

Plenary Session Speeches

Formulating an East Asian Economic Community - Challenges and Opportunities

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by

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(Panel Speaker)

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Thank you very much. I would like to break protocol a little bit as I acknowledge the audience, by starting with the young people of East Asia represented here by the 28 participants of the 9th Hitachi Young Leaders Initiative. I also wish to greet the young (but not too young!) officers of Hitachi, the organizers of this very important forum. And also my young-at-heart co-speakers, along with our gracious hosts from Indonesia who are either young, or experienced, or both – and all of you new friends of all ages: Good morning to all!

It is truly an honor for me to be a speaker in this 9th Hitachi Young Leaders Initiative and to be given the opportunity to share my own thoughts, experience and insights on this topic of building an East Asia Economic Community. Allow me to give you an overview of what I plan to take up with you in the next 15 to 20 minutes.

I will begin with the Asian challenge that the Minister has already indicated to us. I will then address the assertion that the world is both globalizing and regionalizing, and focus more closely on regional economic cooperation, the levels at which this has been happening, and the effects of all this. I will then specifically examine East Asian trade cooperation: its rationale, manifestations and initiatives. I will then look at East Asian Economic Cooperation beyond trade, and will finish with Opportunities and Challenges.

The Asian Challenge, as already mentioned earlier, is that the 21st century is widely recognized to be the century for the Asia-Pacific. Asia-Pacific, as you know, has emerged as the new focal point for the world economy, having shifted from North America which was essentially the focal point of the global economy in the 20th century, and previous to that was Europe, in the 19th century and prior.

There's a particular challenge in the fact that Asia, where we are, is the world's most diverse continent in many ways: In the economic sense, countries vary widely in average income levels. In the social sense, looking at the UN Human Development Index ranking, we have in Asia the fourth ranking as well as the 150th ranking in that array of 177 countries. In the physical sense, countries in Asia span the wide range from landlocked, mountainous countries to small island nations. Asia is also very culturally diverse; one manifestation of this is that all of the world's major religions can be found in this continent. Political diversity can be seen in the presence of the extremes of political systems within the continent, from free-wheeling democracy to authoritarian rule.

Meanwhile, there are hopeful signs in particular that poverty has declined markedly in East Asia, which is home of the fastest growing economies in the world in recent decades. Economic growth measured in growth of gross domestic product (GDP) has been in the neighborhood of 7-8 percent annually, with China growing even beyond 10%. There are now about 28 percent of East Asians, or about 500 million people, who live on less than \$2 per day, down significantly from what it was in 1990, at which time the ratio was 69 percent.

All this has come at some cost. The rapid growth of the East Asian economies and their populations has been accompanied by, among other things, widening income disparities and widespread resource degradation -- marine, inland, water, forest and soil resources, among them. There is also air and water pollution, rapid urbanization, solid waste management problems and a host of other problems, social, environmental and otherwise, that has come with this rapid economic growth.

Major challenges indeed remain. One stark fact is that over 90% of East Asians who are living under \$1 a day – that is, those who are very poor – live in rural areas. Thus, the problem of rural poverty persists. In fact, the gap between rural and urban incomes is growing; the ratio of rural to urban poverty increased from 2:1 in 1993 to 3.5:1 as of 2000.

Let me now dwell on two simultaneous world trends happening right now: globalization and regionalization. We all know that the world is globalizing in terms of several things. In terms of trade in goods, world merchandise trade as of 2002 was 16 times the level in 1950 while the total world output only grew 5.5 times within that same period. The ratio of the world exports to world output measured as gross domestic product (GDP), climbed from 7% to 15% within that same time interval.

This can be seen in the graph, which shows growth in world trade far outstripping the growth in world production of goods and services. This clearly tells us that the world has indeed been globalizing through the years. Foreign direct investments show a similar globalization trend. Global foreign direct investments made in 2006 were estimated to amount to 1.3 trillion US dollars. The global stock of investments, that is the overall stock in place, was about 12 trillion dollars worth in 2006. The US is the top source of this foreign direct investment; in fact, 25% or one quarter of total outward foreign direct investment in the world comes from the US.

The Asia Pacific is the top regional destination, amounting to about 395 billion dollars as of 2007. China is the single biggest country destination for foreign direct investment now, receiving about 90 billion US dollars a year. In recent years, the first place as investment destination has been a toss up between the United States and China. The US was in fact traditionally the biggest until about 2003, when China overtook it, but in recent years the lead has been moving back and forth between US and China.

Another manifestation of globalization is the magnitude of flow of money or financial capital flows. The daily currency trade in the currency markets of New York, London and Tokyo amounted to just about 190 billion US dollars' worth in 1987; as of last year there were 3.2 trillion dollars worth of currency being traded everyday. The private capital flows going to emerging markets in 1990 only amounted to about 50 billion dollars, but by 2007, this had ballooned to 782 billion dollars.

Globalization is also manifested in easier movement of people. According to recent statistics, 898 million or close to one billion people traveled abroad as tourists in 2007. At least 175 million people lived outside of their own countries of birth – that is, as migrants – and this is more than double the corresponding number in 1975. Also, 21.7 million people or nearly one out of every 275 people on earth are refugees, seeking refuge in countries other than their own.

What benefits do these globalizing trends lead to? In general it has been observed that countries that are more actively globalizing also attain faster rates of economic growth. This is because there is improved resource allocation as this permits the use of scarce resources of the world in their best uses as countries specialize in what they are good at, and just trade with one another on the goods that they are not.

It has also led to more active and wide technology transfer, which is beneficial especially for those who are recipients of this technology transfer. It has widened the choices of consumers – I think all of us as consumers can see this – and perhaps those of us who can remember about 10 or 15 years ago, the range of choice in consumer products that was before us was much more limited than what we have now. And part of this, again, is lower prices because it has been possible to go after the source of products or commodities where they are cheapest. In the Philippines, the overall decline in inflation in the past ten years was largely attributable to globalization, or more open trade.

There are of course drawbacks. Not everything is positive about globalization and the most prominent problems associated with globalization have been greater income inequality, job losses and worker displacement (particularly because of adjustment requirements in the short run), and environmental degradation. There has been a phenomenon called the “race to the bottom” which is used to describe the way countries competing for foreign investments tend to compromise their own standards on environment and labor protection, just to be able to attract these investments. In doing so, countries try to outdo each other in making themselves attractive to investments, thereby racing to the bottom, so to speak.



There is also heightened market volatility that has resulted from this openness across countries. Thus, there tend to be more incidences of market crisis, whether in the financial markets or now in the commodity markets, where we have very high prices for food and energy products. And it has also led to greater macroeconomic vulnerability, as governments in individual economies now find it harder to be truly in control of their economic outcomes because of such openness. Indeed, it is now possible with one push of a computer key to transfer billions of dollars across national boundaries, and that leads to volatility, vulnerability and instability in many economies.

Equally important and of more significance to us in this forum is the fact that the world is regionalizing as well. That is, countries are coming together in regional groupings, and we all know the manifestation of this in terms of the European Union being perhaps the most mature of all such regional arrangements. We have also seen the North American Free Trade Area or NAFTA and the Latin American Free Trade Association, known before as LAFTA. There is an initiative to unite these two into the Free Trade Area of the Americas or the FTAA, to unite all

of the Americas into one large trading arrangement. A similar free trade area exists between Australia and New Zealand, under the so-called CER or Closer Economic Relations between the two.

And of course closer to home is the ASEAN Free Trade Area or AFTA. As already mentioned by the Minister earlier, we have gone beyond ASEAN and are also looking at ASEAN plus 3, ASEAN plus 4 or 5, with the most dominant in the partnership beyond ASEAN being China, Japan and South Korea. And that's why ASEAN PLUS 3 perhaps would be closest to our picture of an East Asian economic integration or community. Worldwide, it is estimated that there are more than 180 regional trading arrangements in place.

There are various levels of regional economic cooperation that we economists teach our students in courses of international economics. The first level is what we see now in the ASEAN Free Trade Area where it simply means that the country decides to remove or dramatically lower import tariffs on products that flow across the member countries, usually subject to some exceptions. However they are free to maintain whatever tariff rates they want to impose on all the other non-member countries, so they can differ on this.

The next higher stage would be a customs union, where besides having a free trade agreement, there is an agreed common or uniform tariff rate applied on products of non-members imposed by all the member countries of that grouping. A still higher stage would be a common market, wherein apart from being a customs union having those attributes, there is also free movement across member countries of factors of production, especially capital, and to some extent, labor. The highest form is an economic union which is what the European Union already is, with full economic integration in the sense of having integrated trade, investment and financial markets, to the point of even having one single currency.

What are the effects of regional trading arrangements? One important effect is trade creation because the member countries find it cheaper to import certain products from other members rather than producing them by themselves. In this manner it permits improved allocation of resources; that is, resources are put to their best uses. For those countries involved, this effect is thus a positive one.

But there is also a negative effect called trade diversion. It is quite likely that when specific countries decide to band together, the member countries may stop importing certain products from the most efficient producers somewhere else, in favor of tariff-free importation from a member country with possibly higher cost (and is therefore less efficient). This can in fact worsen world resource allocation and therefore is considered a negative effect of a regional trading arrangement.

What is the rationale for the pursuit of greater economic cooperation in East Asia? It is often argued that the diversity within the region offers opportunities for complementation and synergies, thereby providing mutual benefits in the grouping. A unified East Asian market in fact is recognized to be a formidable force in the global economy. We saw this during the East Asian financial crisis in 1997-98, when world grain prices went down to historical lows because demand fell drastically in East Asia, which was most hard hit with declines in income. These translated into lower demand for cereal grains, thereby leading world prices worldwide to go down. And now, the current food and energy security issues highlight the value of cooperating more closely within the region to cope with such crises.

What have been the manifestations of increasing East Asian cooperation? Between 1990 and 2001, the trade among East Asian countries or intra-regional trade as a percent of world trade, rose from 8.4% to 11.9%. The intra-regional exports as a proportion of the region's own trade grew also from 40% to 47.5%, and intra-regional imports' share also grew from 47% to 56% -- all signs that there is in fact more active trade within the countries of East Asia.

What have been the initiatives in this direction? The ASEAN Free Trade Agreement or the AFTA is the only formal multilateral Regional Trading Arrangement in place in East Asia, covering ten South East Asian countries with the addition soon of East Timor. The free trade area began with the ASEAN 6: Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand since January 2002, while the rest, namely Vietnam, Laos, Myanmar and Cambodia have been following in succession, with Vietnam already a full participant.

Full tariff elimination is expected among the early starters by 2010, and by the other countries by 2015. An ASEAN Economic Community is envisaged to be achieved by 2020. The ASEAN PLUS 3 now includes Japan, Korea and China. The precursor of this was the 1990 Malaysian proposal for an East Asian Economic Group, which later became the East Asian Economic Caucus which at the time covered ASEAN plus Japan, China, South Korea and Hong Kong. Those earlier initiatives fizzled out because of the objections of the United States, who wanted to strengthen the bigger grouping of the Asia-Pacific Economic Cooperation (APEC). The US felt then that EAEG or EAEC was undermining APEC. Thus, for East Asian economic integration, what we are seeing is the ASEAN PLUS 3 grouping.

The APEC itself is a bigger group of all the Pacific Rim countries, including the US, Canada, Australia, New Zealand, Mexico and Chile on the other side of the Pacific. It is built on the basic principle of open regionalism, that is non-discrimination against non-members, and it also seeks zero tariffs across the countries by 2010 for developed country members, and 2020 for the developing members. And now we are seeing a host of regional and bilateral free trade agreements and economic partnership agreements, especially between Japan and China on one hand and the rest of the region. The Japan-Singapore Economic Partnership Agreement is already in place. The ASEAN – China Free Trade Agreement is expected to be in place by 2010 and 2015, although the so-called “early harvest” mechanism is already on.

Japan has been pursuing Economic Partnership Agreements with other ASEAN countries, particularly Indonesia, Malaysia, Philippines, Thailand and others. Singapore already is advanced in similar moves with the US, New Zealand and the European Free Trade Area and other similar initiatives.

But beyond trade there are also other forms of economic cooperation we are seeing right now within East Asia. One is the complementation between trade and foreign direct investment and this means a strategic distribution of specific product lines for production processes across various countries of East Asia, such as car components, appliances, and processed food products. Some big companies distribute specific product lines or processes across countries in the region, taking advantage of economies of scale and subsequently moving the different products freely across the countries because

of the free trade area. This permits more efficient division of labor, and provides for deeper integration of the respective economies, thereby showing that foreign direct investment can be a complement rather than a substitute for trade.

A very good example is the Hitachi company itself, which distributes production strategically across countries in the region. Indonesia is known for the color TVs, gas cookers, and rice cookers that Hitachi produces here. In Thailand, they produce vacuum cleaners and refrigerators. In the Philippines, Hitachi produces digital media products, especially components of hard disks. In Fujian, China, Hitachi manufactures wide screen color TVs. There is strategic reason for the pattern of deployment because there is a complementation that occurs given that there's free trade among countries in the region.

Another form of integration or cooperation beyond trade is financial integration. This covers arrangements like more liberalized capital flows, cross-border bank loans, bank inter-connections, opening of securities and equity markets and other self-help mechanisms so that the countries of the region can help each

other in times of crises. Some of you may know about the Chiang Mai initiative on currency swaps whereby the central banks of the member countries can help one another replenish their reserves in the event of financial crises. There is also the ASEAN surveillance mechanism, which involves close monitoring of each other's macroeconomic performance so they can achieve coordination. Pursuing an ASEAN bond market will facilitate selling of bonds region-wide rather than just within individual countries.

What opportunities do these initiatives give us in East Asia? For one thing, East Asia is a vast market with a total population of about 2 billion people. China is in fact seen as a very dominant force but many people would positively think of it as less of a threat and more of an opportunity for the other countries in the region. The collective output or GDP in the region is comparable to that of the European Union or the North America Free Trade Area. And the landmass involving East Asia is bigger than both the EU and the NAFTA combined.

We also have to see the diversity as an opportunity for complementation and development cooperation. This so-called "South-South" cooperation across countries is often more effective and efficient rather than depending on assistance from richer countries. Other opportunities include labor market pooling via services sector liberalization, for example, if we let our skilled workers or experts move more freely within the region. We would also promote information sharing, technology transfer and intellectual proprietary rights protection, risk sharing and collective crisis response as is being done now in the case of rice, sharing good practices and cross-cultural exchange and enrichment.

There clearly are some challenges or downsides as well. One practical challenge is the need to avoid having excessive proliferation of specific regional arrangements such that there may be what has been called a "spaghetti-bowl" effect of having duplicating and overlapping FTAs, and EPAs. What is needed is to ensure consistent, harmonized and uniform rules in each of these initiatives. Furthermore, there can be tremendous social and political costs from needed sectoral adjustments as trade is liberalized among the member economies, especially with China's dominating presence. Divergent income levels, industrial structures, human resource capacities, level of development of institutions and maturity of financial markets also make integration moves extremely challenging. Suspicions of hidden motives on the part of more powerful members (e.g., control of natural resources, toxic waste dumping), along with perceptions of lopsided benefits, lead many to question specific initiatives, especially bilateral ones, for greater integration (JPEPA is a case in point). This suggests that greater economic integration would be better pushed in a



multilateral context, i.e. ASEAN with its East Asian neighbors, where the likelihood of lopsidedness can be better avoided.

I will close by posing at least four questions that the young people may want to consider as they do their work and try to expand on our theme. First, what are the particular opportunities and challenges for individual country members as we pursue greater East Asian economic integration? How can these opportunities be best tapped? How must peculiar challenges be addressed?

Second, what are specific areas for complementation and synergy that may be tapped among the specific members of East Asia? Third, what changes need to be made on the policy environment, the institutional environment, and in the nature of public investments to enhance the benefits and minimize the challenges? And finally, what specific roles can the youth play in making an East Asian Economic Community not only a reality but a positive reality?

Finally let me end with a very simple message that I heard from an Asian statesman not too long ago. He said that the secret to meeting our problems right now is simply to consume less, produce more and share more. By “consuming less” he had in mind the famous quote from Mahatma Gandhi that says “The world has enough for man’s need, but not enough for man’s greed”. Perhaps, he said, we simply have to consume less only to the point of what we need.

“Produce more” does not only refer to producing products, but producing wealth. An Asian modern day philosopher has defined wealth as consisting of three components: material well being, the common good, and beauty. We should strive, then, to produce more of these three – including promoting beauty and the arts.

And finally, “share more,” which teaches us that the East Asian community should be built upon sharing and caring – and that means we should work on our shared dreams, our shared resources, and our shared efforts to truly achieve a working East Asian community, a community not just in the economic sense but in a social, environmental, political, cultural and spiritual sense as well.

A good day to all of you. Thank you very much!