

**“Japan and Economic Integration in East Asia”**  
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**The impact of East Asian Economy on the U.S. and Japan**

The degree of economic interdependence within East Asia is notably high. Inter-regional trade within ASEAN+3, Hong-Kong and Taiwan included stands at 55%, surpassing the 43% of the NAFTA countries, and is edging toward the 62% of the EU. This demonstrates that the economic achievements of GDP are not simply understood by adding up the total GDP for all the countries within the region; GDP also reflects the results achieved by cooperation between individual countries within the region.

With the progress of globalization, the scope of global trade and investment is also growing. In these circumstances, economic globalization continues to develop, and with it economic interdependence in a global economy. Given this, the stronger the cooperation between large economic regions, the greater the resulting trade and investment opportunities for the parties involved. The U.S. and EU markets are the main importers of East Asian products. In parallel with this, the continued and rapid expansion of the East Asian economy will create an enormous market for the U.S. and EU in places especially in China and in India.

With East Asian economic development, income levels will grow and individual consumer needs will increase. For countries outside the region, this creates a promising marketplace. Asian economic development will greatly benefit economies outside the region.

**The History of Development of Economic Cooperation in the East Asia**

Putting its past glory empires aside, East Asia has a relatively short history of growth in development of secondary and tertiary industry. The NIES countries were the

first to make the transition to industrialization. In the post-1980 period, the ASEAN 4 (Singapore, Malaysia, Indonesia and the Philippines) FTZ (Free Trade Zone) allowed direct investment, which stimulated economic development. Japanese industry had been active there in various forms since the 1950s, but after the 1985 Plaza Accord and the rapid yen appreciation that followed, investments in the ASEAN countries grew quickly.

The reasons for Japan's presence in East Asia have slowly changed. During 1990s, Japan entered into a long phase of structural depression, and Japanese industry sought to cut costs by developing facilities in parts of Asia that offered low-cost labor. This move also supported Asia's industrial development. Advanced industries were supported by efforts to develop intermediate products, and financial services, EMS and logistics services also advanced.

Electronics manufacturers began to build Asian facilities in the 1980s. Thanks to advances in "modularization" in production technologies for electronics, electronic parts became increasingly generic. This supported a division of labor in the production process, with basic design taking place in Japan and final assembly of finished products in Asia, where labor costs were lower.

Please allow me to take up the Toshiba's case which I am very much familiar with. Toshiba's production of digital products illustrates the trend. In 2006, 95% of PCs, 45% of TVs, 49% of projectors, 94% of DVD players, recorders and VCRs and 76% of hard disk drives and optical disc drives were produced in Asian countries outside Japan.

With different stages of production of electronic products being carried out in different places, the construction of production facilities across Asia stimulated creation of a physical distribution (PD) network. This achievement of Asian SCM also allows western companies to commission large-scale EMS, companies like Flextronics International, to develop and manufacture products.

As Asia ramped up manufacturing, the products it manufactured were exported to the developed countries of Europe, the US, and Japan. This created a positive environment for fiscal policies favoring infrastructure development, and resulted in investment in social infrastructure systems, such as highways, airports and ports. This kind of industrialization and infrastructure investment naturally stimulated individual consumer spending, and as a result the Asian economies entered a high growth period.

Today, each part of the Asia region has developed its own industrial identity. Alongside this, the region has put in place a network of physical distribution for semi-finished goods. Singapore plays a strategic role in transportation, both as a financial center and a physical distribution center with its harbors and airport. Taiwan's development is centered on production of electronic and mechanical goods. Korea's

industrial base was built on automobiles, steel, heavy industries and electronics. India and Thailand are also cultivating automobile production. China has made advances practically in every category of products. Southern and Eastern China have made advances in petrochemicals, which supports the IT and automobile industries. Petrochemical plants have been built, and now supply materials for construction-related goods.

Today, from a Japanese company's viewpoint, the attraction of Asia is no longer only its cheaper labor. The establishment of infrastructure has brought with it the ability to promote advances in new industries. However, there are still vast areas of Asia that remain untouched by industrialization. While many of the workers of Asia cannot be called privileged, they are gifted with optimism and the determination to improve their lives. Building up production with those workers, and seeing productivity improve will further motivate the corporate side, and stimulate even greater gains.

### **Achieving Further Industrial Development in East Asia**

The high market demand for quality automobiles with low gas consumption has led to the development of electric-gasoline hybrids and other types of vehicles. At the moment North America still leads the world in automobile production, but Asia is increasing production and moving to catch up.

Automobile industries in Asia are usually developed with government support to create an industry that can stimulate other parts of the economy. Malaysia is a current example. So was Japan, 50 to 60 years ago. Most of Japan's offshore production of automobiles has been in the US and Europe, but in last decade the ratio in Asia has been growing. The quantity of automobiles that Japanese manufacturers produce at Asian affiliates in Asia is growing fast. The total number of units produced overseas was six million in 2000, and it has grown at a pace of 1 million a year since 2004. By 2005, the figure stood at 10,610,000 units. Japanese automakers manufacture around 10 million vehicles a year in Japan, a figure that is growing slowly. In other words, the total production of Japanese auto manufacturers is roughly split between Japan and overseas. For this overseas production, China, Thailand and India have been remarkably developed by Japanese, Europeans and United States automobile companies.

If one company decides to build a facility in a certain place, it is not unusual for a supplier with a history of working with that company to build its own factory in the same region. In the beginning, local workers usually did not have very well developed manufacturing skills, and so only simple parts were manufactured. The

tendency at that time was to rely on Japan for advanced products. However, local workers improved with experience, and it is now possible for these facilities to supply advanced equipment.

The auto industry has recently started to change, albeit slowly. First of all, electronic systems are increasingly replacing mechanical systems. There have also been significant advances in automobile-related information processing, the field known as telematics. As a result, auto manufacturers and electronics manufacturers have new opportunities for collaboration.

With the increase in electronics and auto manufacturing in Asia, demand for supply of materials for home-appliance, IT-equipment and auto-parts production facilities has grown. This is particularly true in China, where social infrastructure development of highways, airports and ports, along with the investment of foreign enterprises, has promoted economic advancement and demand for a wide variety of parts, components and materials. In 2001, China's share of world production of air conditioners, microwave ovens and printers was estimated at over thirty percent. For other home electronics, the figure was more than half the world total. During the 1990s, China's market opening stimulated advances, mostly driven by foreign enterprise, but more recently local industries have also developed. For example China's Guangdong province, developed local industries supplying electronics equipment, IT products, toys and other miscellaneous goods for export, as a result of commissioned production of plastics from a direct user.

### **Opportunities of East Asia's Interdependent Structure**

After the 1980s, economic momentum in East Asia was stimulated by direct investment by foreign enterprises. Currently, there are various debates on the necessity and possibility of advancing government integration for the purpose of system harmony. I would like to express my opinion.

To begin, many negative opinions about the realistic possibilities for an Asian alliance begin by contrasting Asia with the EU. First, the EU is a democracy, with common traditions in many areas, such as Christianity, Indo-European languages with roots in Latin and Greek, as well as general use of the alphabet. Over the course of history, the European continent has been a battleground many times, but after the Second World War, there was a deep desire for permanent peace that came to outweigh each country's insistence on sovereignty. As a means of accomplishing this political goal, economic cooperation was encouraged, and under the 1851 Treaty of Paris, the

European Coal & Steel Community was formed. That was the beginning of the long road to the EU.

Asia is different. For a start, not all of the countries of Asia are democratic. The range of political systems covers communism, dictatorships, socialism and different types of democracies. Religions range from Buddhist to Muslim to Hindu and beyond. Asia's many languages do not share common linguistic roots, and some countries have more than one official language. Depending on the estimate you accept, there are between six hundred and a thousand different racial tribes in the region. There are also enormous differences in economic status between countries in the region. If you think about it realistically, if the cost of advancing government integration is the loss of Asia's diversity, the whole thing is a negative.

However, I am sure that the main issue concerning the feasibility of greater unification is not the diversity of the region or its economic inequalities; it is the lack of awareness on the part of governments of the need to integrate and to promote further legal and systemic cooperation. The countries of the EU may have a lot in common to begin with, but the way that the current 27-member EU was created by facing and overcoming regional differences and economic imbalances. In its time, the US also overcame such issues as immigration, civil war, the economic recession of the 1980s and trade deficit, and has maintained itself as a beacon for talented and ambitious students and workers. In this respect, East Asia has much to learn from the US and the EU.

### **Regarding the Necessity of East Asian Cooperation**

Because the still-developing East Asian region wants further economic growth, along with a desire for harmonized regulations and regional security, opportunities for regional integration are growing. Currently, the only alliance within the Asia region is ASEAN. This year, 2007, ASEAN celebrated its 40<sup>th</sup> anniversary. On November 20<sup>th</sup>, 2007 at the Singapore summit meeting, the ASEAN charter was signed. It contains a blueprint for establishing an economic union by 2015, and this can be seen as the first step toward a regional alliance.

Is ASEAN self-sustainable with only ASEAN? In my opinion, ASEAN works only because of other countries. There are currently discussions on the possibility of an ASEAN+3 or ASEAN+6. Debate on an East Asian economic alliance began in 1991 at the meeting on East Asian Economic Cooperation (EAEC) in Malaysia. In 1997, at the time of the Asian monetary crisis, the first ASEAN+3 summit was held.

The abrupt devaluation of the Thai baht in 1997 and the ensuing monetary crisis taught Asia important lessons. First, the World Bank did not have enough funds to save Asia from this crisis. Second, even the IMF (the International Monetary Fund), established as the world's financial security mechanism by the 1944 Bretton Woods Agreements, could not handle the crisis. The first lesson was that the existing international system could not produce a tailor-made solution to a unique Asian problem.

The Asian monetary crisis taught a second lesson. Currently, due to economic and financial globalization, any significant regional event impacts on worldwide financial, stock and economic trends. A recent example is the losses suffered by EU and Japanese financial institutions in connection with the sub-prime loan crisis in the U.S. This has raised concern over impacts at even the macroeconomic level. Establishing stability and guaranteeing regional security, as well as economic, industrial and financial security, will not only be good for the Asian region. There will also be a need for a mechanism for containing problems that arise in Asia, so they do not spill over into the US, Europe and the rest of the world.

Learning from this experience, a failsafe against a recurrence of the monetary crisis was created, financial cooperation of the East Asian countries within ASEAN+3. Based on the CMI (Chiang Mai Initiative), this became the Asian bond fund, an initiative to create a bond market in Asia that would allow bilateral currency swap agreements of foreign loans. In 2005, the bilateral swap agreement secured 58 billion dollars, and at the June 2007 ASEAN+3 financial affairs ministry meeting, the total sum of the monetary swap fund was boosted to 80 billion dollars. The remaining question now is whether or not this is enough. I would like to insist on in order to be effective when a crisis unfolds, the CMI initiative's power and the Asian development bank's financial power must be strengthened as soon as possible.

The lessons of the Asian monetary crisis do not end with currency. One thing made clear was that the international mechanisms created by Europe and the US are not necessarily the best solution for Asia's problems. Also, the Asian region's endemic diseases, its viruses, including the avian flu that first appeared in Asia, and its weather, are far beyond the WHO's support capabilities. East Asia may utilize the concept of "Subsidiarity" as defined by EU. That is the principle which state that matters out to be handled by the smallest (or the lowest) competent authority included in the Maastricht Treaty. What can be done within the region must be done by the region. The region must be capable of solving its own problems. In the future, this approach will provide the basis for forming an Asian regional alliance.

## **US and Japan Relations and the Asian Alliance**

Multilateral currency cooperation within the ASEAN+3 was created in response to the occurrence of a real problem, the Asian monetary crisis, and it has continued to develop since. In that respect, it is a clear example of a realistic cooperative effort. However, in terms of ensuring East Asia's security and continued economic activity, there are plenty of opportunities beyond of the framework of ASEAN+3.

Given this, and that the ASEAN+3 already relies on India, Australia and New Zealand, an effective step forward would be to include these countries in an ASEAN+6. In addition, APEC-wide economic cooperation, including the US, is also being considered. The Japanese economy is dependent on the US and China. In the same way, the US is dependent on Japan and China. Japan and the US also have a security treaty. In order to ensure security and economic stability in the Asian region, this US-Japan security alliance should be pivotal. That means that US involvement is a must.

As I have noted, several topics are now being considered in connection with creating an East Asian (economic) union. In the future, whatever framework is decided upon for the clear realization of that East Asian union, continued promotion of economic integration, establishment of government and private sector joint meetings, a US-Japan EPA, strengthening Sino-Japanese economic cooperation, and an APEC-wide trade framework will continue to be discussed. As a different approach, bilateral economic cooperation between the two countries (for example, Japan and Thailand or US and Korea) which is already signed being extended to other countries is another possibility.

At this point, it is still too soon to determine the framework of the East Asian alliance. Just as the members of the EU and NATO are different countries, reflecting different concerns, East Asia also may not be able to form a single alliance for security and economic cooperation. It is necessary for the countries of Asia to discuss the issues that will allow them to achieve secure, continued development. In order to do this, and to look at the many issues involved, may require the ASEAN+3, ASEAN+6 and APEC to form many combinations.

The US and Japan have many and various interdependent relationships, all pivoting on the security alliance, and it is much to be hoped that we can work together to overcome environmental problems. More specifically, we should reinforce our cooperation in creating an international framework for responding to global warming, environmental pollution and conservation and management of energy resources. We

should also cooperate in system harmonization, intellectual property protection, fair competition and international immigration services.

Thank you