

**The Perspectives  
on  
Asian Economic Cooperation**

**Tokyo American Center, the US Embassy in Japan**



**Institute for International Monetary Affairs**

**I I I M I A**

**Institute for International Monetary Affairs**

**Occasional Paper 16**

**Occasional Paper  
No. 16**

**The Perspectives  
on  
Asian Economic Cooperation**

**Tokyo American Center, the US Embassy in Japan**

**Institute for International Monetary Affairs**

**Tokyo, January 25, 2006**

## **Preface**

Recently there has been a mounting debate on the regional cooperation in Asia. In order to promote a true regional partnership in Asia, however, it is increasingly important to foster cooperative relations within Asia, as well as with the United States and other Pacific Rim countries. Both the Asia-Pacific Economic Cooperation (APEC) conference in November, and the first East Asian Summit in December, provided opportunities for the active exchange of views on cooperation in the Asia Pacific.

Taking the advantage of these occasions, Tokyo American Center of the US Embassy in Japan and the Institute for International Monetary Affairs have planned a symposium on "Perspectives on Asian Economic Cooperation". We think it was very timely and we were much honored to have such distinguished panelists from a number of Asian countries and the United States, to share their perspectives on ways to promote regional economic cooperation in Asia.

We hope this publication that records their speeches and discussions will provide some valuable insights on the future prospects for Asian economic cooperation to those who are interested in the development of Asian regional integration. Please note all the responsibility in compiling these speeches and discussions is solely of IIMA's as are any errors in their presentations here.

**Tokyo American Center**

**<http://japan.usembassy.gov/e/tamc-main>**

**Institute for International Monetary Affairs**

**<http://www.iima.or.jp>**

## **Panelists:**

### **Yi Gang**

**Assistant Governor, the People's Bank of China**

- 1980 Peking University
- 1986 Ph. D in Economics, University of Illinois
- 1986 Assistant Professor, Indiana University
- 1994 Professor, Ph. D Advisor, Peking University
- 1997 Deputy Secretary-General, Monetary Policy Committee of the People's Bank of China (PBC)
- 2002 Director-General, Monetary Policy Department of PBC  
Secretary-General, Monetary Policy Committee of PBC
- 2004 Assistant Governor, PBC

### **Jusuf Wanandi**

**Vice Chairman, Board of Trustees, Centre for Strategic and International Studies, Indonesia**

- 1960 Master of Law, the University of Indonesia
- 1964 Secretary, Supreme Advisory Council (DPA)
- 1965 Secretary General, Indonesian National Education Council
- 1968 Member, Provisional People's Consultative Assembly (MPRS)
- 1971 Vice Chairman, Board of Trustees, CSIS  
Deputy Secretary General, The Central Board of Golkar
- 1973 Head, Dept. of Planning & General Affairs, The Central Board of Golkar
- 1978 Deputy Treasurer, The Central Board of Golkar
- 1983 Head, Department of International Affairs, The Central Board of Golkar  
Member, Board of Governors, East-West Center, Honolulu, Hawaii  
Chairman, Indonesian National Committee for Pacific Economic Cooperation (INCPEC)  
Member, the Standing Committee for Pacific Economic Cooperation Council (PECC)
- 1992 Vice Chairman, The Gemala Group of Companies  
President Director, PT Bina Media Tenggara, publishing company for The Jakarta Post
- 1997 Co-Chairman, Council for Security Cooperation in Asia Pacific (CSCAP)

## **Il SaKong**

### **Chairman & CEO, Institute for Global Economics, Korea**

- 1964 Graduated from Seoul National University
- 1966 MBA, University of California at Los Angeles
- 1969 Ph.D., University of California at Los Angeles
- 1969 Assistant Professor, Economics and Finance, New York University
- 1973 Senior Fellow, Research Director, Korea Development Institute
- 1982 Vice President, Korea Development Institute
- 1983 President, Korea Institute for Industrial Economics and Trade
- 1987 Minister of Finance, Korea
- 1989 Special Consultant, International Monetary Fund
- 1993- Chairman & CEO, Institute for Global Economics, Korea

## **Roberto F. de Ocampo**

### **President, Asian Institute of Management, Philippines**

- 1967 Graduated from Ateneo de Manila University
- 1970 MBA, University of Michigan
- 1971 A post graduate diploma from the London School of Economics  
Senior loan officer, the World Bank
- 1989 Chairman and CEO, the Development Bank of the Philippines
- 1992 Secretary of Finance
- 1998- President, Asian Institute of Management, Philippines

## **Michael W. Michalak**

### **Ambassador, U.S. Senior Official for APEC, Department of State**

- 1969 Graduated from Oakland University
- 1969 Research Physicist, NASA Goddard Space Flight Center
- 1972 Staff Assistant, Office of Science and Technology Policy, Department of State, Washington DC
- 1972 Master of Science/Physics, The Catholic University of America
- 1974 Commercial Officer, American Consulate General, Sydney, Australia
- 1977 Financial Economist, Economic Section, U.S. Embassy, Islamabad, Pakistan
- 1981 Master of Science/ Public Administration, Harvard University, John F. Kennedy School
- 1981 Economic Officer, Asia Bureau Regional Affairs Office, U.S. State Department, Washington DC
- 1982 Economic Officer, Japan Desk, U.S. State Department, Washington DC
- 1986 Chief, Bilateral Trade Unit, U.S. Embassy, Tokyo, Japan
- 1991 Deputy Chief, Economic Section, U.S. Embassy, Beijing, China
- 1993 Deputy Director of Economics, Office of China and Mongolian Affairs, Washington DC
- 1996 Deputy Coordinator, Office of Eastern European Assistance, Washington DC
- 1997 Senior Advisor, National Center for APEC, Seattle, WA
- 2000 Minister-Counselor, Economic Section, U.S. Embassy, Tokyo
- 2004 Deputy Chief of Mission, U.S. Embassy, Tokyo
- 2005- U.S. Senior Official for APEC, Washington DC

**Haruhiko Kuroda**  
**President, Asian Development Bank**

- 1967 Graduated from University of Tokyo
- 1967 Joined the Ministry of Finance
- 1971 M. Phil. in Economics from University of Oxford
- 1975 International Monetary Fund
- 1987 Director, International Organizations Division, International Finance Bureau,  
Ministry of Finance
- 1992 Deputy Vice Minister of Finance for International Affairs
- 1996 President, Institute of Fiscal and Monetary Policy, Ministry of Finance
- 1997 Director-General, International (Finance) Bureau
- 1999 Vice Minister of Finance for International Affairs, Japan
- 2003 Special Advisor to the Cabinet  
Professor, Hitotsubashi University, Graduate School of Economics
- 2005- President, Asia Development Bank

**Moderator:**

**Toyoo Gyohten**  
**President, Institute for International Monetary Affairs**

- 1955 Graduated from the University of Tokyo
- 1955 Joined the Ministry of Finance
- 1984 Director-General, International Finance Bureau
- 1986 Vice Minister of Finance for International Affairs
- 1990 Visiting Professor at Princeton University
- 1992 Chairman, The Bank of Tokyo, Ltd.
- 1995- President, Institute for International Monetary Affairs
- 1996- Senior Advisor, The Bank of Tokyo-Mitsubishi, Ltd.

## Contents

1. Opening Remarks .....	1
Joanne Gilles Deputy Director, Tokyo American Center, U.S. Embassy in Japan .....	1
Toyoo Gyohten President, Institute for International Monetary Affairs .....	2
2. Chinese Economy and Exchange Rate System .....	6
Yi Gang Assistant Governor, People's Bank of China, China	
3. East Asia Community Building and the Role of Japan .....	11
Jusuf Wanadi Co-founder; Vice Chairman, Board of Trustees, Center for Strategic and International Studies, Indonesia	
4. An Enhanced East Asian Economic Cooperation toward the East Asian Community .....	16
Il SaKong Chairman and CEO, Institute for Global Economics, Korea	
5. Promoting Regional Economic Cooperation in Asia .....	20
Roberto F. de Ocampo President, Asian Institute for Management, Former Secretary of Finance, Philippines	
6. U.S. strategic interests in the Asia-Pacific region .....	25
Michael Michalak Ambassador, U.S. Senior Official for APEC, Department of State	
7. Challenges of Regional Cooperation and Integration in Asia .....	32
Haruhiko Kuroda President, Asian Development Bank	
8. Questions and Answers .....	38

## **1. Opening Remarks**

**Joanne Gilles**  
**Deputy Director, Tokyo American Center**  
**Embassy of the United States in Japan**

(Based on simultaneous interpretation from her speech in Japanese)

Good afternoon, ladies and gentlemen, and thank you for the introduction. I'm Joanne Gilles, Deputy Director of the Tokyo American Center of the Embassy of the United States in Japan. I'd like to take this opportunity to thank you for taking the time from your busy schedule to attend this 14<sup>th</sup> International Symposium. The topic of this symposium today is the perspectives on Asian Economic cooperation. As we look toward the future in Asia –Pacific region, there could be various modalities and ways for economic cooperation. Now gathered here today, experts in this field about economic cooperation in Asia and Pacific regions, they will talk to us from global perspectives based on their extensive knowledge and experience. Both from Asian countries and from the United States as well, we believe that this is a real significant occasion to be able to have a symposium of this kind.

Also, as a co-organizer of this symposium, I am very happy that we have been able to invite Mr. Michael Michalak, Ambassador–designate, the US Senior Official to APEC of the Department of the State of the United States. Mr. Michalak as a senior official to APEC has had a very wide-ranging knowledge and experience about economic cooperation in the Asian region which is precisely the topic we are taking up today, but also as Deputy Chief of Mission of the US Embassy in Tokyo, the Minister Councilor, he has a broad knowledge about Japan as well.

Let me conclude by thanking the speakers and panelists for graciously accepting to participate in this symposium and also wish for good health and further prosperity for everyone who has gathered here today. Thank you very much.



## **Toyoo Gyohten**

### **President, Institute for International Monetary Affairs**

(Based on simultaneous interpretation from his speech in Japanese)

Thank you. My name is Gyohten from the Institute for International Monetary Affairs. I'm so glad to see such a large audience here with us this afternoon and to the members of the panel I would like to thank them for traveling long distance to participate in this symposium. And also, the Tokyo American Center of the Embassy of the United States in Japan has been gracious to co-sponsor and co-organize this symposium. Thank you very much for your support and cooperation. We are very happy to have you as our partner.

Now, Institute for International Monetary Affairs was established in 1995, so actually we have just celebrated our 10<sup>th</sup> anniversary and to commemorate the 10<sup>th</sup> anniversary, starting last year we have conducted several commemorative events and functions. In particular, one of the important ones, was that towards the end of last year, we carried out an event which was to solicit articles and essays from the Asian students on "What should be done to promote Regional Economic Cooperation in Asia." We had many entries and Prof. Tetsuji Murase from the Kyoto University served as the chairman of the judge, or screening board, and after going through very rigorous screening, testing and examining, Miss Aysun Uyar, a lady from Turkey who is studying in Yamaguchi University, won the first prize for her essay or her paper. The second prize went to a person who is studying at the Philippines University, Miss Andrea Chloe A.Wong, a lady again, and the third prize went to a person called Mr. Laxmisha Rai, who is studying at Kyungpook National University in the Republic of Korea. They have all written very solid and high-standard papers. (Their essays are accessible on IIMA's website at <http://www.iima.or.jp/english.htm>)

Today, as part of this 10<sup>th</sup> anniversary event, we are hosting this 14<sup>th</sup> International Symposium, and as Miss Gilles mentioned, we have very distinguished members to participate as panelists, and to us, Institute for International Monetary Affairs, we are very honored and privileged to have such a splendid panel of speakers. But there is one note of regret and maybe some of you have already read it in the paper and it has to do with the chairman of the Institute of Strategic and International Studies of Malaysia, Dr. Noordin Sopiee, who passed away on 29<sup>th</sup> of December. Mr. Sopiee had been looking forward, we hear, to attend in this symposium so it's with a great deal of sadness that Dr. Noordin Sopiee is not able to attend this symposium. He is a well-known scholar and a powerful opinion leader not only in Malaysia, but in fact for the entire Asian region. He has written so many books and papers. He has spoken to us on many occasions, so it's a great loss for all. We would like to pray for the repose of his soul.

Now ladies and gentlemen, needless to say, the Asian financial crisis that occurred in 1997 has triggered a great deal of interest about Asian regional economic cooperation. This heightened interest, I think, is the result of some serious soul searching and reflection about our past activities, mainly in four areas, or four fields. What are those four fields of reflections?

The first one is this: that maybe there had been unsoundness about financial institution management in this region. There had not been good and solid-enough financial supervisory systems installed, and also the financial market, money and markets in this region, had not developed well enough. The second area has to do with the fact that perhaps we did not have a good-enough system for economic management or for mutual supervision of economic management of all the countries in Asia; we neither had good enough system for mutual support. The third reflection has to do with the fact that maybe we had depended too much on US dollars both in terms of trade and investment. The fourth reflection has to do with the fact that the savings we had collected within the region had not been utilized effectively for productive investment within the region.

So these are some of those areas, or mainly the four areas of reflections and we have some future directions to think about seriously. Ever since then, however, with these soul-searching reflections, the countries in the region - each one of them - stepped up their efforts for inter-regional cooperation both at government as well as private sector levels. And we are seeing some very steady results - good results - stemming from those efforts, and thanks to those efforts, Asian economy as a whole is developing very smoothly at present. The development in Asia is a powerful engine next to the US economy and as such a powerful engine, it is contributing to the growth of the world economy, and many people believe that the 21<sup>st</sup> century is the century of Asia, or century for Asia. But if we look back upon the pathway of Asian economic cooperation over the last ten years, I think there are some special features to be mentioned here - mainly four special features.

The first one has to do with the fact that in the production, trade, and investment area - these are the real economy in fact - Asia, in particular East Asian economies are quickly and rapidly and steadily integrating amongst themselves. I'm sure this is going to be mentioned later on, but already 50% of trade and investment is intra-regional and so it's comparable to the European Union or North American Free Trade Agreement. What I could consider as particularly important is the fact that in the area of parts and components and materials, the production and supply of them are being stepped up here in Asia and they are extending to manufactured goods and processed goods. In other words, an entire production network has been already established here in East Asia, and this East Asia is self-contained area in fact. In short, you can say that East Asia is now the biggest production plant or factory in the world.

The second feature to be mentioned is that a big network of bilateral cooperation has been created by economic partnership agreements – including trade, investment and technology transfers.

And the third feature is: when you look at the financial sector, indeed you see that practical cooperation and various research works are underway smoothly. However, if I may speak candidly, when it comes to co-ordinations of financial policies or exchange rate policies that some people feel will interfere with the sovereign right of a nation, there is still quite a resistance within the Asian countries and some hard efforts are needed in order to rectify the situation and get people ready to mutually renounce that kind of sovereign right to determine and decide on their own policies individually.

Now the forth one; when you think about long-term expansion of intra-Asia cooperation, it has become increasingly clear that you need a stable balance of power and also a strong leadership structure within the region. You cannot try to have a long-term expansive intra-Asian cooperation without this kind of stable balance of power or solid leadership structure. In my concrete terms, ASEAN, Japan, China and the Republic of Korea - these are really the four pillars of Asia, and what sort of relationship can these four pillars develop, and what sort of rules can each of these four pillars play? Now we need to hammer out basic and common understanding about the role to be played by these countries respectively. In addition, one of the most important stakeholders in Asia is historically the United States. So, how is the United States going to involve itself with Asia in the future? Again, we need some common understanding about the role to be played by the United States as an important traditional stakeholder. As you know, here in Japan, the interest in Asian regional cooperation is at its highest at present, and there are so many meetings, discussions, research works, publications on this topic of Asian regional cooperation.

However, I have certain apprehensions about this whole phenomenon. Yes, we know that Japanese people are increasingly interested in this Asian inter-regional cooperation, but perhaps we have focused too much attention on the Japanese stance or the Japanese benefits, and we have somewhat neglected to study deeply enough what other stakeholders think about this Asian inter-regional cooperation. What sort of role Japan is expected to play by these other stakeholders?

We have had some basic objectives in planning and conducting this symposium. The biggest one is that we wanted the Japanese people to listen to the voice of other stakeholders and we think this is a good opportunity to do so. By listening to the views of other stakeholders, Japan will be able to take much more realistic policies concerning Asian regional cooperation and that our policies may be able to win more realistic international sympathy and support. Once again, we have been able to get together with us some of the

most outstanding stakeholders and I am sure that the audience will receive a lot from attending this symposium.

As for the way we want to proceed with this symposium, as it's been already mentioned, we will first of all have keynote speeches in the order listed on the program. The six of the members of the panel will be giving their remarks. I will not be introducing them again because already on the program their backgrounds are well-introduced and besides, they are such prominent members that no detailed introduction will be needed. So, we will have some opening remarks by the six panelists, and after that we will have a coffee break upon completion of these initial statements by the six panelists. During that coffee break, I would like you to write down the questions to the members of the panel. We would like to solicit and entertain as many questions as possible. After the coffee break, I will be sorting out these questions and direct those questions to the members of the panel and also there will be the opportunities for the members of the panel to discuss amongst themselves as well. So, this is how I would like to conduct the whole session and so we would like to start with the first speaker. The first speaker is, as is written on the program, Dr. Yi Gang, Assistant Governor, the People's Bank of China. Mr. Gang, please.

## **2. Chinese Economy and Exchange Rate System**

**Yi Gang**

**Assistant Governor, People's Bank of China, China**

Thank you, Mr. Chairman. Ladies and gentlemen, good afternoon. First, let me express my thanks to the organizers of this symposium. Especially, I would like to give my gratitude to President Toyoo Gyohten for his excellent work in organizing this wonderful seminar together. And I think the topic of this seminar, "Perspective on Asian economic cooperation" is a very important one. I would like to take this opportunity to make three related points.

First point is about trade. I think trade is one of the most important aspects of regional economic cooperation. China now already has become the third largest trader in the world in terms of the regional cooperation of trade, and we see that the current globalization and the current trade pattern of the world have certainly very important characteristics. China now has a fairly large trade surplus with the United States and Europe, but has a trade deficit with Asian countries. With ASEAN, with Japan and with Korea, we have a trade deficit. Some people may argue with me and I also read newspapers about the trade statistics – they have a debate on whether China-Japan is trade deficit or surplus. But if we look at last five years, from 2001 to 2005, definitely China has trade deficit with Japan, Korea and ASEAN. And from 2001 to 2005 -these five years China has a trade deficit with Japan of 55 billion US dollar and trade deficit with Korea, 124 billion US dollars, and ASEAN 69 billion US dollar. These are 5-year cumulative.

At the same time, we have trade surplus with US and Europe. This is certainly a result – a consequence of globalization and division of labor. We import a lot from our neighbors and then we export a lot to the US and the Europe market. In this kind of division of labor, China, sometimes might be under pressure from US and from Europe, and they say that there is an imbalance of trade. But I think for the short time, it's very difficult to change this pattern of division of labor, and we will see this kind of trend will last for some time. And we try to adjust our policy and try to promote inter-regional trade and try to promote global trade on a more sustainable pattern. I think we will continue to commit to trade liberalization and open-door policy, and hopefully to enhance the regional trade further, and we will try to make a better trade policy and better facilities and we will try to realize our WTO commitment by the end of this year. And you know that this year is the last year of WTO transition period for China, and after this year you see all the commitment on joining WTO will be finished, so that our policy in general, all the promises and commitment on WTO, especially on the trade issue in terms of cutting tariff and facilitating easy trade policies so on and so forth will be realized on time.

The second topic I want to discuss is the exchange rate, and a lot of people have many questions about exchange rate policies of China. Probably you all know that last year in July, China de-pegged renminbi against the US dollar and we started managed floating regime with a reference of a basket of currencies. And right on that day, renminbi appreciated against US dollar 2.1%, and since then another 0.5% appreciation, so that right now if you compare with July 21 last year, renminbi already appreciated about 2.5% against US dollar, but if you look at the appreciation against Japanese yen and Euro, the appreciation of renminbi is much larger than that amount.

Let me just say a little bit about the history of the exchange rate policy of China. In the beginning of 1994, China unified so-called two-track exchange rates which are official rate and market rate, and then we have managed floating regime since then. And if you look at the newspapers and comments, some people said there was a large depreciation of renminbi at the beginning of 1994. And I want to explain that a little bit. You see before 1993 China had a two-track system, one official, one market. In 1993, if you look at the market share of the two-tracks, and you will find 85% of the trading was under the market rate. Only 15% of the trading in 1993, 1992, I mean before 1994, only 15% of the market trading was under official rate. The official rate was 5.85 renminbi equal to a dollar, whereas, the market rate in 1993 was 7 renminbi, to a dollar, and during the summer 1993 it went up to 8, 9, 10, 11 renminbi equal to a dollar. So if you look at the weighted average of the exchange rate of the market track, I think it's around 9 renminbi equal to a dollar in 1993. So we unified renminbi at the beginning of 1994 to 8.7 renminbi equal to a dollar, and if you look at the weighted average of market trading and official track, actually depreciation of renminbi is not very large. Those people, who had comments, said that you have a lot of depreciation at the beginning, referring to from 5.85 to 8.7. 5.85 was the official rate, but you see there is no way you can buy the dollar at that rate. At that time in 1993, there was already a black market trading the quotas. The quota for the official rate is worth 3-1, something like that. The 5.85 plus the quota price is equal to the market track rate. That's the situation and I would like to explain that to clarify the question on that issue.

From 1994, we unified the rate to one rate, 8.7, and since then renminbi appreciated 5% before the Asian crisis since renminbi was managed floating rate. By Asian crisis, renminbi already became 8.28 to a dollar, nominal appreciation is 5%, right? So, the managed floating regime was working before the Asian crisis. During the Asian crisis, and probably everybody knows that most of the Asian countries' currencies depreciated significantly against the US dollar and the renminbi did not depreciate and stayed at 8.28 throughout the Asian crisis. China was under tremendous pressures, and actually at that time the most market people believed that there was no way that renminbi could stay. But actually renminbi stayed, and they went through the Asian crisis, and actually stopped the further shock of the Asian financial crisis. But one of the consequences of this stable

exchange rate policy was that as a result of the renminbi's no depreciation policy, renminbi started to peg to the US dollar at 8.28 for a long time, all the way to the middle of last year, when this new round of reform started.

I would like to say that since last July we have this managed float of renminbi exchange rate regime with the basket of currencies as reference and the situation has been fairly stable, if you look at capital inflow, if you look at the NDF market in Hong Kong, in Singapore, and overseas market, although it still has pressures. The market still predicts that renminbi will appreciate. But if you look at the gap between the interest rate of renminbi and the US dollar, right now, short-term interest rate of renminbi is 1.5% and the short term US dollar rate is about 4.5% so that the interest rate differential is about 3%, 300 basis-point. If you look at, say, the one-year NDF market, the amount of appreciation market expect on renminbi is about 3%, so the NDF market and the forward-looking future rate predicted by the NDF market is pretty much consistent with interest rate parity prediction. That is the current situation, and this situation has been fairly stable since last July. And last July, the NDF was basically 4,000 basis-point appreciation and now it is converging to about 3,300 - around 3,000 basis-point appreciation. That is the market. I would like to emphasize that the expectation of renminbi appreciation, and people believe that China has a rapid economic growth, and we recently adjusted our GDP data and our adjusted GDP for 2004 was 16.8% larger than before, right? And from 2004 and on, including 2005, we will have our GDP based on the new measure of statistics. Actually this morning China released its new GDP for 2005. For last year, GDP growth rate was 9.9% and it's quite robust. And also there is productivity gain in China, both in terms of labor productivity and in terms of total factor productivity. So people have a lot of fundamental reasons to believe that there is a further renminbi appreciation going on.

I would like to take this opportunity to remind you that you have to also look at the risk of Chinese economy, and we have tremendous problems in Chinese economy. For example, the financial sector needs to reform. We still have relatively low efficiency in the financial sector and security sector, we still have large NPL and we need financial and security reform. And in terms of social security, we have a fairly large social security liability of the government. That is the contingent debt of the central government. We have environmental problems and other problems.

Look at NPL and the potential contingent government liabilities, and all of that need to be solved in certain way. That means that the central government has to spend resources. What kind of resources - that is the concrete question, but in general, somehow, somebody has to pay that bill. So those problems imply that renminbi might have depreciation pressure in the future, if you try to solve those problems. So I would like to say that the market should look both positive and negative perspectives of China's economy and have a more balanced view of the future possibilities. And in our view, the current regime, the

managing floating regime is able to keep our exchange rate stable at close to equilibrium level. By our calculation in terms of the trade, service trade, capital and financial account, I think that this mechanism is working and renminbi is flexible on both directions, both up and down. And if you look at the trade for the last hundred and more trading days since the reform, close to 70 trading days renminbi was appreciated, about 50 trading days renminbi was depreciated, and also it linked to the basket for sure. So this flexible mechanism is working. A lot of people say it's not working enough, your flexibility is not enough. So far the flexibility is fairly small, but I think that the mechanism itself is in the right direction, and I think in terms of flexibility, it will gradually be determined more and more by the demand and supply of market force.

The last comment I want to say on the exchange rate is that you cannot expect that the adjustment of exchange rate will solve everything. What kind of problem are we thinking along this line? We are thinking really about the fundamental imbalances of international economy. We are thinking about the twin deficit of the United States. We are thinking about the very low saving rate of the United States. We are thinking about the very high saving rate of China. We are thinking about the global division of labor and the trade pattern and so on. All of these cannot just be corrected by the adjustment of exchange rates. Think about it, and also by looking at the history of Japan and Germany's exchange rate changes. Did the exchange rate appreciation of yen totally correct the imbalances of trade between Japan and the US? The answer is no. No matter how much yen appreciated, the imbalance was still there for many, many years. So was Germany. So the exchange rate adjustment is an important aspect, but other adjustment is also important.

The third point I want to make is the macroeconomic policy of China. The discussions and efforts of Asian countries to promote regional cooperation and to promote solving the problem are in the right direction. In this context, the macroeconomic policy of China is that we are going to emphasize on domestic demand. Between the external demand and the domestic demand, we will emphasize on the domestic demand. I repeat that several times. Within the domestic demand, there is domestic demand mainly in investment and consumption. We try to emphasize consumption. And within consumption, we try to emphasize the service consumption, and between the urban consumption and the rural consumption, we will emphasize on the rural consumption. And I think if you watch China closely and you will see that some macroeconomic policy will be issued to address those problems. For the rural consumption, we are going to emphasize on the infrastructure of the countryside on road, or water. We are going to spend a lot of resources on rural education. Basically starting from this year, in the middle and the west regions, rural kids can go to public schools free. Next year for the whole country, rural kids go to school without paying anything. And we are going to emphasize on the rural medical program and so on. And also, we will emphasize on the intellectual property rights protection and we will have higher labor standard for the rural workers who work in



the urban area and try to give them the social security, medical insurance and everything to the rural workers who work in the urban area. And also, we will start to emphasize on energy efficiency and energy saving program and the 11<sup>th</sup> 5-year plan of China has a goal. By 2010, the per-unit GDP energy consumption definitely should decrease by 20%, and that means tremendous efforts will be made to reduce the per-unit GDP consumption of energy. And also, we will have more rigorous implementation of environmental protection program and we are going to enforce laws more strictly for the environmental pollution and all of that, with the emphasis on the domestic demand, with the emphasis on the consumption, especially rural consumption, and we will see a more balanced trade, you will see a larger import of China. We do not pursue trade surplus. I think we should - given China still has quite robust FDI and capital inflows - , actually more or less balanced trade is good for China and good for the rest of the world, and we are going to emphasize on our import and hopefully we will have a more balanced trade account. And together of the above discussion, trade, exchange rate and also domestic macroeconomic policy, I'm confident that the future cooperation with ASEAN, with Japan and Korea and with Asian neighbors, will be much more positive and prosperous for both China and for the Asian and for the region as a whole. Thank you very much.

### **3. East Asia Community Building and the Role of Japan**

**Jusuf Wanadi**

**Co-founder; Vice Chairman, Board of Trustees,  
Center for Strategic and International Studies, Indonesia**

Thank you Mr. Chairman. Let me first express how honored I am to be a part of this important symposium and a member panel of a very illustrious one. I would like to thank the Chairman and the Institute for inviting me to make this possible. Let me also congratulate the Institute for its 10<sup>th</sup> anniversary. What I'm going to talk about maybe is more on East Asia community building and the role of Japan. The Chairman, at the end of his introduction, has mentioned that inputs what we, in the region, expect of Japan could be indeed a very important factor in the development of the idea.

Japan's role in establishing regional cooperation was always prominent from the beginning. First, it was for the Asia Pacific as a reaction to Europe's effort for establishing the European economic cooperation. It had, as its first institutionalization, PBEC, or the Pacific Basin Economic Cooperation among business in the 1970's. Only in 1980, was PECC, the Pacific Economic Cooperation Council, established as a tripartite organization among academics, business and officials in private capacity. Based on PECC efforts, APEC was formed in 1989 as an inter-governmental institution for the Asia Pacific.

In both organizations, Japan's role was quite important to start the idea, with Australia as a partner, and ASEAN as a supporter. Unfortunately by the early 2000, these institutions have not moved forward fast enough, because of the financial crisis in East Asia and somewhat the decline of the US leadership in these particular institutions.

In the security field, with the end of the Cold War, ASEAN was given the chance and the initiative to establish the ASEAN Regional Forum, or the ARF, for confidence buildings, through deliberations and dialogues. It was meant as a complement to US dominance in the region based on Cooperative Security Principles. And again, Japan's role to make the US accept the idea was crucial, indeed.

The idea of community building in East Asia arose from the economic interdependence created by Japanese investment into East Asia, with the relocation of her manufacturing capabilities to maintain international competitiveness. In the end of the 1990's, this phenomenon has been replaced or complemented by the huge inflow of investments into China that makes her the center for East Asian manufacturing capabilities.

The financial crisis of 1997 has given a real impetus to the East Asian region to organize itself, as it shows that every country has to depend on herself and on her neighbors.

Different than in Europe, where political ideas and visions have been the driving force for the top-down process towards integration, in East Asia the process has been driven by business and the market and has been a bottom-up process. However, in East Asia there also is a strong strategic objective underlying the desire for regional cooperation.

One such factor is how East Asia can cope with rising China. Second is how to facilitate the improvement of relations between China and Japan. And third is to alleviate future competition or even potential confrontation between China and the US.

The idea of an East Asian Community, according to the East Asian Vision Group, established in 1999 by the ASEAN+3 Summit, is to start with economic cooperation, although political and even security cooperation should follow at a later stage because economic cooperation alone will not be adequate.

When Prime Minister Mahathir first mooted the idea of an East Asian Economic Grouping, or EAEG in 1990, he was reacting to the possible failure of the Uruguay Round, and the creation of trading blocks in North America, in the case of NAFTA and in the future closing of Europe, in the case of the EU. He proposed the EAEG, which later was softened by ASEAN into an EAEC, or the East Asian Economic Caucus of APEC, in order to overcome the vehement opposition of the US under the leadership of the then Secretary of State, James Baker. Being the leading economy of East Asia, Japan's support for the idea was critical. However, under heavy US pressures, Japan refrained from doing so.

During the economic crisis of 1997, there was a Japanese proposal for an Asian Monetary Fund, which was again shot down by the US. The crisis, nonetheless, has brought the East Asian countries closer together, and the idea of an East Asian Community, or EAC, began to gain wider support. For Japan, who is looking for an Asian policy, the EAC has offered a new paradigm for her.

It is interesting to see that now that the concept of an EAC, or the East Asia Community has taken off, pursued both through the ASEAN+3 process and the East Asia Summit, or the EAS, which had its first meeting last December in Kuala Lumpur, APEC has received renewed attention because it is the forum that involves the US, and after all US presence and leadership in the region are important. One view is that the EAC should be embedded into APEC, where the US is expected to have shared leadership, and in that way will help assure US presence and role in East Asia as well as in the Asia Pacific.

Regionalism in East Asia began in 1967 with the establishment of ASEAN, or the Association of Southeast Asian Nations, to create a regional order for the South East Asia sub-region. Following ASEAN's consolidation with the first summit in Bali in 1976, and

later its success in overcoming the challenge of Vietnamese invasion into Cambodia through the Paris Agreement in the early 1990s, ASEAN began to look to the wider East Asian region. In the meantime, the large wave of Japanese investment into East Asia in the second half of the 1980's has brought about greater regional economic integration. Following the end of the Cold War, there was the danger that the US might turn her attention away from East Asia and become more inward-looking as she wanted to collect the "peace dividend" after such a long process of the Cold War.

APEC provided, however, a new focus for the US towards East Asia. APEC was based on a Japanese idea, initiated by Australia, but could get off the ground because of ASEAN's endorsement. In the early 1990's, ASEAN also created the ARF, or the ASEAN Regional Forum to promote confidence building measures, or CBMs, through discussions and deliberations for the East Asian region, but with the involvement of the US, the EU, Russia and India. Following the financial crisis, the East Asian Community idea came to life and was pursued through the ASEAN+3 process.

Since the early 21<sup>st</sup> century, the rise of China has become the main attraction for the region as well as the world, while Japan has gone through a period of malaise. China has become another main center for manufacturing in East Asia. All these have aroused an increased sense of competition between Japan and China for the leadership of East Asia.

As former PM Lee Kuna Yew from Singapore already said in 1997, it will be the first time in East Asian history that Japan and China become strong states, and a certain rivalry, therefore, will be inevitable.

China's sudden rise, paired with her sophisticated diplomacy, appears to make her have a natural upper hand in the competition. This should perhaps be seen as a natural development. But Japan remains an important power. Her presence and involvement in the region is deep. And the relations and friendship with the countries in the region remain strong. Japan's investment and development assistance remain unsurpassed by other powers.

However, in approaches as well as diplomacy, China has become very adept, and she has played it quite well in Southeast Asia. It is only recently that Japan has become more aware of the competition and tried to do more in relation to ASEAN and East Asia.

ASEAN as a whole will not be taking sides in this competition. In fact, ASEAN expects that both will be able to develop normal relations and together with India in the future will play an important role in the region's longer term future.

ASEAN is placed at this state as the driver's seat in the development of the East Asian

Community idea due to the fact that the two natural leaders, China and Japan, could not do so for the time being. Improvement of their bilateral relations will allow them to assume leadership in the region. The challenge for China and Japan is to contain rising nationalism in their societies, overcome the problem of history, and to resolve overlapping claims on their sea-borders. It should be remembered, however, that bilateral trade is at its highest, amounting to over 200 billion. People-to-people relations are enormous. Four million Japanese people visit China annually. There are over 700 flights a week between the two countries. 80,000 Chinese are studying in Japan, and there are hundreds, if I'm not mistaken, over three hundreds of sister relations between towns, cities and counties within the two. That is why they have to find a *modus vivendi* on their state-to-state relations.

As expressed by some ASEAN leaders in the first East Asia Summit in Kuala Lumpur a few weeks ago, ASEAN hopes that both will soon patch up their relations for the interest of East Asia as a whole. The mechanism of ASEAN+3 and the East Asian Summit are also meant to contribute to China-Japan relations in the context of an overall cooperation of the region.

The visit of Prime Minister Koizumi to the Yasukuni Shrine has become increasingly unpalatable not only to the Chinese and Koreans, but also to more and more Southeast Asians, I have to admit. Until now, Southeast Asians did not comment much on Japan's history in World War II, because it has seen and studied how Japan has developed in the last 60 years as a peaceful nation and as a cooperative partner for ASEAN. But more and more, they feel uneasy and are concerned because the philosophy and morality that the Shrine stands for on the issues of World War II and its rationale as well as its abuses portrayed in the exhibition or museum that was introduced 7- 8 years ago, are a real insult and worry to many people in the region and against their common understanding about the origin and reasons for the war as well as its abuses.

Paying homage to the dead can be done, and should be done, but could be done at a more appropriate place or shrine. The problem could only get worse if Prime Minister Koizumi showed his defiance and indifference towards East Asian feelings about his visit to the shrine. Of course, the Chinese also must do their part, especially in educating the younger generation on what kind of nationalism is healthy for the Chinese in the future and about the peaceful development of Japan in the last 60 years. These are all the more important if both of them have ambitions and of course the natural role to lead East Asia in the future.

The idea of an East Asia Community has received a new momentum with the holding and establishment of the first East Asia Summit. It can complement the ASEAN+3 instrument in the building of an East Asia Community. It could well be that ASEAN+3 will be the main vehicle for functional cooperation including trade, while the EAS, or the

East Asian Summit will have a wider scope and include strategic and security issues, such as energy, global terrorism and the avian flu.

At a later stage the two could be merged into one organization. It could also be that the EAS, or the Summit, will remain a Summit Meeting, which will not lead to the creation of institutions. It could become a kind of concert of powers in East Asia to complement the dominant role of the US in the region. Some have suggested that for that to be effective, it should also have the US and Russia as members in the future.

Japan's role will be crucial in persuading the United States to be willing to accept the East Asian Community. If the US is not willing to be part of it, Japan should make sure that EAC, the Community will be embedded into APEC. APEC itself needs to be reformed and improved. Through the EAC idea, or the community idea, and its implementation, Japan could define her Asian policy and her role in the region. Japan should also become the intermediary between Asia and the US. In that capacity, Japan can assure US future presence and role in East Asia. I thank you.

## **4. An Enhanced East Asian Economic Cooperation toward the East Asian Community**

**Il SaKong**  
**Chairman and CEO, Institute for Global Economics, Korea**

Thank you very much, Mr. Gyohten. Good afternoon, ladies and gentlemen. I'd like to also join earlier speakers in appreciating organizers of very timely symposium, for organizers, the IIMA which is led by Mr. Gyohten and the Tokyo American Center, for inviting me. Although the topic of this symposium is "Perspectives on Asian Economic Cooperation," my remark today will be primarily focused on the East Asian economic cooperation, simply because this region since 1997-98 financial crisis has been witnessing numerous institutional initiatives to enhance the region's economic cooperation. In doing so, however, I will devote a substantial portion of my time in discussing how to enhance institutionalized cooperation in the Northeast Asian region, which totally lacks the institutional basis for closer economic cooperation.

On the trade and investment front, we all know that there are already numerous bilateral and plurilateral FTAs already signed or being negotiated among the East Asian countries. More specifically speaking, they are mostly within ASEAN and members of ASEAN and three Northeast Asian countries - namely China, Japan and Korea.

At this point I just want to draw your attention on the fact that Southeast Asians, as Jusuf Wanandi just talked about, already have strong institutional basis for closer economic cooperation among themselves. And notably AFTA is already there. However, three Northeast Asian countries which contribute 90% of GDP of total East Asia do not have bilateral or plurilateral FTAs established among themselves. Japan and Korea launched the FTA negotiation which was an admirable event, but even that negotiation is currently stalled. Obviously I am concerned with competitive initiatives of establishing bilateral and plurilateral FTAs in the region which are strongly motivated by geopolitical factors, especially on the part of China and Japan. As such, unlike the European Union, these regional initiatives lack a long-term vision and a clear roadmap to achieve such a vision. Instead, the ad-hoc competition in establishing FTAs entails the danger of creating a regional spaghetti bowl of FTAs and a competitive hub-and-spoke dilemma.

On the financial and monetary cooperation front, the region already has the Chiang Mai Initiative in operation. In addition, various initiatives have been launched to help develop the region's bond and security markets and there are many other projects already in operation. However, still the Chiang Mai Initiative, or CMI in short, needs to be further expanded and multilateralized to develop into a full-fledged regional monetary facility

which I'll come back to the point in a minute.

This leads me to my major points. It is needless to say that an enhanced economic cooperation is necessary if the ultimate goal of the region is to build a *bona fide* community, and it certainly requires the establishment of strong institutional basis. In this regard, I personally would like to see the region set the ultimate goals of, first, the establishment of an East Asian FTA, and second, the creation of an East Asian or Asian monetary facility. Towards these ultimate goals, China, Japan and Korea in turn should set their own eventual goal of establishing the Northeast Asian FTA. For this purpose, they should accelerate the currently ongoing three-country co-sponsored joint FTA study. In the meantime, for practical reasons, the currently stalled Japan-Korea FTA negotiation should immediately be resumed. In the process, however, both governments, namely Japan and Korea, should not forget that the Japan-Korea FTA will have to be the core of the eventual China-Japan-Korea FTA. There is no doubt that three most dynamic economies in the world with their global economic weights, will gain so much from institutionalized economic cooperation and policy coordination among themselves. They seem to see the benefit of close economic cooperation among themselves. Unfortunately, however, they are still uncomfortable sitting together by themselves. The ASEAN+3 process is very desirable one, but it itself reflects the atmosphere existing in this region. The heads of three nations, China, Japan, Korea, had the Summit meeting in the context of ASEAN+3 process, which was kind of ASEAN+3 side show. But even this side show did not happen last year because of some historical political reasons.

Therefore, the most immediate task for the region is to lay the foundation to enhance the level of mutual trust and improve the political atmosphere for the regional cooperation. Most of all, the region has to grow out of its negative historical legacy. In this connection, the region, three countries in particular, should draw valuable lessons from the post-war European reconciliation of the experiences. Unfortunately, I must say that, however, political leaders and social elites of three countries tend to take advantage of nationalistic sentiment existing in their own countries for their domestic political gain.

I must say that all three countries, namely China, Japan, Korea, have their parts to play, but in front of Japanese audience, we expect that the Japanese leadership is here and Japan is expected to take a lead. It is needless to say that mutual trust and respect among the three countries are the critical prerequisite for a closer economic cooperation and policy coordination. Any policy coordination among the three countries without mentioning the introduction of a common currency or establishment of a common market presupposes the countries in the region are willing to sacrifice domestic policy, autonomy, or even national sovereignty. Mr. Gyohten briefly touched on it in his introduction remark. To some extent, they should be ready to accept pure pressure from their neighbors.



For this to happen, the mutual trust and mutual understanding is critically important. As an effort towards trust building for the region, it will be very wise for these three countries first to engage in specific projects, that would produce mutually beneficial, tangible results; such development project as energy development and conservation and environmental protection and many other areas where peoples of three countries can engage in constructive projects, which are mutually beneficial rather than destructive to erase the destructive memories. In this regard, again, these three countries can learn a great deal from the European experiences. I want to remind you of the fact that today's EU started with steel and coal cooperation. They engaged in a very practical specific project. With these efforts, once the three-country FTA is established, then it should merge with AFTA to create an East Asian FTA which is the ultimate goal of the trade and investment-side cooperative institutionalization.

On the financial and monetary side, as I mentioned earlier, there already the Cheng Mai Initiative is in operation. The Cheng Mai Initiative, in my view, should be first expanded then multilateralized in its swap arrangements. Secondly CMI surveillance and monitoring mechanism should be strengthened with the ultimate goal of the CMI developing into a regional monetary facility. Of course, operating principles of such an organization should be consistent with those of the IMF. So with this mechanism, closer macroeconomic cooperation for securing stable exchange rate among currencies over the region and the common financial supervision and regulation in the region could be achieved.

As the regional monetary facility starts to function properly, the introduction of a common currency in Asia or an East Asian Monetary Union could be a long-term goal for the region. However, the process toward such a long-term aim should be well-sequenced with the stronger political leadership commitments of major nations in the region. In this regard, the trust-building process should be re-emphasized as the critical first step towards the region's long-term objective. It took more than fifty years for European countries to come to the current EU status, even though they started with a clear long-term vision and dedicated leadership. The East Asian region still lacks such a vision and appropriate leadership.

Furthermore, the Northeast Asian region is far behind to Southeast Asian region in its integration efforts. Therefore, it is critical for the three key Northeast Asian countries first to engage in Northeast Asian economic integration efforts so as to cooperate with ASEAN towards achieving the eventual goal of East Asian Community.

In this connection, I fully support former Prime Minister Nakasone's recommendation to have regular Summit meetings of the heads of three nations hosted by three countries on a rotational basis. At the same time, I will further recommend counterpart ministers from these three countries to meet frequently through their casual working visits to get to know

each other and to better understand each other's major policy, issues and priorities. Establishing East Asian Community is a highly desirable, the ultimate goal. However, unless the Northeast Asians can grow out of the past historical legacy, the East Asian-wide community building may be just a rhetoric for many years to come. To be realistic, I think we have this region has to solve, and because this region still, as I mentioned earlier, produce 90% of East Asian region as a whole, so it is critical to have community building institutional basis set up for Northeast Asia so that we can have very prosperous East Asian Community in the years to come. Let me stop here and maybe I'll have time to entertain some questions. Thank you very much.

## **5. Promoting Regional Economic Cooperation in Asia**

**Roberto F. de Ocampo**  
**President, Asian Institute for Management,**  
**Former Secretary of Finance, Philippines**

First of all, let me thank the Institute for International Monetary Affairs, particularly my good friend, Gyohten-san, as well as the Tokyo American Center for the honor of inviting me to address you and also to give me yet another opportunity to visit your beautiful country. You know I've been visiting Japan since 1962 and one of the most memorable things in my entire life was having the honor and privilege to have been able to dine inside the Imperial Palace with His Majesty and the rest of the Imperial Family on the occasion of the state visit at that time of President Ramos. So you see I've had very memorable visits to Japan and my only complaint on this particular visit is that it's a bit too cold for me to play golf. But let me proceed with my presentation.

Since the resurgence of the Japanese economy, Asia has been associated on the global scene with phenomenal growth. So phenomenal was the growth of Japan and the so-called tiger economies of Asia from the 1970s to the mid '90s, that many, including the World Bank, took notice of what was then called the "East Asian miracle." These countries followed a relatively common pattern of export-led growth based on competitive wages and acceptable levels of skills as companies, especially from the West, started to globalize.

During this period, East Asian community building and possible integration was being promoted in various forums. There was SEATO, MAPHILINDO, ASEAN, etc, notably though, most of these addressed only security issues.

Then came the Asian Financial Crisis, and at that time I had the honor, the fortune or the misfortune, of being the Chairman of the Asian Finance Ministers. And that crisis severely clouded the aura of the Asian miracle. But it also became a major impetus towards more serious discussions of economic cooperation for a number of reasons: (1) the impact of the so-called contagion effect, wherein sound economic fundamentals of individual economies did not seem to be enough to avoid being swept by this financial tsunami; (2) the fact that the crisis was primarily a banking one exposing a common vulnerability of Asian economies occasioned by their individual and collective lack of capital markets development; and (3), the observation that Asian countries recovered more quickly from the crisis than most expected, partly due to growing intra-Asian trade.

It is always useful to look back at the crisis because it did not only highlight the extent to which economic integration had evolved in the region, but it also made clear three important things: (1) Economic interdependence is an unavoidable by-product of

globalization. The quick recovery of the region from the crisis can be attributed significantly to closer economic ties. Increased intra-regional trade ensured a market for the region's exports, which previously were directed to the US and Japan. (2) The private sector had begun to play an increasingly crucial role in economic growth and sustainability; and (3) Rapid technological advance had permanently altered the mechanisms of international finance that, if not well managed, could result in undesirable outcomes.

Thus, the increased sense of economic cooperation following the Asian crisis was fueled by the need to secure the region from future crisis of a similar nature, to secure gains attained before the crisis, as well as to ensure a more stable basis for continued growth based on increasing intra-Asian trade and increasing interdependence among regional financial resources.

This had given rise to a set of proposals designed to recover from and subsequently avoid an Asian financial crisis. First was the Manila Framework, drafted during the 1997 APEC Finance Minister's Meeting that I had the honor to chair. The Manila Framework reiterated the importance of a free and open economic environment. Second was the Chiang Mai Initiative, the first regional financing arrangement aimed at helping countries manage disruptive capital flows and maintain exchange rate stability. It has led to central bank swaps denominated in national currencies as well as the beginnings of a serious look into the establishment of an Asian Bond. Other fruits of heightened economic cooperation are a slew of free trade agreements and ASEAN expanding to ASEAN+3. Therefore, we can say that a major conclusion drawn from the experience of the Asian crisis is for the region to have more, not less, economic integration.

But managing regional economic cooperation means four things: (1) strengthening regional financial cooperation; (2) strengthening regional trade and investment; (3) ensuring the provision of essential cross-border infrastructure; and (4) facing the challenges and opportunities posted by the rise of China and India.

Let's discuss each one briefly. Strengthening regional financial integration is at the forefront of regional dialogue. Both the ASEAN+3 countries and the Asian Development Bank are intent on creating a well-designed regional financial architecture. Efforts are currently focused on three main initiatives: 1) the creation of a regional liquidity support arrangement, 2) the establishment of surveillance mechanisms, and 3) the development of bond markets. At the heart of financial interdependence is the development of an institutional and regulatory policy framework that is meant to govern capital flows in the region. The end goal is to manage the risks that come with the capital flows, and to provide early warning systems to prevent another crisis from happening. Complementing these efforts are global prudential regulatory requirements such as the Basel II and the International Accounting Standards. These efforts are already beyond the initial planning

stages. For instance, an Early Warning Systems model has already been developed as a first step towards regional financial surveillance.

As for trade, it is clear that intra-regional trade played a crucial role in East Asia's recovery post the 1997 Crisis. Thus, it is imperative that regional trade be further strengthened. At the moment, the AFTA provides a venue for promoting free trade among ASEAN members. Under the Common Effective Preferential Tariff, or CEPT, tariffs on goods traded within the ASEAN region, which meet a 40% ASEAN content requirement, were reduced to 0 to 5% in 2003. That reduction would be in 2006 for Vietnam, 2008 for Laos and Myanmar, and 2010 for Cambodia. The recent surge of free trade agreements – FTAs - in East Asian economies is also notable. As of April 2005, a total of 11 FTAs are in effect in East Asia, including the China-ASEAN FTA. Singapore has current FTAs with New Zealand, Australia, Japan and the United States. Japan is negotiating or has concluded negotiations on FTAs with the following ASEAN countries - Malaysia, Thailand and the Philippines.

Of course as the previous speakers have also indicated, questions have been raised on the existence of these FTAs vis-a-vis the overall WTO framework. It should be reiterated, however, that FTAs are not meant, or should not be meant to undermine the WTO. Discussions in bilateral and regional trading arrangements are even seen by some to help negotiations in the WTO. Existing bilateral FTA talks could lead to fewer arguments, perhaps, within the WTO as countries may have already sorted out trade issues bilaterally. So, under this perspective FTAs could be viewed not as a threat, but rather as a supplement to the furtherance of WTO agenda.

As intra-regional trade gains momentum, so does intra-industry trade. Research shows that the automotive, electronics, and healthcare products industries in ASEAN are now highly integrated with each other. The production process for a certain end good is broken down into several stages and located in several countries within the region. These regional production networks, in turn, drive foreign direct investment, or FDI. Traditionally, the major sources of FDI in Southeast Asia were the United States, Japan and Europe. At present, however, intra-regional FDI is becoming an important source of capital for East Asian economies. In fact in 2001, the share of intra-regional FDI in total inflows to East Asia reached about 40 percent. This emerging pattern further deepens economic integration in the region.

Another important requirement of regional economic interdependence is the provision of crucial cross-border infrastructure. Efforts are already underway to provide such infrastructure, for example in the Greater Mekong Region. In fact cooperation in the Greater Mekong Sub-region now includes the harmonization of legal and regulatory frameworks. These efforts are meant to improve connectivity and allow smaller countries

to take advantage of economies of scale through efficient cross-border flows of goods and resources. Prospects are also underway to try to do the same in South and Central Asia.

The growth of China's economy is of course a major phenomenon that Asia faces. China has emerged as a global economic power within just two decades. China accounted for merely 1.9% of global merchandise exports in 1990, but its share doubled to 4% in 2000, climbed to 6% in 2003 and doesn't show any signs of letup. China's emergence, at first, was largely seen as a threat, but at present, the ASEANs have realized that China presents abundant opportunities as well. Most measurable impacts of China's growth on ASEAN have been positive and big. Imports from and exports to China are growing at rates of 20-40% since 2000 for the major Southeast Asian countries. In addition, every Southeast Asian country has positive and growing trade surplus with China. More importantly, it is not only the figures that are improving but even the quality of ASEAN exports as well. Malaysia, the Philippines and Thailand largely exported primary goods to China a decade ago, but by 2003, high value and high technology machinery and electronic machineries composed three-fifths of these countries' exports.

The ASEAN envisions a high value interdependence for China and the Southeast Asian economies, something which is not far from reality. At the moment, firms from Japan, Korea and elsewhere in the region, are more and more confined to manufacturing sophisticated components in their home country. These components are shipped to China, which in turn, purchase less complicated parts in the domestic market, and assemble the end commodity for shipment in North America and Europe. In fact a post APEC meeting analysis states that East Asia is fast becoming a regional production center, with each country specializing perhaps in a component or process it can do most efficiently - something that gave rise to the dream of NAFTA decades ago.

Likewise, the emergence of India as an economic giant is not far behind. We have a tendency to keep talking about China, but watch India. Although growth in India is slower than in China, it has managed to grow at seven percent in the past two years. As of today, trade opportunities are already abound from India. Most Southeast Asian economies have a growing trade surplus with India, though smaller than that with China. If India's present growth pattern is sustained, then in a decade or so, East Asia must once again face another economic giant. An interdependent East Asia with China and India as growth centers is not far from reality, and might even be an ideal economic architecture.

With about 60% of the world's population, an integrated Asia, undoubtedly, has high potential to be the event of the century. The emergence of China and India will definitely benefit the Asian economies in terms of opportunities; provided that these economies are able to increase productivity and improve innovation. More importantly however, regional cooperation must be aimed towards an institutional and regulatory framework that ensures

the stability of the region's economy. The Asian Crisis might have highlighted regional economic interdependence in a negative way, but Asia has learned its lesson well. This time around, economic interdependence will no longer be just a by-product of globalization or liberalization. There will be no miracles this time too. There will only be the reality that economic interdependence will be Asia's engine of growth this century.

Another clear sign that Asian economic integration is here to stay is the holding last month of the first East Asian Summit in Kuala Lumpur. But I would not expand on that since the previous speakers have already dealt with that in some detail.

Let me go to the challenges and just enumerate them and we can expand on that during the open forum. The horizon for economic integration looks rosy with all these developments, but what challenges lie in the path of economic cooperation in Asia?

1. Political ones - how to reduce tensions and convert hostile relations to friendly ones. These, of course, include the relations among China, Korea, North Korea, Japan; the Taiwan issue and the United State's role in all of these.
2. The question of disparities among ASEAN countries - from oil fields of Brunei to rice fields in Laos, we see disparities in stages of development, in degrees of democratization, and in qualities of governance.
3. The need to intensify functional cooperation - the question is whether the network of bilateral FTAs can lead smooth transition to regional FTAs and eventually fold neatly into the overall WTO framework.
4. Capacity building and human resource development - concerns about continued widespread poverty and shortage of local and integrating infrastructure. Bear in mind that nearly two-thirds of the world's poor still live in developing Asia.
5. The multiplicity of the existing organizations and the need to rationalize their interaction - ASEAN+3 moving towards inclusion of other countries - India, Australia and New Zealand - the role of APEC and so forth and so on.
6. Challenges and opportunities, as I mentioned, from the rise of China and India. And
7. Of course the building not only foreign reserves, but the building of adequate domestic capital markets.

Solutions call for constant dialogue and further economic cooperation. And the questions as also posed by the previous speaker – will there be an Asian Community like Europe? Well, if there is one important lesson from Europe on this, it is that it took them 50 years to arrive at a European Union. What is important is, first, not to lose sight of the vision or to articulate it more clearly, and second, not to picture an Asian union identical in form to the European Union. Building block steps such as currency swaps, FTAs and an Asian bond should be encouraged, but in the end, the likelihood may be that of a regional economy integrated the Asian way, characterized by unity in diversity. Thank you.

## **6. U.S. strategic interests in the Asia-Pacific region**

**Michael Michalak**

**Ambassador, U.S. Senior Official for APEC, Department of State**

Let me begin by saying that I am delighted to be back in Japan. I spent a number of years working in Japan and have fond memories from those years. Thank you, Joanne for that introduction. It's a privilege to be here to address such a distinguished group of academic, business and government leaders. It's also a great pleasure to share this stage with such a distinguished group of panelists.

I have been asked to talk about U.S. views on regional integration efforts in Asia. With your indulgence, I would like to expand my topic a bit further to talk about U.S. strategic interests in the Asia-Pacific region and how regional integration efforts affect the U.S. policies toward the region.

First, let me stress that the United States is an Asia-Pacific nation. We are engaged in the region and will continue to be so. For the past 60 years, the United States has played a vital and active role in supporting the region to achieve its continuing economic and developmental success. Today, the United States enjoys many economic and political ties to the region. In 2005, U.S. exports to Asia reached over \$200 billion, accounting for nearly 25% of total U.S. exports. The United States imported over \$540 billion worth of Asian goods, over 35% of total U.S. imports. Many security ties with the region have resulted in a dense network of alliances and friendships. The Asia-Pacific region, which is becoming the center of gravity of international relations in the 21st century, is of large and growing importance to the United States.

Integration does not take place in a vacuum, without context or prerequisites. We see three major areas which are important to form the framework in which integration can take place in an environment of mutual trust and cooperation, these are: 1) security; 2) prosperity; and 3) freedom. Advancement in these three areas is inextricably tied to each other. As Secretary Rice told an audience in Japan last March, "Security shelters the prosperity that opportunity brings; security and prosperity, in turn, allow human creativity to flourish -- but human creativity can only flourish fully in freedom."

### **Security**

Terrorism, which poses a serious threat to the welfare and security of U.S. citizens as well as those of our regional friends and allies. Both the United States and Japan have directly experienced the horror of terrorist attacks as well as witnessed the bombings in Bali and Jakarta, and the kidnappings in the Philippines. Terrorism interrupts positive regional trends toward stability, democratization, and prosperity.



Many nations in the Asia-Pacific region have contributed in the fight against terrorism. Today, the United States is promoting further build up of defenses in port and border security, and combating terrorist financing. By utilizing our collective strength, sharing information and applying technology to the movement of people, goods and money, more completely, we can improve the free flow of trade, investment and travelers as well as enhance our security.

Securing true peace and stability in the Korean Peninsula is and remains one of the central security challenges in the Asia-Pacific region. The D.P.R.K.'s nuclear ambition is a decades-old problem, and its nuclear programs threaten its neighbors and the integrity of the global nuclear non-proliferation regime. The Six-Party Talks, as a multilateral diplomacy strategy, offer the best framework for dealing with this problem. Timely progress and credible breakthroughs, however, have been elusive despite considerable efforts by the United States and our allies. The United States remains committed to resolving the nuclear issue through peaceful, diplomatic means.

China, now integrated into the international community, must take on the responsibilities of a stakeholder in the international system from which it benefits. At the same time, the sensitive issue of Taiwan and cross-Strait relations has complicated security in the Asia-Pacific region. The longstanding U.S. position, based on our one-China policy and commitments under the joint communiques and the Taiwan Relations Act, has been that cross-Strait differences must be resolved peacefully through dialogue in a manner that meets the aspirations of people on both sides of the Strait. To that end, the United States strongly opposes unilateral changes to the status quo by either party, and encourages cross-Strait dialogue of all forms.

### **Prosperity**

Asia is a region that knows very well that its future economic growth is tied closely with free and fair trade. To facilitate free and fair trade, the United States is concentrating on opening markets, improving the region's overall business environment, and maintaining a stable macro-climate favoring open trade and growth. A free and fair trading system will allow a very broad and mutually beneficial economic and trade relationship among economies in the Asia-Pacific region.

### **Opening markets**

Open trade not only levels the playing field but also encourages governments to adopt open and transparent rulemaking procedures, and non-discriminatory laws and regulations. Trade liberalization is also a pathway out of poverty and despair. A recent World Bank study showed that the income per person for globalizing developing countries grew more than 5% a year, while the income in non-globalizing countries fell a little over 1% a year. Traditionally, the United States has focused on multilateral efforts to liberalize trade, through the World Trade Organization (WTO). More recently, the U.S. has increased

emphasis on bilateral free trade agreements to supplement multilateral negotiations in the Asia-Pacific region.

### **Business environment**

Open markets are meaningful to the business community in the context of a favorable business environment. The United States is working with partners in Asia to improve the business environment in the Asia-Pacific region by opening up civil aviation and telecommunications industries, improving intellectual property rights protection, and combating corruption and ensuring market integrity. The United States has also worked with national authorities and the business community to reduce structural impediments to trade and investment.

### **Macroeconomic environment**

Maintaining a stable macroeconomic climate is also a critical element in advancing and maintaining economic prosperity in the Asia-Pacific region. The United States is working with partners in Asia to encourage prudent, sustainable fiscal policies, monetary policies focused on price stability, and increased openness to international trade and capital flows. The United States has also urged regional economies to undertake structural reforms that can raise sustainable long-term growth. As a result, interest rate spreads are down; there have been no major foreign exchange or balance of payments crises; cooperation among financial authorities has reduced the risk of "contagion"; and, among those economies with flexible exchange rates, volatility has decreased.

Establishing a stable macro-environment is also a priority in the economic development agenda advanced by the United States. The core principles in U.S. development policy include (1) increasing financial assistance to the poorest countries; (2) providing more assistance in the form of grants; (3) measuring the results of our assistance efforts rigorously; and (4) targeting support to countries that pursue pro-growth strategies.

### **Freedom**

Promoting democracy, the rule of law, and human rights remain high priorities on the U.S. agenda. The relative stability of the East Asia and Pacific region has showcased some of the most impressive democratic transformations of our times in places as diverse as South Korea, the Philippines, Mongolia, Thailand, and Taiwan. The governments in these flourishing democracies have become more accountable to their citizens. Increasing freedom and individual rights are also attracting economic opportunities and investments. The United States will continue to help enlarge the trend of democratization and more open societies in the region, through education and assistance.

### **U.S. Bilateral and Multilateral Engagement in the Region**

As I have said before, the United States engages the Asia-Pacific region at the global, regional and bilateral levels. The United States sees this engagement as a means not only to

advance its policy interests, but also to build a sense of community within the region by promoting shared values in human rights, stability, democratization, free markets, and security.

On a global level, WTO has provided the best framework for engaging economies on trade and investment liberalization issues. The United States is actively working with various Asia-Pacific economies to advance the WTO Doha Development Agenda. We are pressing China, Taiwan, and Cambodia to fully implement their WTO obligations, and support Vietnam's accession to the WTO. We are working to increase regulatory and administrative transparency in the region, especially China, Indonesia, and Korea. We will continue our work to reduce or eliminate tariff and non-tariff barriers throughout the region.

The United States has also been deeply involved in APEC and the ASEAN Regional Forum, and is working to bolster those organizations' effectiveness. In APEC, the United States and 20 other member economies are working diligently to facilitate and promote free trade, economic growth, investment and cooperation in the Pacific region. Last year was another productive year in APEC, reaching consensus on a variety of issues affecting economic development and trade. The Leaders issued a strong stand-alone statement underscoring their commitment to achieve a successful conclusion of the Doha negotiations and their determination to provide the strong political leadership necessary to move the negotiations forward. The Leaders also

- endorsed model guidelines on intellectual property rights;
- adopted a plan of action, known as the "Busan Business Agenda," to improve the business climate in the Asia-Pacific region in real, measurable ways;
- endorsed a strong initiative on "Preparing for and Mitigating an Influenza Pandemic";
- agreed to advance further work on reducing the threat associated with man-portable air defense systems, radioactive sources, and work to secure the global supply chain within the APEC region from exploitation by would-be terrorists; and
- agreed to intensify regional cooperation to prosecute and deny safe haven to officials and individuals guilty of corruption.

In 2006, the United States will once again look to advance trade, improve business environment and mobility, improve health security and emergency preparedness, and advance security within APEC.

The United States is an active participant in the ASEAN Regional Forum (ARF), and strongly supports its continued development. As the leading security forum in the Asia-Pacific region, ARF has contributed to the peace and stability of the region by building confidence among the participants and promoting cooperation on such vital areas as enhancing the security of Southeast Asia's strategic waterways, non-proliferation, and

counterterrorism. The United States also has a growing relationship with ASEAN itself, and is developing a comprehensive Enhanced Partnership with that organization, which will help strengthen ties and increase cooperation between the United States and ASEAN's member countries.

The United States is also advancing transparent economic policies and openness to trade and investment through the Millennium Challenge Corporation. Millennium Challenge Account assistance is awarded only to countries with a proven record of governing justly, investing in people, encouraging economic freedom, and fighting corruption. Three Asia-Pacific countries, Mongolia, East Timor, and Vanuatu, are currently eligible to apply for assistance. In addition, Indonesia and the Philippines are part of the Millennium Challenge Account's threshold program for countries that have demonstrated a significant commitment to meeting eligibility requirements.

Bilaterally, the United States is pursuing trade liberalization through an aggressive approach to negotiating free trade agreements. In the last 3 years, we have completed FTAs with Singapore and Australia. Negotiations are currently under way with Thailand. Our Bilateral Trade Agreement with Vietnam, which was signed in 2000, has been a catalyst for economic growth and development in that country.

Strengthening alliances with five treaty allies in the region -- Japan, Australia, South Korea, the Philippines, and Thailand -- remains a policy priority for the United States. Here, fostering a close alliance with Japan is not only of critical importance in the Asia-Pacific region, but also around the world. Let me tell you the depth of U.S.-Japanese cooperation around the world. Japan has been a major player in rebuilding Afghanistan and Iraq, and is the second largest donor in both of these countries, next to the U.S. Japan has also been an invaluable partner in combating terrorism, providing tsunami relief, preventing the spread of HIV/AIDS, and supporting the Asia-Pacific Partnership on Clean Development and Climate. Japan is a vital partner in the Six-Party Talks on DPRK. Our two countries also provide about 40% of all government assistance to developing countries throughout the world, and are working to improve the strategic impact of our assistance programs thru the Strategic Development Alliance, launched last year. The United States and Japan have a shared commitment to peace, freedom, and market-based economic prosperity. We believe these efforts in the global, regional and bilateral agenda are helping to facilitate the integration process.

### **Regional Integration Effort in Asia**

As you know, in recent years, with accelerated intra-Asian trade and investment, we have seen movement toward more pan-Asian organizations, such as the ASEAN+3 and, of late, the East Asia Summit that met for the first time last December in Kuala Lumpur.

The United States does not view such meetings as inimical to U.S. interests; we do not need to be in every room and every conversation that Asians have with one another. We do, however, want to ensure the strongest possible continuing U.S. engagement in the region and continue to believe that the strategic and economic geography through which Asia can best build on its success is via trans-Pacific partnerships and institutions. As the United States integrates its global, regional and bilateral engagements in the Asia-Pacific region to advance its policy goals, we also hope that multilateral structures in the Asia-Pacific region are strengthening existing partnerships and making each other more effective programmatically. As I mentioned at the outset, the United States helped to promote positive growth in the Asia-Pacific region for the last sixty years and we will maintain our important role in helping the region achieve its highest aspirations.

### **The challenges in and prospects for forging effective and enduring regional integration in the Asia-Pacific region**

Before I close my remarks, I would like to say a few words on possible challenges in and prospects for forging effective and enduring regional integration in the Asia-Pacific region. First of all, the United States supports multilateral institutions that build constructive relationships in the Asia-Pacific region. If multilateralism developed in Asia in a way that pitted one organization against another, or one group against another, neither Asia nor the world would benefit. Asia is fast becoming an important focus of the new global order, and its actions will have consequences that transcend the region.

With the burden of history looming over many bilateral relationships in Asia, multilateral institutions are critically important for making progress on important issues. The reality is that unresolved tensions among key countries in Asia, like China, South Korea and Japan, reemerge from time to time, causing disruptions in the development of relationships that are of great importance to the region.

We believe the region and both pan-Asian and trans-Pacific fora would benefit from more emphasis on functions and less on process alone. There is no necessary benefit simply from holding more gatherings. The lessons of history suggest that institutions are formed to solve problems and tend to be most effective to the degree that they address issues of common concern. So what we want to see are multilateral institutions that first tackle issues that build confidence and maximize benefits of coordinated, collective action, such as trade liberalization, combating terrorism and corruption, bolstering energy security, and containing the spread of infectious diseases. APEC is already the premier forum in the Asia-Pacific region for addressing economic growth, cooperation, trade, and investment. The United States is also pursuing cooperative relationships with ASEAN and within ARF to stabilize relations among diverse interests represented in the Asia-Pacific region. Again, I emphasize that the United States can and will promote shared interests in the Asia-Pacific region. The United States is a firm advocate of political maturation and evolution of

political/economic institutions in the Asia-Pacific region, and will do its best to build a sense of community in the region.

Thank you very much. Now, I look forward to hearing from our distinguished panel and from all of you.

## **7. Challenges of Regional Cooperation and Integration in Asia**

**Haruhiko Kuroda**

**President, Asian Development Bank**

Like other speakers, first I would like to thank the Institute for International Monetary Affairs, and Tokyo American Center for inviting me to participate in this very timely and important symposium.

Last year, Emerging East Asia grew well over 6%, a pace sustained since 2002 and expected to continue this year. The East Asian miracle endures, despite the interruptions caused by the 1997-98 financial crisis. Yet we must not become complacent. With hundreds of millions of East Asians still suffering the poverty and some even extreme poverty, and Emerging East Asian per capita income still low at about 1,090 US dollars, about one-twentieth that of Japan, sustained growth well into the future is crucial, necessary.

So, why should we, particularly those of us mandated to the eradication of poverty, care about regional cooperation? The answer is simple. We promote regional cooperation because we are compelled to do so by the overwhelming benefits. Effective cooperation nurtures a sense of community and safeguards trust and peace. It ignites convergence of poorer countries toward the prosperity of richer nations. It propels economic growth, development and systemic poverty reduction.

From trade and investment, to policy coordination to efficient transportation and communication systems, and even more effective responses to cross-border threat to public health and the environment, cooperation has a tremendous potential to multiply individual country efforts into a regional tide of progress toward a stable and prosperous Asia.

So, yes, we want to encourage regional economic cooperation. Yet, it is already occurring. What may be most needed is to guide it toward the best outcome: one that addresses the needs of a diverse Asian community, gives a global voice to Asian concerns, and ultimately strengthens global cooperation and integration initiatives.

Thus, it is important to move beyond bilateral and sub-regional arrangements to region-wide and inter-regional initiatives. East Asia has long had a global perspective and this will only be strengthened by a revitalized regional focus.

Where are we at present? East Asia shares a common outward-looking orientation. Early trade and investment liberalization fed globalization, which in turn led to the substantially market-driven trend of regional trade and investment integration.

As a sign of East Asia's rapid emergence as a global production and service platform, FDI inflows to East Asia including Japan more than quadrupled from 7% to 31% of world FDI inflows over the period of 1980-2004. Furthermore, East Asia's sustained dynamism fueled an increase in FDI outflows from 5% to 14% of world outflows over the same period. Notably, much of these flows were intra-regional, especially from Japan and the Newly Industrialized Economies to ASEAN and the People's Republic of China, and some from ASEAN to ASEAN and to the PRC. At the same time, global and regional linkages rose as total East Asian trade grew faster than world trade and the intra-regional trade share increased from 35% in 1980 to 55% in 2004.

As East Asia evolved into a pivotal global economic presence, it became more interdependent — a fact made brutally evident by the financial crisis as many previous speakers mentioned. The revealed need for policy dialogue, economic surveillance, and joint action to manage rising interdependence, led to regional economic cooperation initiatives. At the same time, growing trends in regionalism in Europe and the Americas sparked desires to deepen and secure market-driven regional economic integration through more formal arrangements. It is ever clearer that East Asia's dynamic global reach must be sustained through regional strength.

To name four major cooperative efforts to strengthen financial systems and ensure regional stability:

First, the ASEAN Surveillance Process involves regular economic and financial peer review by the Finance Ministers as well as development of Early Warning Systems and strengthening of National Surveillance Units as Dr. De Ocampo emphasized.

Second, the ASEAN+3 process involves a series of Economic Review and Policy Dialogue forums among Finance Ministers as well as Finance Ministry and Central Bank Deputies. At the December 2005 9<sup>th</sup> ASEAN+3 Summit, the ASEAN+3 heads of state and government reaffirmed their commitment to use the summit, I quote, "to guide and provide political momentum to East Asian cooperation and community building efforts", unquote.

Third, the network of bilateral swaps under the Chiang Mai Initiative grew to 17 bilateral arrangements totaling 58.5 billion dollars as of November 2005. At the May 2005 annual ASEAN+3 Finance Ministers meeting in Istanbul, there was agreement to substantially strengthen the Chiang Mai Initiative arrangements through various ways, including so-called multilateralization of the mechanism.

Fourth, the Asian Bond Markets Initiative with four working groups is marshalling technical expertise and building capacity for regional bond market development. Currently, these working groups are engaged in discussions on development of a regional credit



guarantee mechanism and on strengthening Asian credit rating agencies in conjunction with Basel II implementation.

Just as East Asia is beginning to realize the fruits of deeper financial cooperation, it is also formalizing and strengthening the institutional arrangements that underpin regional trade and investment integration. Prior to the 1997-98 financial crisis, the intra-regional ASEAN Free Trade Agreement, so-called AFTA, was the only government-led initiative in East Asia.

Since then, much has changed. We now have dozens of bilateral and sub-regional arrangements involving at least one Asian partner. There are 15 under implementation, close to 10 signed, more than 20 under negotiation, and at least 16 proposed. Whether this entails a “spaghetti bowl” or “Asian noodle” effect, it represents an explosion of new trade and investment initiatives in the region. However, these new initiatives vary in reach and scope. Some, like the ASEAN-China FTA implemented in July 2005, are broad regional agreements but only cover trade in goods. Others, like the Japan-Singapore Economic Partnership Agreement, are bilateral but extend to trade in services as well as facilitation of trade, cooperation in investment, technology and many other areas.

Thus, our challenge is to shape these myriad efforts at cooperation and integration into an effective cohesive outcome that will strengthen the East Asian region as an important global partner in world events.

How do we achieve this? Crucially, I think, the next steps are to broaden trade and investment initiatives and deepen ASEAN+3 financial cooperation, so as to ensure that regionalism trends in East Asia and across various parts of the world ultimately strengthen the global economic system. With that in mind, it is useful to start with the World Trade Organization, WTO.

There are perhaps many who were disappointed by the seemingly limited progress at the December 2005 Sixth WTO Ministerial Conference in Hong Kong, China. This together with the proliferation of bilateral and regional agreements raises concerns in some corners that the era of multilateralism is fading. But it need not be so. Ultimately, despite the difficulties faced in securing multilateral agreements, these are the first best way to the maximum benefits for individual nations and to maintain a common global forum for trade liberalization. The way forward involves, of course, difficult challenges and painful choices for industrialized as well as developing nations. These challenges must be met and these choices must be made.

An important task is to ensure that regional initiatives are actually liberalizing rather than fortress-building and that they are systematically broadened to ensure that they are in

the spirit of open regionalism — that which is outward-looking and global in perspective, even if its institutions are regional in focus.

One key area of trade agreements, for example, that should be watched closely for hidden barriers are rules of origin. If excessively burdensome, these rules – rules of origin - can make trade agreements ineffective in generating freer trade and investment. Administrative costs of handling various types of rules of origin can be prohibitively high, particularly for small and medium-scale, trade-oriented firms.

Broadening various sub-regional initiatives into region-wide and even inter-regional cooperation efforts that are as inclusive as possible will maximize the potential for creating greater trade and investment opportunities. A possible solution to this potential problem is to consolidate the various agreements into a single East Asian FTA.

East Asia is already moving somewhat in this direction with its ASEAN and ASEAN+3 processes, and indeed, just took a great step forward with its first East Asia Summit, which was held in Kuala Lumpur, Malaysia at about the same time as the December WTO meeting in Hong Kong. In addition to the 13 ASEAN+3 members, Australia, New Zealand and India participated.

The East Asia Summit was established as a “forum for dialogue on broad strategic, political, and economic issues of common interest and concern,” and intended as an integral part of the overall evolving regional architecture, with ASEAN as the driving force and the ASEAN+3 process as the vehicle for realization of an East Asian Community. The East Asia summit can make an important contribution to that process if its participants can meet the challenges of, (1) forging common views on key objectives and modalities, (2) narrowing the development gap among participants, and (3) creating an enhanced sense of unity and trust among the participating nations. A parallel development is the exciting prospect of closer cooperation across Asia as East Asia and South Asia begin to explore areas for inter-sub-regional trade and investment cooperation.

If the experience of Europe can guide us, then this process of greater integration in Asia can only strengthen the region and amplify Asia’s already significant contributions to the global community. But, as the experience of Europe brings us to the question of how far East Asian integration should go, this is not so simple. Should it be more like the experience of Europe or that of North America?

The deep integration achieved within the Euro area was obviously a long-term and difficult achievement. Yet, in principle, it is this sort of comprehensive integration that has the greatest potential for capturing the dynamic benefits of a common currency and macroeconomic, structural, and regulatory policy coordination.

Although there is no indication at present that East Asia can or will attempt to achieve a monetary union, it seems clear that there is interest in going beyond a NAFTA-style arrangement. A stated medium-term goal of the ASEAN+3 process, for example, is greater monetary and exchange rate coordination. Deepening monetary and exchange rate policy coordination can be especially beneficial to highly export-oriented and deeply interdependent East Asian economies. Moreover, regional financial cooperation greatly contributes to global financial stability, and hence is an important compliment to the International Monetary Fund and international monetary system as a whole.

A tentative step in this direction was taken by the People's Republic of China and Malaysia in July 2005 when they revised their exchange rate regimes, but I must say bolder coordinated steps would increase the flexibility of regional currencies relative to the US dollar while maintaining intra-regional exchange rate stability. Avoiding excessive volatility in intra-regional exchange rates would promote intra-regional trade and investment and enhance regional financial stability. In this regard, ADB is currently studying and developing a useful indicator for monitoring regional currency movements: the Asian Currency Unit, or ACU.

This ACU could also facilitate development of an Asian multicurrency bond market, which would deepen capital markets and help to reduce exposures to external shocks. Stability would be further secured by a professional secretariat charged with regional economic surveillance and armed with a regional financing facility — the natural next step for the Chiang Mai Initiative.

Though there are many challenges ahead, East Asia is on its way towards a liberalizing, broad, and deep form of regionalism that will build a stronger East Asian community with greater global ties.

What is ADB's role in this process? I will be brief because ADB is not driving this process — we are playing a supportive, yet strategic, role. From its inception, regional cooperation has been a core element of ADB's mandate. And our institution has long supported regional cooperation efforts through, for example, the Greater Mekong Sub-regional Program which includes Cambodia, Lao PDR, Myanmar, Thailand, Viet Nam and the PRC. That support focuses on soft and hard infrastructure building in the areas of transportation, tourism, trade and industry, legal and regulatory frameworks, environmental and social issues and cross-border movement of goods, services, and people.

ADB has played a key role as well in providing intellectual and capacity-building support to the ASEAN and ASEAN+3 efforts to improve regional economic and financial surveillance and cooperation. This support is beginning to broaden to other sub-regional

groupings in South Asia and Central Asia.

Moreover, as these various initiatives multiplied, ADB redoubled its efforts to assist other developing member countries in this vital area. Our new Office of Regional Economic Integration is acting as a focal point for our efforts to support regional cooperation and integration activities in the areas of, (1) trade and investment, (2) money and finance, (3) infrastructure and software, and (4) regional public goods like measures to address HIV AIDS, SARS, avian flu as well as various natural disasters the Asian-Pacific recently experienced. And we will do so in the spirit I've enunciated here today — that is, with a mind towards strengthening open regionalism, that maximizes efforts to achieve a stable and prosperous Asia.

In concluding, let me reiterate my message. The East Asian miracle endures but we cannot take it for granted. All of us - the intellectual community, government officials, the private sector, representatives of international organizations, and of course the general public - have a role to play in promoting processes that will propel East Asia forward toward prosperity. One such process can be a move toward regional cooperation and integration that unifies while celebrating a diverse Asian community, sharpens the global reach of Asian ideas, and builds Asian regional strength into a pillar of the world community. Thank you very much.

## 8. Questions and Answers

**Gyohten:** As I anticipated, floods of questions and comments were produced during the short break, so I have to exercise my prerogative as a moderator, that is to take advantage of my own discretion to sort out and assign a couple of questions to each of our panelists. I discovered that the first part of our symposium was extremely informative, because without much overlapping between the panelists, we could cover different aspects of this issue and we could learn first hand and frank views expressed by each panelist. So since we are short of time, as I said, I will pose one or two questions which I picked up from the large number of questionnaires to each one of you. So feel free to digest those questions in your own way and prepare your answer.

I think I will follow the order of a presentation, so that means I will ask you, Dr. Yi, there were quite a large number of questions posed to you. But I think this one is quite interesting. “There is a very popular view in Japan and elsewhere that as the first step to reach Asian Common Currency, Asia needs to have some kind of Asian Basket Currency. Do you consider this idea is worth studying? And if so, what is the role of renminbi in that basket?” This is the first question posed to you. Second one is, “China has accumulated a huge amount of foreign exchange reserves. What is the basic policy of People’s Bank of China in the management of these reserves? Does People’s Bank of China have any plan to make use of the reserves for the purpose of promoting Asian financial cooperation?” The third question is a bit embarrassing but, I think I have to give it to you. The third question is “when will be the next appreciation of renminbi and by how much?” OK, Dr. Yi, can you respond to one, or two, or three of these questions in five minutes if possible.

**Yi Gang:** Yes, I think they are great questions. First, I think the ACU idea, Asian Currency Unit idea is worth exploring. One reminder I have to say here is that if you look at Europe and Asia and North America, there are tremendous differences in terms of history, culture, social, and political framework, so that I think it’s a long process although at this point I think it’s a good idea which is worth exploring.

The second question about the reserve management policy: I think as every country especially as most other Asian countries that accumulate significant reserves, our policy is, although other economies argue, in this period we need some reserves, although the reserve is not “the more, the better”. I think we already feel that there are some constraints from increasing of our reserves, independent of monetary policy, so that we can feel that pressure. For the use of the reserves, we emphasize on the safety, liquidity and return as most other countries do. That’s our policy. And diversification, we tried to diversify many years ago so that we will make that policy stable, which means that we have appropriately diversified. We won’t pursue to be more diversifying in one direction or the other as some people guessed. I think our diversification policy will be stable as in the past we carry out this policy for many years already. So the market rumor is probably not very accurate in that

aspect. That policy will be stable. You'll see it's stable. As far as we will use that for the Asian stability, Asian financial stability is concerned and we, China – People's Bank of China - is an active pursuer of the Chiang Mai Initiative. We have signed quite a few bilateral swap agreements with other central banks of Asia. And we will continue to pursue along this line to promote the financial stability of the region.

The third question, for the renminbi appreciation perspective; the People's Bank of China has stated clearly that last July was the change of the regime and at that change we had 2% appreciation adjustment. Since then we have this flexible regime and right now the daily maximum range or band is 0.3% on each of the direction, up 0.3% and down 0.3%, which is a actually quite significant band if you consider this is a daily band width. So far we haven't used fully of this range yet. So my point is that this flexible mechanism and this managing floating regime will allow us to adjust renminbi exchange rate flexibly in the future. We will use that regime rather than to jump in a discrete manner. Thank you.

**Gyohten:** Thank you very much, Dr. Yi, for your very comprehensive responses.

Now to Dr. Wanandi, there are several questions concerning your remarks about ASEAN. "Does ASEAN have any plan to promote its economic and financial integration beyond FTA? And if so, in what form?" This is the first question addressed to you. And the second question is also about ASEAN. "You said in your presentation ASEAN is now at the driver's seat in EAC. What do you think, from ASEAN's perspective, is the most desirable balance of power structure in the EAC?" I think these two could be a representative of questions to you. Mr. Wanandi, could you respond to them?

**Wanandi:** Thank you very much for the two questions. They are very important questions and also questions that are not easy to answer. First, as you know two years ago, in 2003, at the Summit of ASEAN in Bali, we decided – that means ASEAN decided, to establish an ASEAN Community that will be based on three pillars. One is the economic pillar, and is the integration of the economy starting, of course you know, with trade but also investment, services, etc. and now they have made it into 15 years. And the second pillar is the security pillar, security community idea to be established where the idea and the objective is that wall between us is unthinkable. And to make this possible, the participation of people is important, and for that matter the third pillar will be the social and cultural pillar where, of course, the concerns of people as well as participation of the people will be guaranteed. As you can see, this is not only an FTA process that ASEAN is aiming at. It will be a full integration of communities that we are looking for in the various aspects of life, economically, security-wise and politically as well as socially, culturally. That is No. 1.

And maybe I have to add also that, as I said, the first stage now has been of course to achieve this trade matters integration but at the same time, now the next already is on stream toward the services and investment policies.

Now the second one is "what is the best in the EAC to have the balance of power?"

Definitely what we are perceiving for the longer-term, maybe medium-term hopefully, will be that Japan, China, India, and maybe India rather than those two in the longer term, will play a very big role as the leaders of the community. And that's why, as you can see in the context of the Asian Summit firstly held in Kuala Lumpur last month, we invited also India to participate. We consider that India actually has a lot of interests and has lots of potential, into partnership and integration with East Asia in the future, and that expectation has actually been reality at this stage and made us consider that India has to be included into this process of an East Asian community building.

So for us, I have to admit, for all the ASEAN countries, although the decision has been made, we think that East Asia is not a geographical limitation. We think that East Asia is a political limitation or has a political limitation so therefore, we consider Australia, and New Zealand are a part of Asia because the integration of a lot of things, not only trade and the economy part, but also intellectually, politically, etc they have so much with East Asia that we should invite them to be a member of the East Asian Community in the longer term. And of course for that we are also looking to India, and in this aim, actually, for the longer term. When Mahathir proposed the idea, it was based on geography and when the Summit was held he was very critical as you remember. He also said that last two, three weeks ago in this Summit when India was considered or Australia considered to be part of East Asia, because he is still, you know, confined to the geographical understanding of the work. We, others and ASEAN now have agreed upon we in East Asia - and this is shown in the East Asia Summit - We take it as a political, economic understanding instead of a geographical one. Thank you.

**Gyohten:** Thank you Dr. Wanandi. Now, to Dr. De Ocampo. Let's see... well, oh, yes that's right, Dr. Il SaKong. No, no, no you cannot escape. Yes, Dr. Il SaKong, you stressed the importance of this Northeast Asian collaboration. What is your thought behind the idea of promoting this tripartite cooperation alongside the strengthening of ASEAN+3 collaboration? How these two approaches could be complementary, supplementary or beneficial mutually? Dr. Il SaKong?

**Il SaKong:** Definitely it's complementary. We have ASEAN which is a group of countries from Southeast Asia. First of all, Asia comprises of two parts, right? One is Northeast Asia and Southeast Asia the other. Southeast Asia already has its own very strong institutional basis for its own community building. But for Northeast Asia, although they are very, very important in terms of the size of economy and the balance of power, whatever, they do not have any, at this point, the regional cooperative institutionalized mechanism. Once you do have that, then Southeast Asia and Northeast Asia can cooperate in a much more efficient and better way. That's why I'm not suggesting to have the Northeast Asian cooperative mechanism as a kind of substitute or a competitive to a Southeast Asian Community, because there is in my mind no doubt that if we are serious about building East Asian Community, unless you have a closer cooperative mechanism

going for this Northeast region, community building of East Asia may be just an empty slogan. Three countries of hassle nations cannot sit together. That's why we borrow ASEAN umbrella to sit together, which is OK.

So, ASEAN+3 process is a very, very valuable thing. But by having this Northeast Asian cooperative mechanism, this will strengthen ASEAN+3 and this will lay the foundation for establishing East Asian FTA and for the development of Chiang Mai Initiative into full-blown regional facility. Just like FTAs, bilateral and plurilateral regional arrangement is complementary to WTO's system. This is just the same. Within East Asia, I like to see Northeast Asia has its own community building institutional base.

**Gyohten:** Thank you, Dr. Il SaKong. Now I come back to Mr. De Ocampo. I think I have picked up two good questions to you. One is, "nowadays everybody seems to be mesmerized by the remarkable developments of China and India. Are you optimistic about the speed of ASEAN's economic development vis-à-vis that of India and China?" The second question is "what is in your view the most important factor which provides cohesiveness to ASEAN's unity?" Dr. De Ocampo?

**De Ocampo:** On the first question, of course everyone is looking at China and India for a number of reasons. The first one, I think, is that prior to the prominent rise of China and now of course the rise of India, the so-called Asian miracle and the growth of the so-called tiger economies really had to do with the countries such as Thailand, who aspired to have a similar growth strategy as Japan, which had to do with an export-driven type of development strategy towards becoming a much more dynamic growth economy at the time that the Giants, China and India were so-called sleeping Giants. Well, clearly they are not sleeping anymore but the question is "have the tigers become pussy cats?" I tend to agree with Kuroda-san's assessment that the tiger-hood phenomenon in Asia might have had a hiatus because of the 1997 financial crisis. But I do agree at the same time that it has bounced back from there quite quickly and more rapidly than others would have expected.

And the reason for that again is the intra-Asian cooperation and the fact, I think, that while at first the rise of China was seen to be a threat, in fact everybody was thinking what happens now to the paradigm of building up one's economy on the backs of low-price labor and plentiful supply and export-orientation when faced with behemoth like China which basically can say, "well we've got all that and more and anything you can do, we can do cheaper". Well the figure seemed to bear out that this intra-regional trade has been beneficial. Add to that of course is the fact that even ASEAN countries that have more difficult time in joining the growth process, you may say, are now being aided by infrastructure, in particular I refer to the Great Mekong sub-region project of Asia. I think for those of you that are in private business, this is well worth watching because this opens up an entirely new ball game in terms of what sort of market, what sort of resources, what sort of links are going to take place. Naturally there are differences and variations among the growth processes of the various countries, but I would have to say that in general the



ASEAN still is worth your time to look at as, I say, growth area and a dynamic investment destination.

The most important factor for ASEAN unity – I think this question arises because of many comments that European Union model of achieving economic cooperation is more, you might say, easier to achieve because of the fact that many, particularly the original European Union countries, come from more or less the same Judeo-Christian cultural background. Their countries are side by side geographically, and their economies are more or less the same, which is not the same for the Asian situation. Therefore, it does give rise to a question of what is going to be the most important factor. Well, I would say, self-interest in the sense. It is clear that those that have involved themselves in this globalized advance through intra-regional trade and much openness – much more openness in the economy – are being helped to target more efficiently the basic difficulties that hound their respective economies, whether that is low growth, leading therefore to continuous incidence in poverty and of course from a global perspective, less capability to join in a more rapid way the overall modernization process. That of course will be fueled, I think, much more by trade, at the start, than anything else, and trade of course, in turn must have as a foundation, or at least a stabilizing factor of regional financial stability.

**Gyohten:** Thank you very much. Now Ambassador Michalak. I also picked up two questions for you. No.1, “there is a concern that APEC is losing its influence because of the declining interest of Asian members in it. Do you share this concern? And if so, how can we reverse that tide?” The second question is, “the US deficit”, I think its current account, “vis-à-vis East Asia is large and looks to be structural. How should the United States deal with this problem?” Michael?

**Michalak:** Very good. Well, gee, I’m shocked. Our deficit large? Come on. Let me take au that question first because it’s a structural question. I get asked that just about every place that I go. And, yeah, the US deficit is large. It is so far not a tremendous cause of concern for us, but I think we believe that the best way to deal with the deficit is not to curb imports. We are not going to stop the fact that American demand for those high-quality stylish goods produced in Japan and China and throughout Asia is going to stop any time soon.

I think our strategy, if you will, is to try to improve American exports and we believe that one of the most effective ways to do that is to take advantage of regional integration to promote it and to promote the spread of open markets and free and fair trade and investment. America’s economy is turning more and more towards services rather than goods. Most of our goods are now manufactured outside of the United States. But still we think that on a global stage, the WTO provides us some good opportunities for opening up markets and services and to continue liberalization and trade and investment. On the regional side, that’s why we are working so hard within APEC and with ASEAN to again make sure that we’ve got a good environment for investment and a good environment for trade that we can

improve our exports. And bilaterally, we are of course taking advantage of FTAs as well as continuing our bilateral economic agenda with many countries in Asia again to ensure that we've got a level playing field and to improve American exports. And I think that is going to be the way that we get our way out of any structural difficulties. Of course if other countries want to make currency adjustments that appreciate the currencies, well, I mean, that might help too, I guess.

The APEC question is very interesting. Normally I get this question in the reverse. Normally the question I get is that APEC is losing its influence because of decline of interest on the part of the United States, and here I'm getting the question that we are losing - APEC is losing influence because of the decline of Asian members. I guess "No", I really don't see that. Again, I see the members of ASEAN have been extremely involved in APEC. Some of my best colleagues within APEC, you know, Malaysia, Indonesia, Philippines, we work together on a wide variety of initiatives and trade and security and investment, so I see no slacking off there. Australia is also like a powerhouse within APEC providing a lot of leadership, a lot of imagination and a lot of her resources. So I think that the Asian members of APEC are very strong and will continue their deep interests in it.

And I also think that the United States is much more interested, much more strongly interested in APEC than it has been in the past. The meeting we just had in Korea I thought was a particularly good one, not only was President Bush extremely pleased with the way that the leaders' meeting went, and the way his meeting with the business community, the ABAC, went in Pusan, but he really had an excellent meeting with the heads of state of the ASEAN countries who are members of APEC. It went extremely well. We had good exchange and it was at that meeting that they all announced and referred to the enhanced partnership with ASEAN that we are working on this year. So now I think APEC is strong, vibrant, and getting more so, and I do believe that there's a lot of opportunity for cooperation among organizations like APEC and ASEAN, ASEAN+3. So, I think that would answer it.

**Gyohten:** Thank you, Ambassador. Well, lastly let me pose also two questions to President Kuroda. "Can you elaborate the idea of Asian Currency Unit which you mentioned in your presentation? What process do you envisage to reach the final goal of Asian Common Currency starting from the ACU?" Second question is, "it seems to me that due to the explosion of internet trading, growth of service trade and intensified anti-globalization movement, the role of the trade liberalization in the framework of WTO has diminished considerably. Do you still believe that the trade liberalization is still a high priority agenda in East Asia?"

**Kuroda:** Two questions are interesting and I think quite important. The first question, the idea of launching the ACU, this is currently under consideration. The idea is such that perhaps we can calculate the sort of weighted average of East Asian currencies vis-à-vis

global or international currencies. This kind of indicator can provide a sense of a regional currency's moving which way vis-à-vis global international currencies. That is at most at this stage we are aiming at. But of course like some Asian stock indicators, or some Asian bond indicators, it could provide the market some information. But at the same time the market maybe, as I indicated in my initial remarks, the market may be interested in issuing kind of a multi-currency bond or currency basket bond based on this indicator. If so, that would be quite useful for the market participants as well as for other stakeholders. But that is of course up to the market whether they utilize this indicator for the denomination of bond to be issued by them and to be invested by financial intermediaries or individual investors.

The second possibility is that not only the market participants, but also analysts, even policy makers, may be interested in this kind of indicator as an indicator showing, again, the sort of average movement of Asian currencies vis-à-vis global international currencies. Then that may facilitate further therefore to bring about intra-regional exchange rate stability, but again this is up to those who are in charge of. ADB has no power or responsibility or influence over the market or the policy makers so whether the market would adopt these indicators as currency denomination or the policy makers utilize this indicator for their cooperative effort. These are up to them. But our idea is just to provide good indicator to many people including market people.

Common currency or single currency in Asia – that is a long, long term possibility although I'm very much in favor of a single currency, common currency for Asian community, but as you may know, it would involve lots of difficult tasks, challenges, hurdles as introduction of Euro showed. Introduction of Euro – it was introduced after about thirty years after the idea was discussed quite seriously. Anyway, single currency, that is a long, long term goal and at this stage the ACU is not closely related to any such long-term goal.

Second issue, I'm quite simple, I still think WTO has strong relevance and importance of multilateral trade organization like WTO. I don't think it has lost influence or it has diminished its importance and I strongly believe that any regional bilateral FTAs must complement the WTO regime, rather than substitute or replace global trade liberalization movement. The regional bilateral FTA only tries to deepen trade liberalization in the context of some region. Thank you.

**Gyohten:** Thank you. Well I'm afraid time is up now and I have to conclude this session. However, before doing that I have to commend the excellent contribution made by all participants. I think they have provided us with really candid, thought-provoking and comprehensive remarks on very pertinent aspects or the features of this broad theme of Asian cooperation. I am sure that all participants including the audience would benefit from today's experience and I hope that their experiences would contribute further to move the whole region and for that matter the road toward this ultimate, well, dream of all the people in Asia. So, please join me in thanking and applauding the excellent contribution of all the panelists. And also I like to add my thanks to our simultaneous interpreters who

have provided an excellent job for our benefit. OK, thank you very much, and the meeting is adjourned.



財団法人 国際通貨研究所 ©2006

〒103-0021 東京都中央区日本橋本石町1-3-2

Tel: 03-3245-6934 Fax: 03-3231-5422

e-mail: [admin@iima.or.jp](mailto:admin@iima.or.jp)

URL: <http://www.iima.or.jp>

**©2006, Institute for International Monetary Affairs**

3-2, Nihombashi Hongoku-cho 1-chome, Chuo-ku,

Tokyo 103-0021, Japan

Telephone: 81-3-3245-6934 Facsimile: 81-3-3231-5422

e-mail: [admin@iima.or.jp](mailto:admin@iima.or.jp)

URL: <http://www.iima.or.jp>