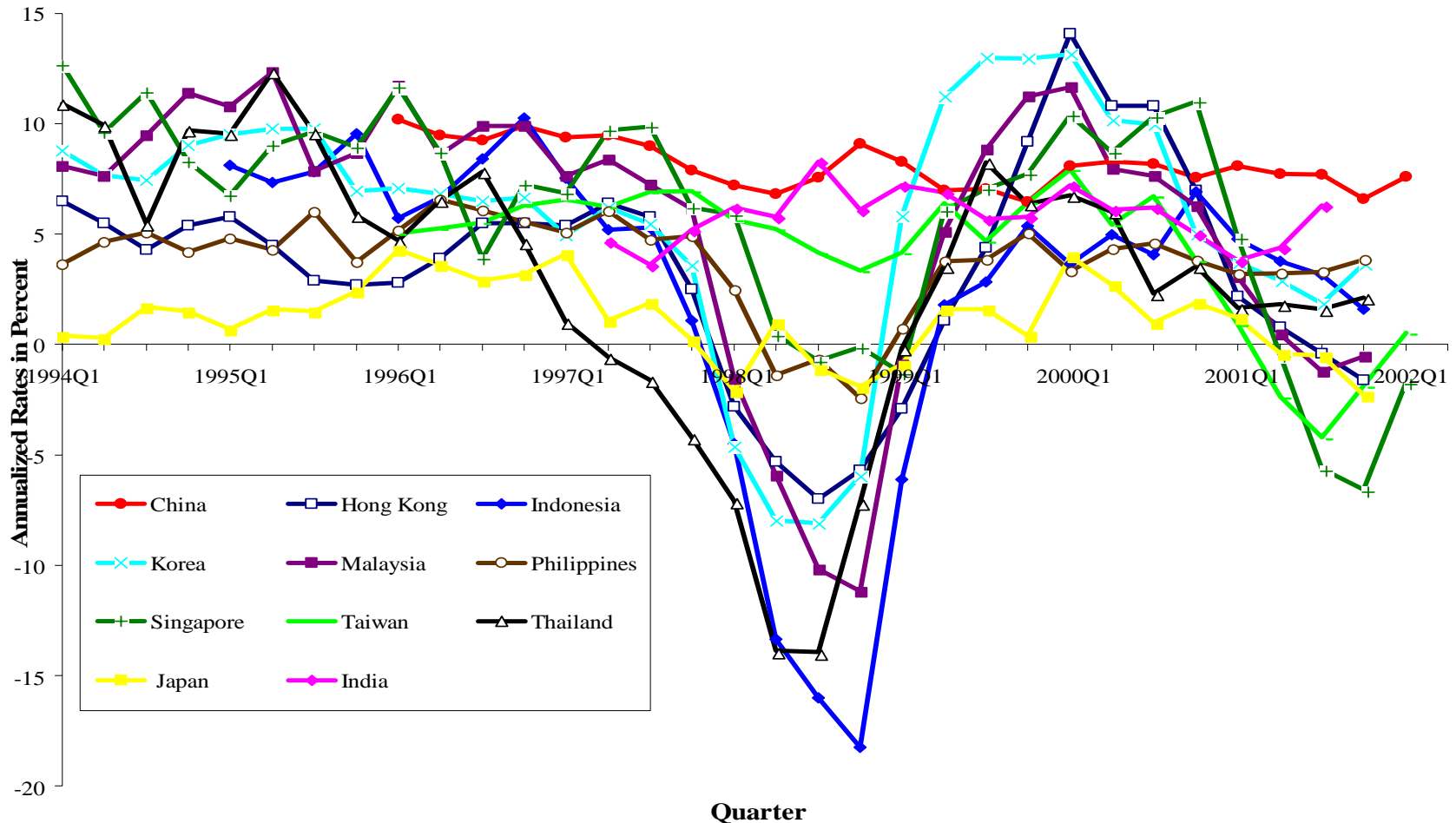
Countries

Rising Intra-East Asian Interdependence from Trade and Capital Flows

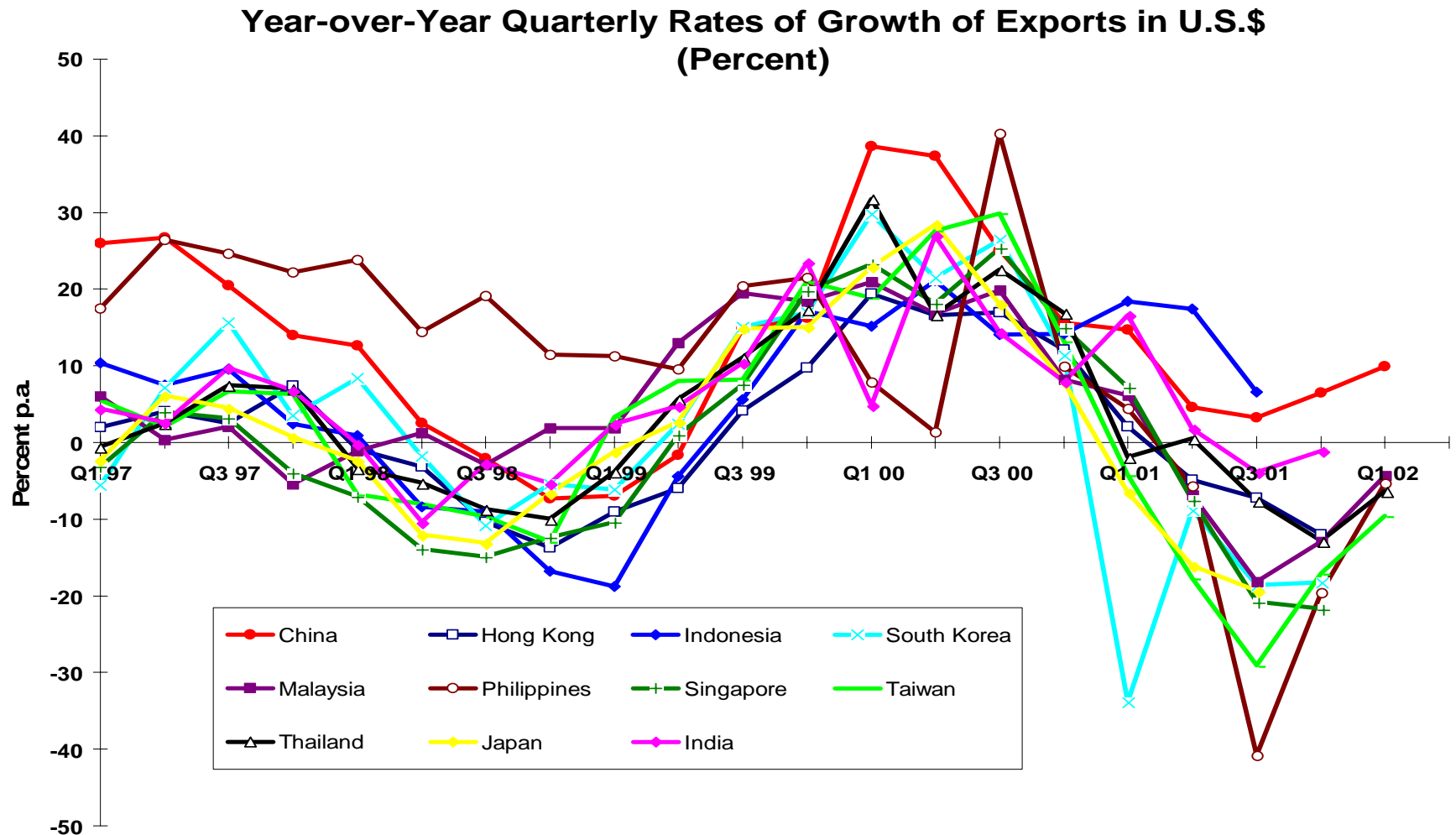
- ◆ Over the last two decades, the shares of exports of East Asian economies destined for other East Asian economies have been increasing rapidly. The share of Japanese exports for East Asian has risen to 40% in 2001. Similarly the share of East Asian exports in Japanese imports has also risen to 40% in 2001.
- ◆ By the late 1990s, approximately 50% of the exports of the East Asian economies are destined for other East Asian economies. The increasing shares lead to increasing economic interdependence.
- ◆ With the possibility of synchronization of economic cycles as, for example, during the East Asian currency crisis, East Asian economies may experience simultaneous downturns in economic activities at the same time, which in turn may cause significant reductions in the demands for one another's exports, further exacerbating their recessions. However, it is also possible that the economic recoveries may be accelerated by simultaneous upturns, with the rising import demands of each economy feeding into rising export demands of its trading partners, as actually occurred during the East Asian currency crisis.
- ◆ The emergence of the Chinese economy on the global market was the one important new development during the past two decades. China-Japan trade reached US\$101.91 billion in 2002 (exports of US\$48.44 billion and imports of US\$53.47 billion). Japan has been China's largest trading partner for ten years, and China became Japan's largest source of imports in 2002.

Quarterly Rates of Growth of Real GDP: Selected East Asian Economies

Quarterly Rates of Growth of Real GDP, Year-over-Year, Selected East Asian Economies

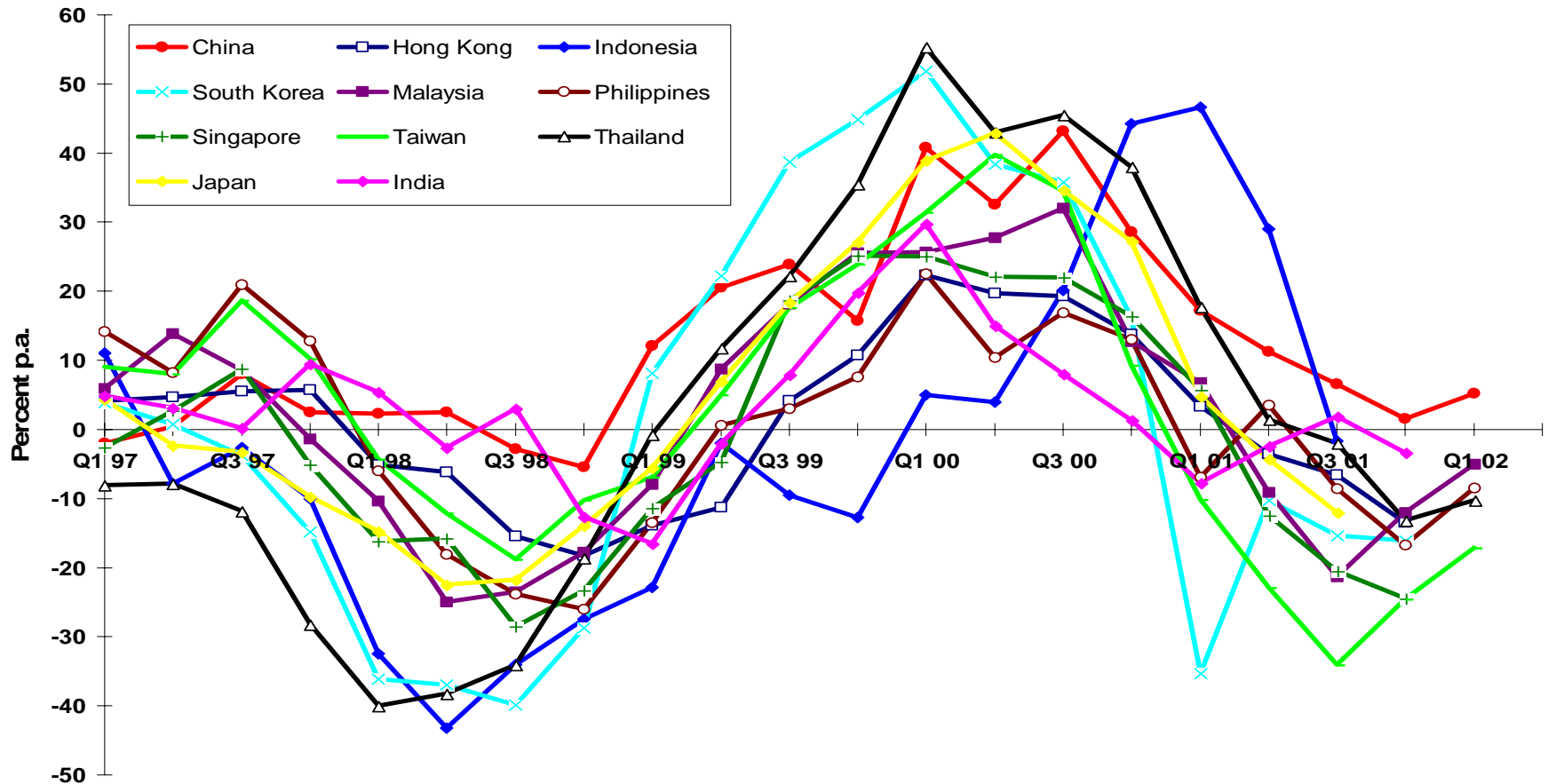


Quarterly Rates of Growth of Exports: Selected East Asian Economies



Quarterly Rates of Growth of Imports : Selected East Asian Economies

Year-over-Year Quarterly Rates of Growth of Imports in U.S.\$
(Percent)



Shares of Exports to East Asia

Table 3.1: Shares of Exports to East Asia

	Japan	China	Hong Kong	Taiwan	S. Korea	ASEAN	U.S.	E.U.	R.O.W.	Total
1980	0.22	0.36	0.62	0.30	0.31	0.47	0.23	0.05	0.16	0.14
1990	0.26	0.54	0.72	0.42	0.35	0.51	0.36	0.08	0.16	0.20
2001	0.40	0.58	0.63	0.53	0.42	0.62	0.30	0.10	0.14	0.24

Export Ranks of China, Japan and the U.S. for East Asian Economies

Table 3.2: Ranks of China, Japan and the U.S. as Destinations of East Asian Exports

	China Export Rank				Japan Export Rank				U.S. Export Rank			
	1980	1990	2000	2001	1980	1990	2000	2001	1980	1990	2000	2001
Japan	4	11	2	2					1	1	1	1
China					1	2	3	3	3	3	1	1
Hong Kong	4	1	1	1	5	4	3	3	1	2	2	2
Korea			3	2	2	2	2	3	1	1	1	1
Taiwan			8	4	2	3	3	3	1	1	1	1
Brunei	N/A	9	8	7	1	1	1	1	2	6	4	3
Cambodia	N/A	13	5	8	3	4	6	4	N/A	N/A	1	1
Indonesia	62	6	6	5	1	1	1	1	2	2	2	2
Laos	N/A	2	11	11	N/A	3	6	12	N/A	19	9	14
Malaysia	13	11	10	7	1	2	3	3	3	1	1	1
Myanmar	25	4	4	4	41	5	5	7	2	9	1	2
Philippines	19	17	12	12	2	2	2	2	1	1	1	1
Singapore	13	14	6	4	3	3	4	3	2	1	2	2
Thailand	13	17	6	5	1	2	2	2	3	1	1	1
Vietnam	N/A	18	2	5	N/A	1	1	1	N/A	48	5	3

Shares of Imports from East Asia

Table 3.3: Shares of Imports from East Asia

	Japan	China	Hong Kong	Taiwan	S. Korea	ASEAN	U.S.	E.U.	R.O.W.	Total
1980	0.26	0.53	0.25	0.20	0.30	0.53	0.22	0.03	0.18	0.15
1990	0.30	0.65	0.42	0.34	0.34	0.51	0.27	0.06	0.21	0.19
2001	0.40	0.48	0.51	0.51	0.45	0.56	0.24	0.07	0.17	0.22

Import Ranks of East Asian Economies in China, Japan and the U.S.

Table 3.4: Ranks of East Asian Economies as Origins of Imports of China, Japan and the U.S.

	China Import Rank				Japan Import Rank				U.S. Import Rank			
	1980	1990	2000	2001	1980	1990	2000	2001	1980	1990	2000	2001
Japan	1	2	1	1					2	2	3	3
China					8	4	2	2	36	9	4	4
Hong Kong	6	1	6	5	32	20	36	37	14	14	21	24
Korea	N/A	27	2	3	13	5	3	3	16	8	7	8
Taiwan	N/A	N/A	14	10	15	10	4	8	10	5	9	10
Brunei	N/A	84	77	60	12	32	37	35	70	87	82	81
Cambodia	N/A	110	78	85	135	132	84	75	N/A	N/A	66	66
Indonesia	55	13	12	15	3	2	5	4	13	25	22	21
Laos	N/A	75	111	110	120	126	125	138	141	165	157	171
Malaysia	15	11	8	7	10	12	8	7	23	20	12	12
Myanmar	N/A	41	61	62	63	87	69	69	126	119	76	75
Philippines	42	42	25	23	16	22	13	13	29	26	19	20
Singapore	18	12	10	9	22	17	15	18	28	13	13	16
Thailand	25	17	13	11	24	15	11	11	39	18	15	15
Vietnam	N/A	99	35	32	73	41	28	25	N/A	N/A	68	63

Intra-East Asian Trade Flows

- ◆ Over time, China has become increasingly an important destination for the exports of other East Asian economies; however, Japan remains more important than China for most of the East Asian economies (in terms of their export ranks), with the notable exception of South Korea—China has supplanted Japan as the second most important export destination for South Korea (the U.S. remains the most important destination for South Korea).
- ◆ The share of imports from East Asian economies has risen considerably for Japan, to 40% in 2001, and has remained high for China, at 48% in 2001. These shares have risen for all other East Asian economies (Hong Kong, Taiwan, South Korea and the ASEAN). The ranks of East Asian economies in both the China and Japan have also been rising (that is, becoming higher in rank and lower in number) over time.
- ◆ In contrast, the share of U.S. exports destined to East Asian economies as well as the share of U.S. imports originated from East Asian economies have declined slightly during the last decade.

Intra-East Asian Capital Flows and Technology Transfer

- ◆ The wild geese flying pattern of East Asian economic development (Kaname Akamatsu (1962))
- ◆ Japan, Hong Kong, Singapore, South Korea and Taiwan have become major direct investors in the East Asian developing economies. More recently, Chinese enterprises have also begun to make direct investments abroad.

Economic Complementarity or Competition

- ◆ Within East Asia, there exist significant economic complementarity between the developed economies (principally Japan) and the developing economies (China and the ASEAN without Singapore)—there is very little overlap and hence competition between what Japan exports on the one hand and China and the ASEAN without Singapore export on the other hand. Japan is still the premiere source of capital goods and technology within East Asia. This complementarity is borne out by the trade statistics at the disaggregated commodity level.
- ◆ The Newly Industrialized Economies (NIEs) of Hong Kong, South Korea, Singapore and Taiwan are actually competitive with the developed economy, Japan, on their high ends and with the developing economies on their low ends (and with one another).
- ◆ Moreover, the bulk of the Japanese exports consists of intra-industry and intra-firm trade, which reflect that the exports are mostly based on long-term supplier-user relationships and/or direct investment by Japanese parent firms. Globalization of supply chains and the concomitant de-verticalization of production and outsourcing have accounted for much of the expansion of intra-industry and intra-firm trade.
- ◆ The largest potential gains from the economic complementarity is therefore a (China-Japan-ASEAN) free trade area (FTA)
- ◆ The continued economic development and growth of East Asian economies, including China, therefore present enormous opportunities for Japan

An ASEAN + 3 Free Trade Area

- ◆ A voluntary and co-operative version of the “Great East Asia Co-Prosperity Sphere”
- ◆ An East Asian Economic Community without the participation of both China and Japan is unlikely to be successful
- ◆ Specialization in accordance with comparative advantage—Japanese strengths:
 - ◆ Capital goods production
 - ◆ Complex manufacturing processes
 - ◆ R&D capability

Identifying a Pareto-Improving Sequence of Implementable Measures

- ◆ Separation of economics and politics, at least initially
 - ◆ Dual leadership (China and Japan)
 - ◆ Inclusivity
- ◆ Free trade per se is likely to face domestic opposition everywhere—in principle, the losers can be compensated; in practice it is difficult to do so
 - ◆ World Trade Organization membership is almost universal among the East Asian developing economies
 - ◆ Free trade can be promoted on the grounds that it increases the size of the regional market and hence is an attraction to foreign direct investors
 - ◆ Free trade can also be promoted if there is an adequate mechanism for compensating the displaced workers
- ◆ Publicly funded compensation for displaced workers in all countries:
 - ◆ Domestic compensation for displaced workers to be paid monthly through a fund financed with tariffs at pre-existing rates, or by equivalent tariffs corresponding to pre-existing quotas on above-quota imports, for a fixed period (5-10 years) for workers above a certain age, say, 45
 - ◆ Tariffs to be phased out completely when the value of the fund is equal to the present value of the liabilities for the displaced workers
 - ◆ Younger workers will be retrained at government expense
 - ◆ Older workers will be encouraged to retire

Identifying a Pareto-Improving Sequence of Implementable Measures

- ◆ Harmonization of standards and facilitation of exchangeability
- ◆ Coordination and stabilization of exchange rates can provide potential Pareto improvement to all economies
 - ◆ Distinguishing liquidity problems from solvency problems
- ◆ Coordination of foreign direct investment policies
- ◆ Coordination of capital market policies
- ◆ Common issues on trade

Harmonization of Standards and Facilitation of Exchangeability

- ◆ Technological standards—e.g., mobile telephones, television, data transmission, financial data protocols
- ◆ Grading, inspection and certification standards for commodities
- ◆ Software standards
- ◆ Certification standards
- ◆ Harmonization of rules and regulations for e-commerce

Co-Ordination and Stabilization of Intra-East Asian Exchange Rates

- ◆ Competitive devaluation can lead to great instability, both for the individual countries and for the region as a whole (as well as globally)
- ◆ Predictability and stability of the exchange rate over the medium to long term facilitate investment and economic growth
- ◆ Thus, the importance of maintaining relative parity among the East Asian developing economies
- ◆ Exchange rate policy coordination among East Asian economies can prevent contagion that may result from unexpected and unintended changes in the relative exchange rate alignments
- ◆ Timely intervention can make a significant difference for all
 - ◆ Prevents over-shooting adjustments with their irreversible negative effects
 - ◆ Prevent/minimize contagion and hence a vicious cycle of competitive devaluation

A Multilateral Currency Swap Framework with Bilateral Agreements

- ◆ The ASEAN (Brunei, Indonesia, Malaysia, Myanmar, Khmer Republic, Laos, Philippines, Singapore, Thailand and Vietnam) + 3 (China, Japan, Korea) have approved, in principle, bilateral standby swap arrangements for the support of the exchange rates of individual economies
- ◆ It is also possible to have bilateral agreements on settlement of transactions in the currencies of the countries instead of the U.S. dollar (up to a maximum amount if necessary), thus conserving foreign exchange reserves and freeing them up for potential use in emergencies
- ◆ The same result can also be achieved through an East Asia-wide multilateral agreement

A Foreign Exchange Lender of Last Resort: A Cooperative Asian Currency Stabilization Fund

- ◆ A regional cooperative currency stabilization fund may have a useful role to play by augmenting the potential foreign exchange reserves perceived to be available for the defense of any single currency. (Timely intervention in the currency markets of certain countries, such as Indonesia, would have helped to reduce the misery significantly.)
- ◆ In order to avoid moral hazard, countries must meet certain prescribed rules of liquidity and solvency in order to avail themselves of the facility
- ◆ The facility is dedicated to the stabilization of the exchange rate only and cannot be used for other purposes
- ◆ The mere existence of such a region-wide currency stabilization facility can actually discourage speculation and help stabilize the exchange rates of smaller East Asian economies.

Is There Room for a Common East Asian Currency?

- ◆ Cooperation between China and Japan is absolutely essential for the emergence of a common East Asian currency
- ◆ An East Asian snake similar to the former EMS snake?
- ◆ The volatility of the Yen/US\$ exchange must be significantly reduced in order for an East Asian snake or more permanent arrangement to be viable

Coordination of Foreign Direct Investment Policies

- ◆ Investment protection
- ◆ Tax treaties—elimination of double taxation and exchange of information
- ◆ Harmonization of investment benefits for foreign direct investors (differentiation by host countries can be permitted based on real GDP per capita)
- ◆ Elimination of export requirements on foreign direct investment
- ◆ Common policy for the free movement of employees of foreign direct investors (on residence, tax, pension and other related matters)

Common Issues on Trade

- ◆ Rules of origin incompatible with the global trends for de-verticalization (fragmentation) and out-outsourcing
- ◆ Dumping and anti-dumping rules
- ◆ Labor standards
- ◆ Environmental standards
 - ◆ Global warming and carbon dioxide emissions
- ◆ Environmental protection and pollution—the possibility of internalization
- ◆ Internalization of costs of adjustment (exporting textile machinery in exchange for increased imports of textiles)

An East Asian Economic Community Will Take Decades to Get Off the Ground

- ◆ Historical Precedent—The evolution of the European Union has been a more than 50-year process, beginning with the Bank for International Settlements and proceeding progressively to the European Coal and Steel Community, the European Common Market, the European Economic Community, and now the European Union and the Zone Euro.
- ◆ The support of the United States and the pressure of the Soviet threat helped to overcome internal political differences.

Is There the Political Will to Move Towards an East Asian FTA/Economic Community?

- ◆ Is each of the East Asian economies ready to trade increased exports for increased imports, thus realizing the gains from specialization and economies of scale?
- ◆ Are the East Asian economies as a group ready to restrain nationalistic sentiments and support the rise of global companies by facilitating the free movement of long-term capital and direct investment?
- ◆ Can Japan and the other East Asian countries put their historical enmity behind them and enter a new era of mutual cooperation?
- ◆ Japan can play a leading role in the economic future of East Asia. It may even be a stimulus for renewed economic growth in Japan. The choice for Japan: East Asia's West Germany or East Asia's United Kingdom?