

## **Chapter 2 Expansion and deepening of international business networks in the East Asia<sup>1</sup>**

True to the prediction that the 21<sup>st</sup> Century will be “The Asian Century,” the economic rise of China, NIEs, and ASEAN has been remarkable, and the influence of East Asia on the global economy is strengthening. The Japanese economy is now laboring under the constraints of low birth rates and an aging, shrinking population, and in order to achieve new growth, a vigorous East Asian economy is essential. Now, Japan’s key priority is building relationships with whole East Asia which contribute to the development of East Asia as a whole and which allow the economy to grow along with the countries of East Asia.

The Japanese economy has already developed close relationships of mutual interdependence with the East Asian economy as a whole through the formation of international business networks by means of trade and foreign direct investment. Moreover, recent years have seen an ongoing systematic integration<sup>2</sup> that underpins the East Asian economy through Economic Partnership Agreements and Free Trade Agreements (EPA/FTA).

This chapter presents an overview of the state of the East Asian economy and describes the East Asian business network and its expanding role in the economy. It also sheds light on the policy issues that will affect the growth not only of the Japanese economy but also of the East Asian economy as a whole.

### **Section 1 The integration of the East Asian economy and its growing influence on the global economy**

Having achieved an economy of considerable scale through a sustained high rate of growth, East Asia now exerts a growing influence on the global economy. At the same time, the intra-regional exchange of goods, money, and people is becoming increasingly intertwined. This section focuses these developments and details efforts to build systems for supporting an integrated intra-regional economy.

#### **1. East Asia’s growing influence on the global economy as a center of growth**

##### **(1) East Asia maintains a high rate of economic growth**

##### **(East Asia will continue to achieve growth surpassing that of other regions)**

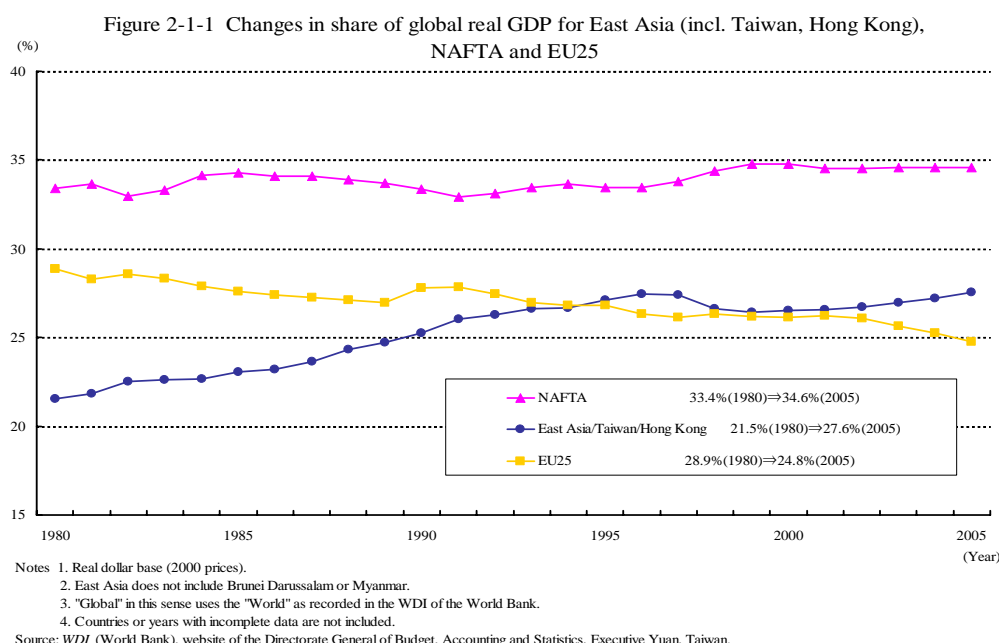
Following the Asian currency and financial crisis in the latter half of the 1990s, East Asia entered a temporary period of stagnation but since then has achieved sustained economic growth in the medium to long term. The global share of real GDP of East Asia, Taiwan and Hong Kong has expanded from 21.5% in 1980 to 27.6% in 2005, surpassing the EU25 and accounting for a substantial part of the global economy (Figure 2-1-1).

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<sup>1</sup> In this White Paper, the term “East Asia” refers to the region and nations below: Japan, China, Republic of Korea, ASEAN, India, New Zealand, and Australia.

<sup>2</sup> In this White Paper, the term “integration of the system” or “systematic integration” refers to the elimination of cross-border or domestic regulations or the harmonization of various economic systems in order to liberalize and facilitate the movement of people, goods, and money of the region between two specified countries or multiple specified countries.

East Asia is expected to continue on a high growth track and strengthen its influence on the global economy.



## (2) East Asia expands its production capacity

The high growth rate of East Asia is particularly prominent in specified product items, and depending on the item, East Asia shoulders a major portion of global production. As a result, East Asia's production trends now exert a major influence on global production trends.

Looking at production in East Asia by product item and at the position occupied by East Asia in global production shows that the number of automobiles produced in 2005 reached 24.66 million units, which means that East Asia has surpassed EU25 and NAFTA as the largest producing region. In addition, production of synthetic fiber in East Asia amounted to 23.04 million tons, capturing a global share of 67.3% (Figure 2-1-2). Production of personal computers and DVD recorders/players in 2006 is expected to reach 214.92 million units and 98.04 million units or a global share of 96.8% and 92.2%. In many fields, East Asia has become the factory of the world (Figure 2-1-3).

Figure 2-1-2 Share of global production in automobiles and synthetic fibers in East Asia

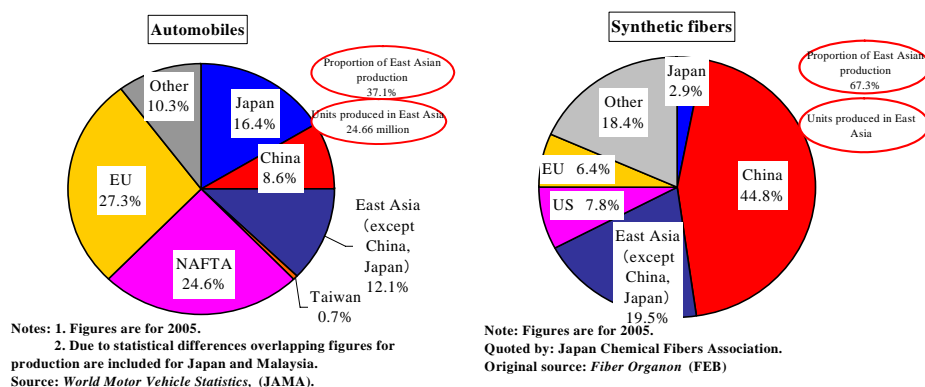
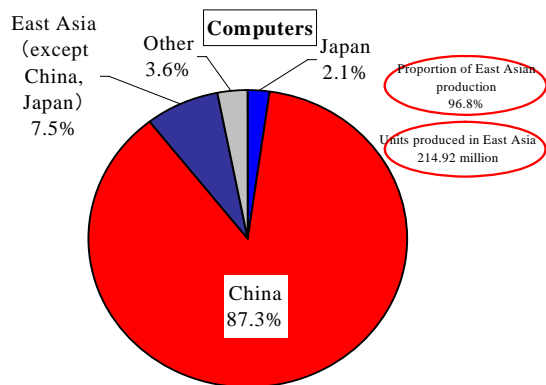
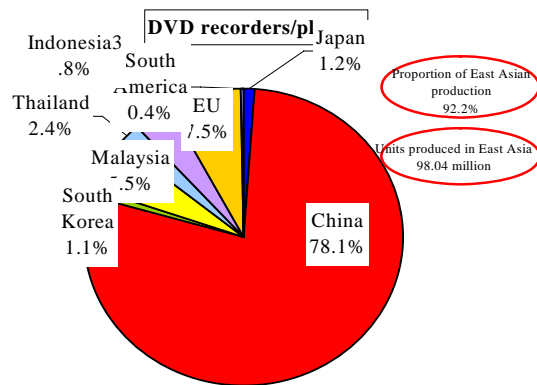


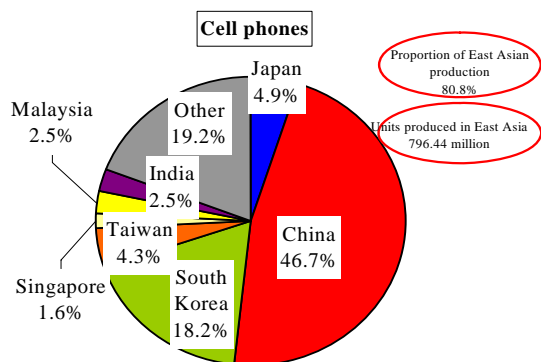
Figure 2-1-3 Share of global production in electrical machinery in East Asia



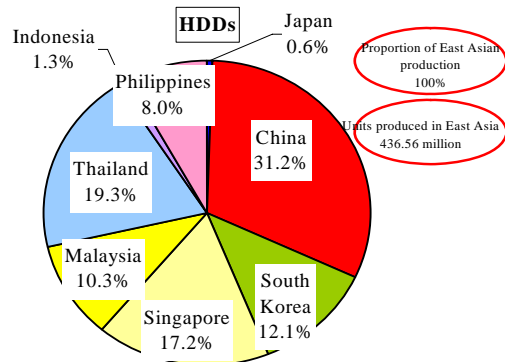
Notes: Figures are for 2006 (projected).  
Source: World-wide Production of Major Electronics from 2005 to 2007 (JEITA).



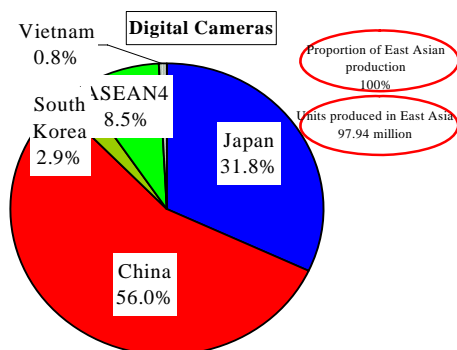
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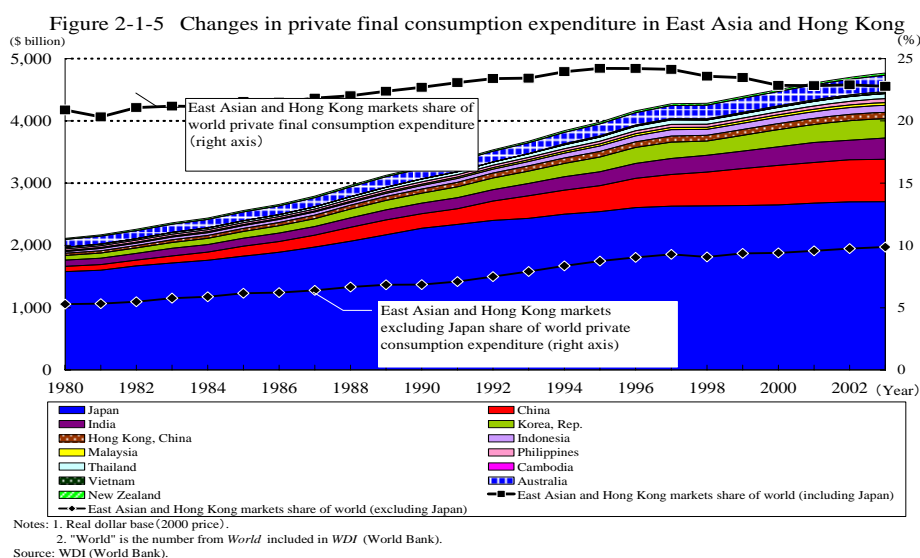
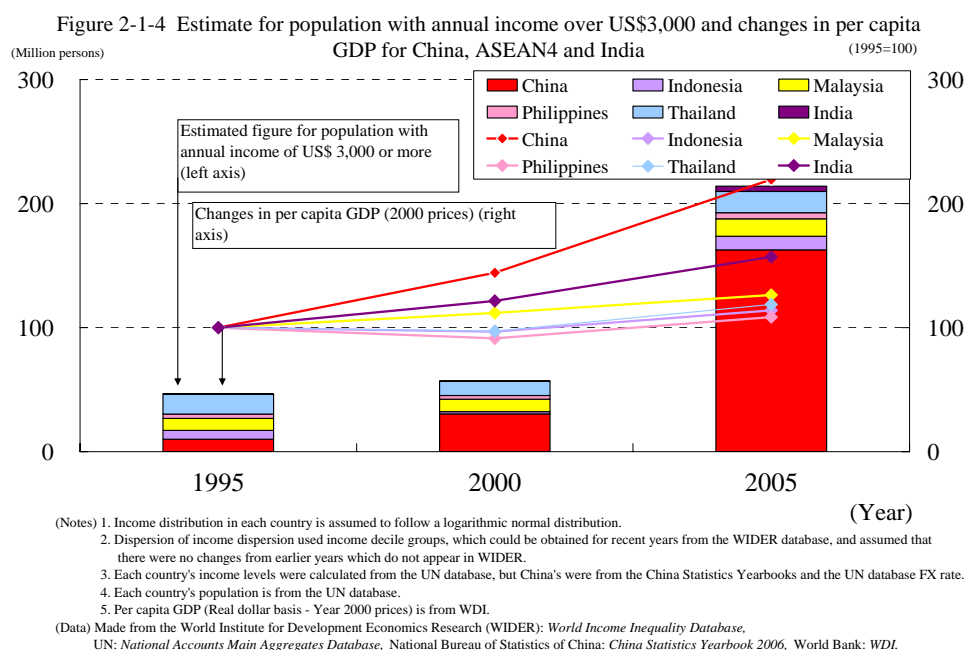
### (3) East Asia grows as a consumer market

With the strong growth just described, East Asia has succeeded in raising per capita income, which is leading to an expansion of the middle class and promoting the growth of East Asia as a

consumer market.

Calculating the population of consumers able to purchase consumer durables such as automobiles, that is, those earning US \$3,000 or more per year, for China, ASEAN4 and India, the population in the range has grown remarkably along with the increase in per capita GDP between 2000 and 2005 (Figure 2-1-4). With the expansion of the middle class, the global share of final private sector consumer spending of East Asia, excluding Japan, and Hong Kong has risen from 5.3% in 1980 to 9.9% in 2005 (Figure 2-1-5). The countries of East Asia are expected to sustain a high rate of growth, and their consumer markets are expected to expand.

Around the 1980s, Japanese companies established many production bases in ASEAN and engaged in exporting while at the same time expanding into local markets. In recent years, Japanese companies have been expanding into China's growing domestic markets. Since East Asia's consumer markets are expected to grow from now, Japanese companies must make strategic inroads into the markets of ASEAN, China, and India.



In response to this market expansion, Japanese companies have stepped up their economic activities in East Asia. The percentages by region of sales and ordinary profit of the overseas local corporations owned by Japanese companies show that as of 2004, East Asia had already become the most important market next to North America for Japanese companies (Figure 2-1-6). What is more, the forecasts for sales and operating profit by region for Japanese companies in FY2010 indicate high rates of growth in Asia (Figure 2-1-7). Japanese companies regard East Asia as the most promising market for growth, and having observed the energy and dynamism of East Asia and its potential to endure, they are inclined toward aggressive economic activity. Developments in the East Asian economy are likely to exert an increasingly large influence on the Japanese economy.

Figure 2-1-6 Changes in Japanese sales of overseas subsidiaries, current profits and distribution by region

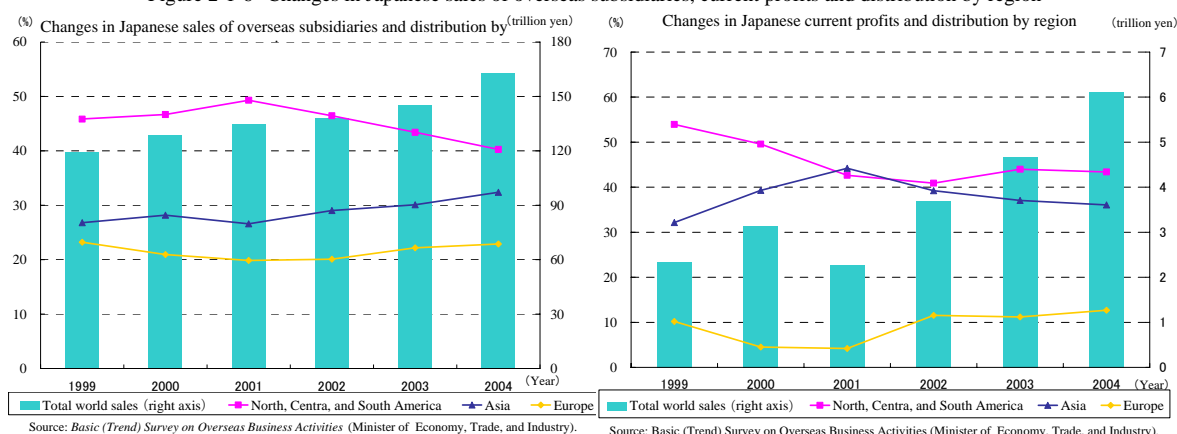
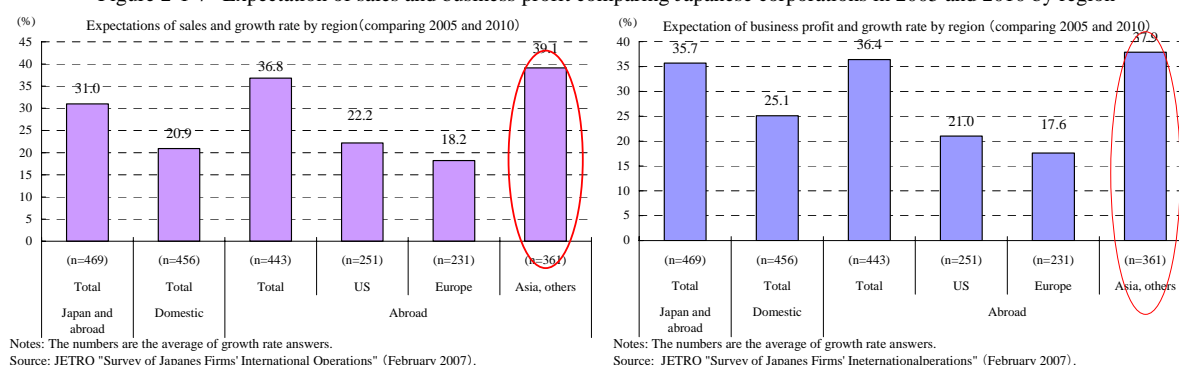


Figure 2-1-7 Expectation of sales and business profit comparing Japanese corporations in 2005 and 2010 by region



## 2. Integration will deepen intra-regional economic relationships in East Asia

The above overview affirms that East Asia will maintain a high rate of growth and that remarkable advancements can be expected both in production and consumption. The following discussion will bring into focus the process of integration of the intra-regional economy as the exchange of goods, money and people within the East Asian region grows.

## (1) Integration of the East Asian economy

### (Exchange of goods, money and people within East Asia to grow)

Looking at the exchange of goods, money and people and examining each from the viewpoint of trade, cross-border investment and movement of people indicates that East Asia is encouraging the movement of these elements within the region.

Beginning with trade, the trade intensity index<sup>3</sup>, which expresses the degree of closeness of trade between two countries (or regions), indicates that in many trade relationships between two countries or regions of East Asia, the index exceeds 1 and that the index increased between 2000 and 2005. This suggests that trade relationships in East Asia are becoming closer, and, with increasing trade volumes, that integration is picking up its pace (Table 2-1-8).

Table 2-1-8 Degree of trade intensity in East Asia (2000-2005) (Exports)

2000		Trading partner country, region						
		Japan	China	South Korea	India	Australia	New Zealand	ASEAN
Base country, region	Japan		<i>1.91</i>	<i>2.82</i>	0.74	<i>1.75</i>	<i>1.34</i>	<i>2.49</i>
	China	<i>3.14</i>		<i>1.99</i>	0.89	<i>1.34</i>	0.84	<i>1.21</i>
	South Korea	<i>2.23</i>	<i>3.23</i>		<i>1.09</i>	<i>1.47</i>	0.84	<i>2.03</i>
	India	0.78	0.54	0.47		0.93	0.75	<i>1.12</i>
	Australia	<i>3.72</i>	<i>1.71</i>	<i>3.28</i>	<i>2.35</i>		<i>29.64</i>	<i>2.38</i>
	New Zealand	<i>2.57</i>	0.89	<i>1.92</i>	0.79	<i>19.62</i>		<i>1.47</i>
	ASEAN	<i>2.53</i>	<i>1.16</i>	<i>1.61</i>	<i>2.26</i>	<i>2.40</i>	<i>1.26</i>	

2005		Trading partner country, region						
		Japan	China	South Korea	India	Australia	New Zealand	ASEAN
Base country, region	Japan		<i>2.30</i>	<i>3.35</i>	0.63	<i>1.94</i>	<i>1.81</i>	<i>2.46</i>
	China	<i>2.45</i>		<i>1.97</i>	<i>1.25</i>	<i>1.34</i>	0.78	<i>1.40</i>
	South Korea	<i>1.87</i>	<i>3.73</i>		<i>1.72</i>	<i>1.24</i>	<i>1.04</i>	<i>1.85</i>
	India	0.64	<i>1.52</i>	0.82		0.85	0.42	<i>1.52</i>
	Australia	<i>4.50</i>	<i>1.97</i>	<i>3.35</i>	<i>5.34</i>		<i>28.57</i>	<i>2.22</i>
	New Zealand	<i>2.29</i>	0.93	<i>1.56</i>	0.64	<i>17.19</i>		<i>1.28</i>
	ASEAN	<i>2.50</i>	<i>1.61</i>	<i>1.70</i>	<i>2.36</i>	<i>3.15</i>	<i>1.83</i>	

Notes: 1. Degree of trade intensity (exports based) was calculated from the equation below.

(Exports from country B to country A/country B's net exports)/(Exports from world to country A/World net export)

2. Trade intensity greater than 1 are italicized.

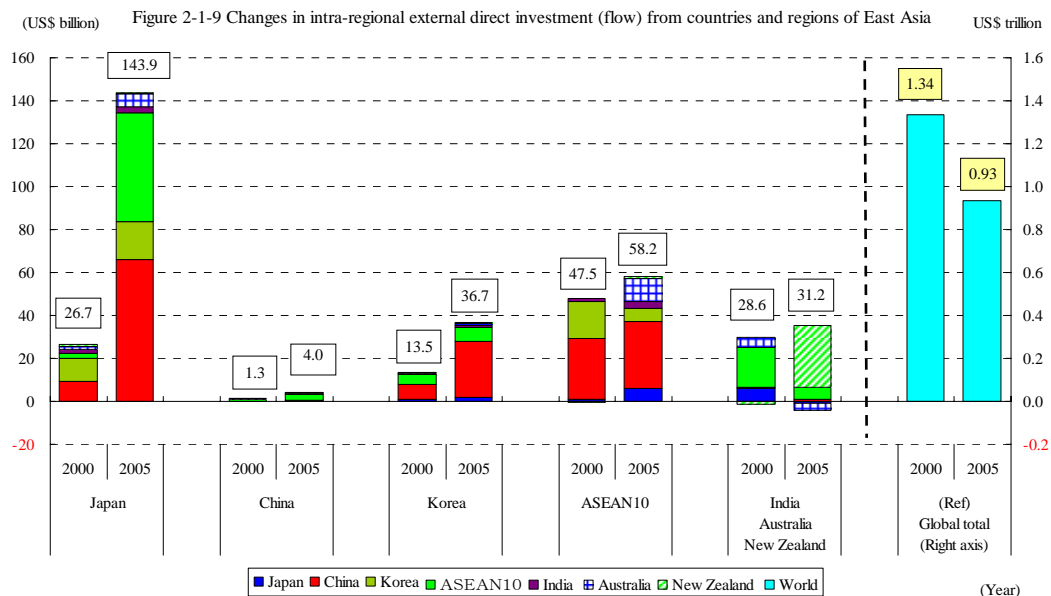
3. Those that have increased compared to 5 years ago are shaded red.

Source: DOT (IMF)

Next, the discussion will focus on cross-border investment, specifically, changes in the amount of foreign direct investment (flow,) from East Asian countries to within the East Asian region. In 2005, the amount of foreign direct investment worldwide declined from \$1.3 trillion in 2000 to \$0.9 trillion; in East Asia the amount of foreign direct investment within the region increased in each country and region. The increase in investment by Japan was particularly large, rising from \$2.67 billion in 2000 to \$14.39 billion in 2005, a five-fold increase in five years, and direct investment from South Korea and ASEAN to within the East Asian region also increased. These trends indicate that the growing

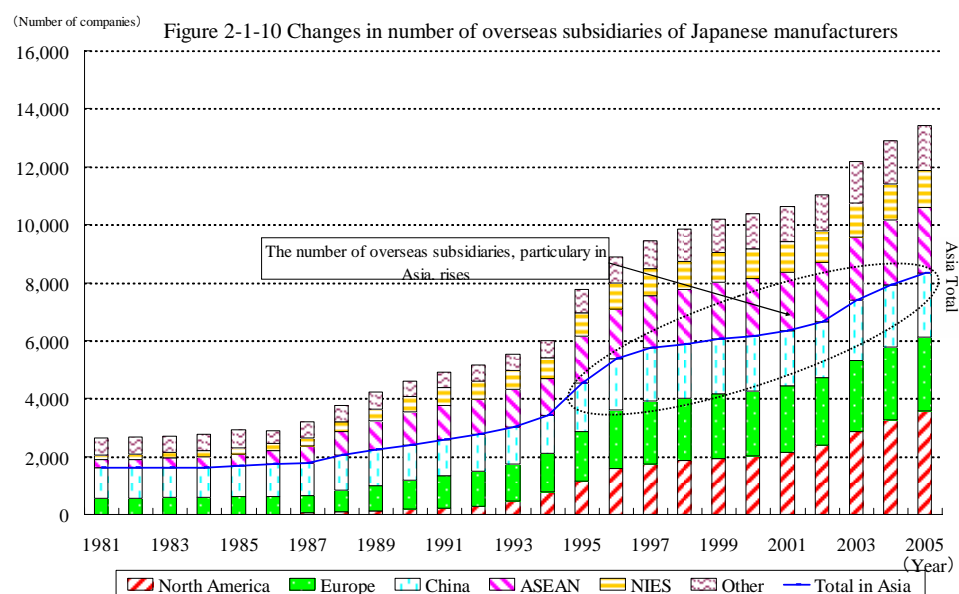
<sup>3</sup> The trade intensity index is the proportion of Country A's export to the total world exports combined, with Country B's total export to Country A deducted. If the numerical value exceeds 1, it means that Country B is exporting a larger proportion to Country A than the other countries combined, therefore, the trade relationship between Country A and Country B is considered closely connected. (In addition, the degree of trade intensity is calculated using the exporting country as the base, therefore, the two countries will each obtain a different numerical value.

business transactions within the region, in terms of investment as well, are hastening the process of integration (Figure 2-1-9).



Notes: 1. Figures for global total, Japan, Korea, Australia and New Zealand are on an international payments base, and figures for China are on an approved amount base.  
 With regard to the volume of external direct investment for ASEAN10 and India, due to data constraints figures have been reverse calculated from the volume of inward direct investment of counterpart countries.  
 (Due to data constraints, inward direct investment data to ASEAN from Korea and India does not include investment to Brunei Darussalam, Lao PDR, Cambodia, Myanmar and Vietnam. Inward direct investment from ASEAN to India does not include that from Singapore, Brunei Darussalam, Lao PDR, and Cambodia.  
 2. Figures for 2000 for Australia and New Zealand, and figures for 2005 for New Zealand are on a fiscal year base.  
 Source: SEKAI SHUYOU KOKUNO CHOKUSETSU TOUSHI TOUKEI SHUU 2007 (ITI).

What is more, the large increase in the number of overseas local corporations of Japan's manufacturing industry sited in East Asia indicates that Japan is forging a stronger relationship with East Asia in terms of investment (Figure 2-1-10).



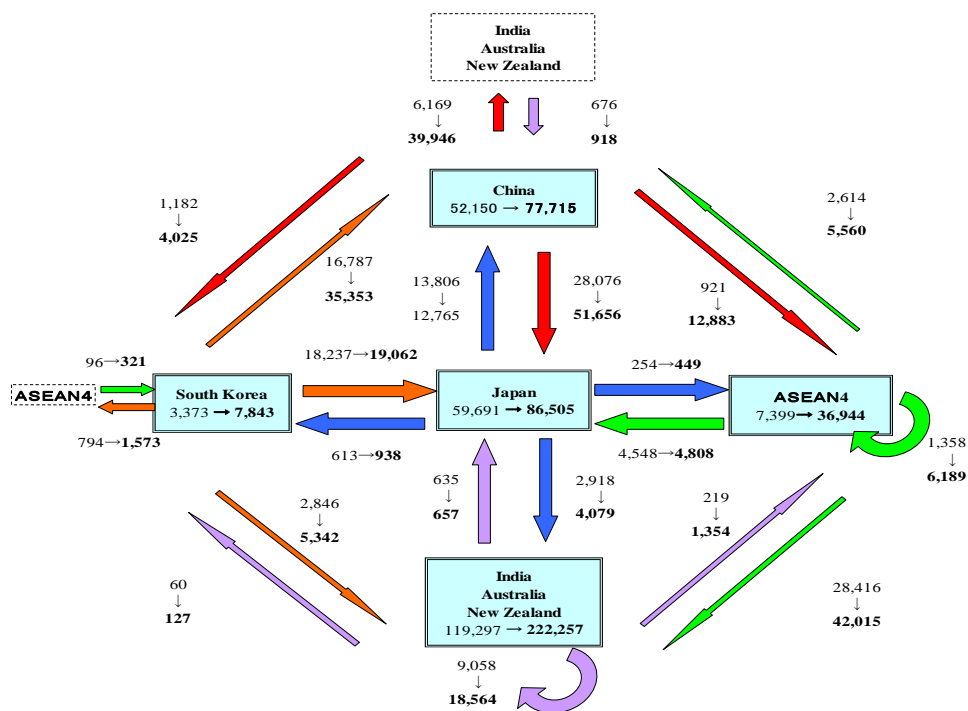
Note: Europe includes Russia. Asia consists of China, ASEAN4, and NIEs.  
 Source: Kaigai Shinshutsu Kigyō Soran (Tokyo Keizai)

Finally, the cross-border movement of people shows that the number of international air passengers within the Asia region more than doubled between 1996 and 2005 (Figure 2-1-11). In addition, the number of international exchange students within the East Asian region increased from 140,000 in 2000 to 268,000 in 2003, another indication that movement of people between countries in the region is growing (Figure 2-1-12).



Note: Shows transportation figures for flights originating and concluding in Asia of airlines that are affiliated to IATA.  
Source: Aviation Statistics Overview 2006, (Japan Aeronautic Association).

Figure 2-1-12 Changes in the number of exchange students within the East Asian region (2000 to 2003)



Notes: 1. Figures in boxes are the total figures for exchange students accepted from around the world in each of the countries/regions.

2. As figures for exchange students to Thailand in 2000, exchange students from the Philippines and Malaysia to China in 2000, and exchange students from India and New Zealand to China in 2000 and 2003 could not be acquired, these figures were not included in the totals.

3. Increases in student numbers relative to 2000 are shown in bold type.

Source: Education Database, (OECD), Educational Statistics Yearbook of China, People's Education Press.

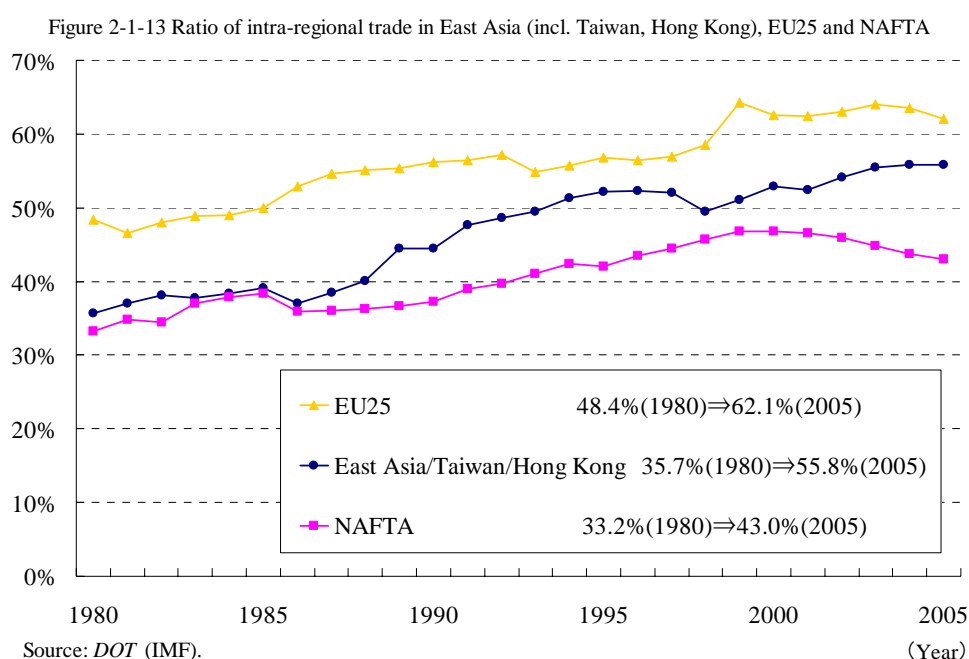


## (2) The deepening economic relationship within the East Asian region

### (Intra-regional trade relationships deepen in East Asia)

East Asia, Taiwan and Hong Kong have substantially increased their trade within the region, more so than their trade outside the region, and the difference between the ratio of intra-regional trade in East Asia-Taiwan-Hong Kong and the ratio of intra-regional trade in EU25, a tariff union formed in 1968, has been shrinking.

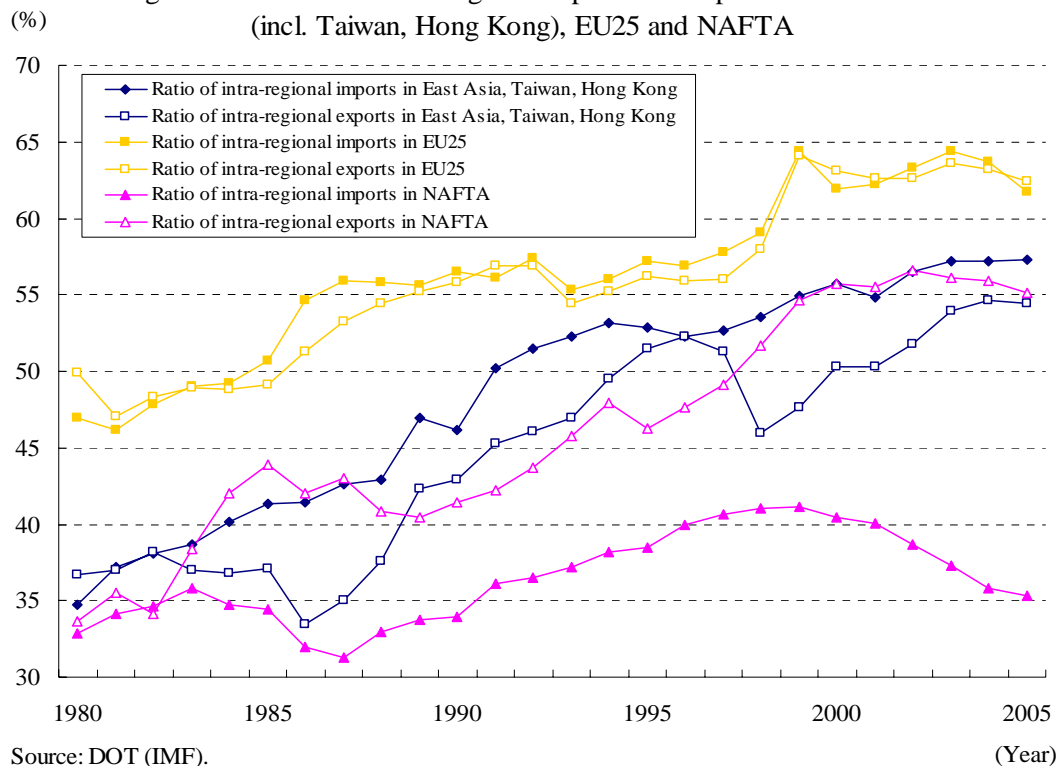
East Asia, Taiwan and Hong Kong have rapidly increased their ratio of intra-regional trade, which rose from 35.7% in 1980 to 55.8% in 2005, substantially exceeding NAFTA's 43.0% and approaching EU25's 62.1% in 2005 (Figure 2-1-13).



### (Characteristics of the import/export structure within the East Asian region)

An analysis of intra-regional trade in East Asia in which trade was divided into the ratio of intra-regional exports and the ratio of intra-regional imports reveals that the latter has consistently been higher than the former, which means that one of the characteristics of trade in the region is the higher degree of dependency on the region for imports rather than exports. Comparing the figures with EU25 and NAFTA shows that the ratio of intra-regional exports and ratio of intra-regional imports in EU25 are both at the same high level, while in NAFTA—in contrast with East Asia—the ratio of intra-regional exports has consistently been higher than the ratio of intra-regional imports, and the difference is large. These figures indicate that each region has differing characteristics (Figure 2-1-14).

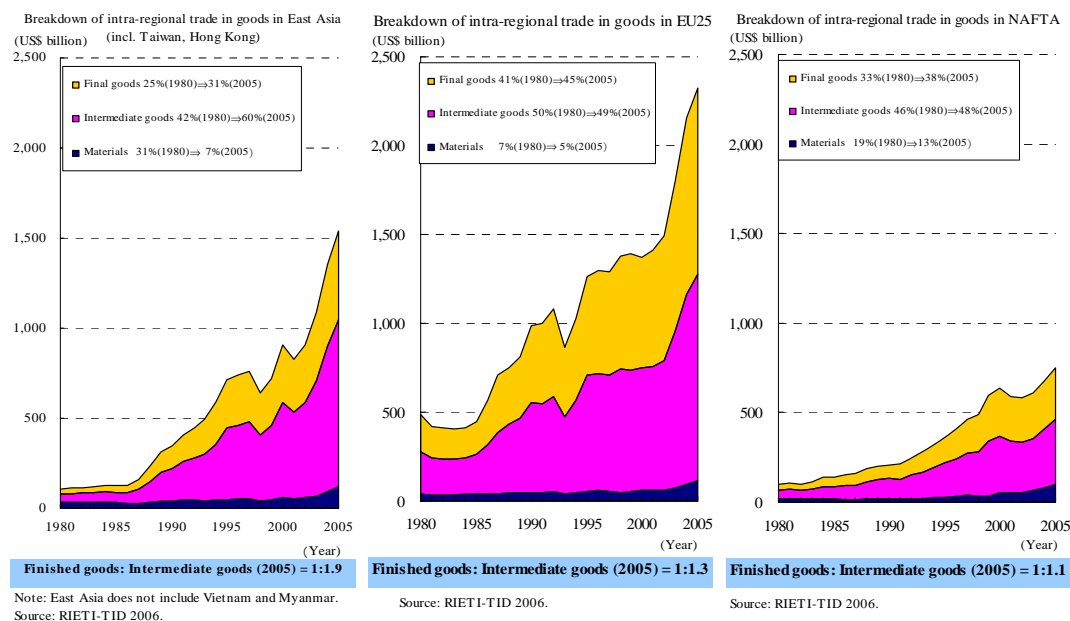
Figure 2-1-14 Ratio of intra-regional imports and exports in East Asia  
(incl. Taiwan, Hong Kong), EU25 and NAFTA



#### (Intra-regional trade in East Asia is led by intermediate goods)

An analysis of intra-regional trade in East Asia by class of product—finished, intermediate or raw material—to determine which class was driving the expansion of intra-regional trade in East Asia shows that the proportion of intra-regional trade accounted for by intermediate goods has increased rapidly, rising from 42% in 1980 to 60% in 2005, which confirms that intermediate goods are driving intra-regional trade (Figure 2-1-15). The ratio of trade volume of finished goods to intermediate goods in 2005 was 1:1.1 in NAFTA and 1:1.3 in EU25. By contrast, in East Asia, the ratio was 1:1.9, and thus its proportion of intra-regional trade accounted for by intermediate goods markedly exceeds that of EU25 and NAFTA. This demonstrates that the countries in the region are specializing in the parts and materials in which they have particular strength and as a result are bringing about a cross-border division of manufacturing process.

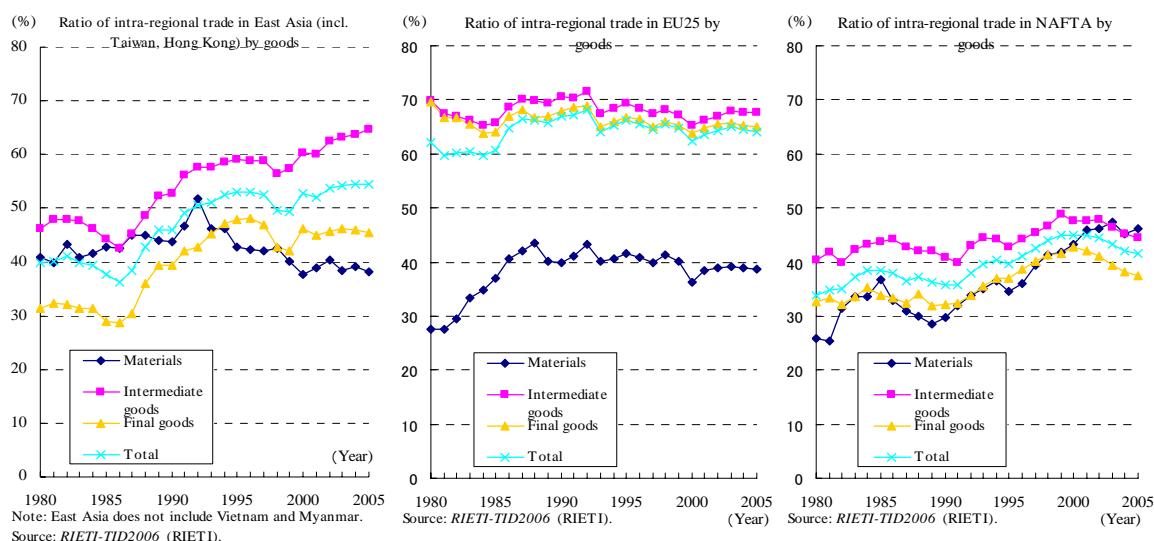
Figure 2-1-15 Breakdown by goods of intra-regional trade in East Asia (incl. Taiwan, Hong Kong), EU25 and NAFTA



### (An intra-regional mutual supply system for intermediate products exists in East Asia)

The ratio of intra-regional trade by class of product shows that in East Asia the ratio of intra-regional trade of intermediate goods has rapidly increased and has reached a level approaching that of EU25. Although the ratio of intra-regional trade of finished goods is rising, it is not high compared with EU25. In NAFTA, the ratio of intra-regional trade of intermediate and finished goods has not reached the level of either East Asia or EU25. Moreover, for whichever region, the ratio of intra-regional trade of raw materials is around 40%, especially in East Asia, this ratio has declined since the 1990s (Figure 2-1-16). The characteristics of East Asia's ratio of intra-regional trade by class of product probably reflect the fact that since the latter half of the 1980s, a mutual supply system for intermediate goods has rapidly developed in East Asia. It also reflects the fact that although a mutual supply system for finished goods has been developing in East Asia, exports to countries outside the region are larger. And for raw materials, amid a healthy economy, there is a growing dependency on procurement from outside the region.

Figure 2-1-16 Ratio of intra-regional trade in East Asia (incl. Taiwan, Hong Kong), EU25 and NAFTA by goods

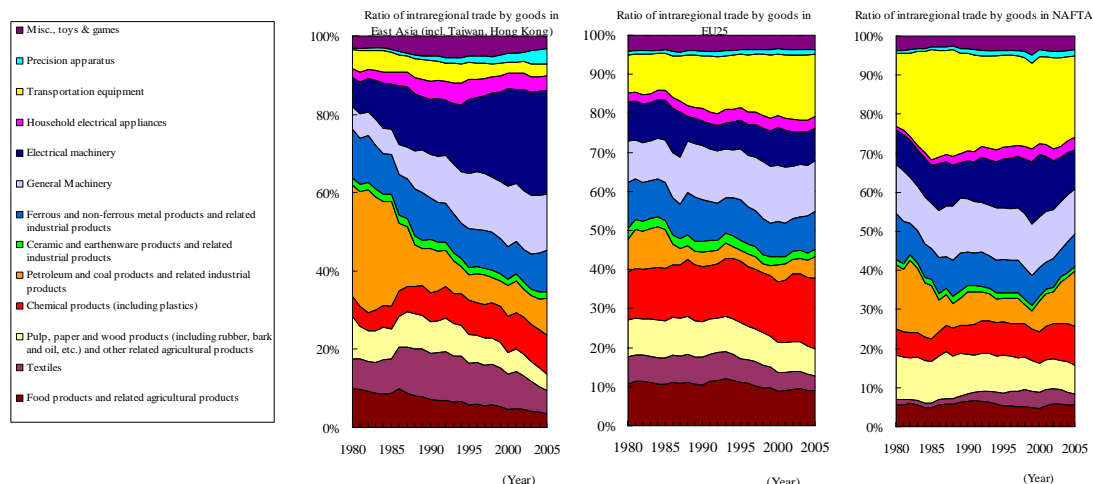


### (Electrical machinery products lead intra-regional trade in East Asia)

Breakdown of the items in intra-regional trade in East Asia was conducted to determine which items are active, and it revealed that the proportion of intra-regional trade in East Asia accounted for by electrical machinery has grown markedly since 1980 and reached 27% in 2005. Due to increasing modularization,<sup>4</sup> transactions of intermediate goods are probably common with electrical machinery products, and intermediate goods are likely to lead intra-regional trade in electrical machinery. Meanwhile, the proportion of intra-regional trade accounted for by transportation equipment was only 3% in 2005, extremely low compared with 16% in EU25 and 21% in NAFTA. In addition, with dependency on sources outside the region for energy increasing, the proportion of intra-regional trade accounted for by oil and coal products and related mining products dropped from 28% in 1980 to 9% in 2005. Furthermore, the proportion of intra-regional trade accounted for by textile goods—a labor intensive industry—remains at around 6% (Figure 2-1-17).

<sup>4</sup> Modularization is a method of manufacturing products from combinations of various components under a standardized interface without the need for adjustments so as to eliminate mutual incompatibility between the components. It provides such advantages as low cost and stable quality.

Figure 2-1-17 Ratio of intraregional trade by goods in East Asia (incl. Taiwan, Hong Kong), EU25 and NAFTA



### (Recapitulation: The characteristics of intra-regional trade in East Asia compared with EU25 and NAFTA and associated background)

As stated above, East Asia has been increasing its intra-regional trade ratio, while maintaining its export surplus outside of the region. The growth of intra-regional trade was driven by intermediate goods in the goods sector and electronic machinery in the products sector. For these reasons, the trade in East Asia is characterized by a production network made up of the various countries and regions, which operate under a cross-border division of labor based on their particular strengths. Production through this network depends upon the mutual supply of intermediate goods—mainly electrical machinery products that are relatively cheap to transport due to modularization—that are produced in various regions, transported elsewhere in the region for assembly as finished products, and then shipped to countries outside the East Asian region. In a sense, then, this production network fulfills the role of “the world’s factory.” Compared with the EU and NAFTA, production in East Asia is carried out not so much at the industry level but at a more elaborate process level in which the economies of the East Asian countries are integrating in a network of organically-tied and deeply-rooted relationships.

### 3. The expanding EPA/FTA networks in East Asia

It can be concluded from the above examination of the true state of the East Asian economy that the intra-regional economies are in the process of integrating. In light of the fact that in recent years FPA/FTA negotiations in East Asia, particularly ASEAN, are rapidly advancing, it would be instructive to focus on the attempts being made to integrate the systems needed to support economic integration. One such attempt is the ASEAN Free Trade Area (AFTA), an FTA within the ASEAN region. The following is an overview of AFTA, a discussion of its merits, and an outline of the expanding EPA/FTA network in East Asia.

## (1) Efforts toward the systematic integration in East Asia

### (Overview of AFTA and its merits)

AFTA was initiated at the 4<sup>th</sup> ASEAN Summit Conference held in January 1992, where it was officially agreed that efforts would be made to fulfill the aims of the agreement in the 15-year period from 1993 to 2008. The Common Effective Preferential Tariff (CEPT), a scheme for actualizing AFTA, was initiated from January 1993, and subsequently the targeted year for effectuating the final CEPT tariff rate (0-5%) was successively moved up. Under the CEPT Agreement, the intra-regional tariffs on 98.7% of the product items targeted for tariff reductions of the original ASEAN member countries (Thailand, Malaysia, Indonesia, Philippines, Singapore and Brunei) were lowered to 5% or less (Table 2-1-18). In addition, intra-regional tariffs would be eliminated by 2010 for the original ASEAN countries and by 2015 for new members (Figure 2-1-19).

In order to receive the advantages of low tariffs using CEPT, approval as an originating good must be obtained. With the exception of some products, it is required that the raw materials or parts must have originated from one of the ASEAN member country (10 countries) and the material must account for at least 40% of the final product.

**Table 2-1-18 Reduction of intra-regional tariff situation in ASEAN countries (as of May 2007)**

	Gross number of items	Applying items							Temporary excluded items	Generally excluded items	Sensitive/highly sensitive items
		Tariffs below 5%		Tariffs 0%		Tariffs over 5%	Other				
			shares in applying items		shares in applying items						
Brunei	10,702	10,598	9,924	93.6%	8,444	79.7%	674	15	0	104	0
Indonesia	8,732	8,619	8,619	100.0%	5,730	66.5%	0	0	0	96	17
Malaysia	12,593	12,504	12,439	99.5%	9,785	78.3%	65	31	0	89	0
The Philippines	11,490	11,444	11,369	99.3%	8,149	71.2%	75	0	0	27	19
Singapore	10,705	10,705	10,705	100.0%	10,705	100.0%	0	0	0	0	0
Thailand	8,301	8,301	8,288	99.8%	4,513	54.4%	13	0	0	0	0
Total of 6 founding members	62,523	62,171	61,344	98.7%	47,326	76.1%	827	46	0	316	36
Camodia	10,689	10,454	5,301	50.7%	603	5.8%	5,153	0	2,447	181	54
Laos	10,690	10,389	9,960	95.9%	629	6.1%	429	0	0	98	203
Myanmar	10,689	10,611	9,325	87.9%	365	3.4%	1,286	0	77	51	27
Vietnam	10,689	10,523	10,285	97.7%	5,478	52.1%	238	0	0	166	0
Total of 4 new members	42,757	41,977	34,871	83.1%	7,075	16.9%	7,106	0	2,524	496	320
ASEAN10 Total	105,280	104,148	96,215	92.4%	54,401	52.2%	7,933	46	2,524	812	356

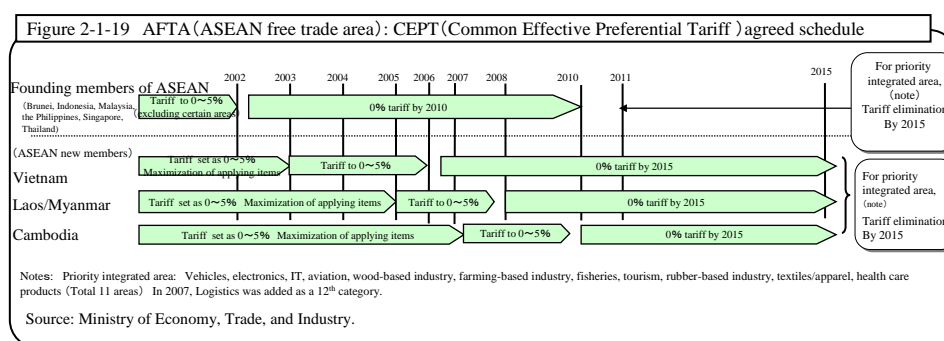
Notes: 1. Applying items are tariff reduction applying items. Temporary excluded items are those that tariff reduction preparations are not in place. Generally excluded items are those that aren't applied to tariff reductions, such as those with defensive and academic value. Sensitive items are those that are flexible towards applying items, such as raw farm products / Highly sensitive items are rice related products, etc.

2. Some items that exceed 5% apply not to ad valorem tax but to per-unit tax (31 items of Malaysia (special tariff)). The number of items exceeding 5% are high in 2007 because of shift from temporarily exclusionary items to applied items (Brunei), shift from sensitive items to applied items, (Malaysia, Thailand, the Philippines, Vietnam), and the postponement of liberalizing 14 Vietnam vehicle related items.

3. The number of items is shown in AHTN (ASEAN Harmonized Tariff Nomenclature) 2002. But, those in Indonesia, and Thailand are shown in AHTN2007.

4. Calculation conducted on the presumption that tariffs abolished in 11 priority integrated areas were entirely abolished.

Original source: 2007 Tentative CEPT Package (ASEAN Secretariat).



## (2) Efforts to build EPA/FTA networks within the East Asian region

In recent years, EPA/FTA negotiations have rapidly advanced among the various countries in the East Asian region, not just limited to AFTA but particularly in ASEAN. The East Asia EPA/FTA network, which in 1997 consisted only of the Closer Economic Relations Agreement concluded in 1983 between AFTA and Australia and New Zealand, has since spread widely, and in 2007, efforts were underway, if joint research is included, between virtually every two-country combination (Table 2-1-20, Figure 2-1-21).

Of the EPA/FTA effectuated in East Asia, Japan has concluded a bilateral EPA/FTA with Singapore and Malaysia, which were effectuated in November 2002<sup>5</sup> and July 2006, respectively. Other EPA/FTA which have already been brought into effect within the East Asian region include, in addition to AFTA already mentioned, the Early Harvest<sup>6</sup> FTA between India and Thailand (tariff reductions began in September 2004), the Closer Economic Partnership Agreement between China and Hong Kong (tariff reductions began in January 2004), and the ASEAN-China Free Trade Area (ACFTA) (tariff reductions began in July 2005).

In addition, EPA/FTA negotiations have also been conducted between ASEAN and Japan, China, South Korea, India, Australia and New Zealand, including the agreement previously effectuated between China and Korea and four other agreements which are expected to be concluded sometime in 2007.

Monitoring these efforts, the Japanese government proposed the commencement of research by private sector experts concerning East Asia EPA<sup>7</sup> at the East Asia Summit held in January 2007, and it was agreed to commence this research by experts.

<sup>5</sup> Upon its fifth year since effectuation, a review of the agreement was conducted, and in January 2007, a basic agreement was reached and signed in March 2007. The topics taken up in the review included, (1) improvement of market access (at the time of conclusion of the current agreement, Singapore had already eliminated tariffs on all product items), (2) improvement of specified agreements associated with financial services, and (3) review of country of origin rules, customs procedures, and safeguard measures, extension of application period, introduction of provisional measures, etc.

<sup>6</sup> The reduction of tariffs in advance for specified product items through framework agreements, etc., in advance of tariff reductions under EPA/FTA agreements on goods.

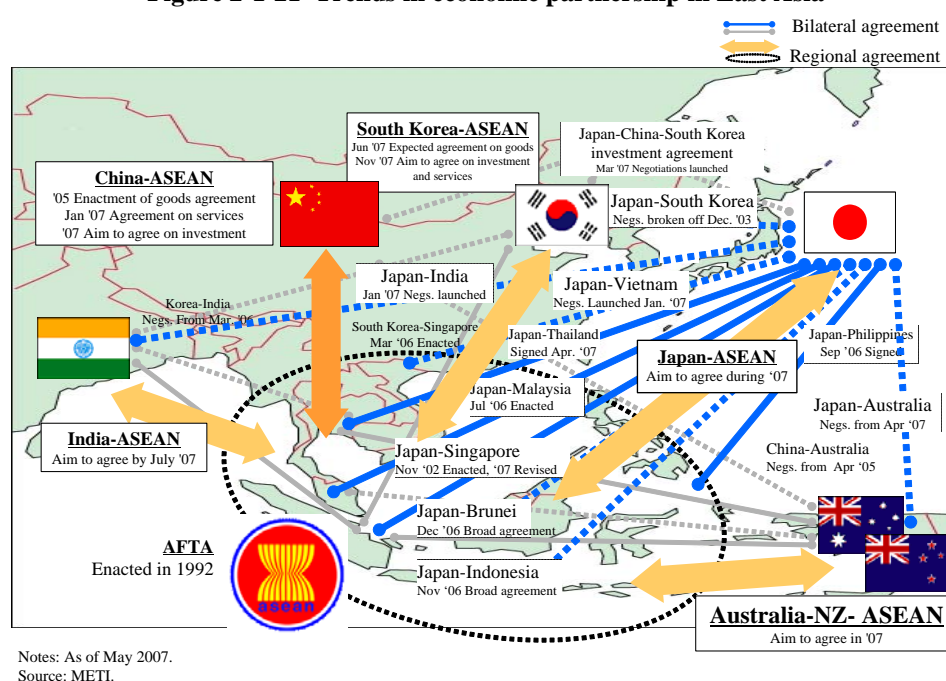
<sup>7</sup> The East Asia EPA is explained in detail in Chapter 4, Section 3.

Table 2-1-20 Status of efforts towards EPA/FTA in East Asian region in 1997 and 2007

	1997	ASEAN												India	Australia	New Zealand
		Japan	Korea	China	Philippines	Indonesia	Malaysia	Thailand	Singapore	Brunei	Vietnam	Lao PDR	Cambodia	Myanmar		
Japan																
Korea																
China																
Philippines																
Indonesia																
Malaysia																
Thailand																
Singapore																
Brunei																
Vietnam																
Lao PDR																
Cambodia																
Myanmar																
India																
Australia																
New Zealand																

⊙: Signed or (partially) implemented; ○: Broad agreement/conclusion  
 □: In negotiation (or agreement to launch negotiations); △: Government-participated joint research or consultations ongoing  
 (Including EPA/FTA among multiple countries)  
 Source: METI.

Figure 2-1-21 Trends in economic partnership in East Asia



### (Use of EPA/FTA networks by Japanese companies)

According to the results of a questionnaire survey concerning Japanese companies' overseas business activities, Japanese companies plan to pursue business while making extensive use of EPA/FTA networks to which Japan does not participate as a party, such as AFTA, and the FTA between Thailand and Australia. Japanese companies are also keen to use the Japan-Malaysia EPA, ACFTA, AFTA and the Thailand-India FTA (Table 2-1-22). It is clear then, that an EPA/FTA encourages cross-border business activities and contributes to the deepening of intra-regional economic relationships.



Figure 2-1-22 Survey results of FTA use in Japanese corporations

FTAs in Asia using preferential tax rates			FTAs in Asia considering using preferential tax rates		
FTA	number of cases	ratio (%) (n=37)	FTA	number of cases	ratio (%) (n=37)
ASEAN free trade area (AFTA)	24	64.9	Japan - Malaysia	24	38.7
Japan - Malaysia	15	40.5	China - ASEAN (ACFTA)	21	33.9
Thailand - Australia	8	21.6	ASEAN free trade area (AFTA)	20	32.3
China - Hong Kong (CEPA)	7	18.9	Thailand - India	14	22.6
Thailand - India	6	16.2	Japan - Singapore	6	9.7
China - ASEAN (ACFTA)	4	10.8	China - Hong Kong (CEPA)	5	8.1
Thailand - New Zealand	2	5.4	Singapore - India	4	6.5
			Thailand - Australia	3	4.8

Original source: JETRO "HEISEI 18 NENDO NIHON KIGYOU NO KAIGAI JIGYOU TENKAI NI KANNSUUR ANKEETO CHOUZA" (February 2007)

### (Towards further integration of intra-regional economies through integration of systems)

The above discussion first focused on the integration of East Asian economies and then clarified the process of integration of systems in recent years through an EPA/FTA.

The integration of the economies of East Asia has advanced in terms of both the economy and systems. Amid this process, Japan has continued to develop and use its technical capabilities, including the product development capabilities and production know-how that form the core of domestic industrial competitiveness, as well as management capabilities. At the same time, in response to the energy and dynamism of the East Asian economy, actively pursuing intra-regional production, sales and development is extremely important for Japan to achieve growth with the countries in the region. By eliminating tariffs and harmonizing systems within the region, EPA/FTA networks lower the walls around national borders that hinder the movement of the productive factors and thereby facilitate efficient production and sales activities in Asia. A seamless economic zone that fosters the comprehensive integration of systems covering liberalization of trade in goods, liberation of trade in services, the establishment of investment rules, security in the movement of people, and protection of intellectual property rights can generate energy not only in Japan but in East Asia as a whole. As a member of East Asia, Japan must take the initiative in building this economic zone.

**(Column 3) An illustration of the relationship between Japan-China-Korea-ASEAN and India-Australia-New Zealand seen from the perspective of trade**

As stated in this section, the Japanese government proposed the commencement of research by private sector experts on an East Asia EPA at the East Asia Summit held in January 2007. Years prior to this, however, ASEAN, Japan, China, and South Korea had already begun to deepen their relationship through conferences such as the 1997 ASEAN+3 Summit Conference, and experts from these countries conducted joint research concerning an FTA within an ASEAN+3 framework.

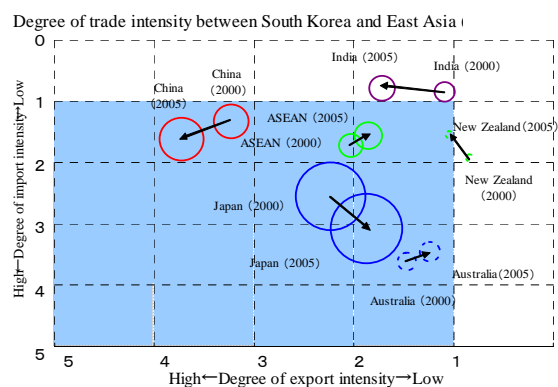
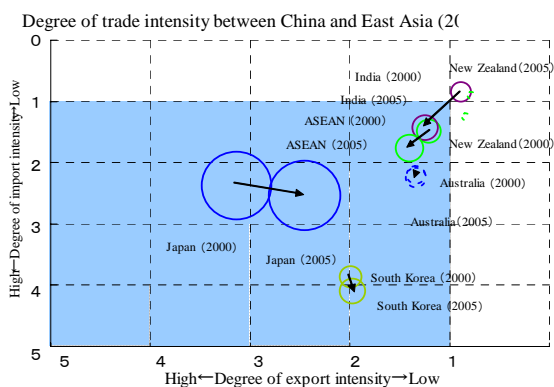
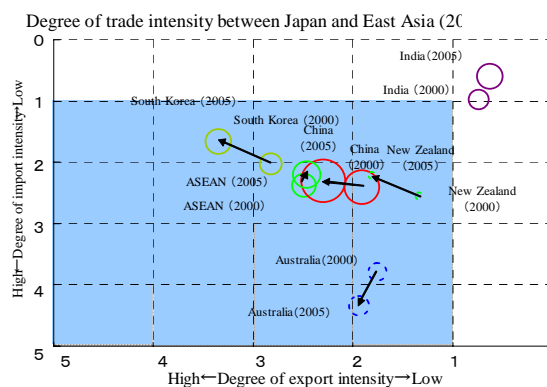
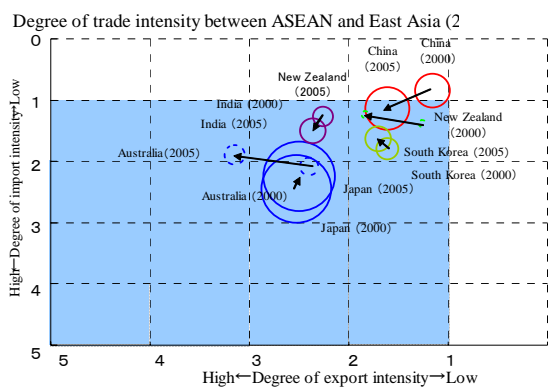
In this connection, the closeness of trade between Japan-China-South Korea-ASEAN and India-Australia-New Zealand was evaluated using the trade intensity index (Figure 3-1). An analysis of the relative relationship, for Japan, China, South Korea and ASEAN, of trade with the other countries and regions that comprise ASEAN+3 and trade with India, Australia, and New Zealand reveals that for any of the countries or regions of Japan-China-Korea-ASEAN, both the import and the export intensity of India, Australia and New Zealand is higher than that of the other countries and regions that comprise ASEAN+3 (in 2005), and that between 2000 and 2005, the intensity rapidly increased in virtually all cases.

For example, the export intensity and import intensity with Australia is, for ASEAN, higher than that with China or South Korea, and the export intensity with Australia is especially high relative to that with Japan. In the case of China, moreover, the export intensity and import intensity with India has rapidly increased, and a similar trend has emerged in Japan's intensity with Australia. In fact, for Japan, the import intensity with Australia is the highest of all these countries.

Instances where both export and import intensity decline are extremely rare, and, for Japan, trade with India would be one of these instances. However, as stated in Chapter 1, Section 4, Japanese companies are strengthening exports and sales from their direct investment targets sited in ASEAN, and therefore closer relationships between ASEAN and India would be desirable for Japanese companies.

In view of the high trade intensity between ASEAN, Japan, China, South Korea, India, Australia and New Zealand, these countries should accelerate CEPEA research by private sector experts and aim to build an open East Asian economic zone over the medium to long term.

Column figure 3-1 Degree of trade intensity between ASEAN, Japan, China, South Korea, East Asia (2000-2005)



Notes: The size of the circles are in proportion to the real GDP.  
Source: DOT (IMF), WDI World Bank.