Regional Economic Integration in Asia-Pacific: Japan's Perspectives

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Contents

1. Japan's Economic Situation

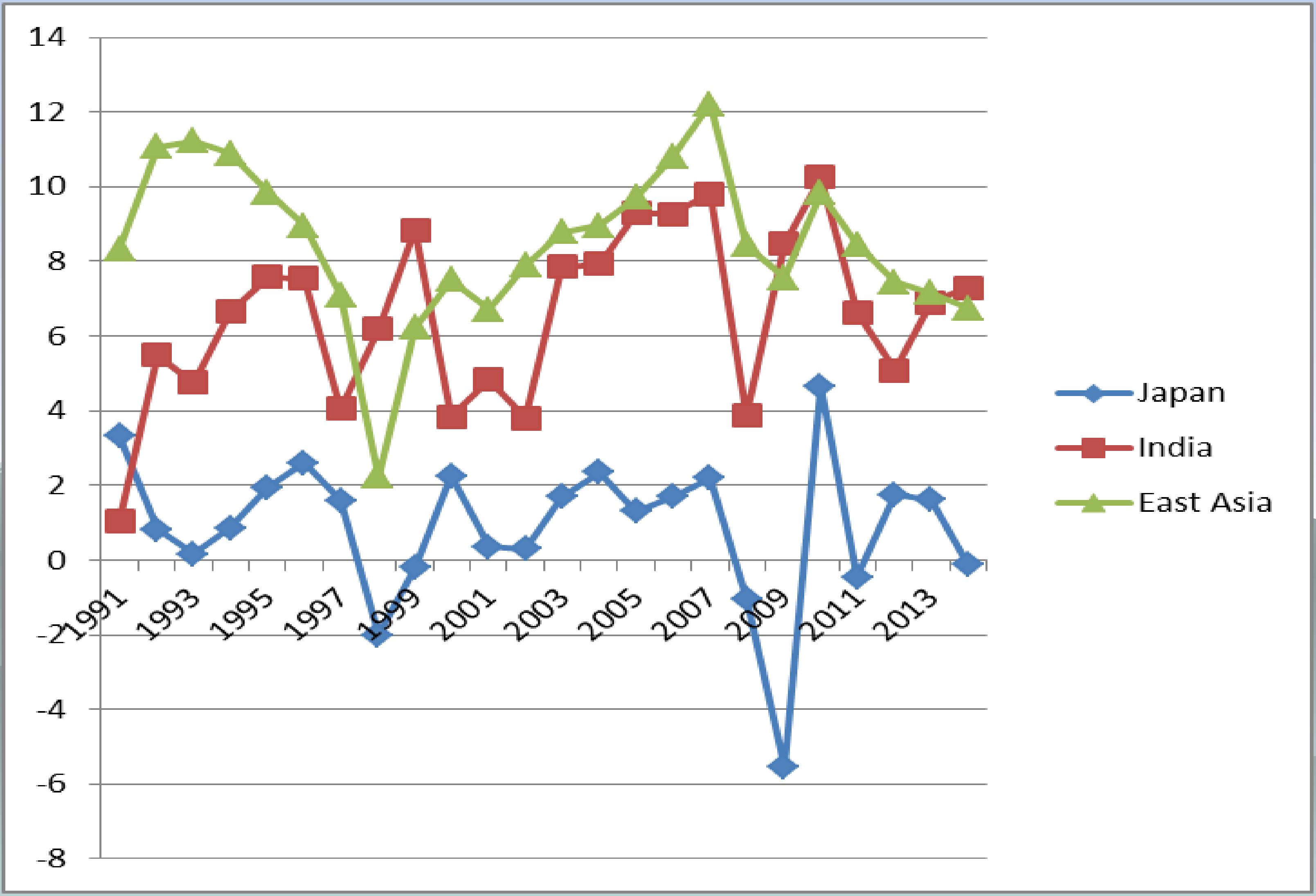
Current situation

- Low economic growth
- Shortage of demand (low consumption and investment)
- Uncertain/pessimistic future economic prospects

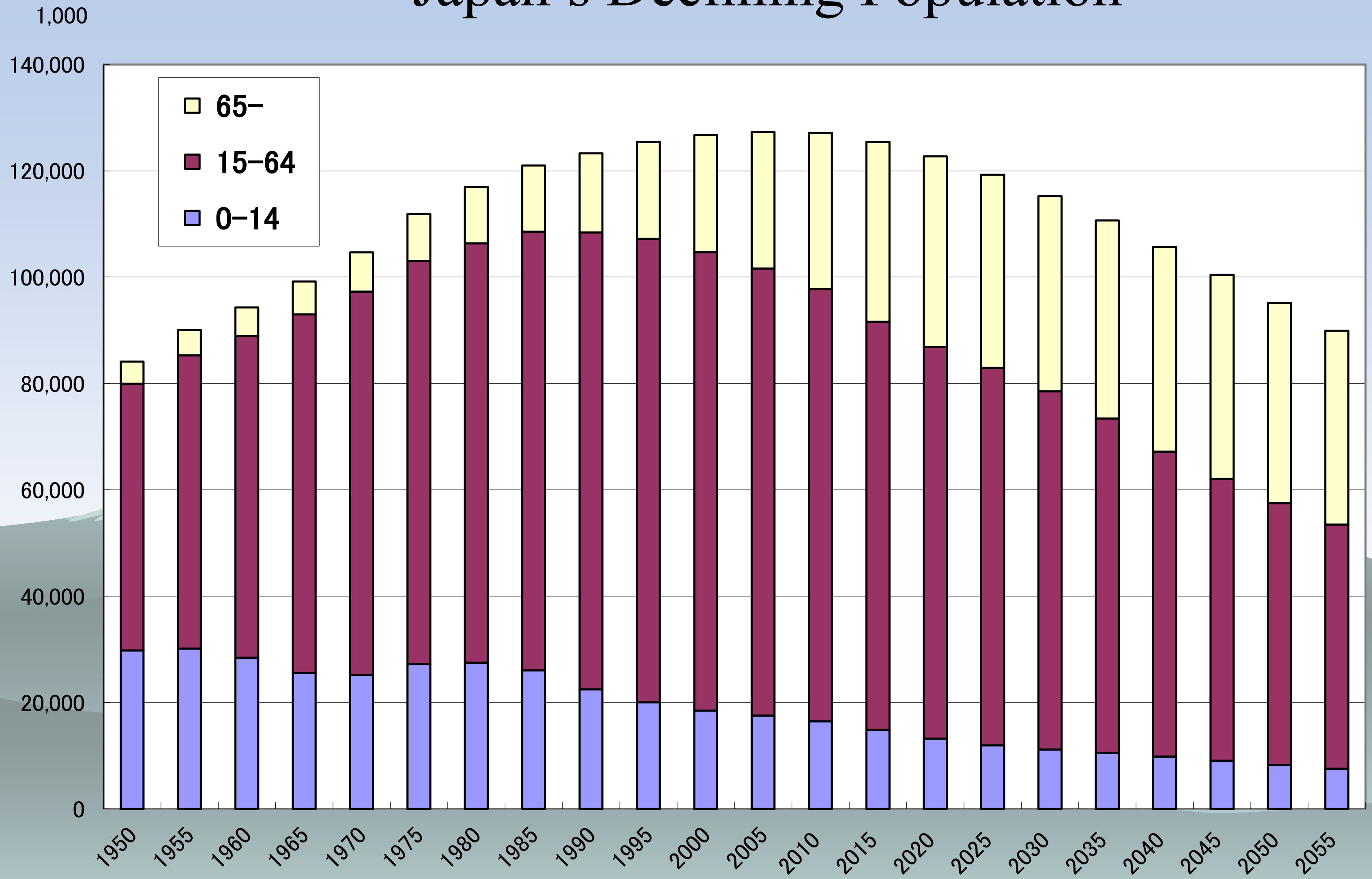
Structural Problems

- Declining and aging population
- Declining savings rate
- Increasing government debt
- Closed economy
- Regulated sectors (agriculture, medical services, etc)
- Low productivity

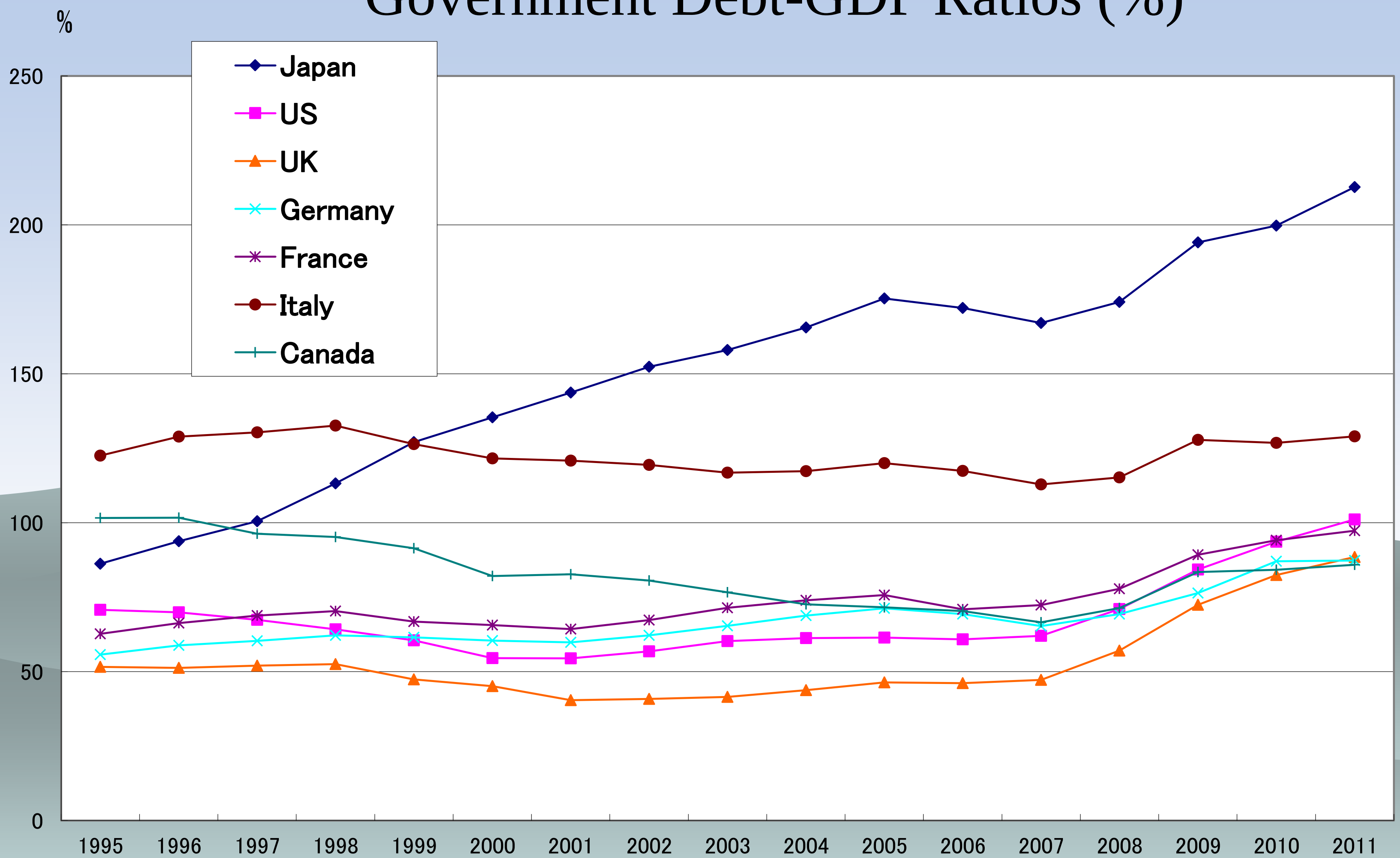
GDP Growth Rates (%)



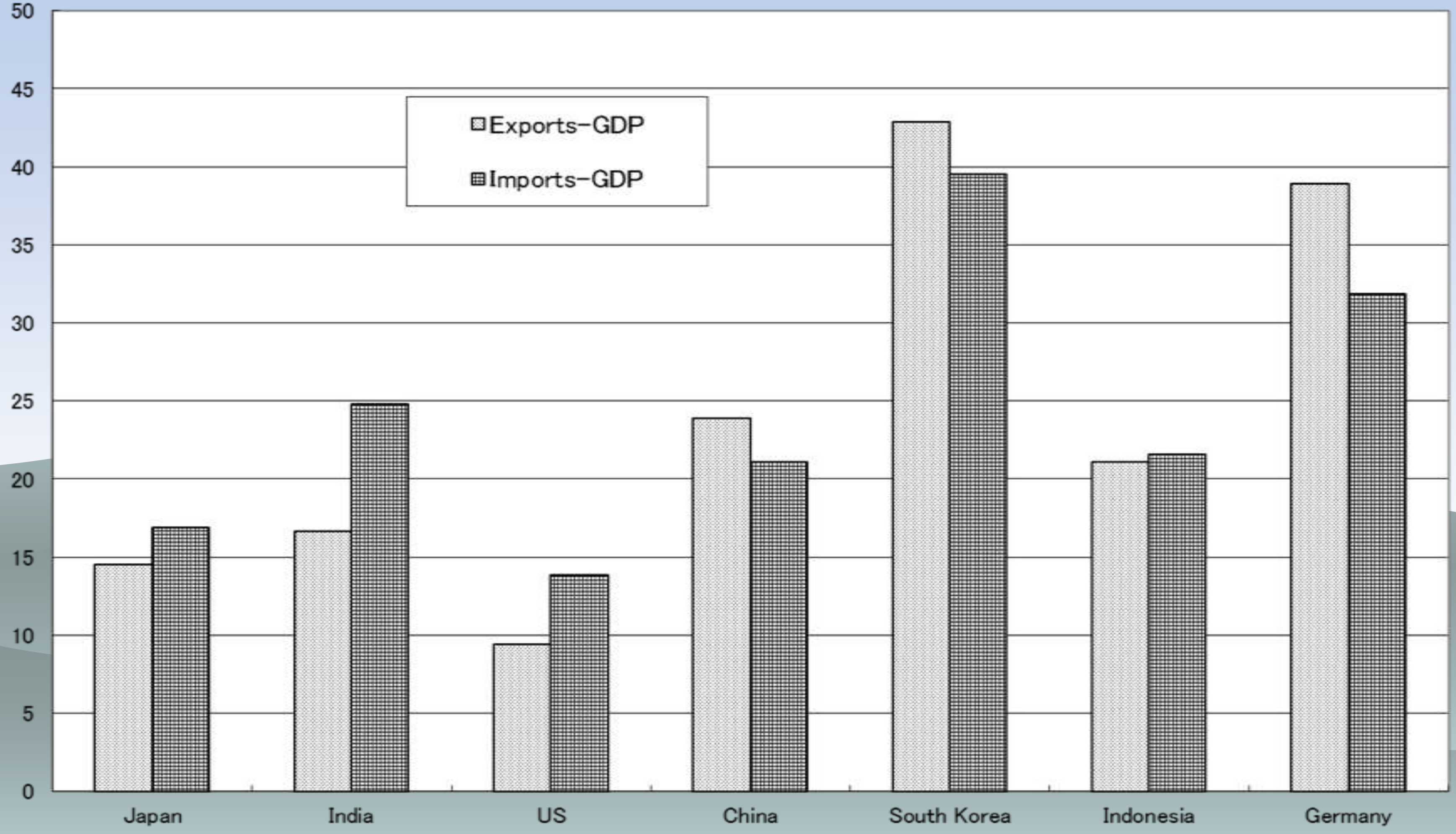
Japan's Declining Population



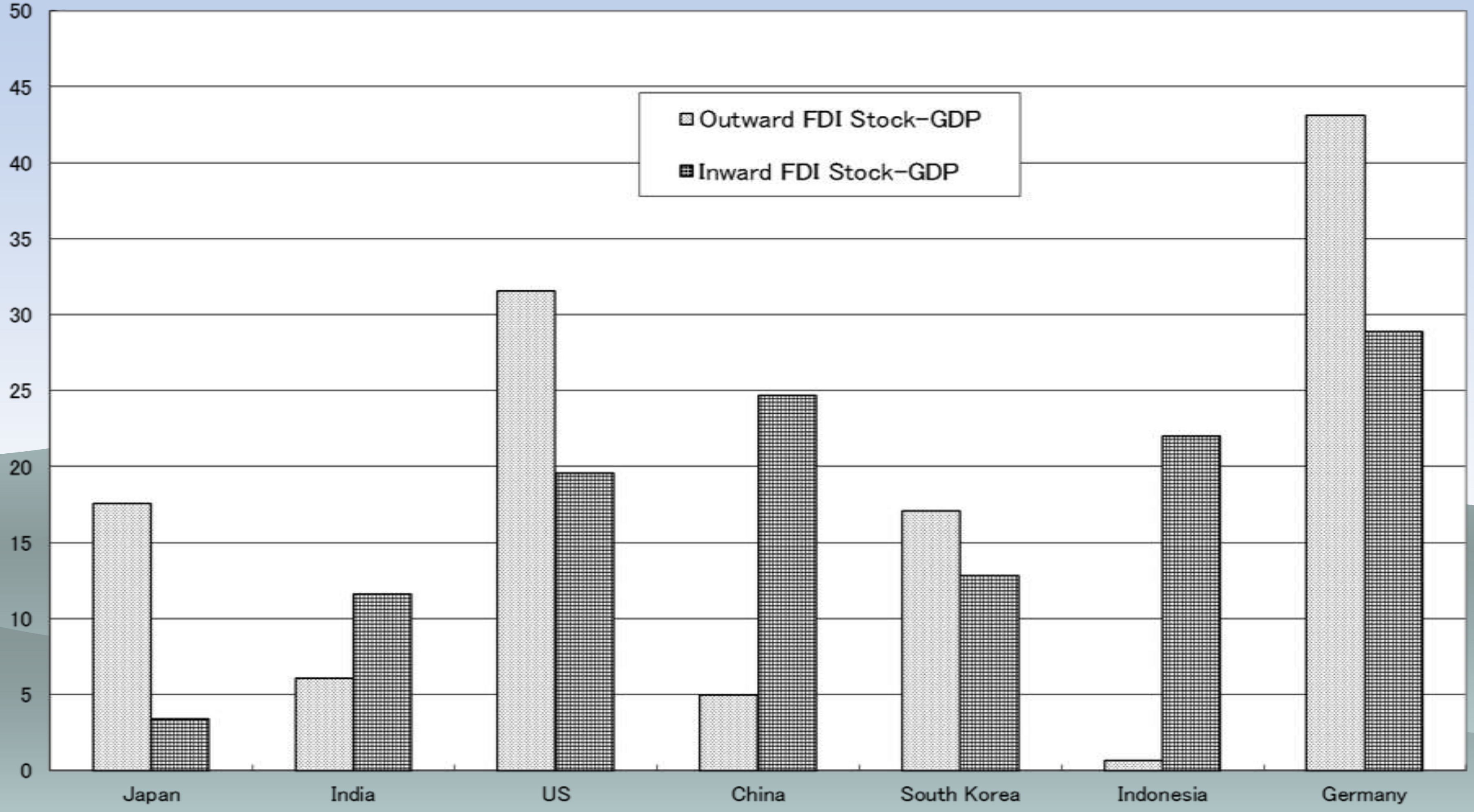
Government Debt-GDP Ratios (%)



Trade-GDP Ratios (%): 2013



FDI Stock-GDP Ratios (%): 2011



Labor Productivity: OECD Member Countries

Rank	Country	Labor productivity	Rank	Country	Labor productivity	Rank	Country	Labor productivity
1	Luxembourg	127,930	13	Spain	87,369	25	Slovenia	64,365
2	Norway	127,565	14	Netherlands	87,195	26	Slovak Rep.	60,702
3	US	115,613	15	Germany	86,385	27	Portugal	60,021
4	Ireland	105,781	16	Canada	85,437	28	Czech Rep.	58,273
5	Belgium	99,682	17	Finland	84,691	29	Hungary	57,491
6	Switzerland	97,238	18	Greece	78,317	30	Poland	57,465
7	France	94,656	19	UK	78,062	31	Turkey	55,848
8	Italy	91,540	20	Israel	76,530	32	Estonia	53,404
9	Australia	90,572	21	Iceland	74,589	33	Chile	49,583
10	Austria	89,603	22	Japan	73,270	34	Mexico	40,716
11	Denmark	89,322	23	NZ	68,559		OECD av	84,609
12	Sweden	88,765	24	Korea	66,393			

Notes: Purchasing Power Parity $US

Source: OECD

Challenge for achieving economic growth

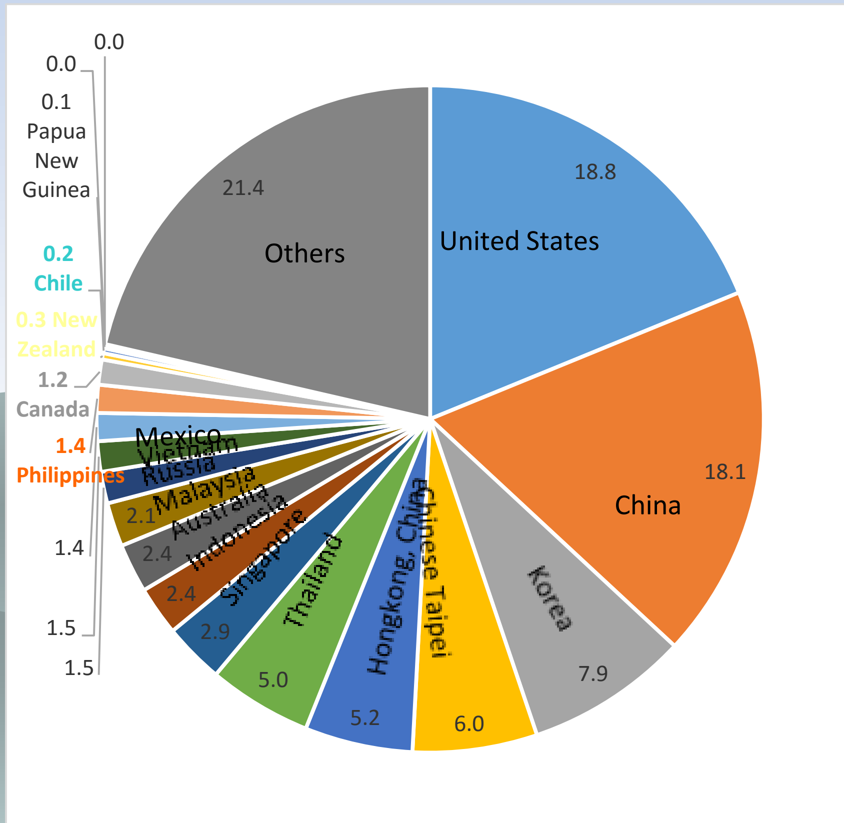
- Increase productivity
- Increase economic interaction with growing Asia-Pacific countries (trade, foreign direct investment (FDI), people exchange): Japan's dependence in foreign trade on Asia-Pacific region is already very high but it could increase and intensify further

Solutions

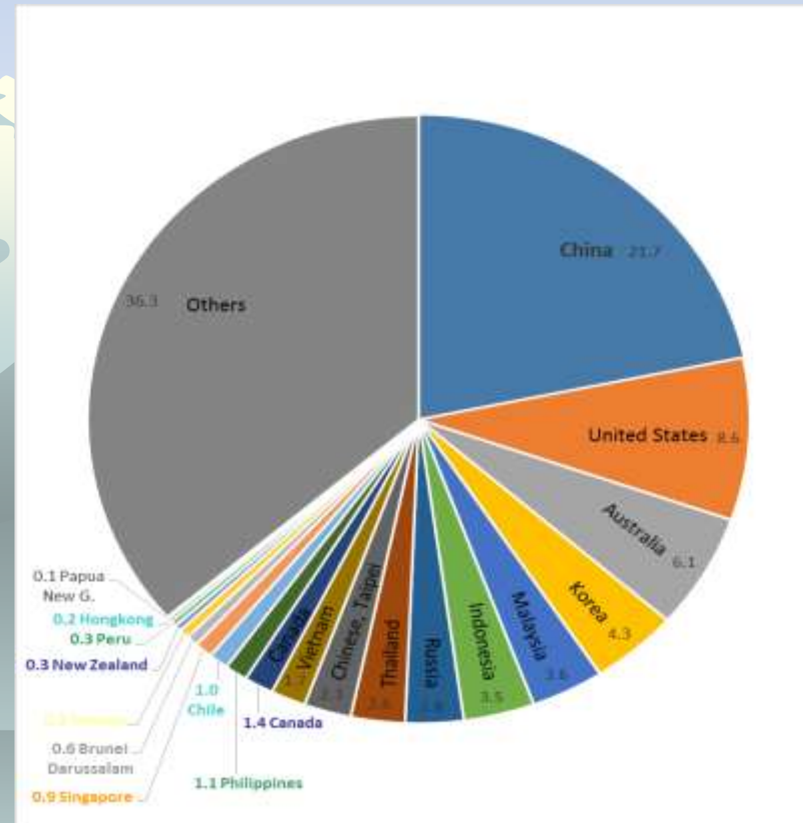
- Abenomics: 3rd arrow (growth strategy)
- Implement structural (policy) reforms
- New Foreign Economic Policy in Asia-Pacific: the Trans-Pacific Partnership (TPP) Agreement, Regional Comprehensive Economic Partnership (RCEP)

Japan's Trading Partners (%): 2013

Exports



Imports

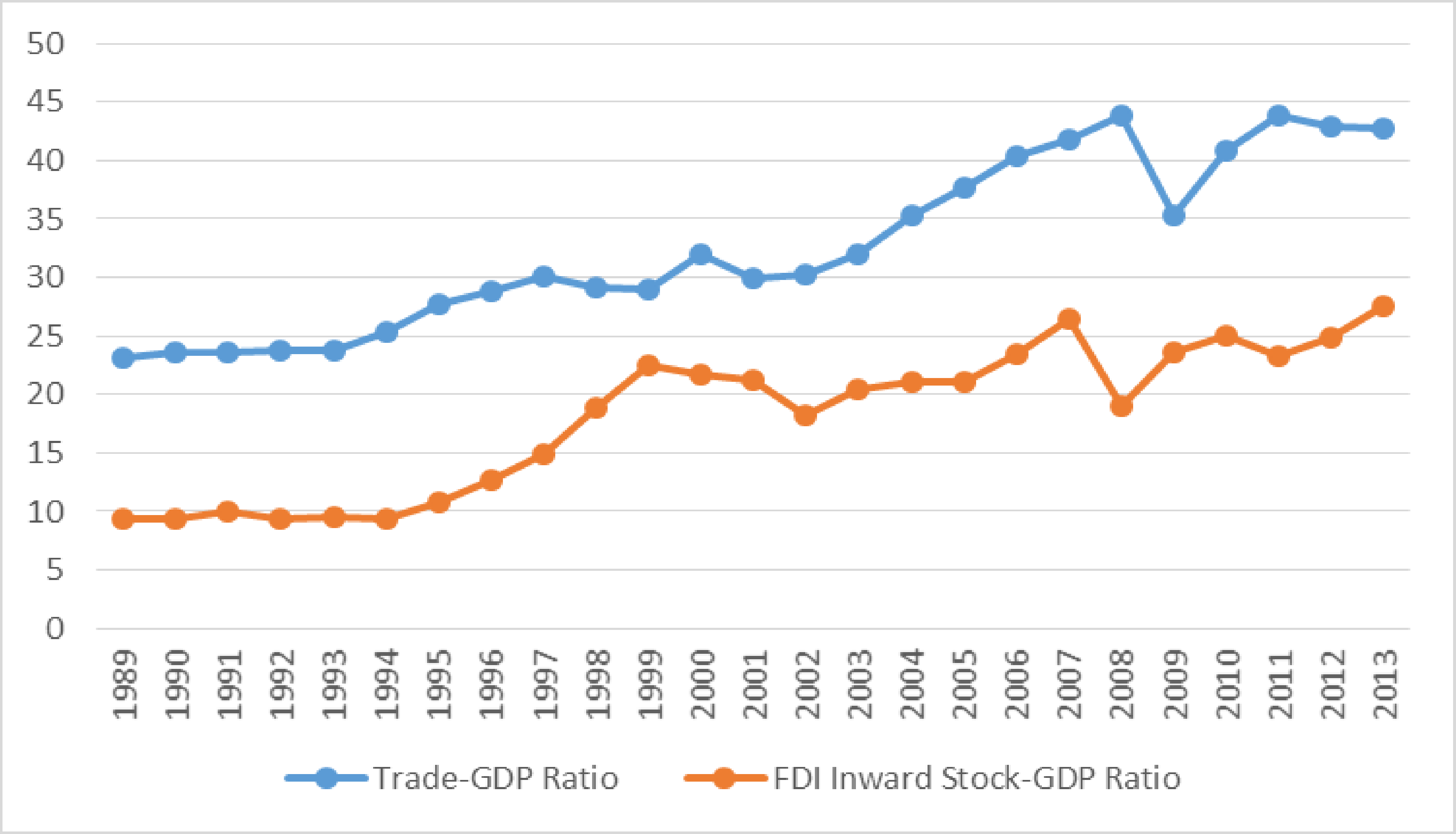


II. High Economic Growth and Regional Economic Integration in Asia-Pacific

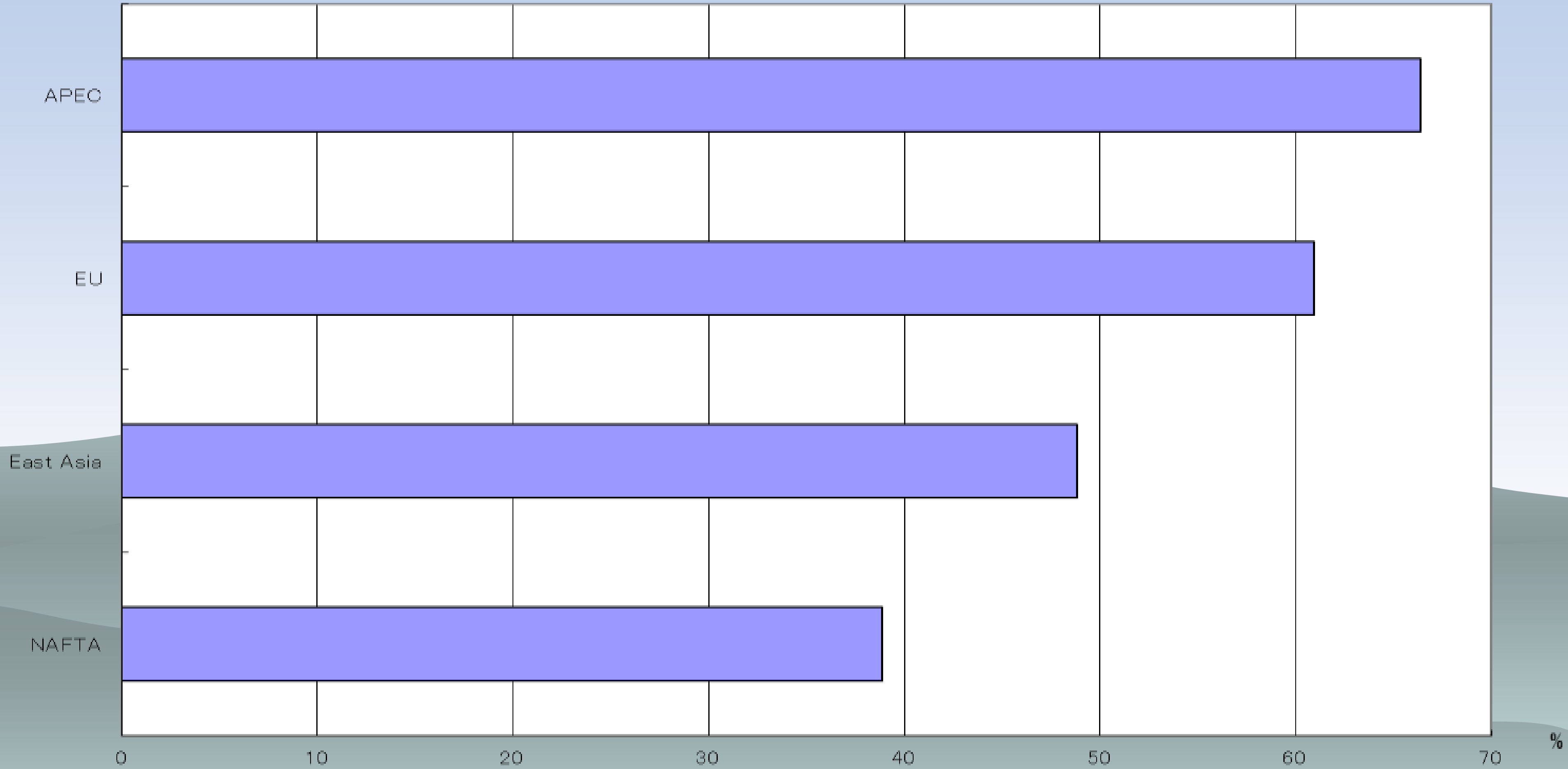
<u>Market-driven Regional Economic Integration</u>

- High economic growth achieved by rapid expansion of foreign trade and foreign direct investment (FDI)
- Advances in regional economic integration
- Expansion of trade and FDI in machinery sector
- Increase in parts and components trade
- Fragmentation strategy by multinational corporations: formation of regional production networks (supply-chains)
- Liberalization of trade and FDI policies
- Further trade and FDI liberalization and facilitation is needed to promote economic growth

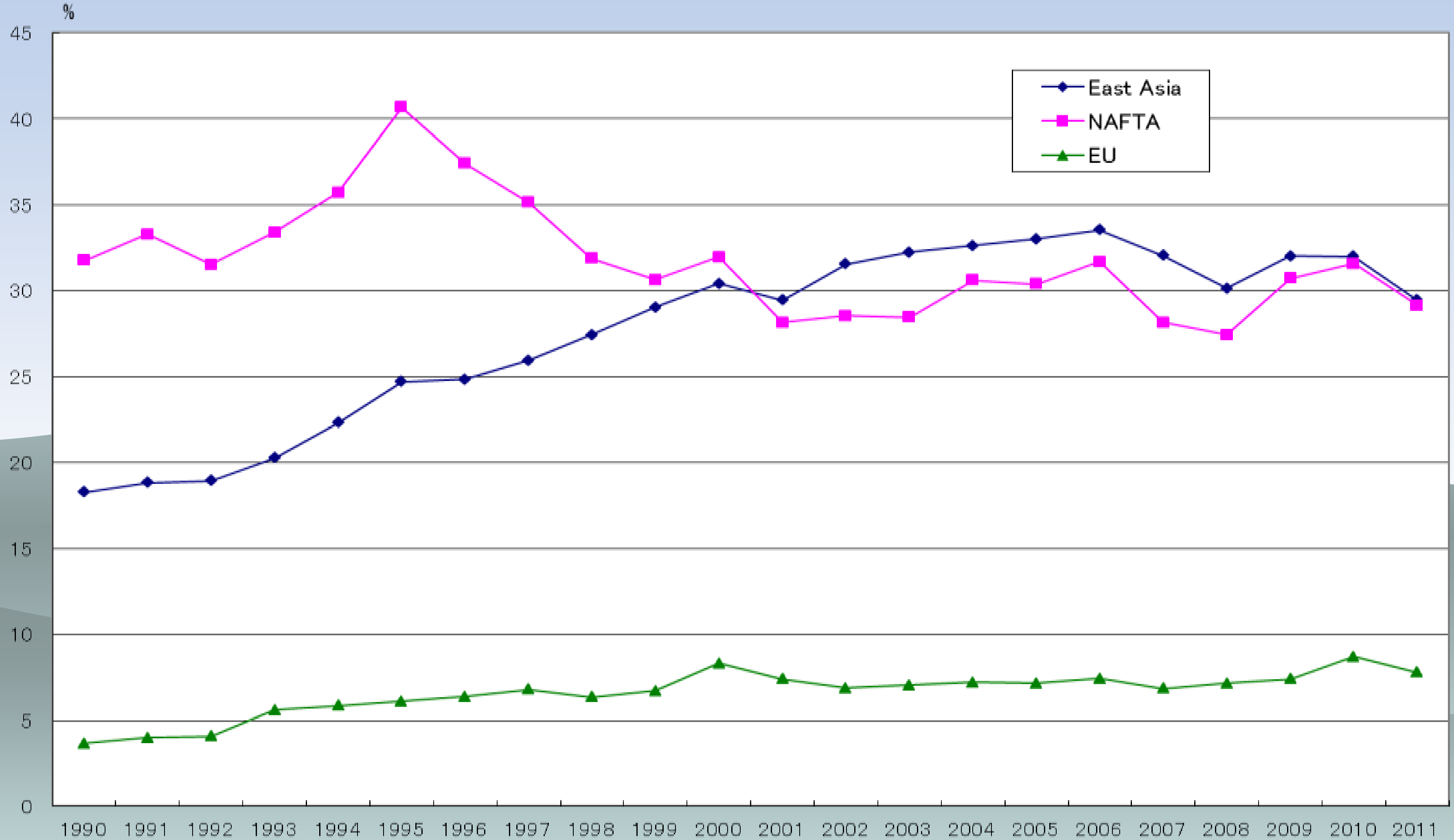
Increasing Importance of Trade and FDI for APEC Economies (%)



Intra-regional Trade Ratio (%): 2012

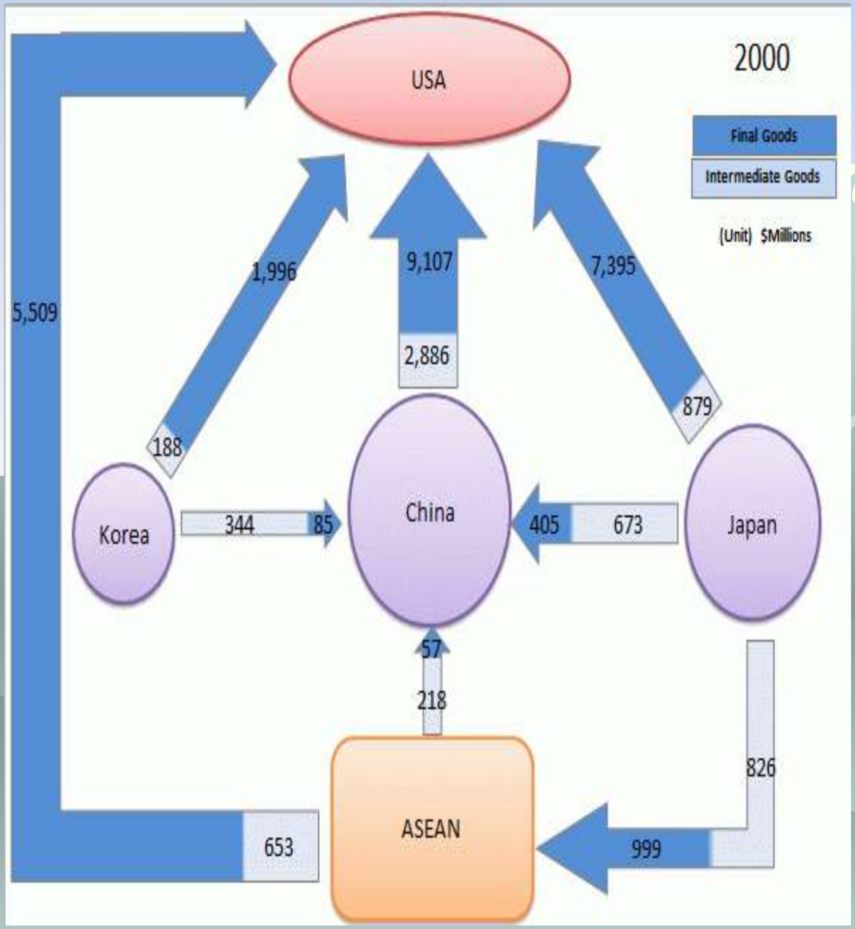


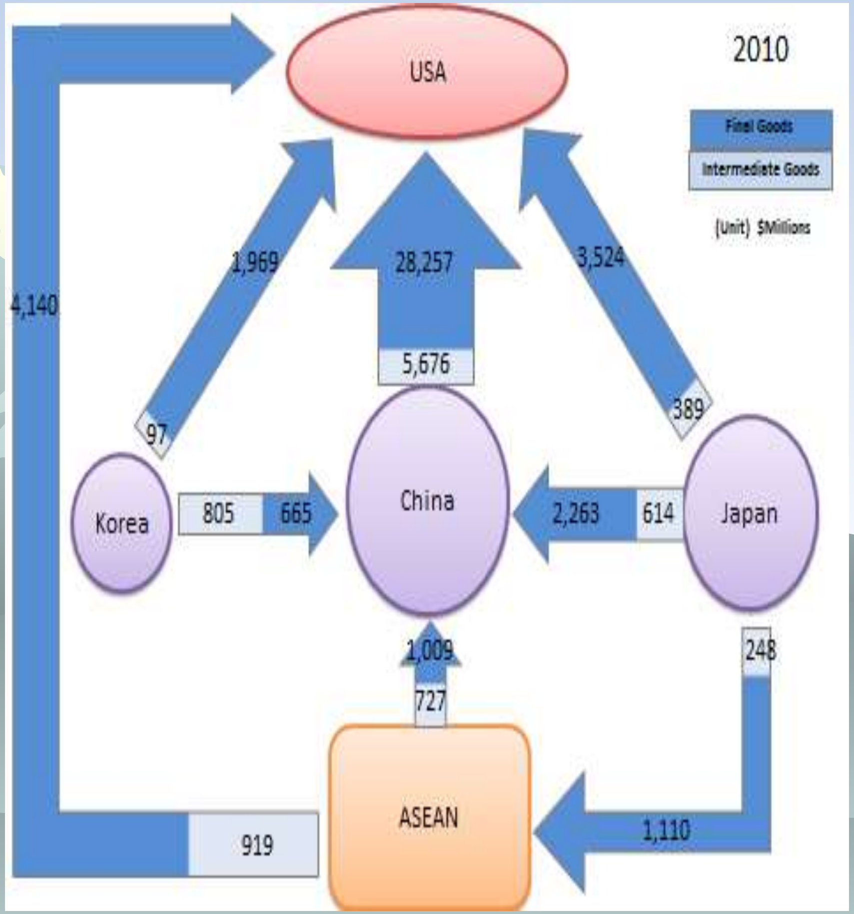
Share of Parts and Components in Intra-regional Trade (%)



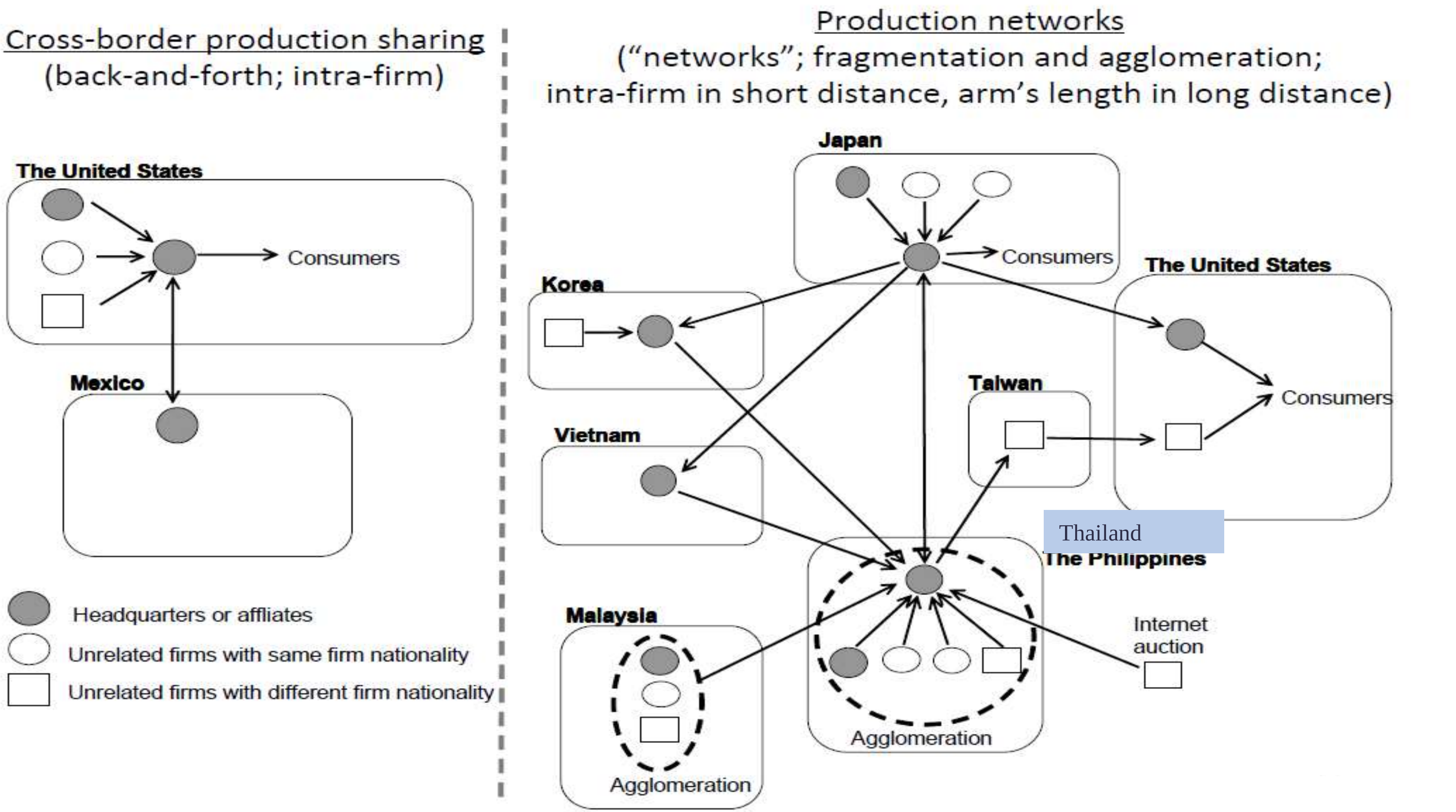
Electronics Trade in Asia-Pacific

($US million)



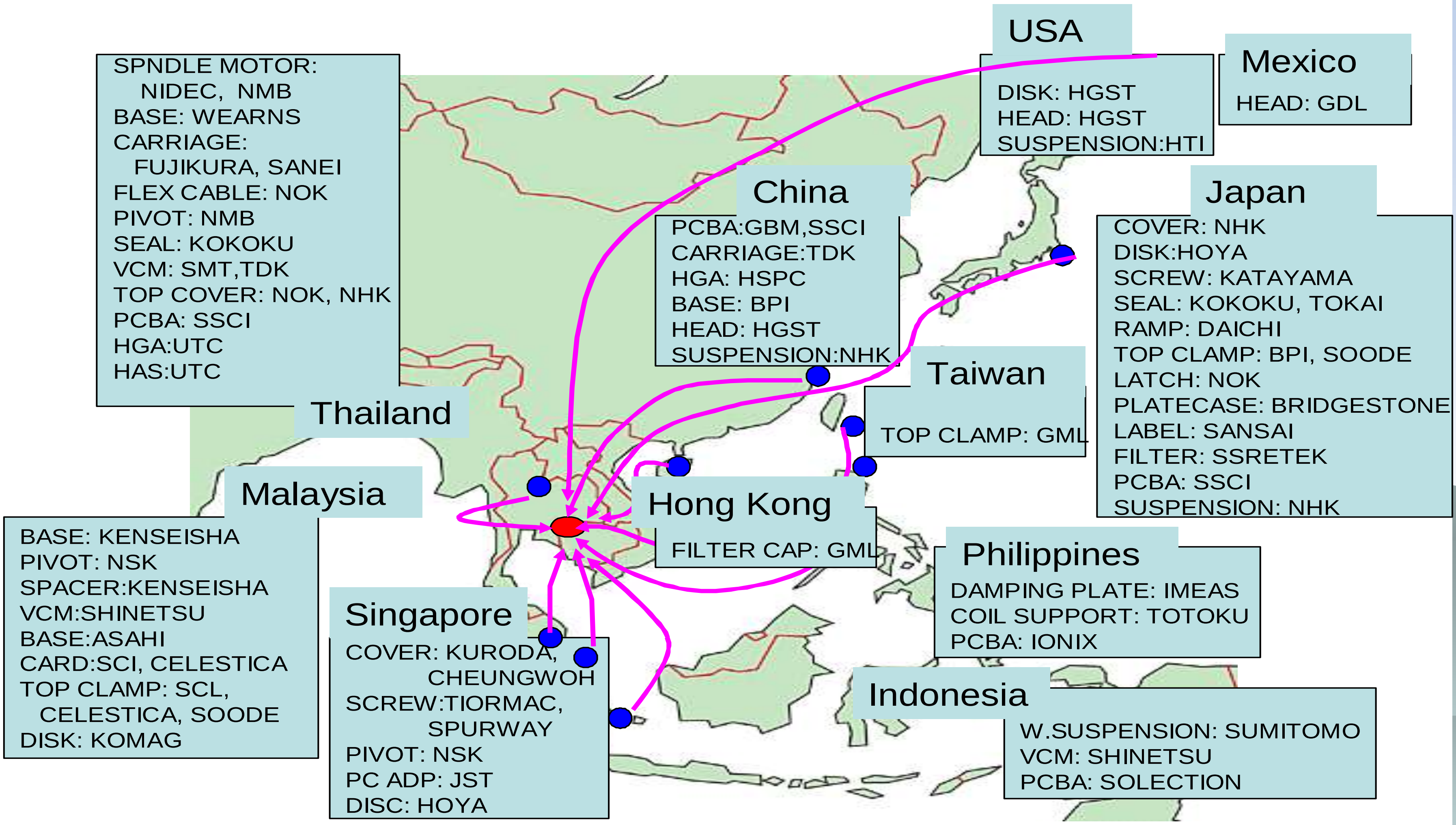


Production Networks: Supply Chains



Source: "ASEAN Connectivity and East Asia", Economic Research Institute for ASEAN and East Asia (ERIA)

Procurement of Parts by a Hard Disc Drive Producer (Production Network)



Trade Liberalization: Declining Tariff Rates (%)

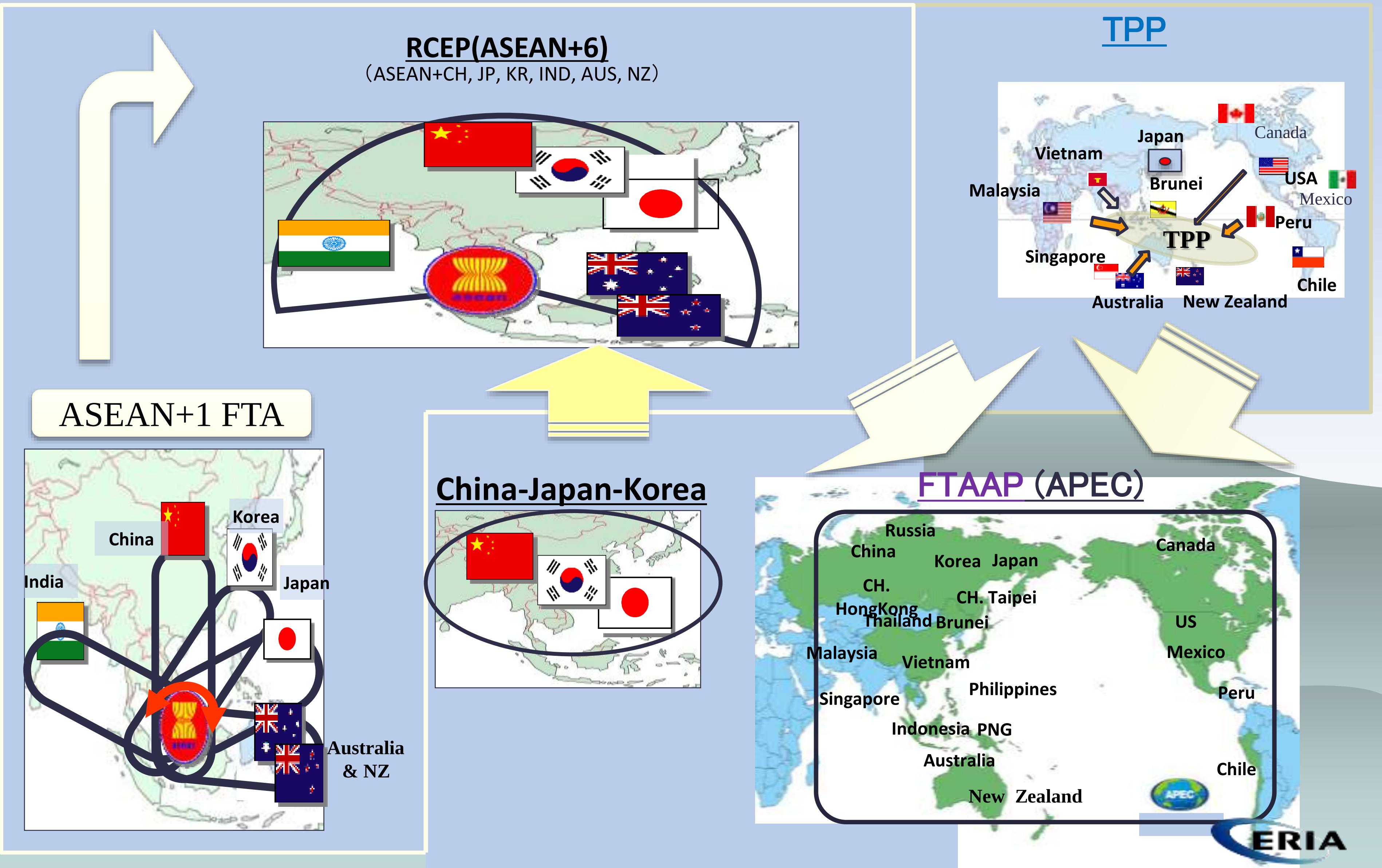
		Primary Products	Non-Primary Products	All Products				Primary Products	Non-Primary Products	All Products
Japan	1988	8.3	3.5	4.2		Singapore	1989	0.2	0.4	0.4
	2010	17.3	2.5	4.4			2010	0.2	0	0
India	1990	71.6	83.0	81.6		Thailand	1989	30	39	38.5
	2009	17.7	8.6	9.7			2010	22.8	8	9.9
China	1992	35.1	40.6	40.4		Australia	1991	9.5	14.2	13.1
	2010	15.6	8.7	9.6			2010	1.3	3	2.8
Korea	1988	19.3	18.6	18.6		US	1989	3.8	5.9	5.6
	2010	48.5	6.6	12.1			2010	4.9	3.3	3.5
Indonesia	1989	18.2	19.2	19.2		Canada	1989	6.1	9.2	8.6
	2010	8.4	6.6	6.8			2010	11.3	2.6	3.7
Malaysia	1988	10.9	14.9	14.5		Mexico	1991	12	13.4	13.4
	2009	10.9	7.6	8			2010	21.5	7.1	9
Philippines	1988	29.9	27.9	28.3		Chile	1992	11	11	11
	2010	9.8	5.7	6.3			2011	4.38	4.91	4.85

Emergence of institution-driven regional economic integration

- Rapid expansion of free trade agreements (FTAs) in East Asia in the 21st century
- FTA (free trade agreement): free trade (elimination, reduction of tariff and non-tariff barriers among FTA members)
- In East Asia ASEAN has become a hub of FTAs:

  5 ASEAN+1 FTAs have been implemented
- Long term goal: Free Trade Area of Asia-Pacific (FTAAP) APEC-wide FTA
- 2 major initiatives (mega-FTAs): Trans-Pacific Partnership (TPP), Regional Comprehensive Economic Partnership (RCEP, ASEAN+6)

Region-wide FTAs in East Asia: RCEP, TPP, China-Japan-Korea (CJK) FTA



Mega-FTAs in Asia-Pacific: TPP and RCEP

Current Status of Negotiations

- TPP negotiations began in March 2010, reached an agreement in October 2015, signed in February 2016, under the ratification process.
- RCEP negotiations began in May 2013, aiming to conclude by the end of 2016.
- 7 countries (Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, Vietnam) participate in both FTAs. The US in TPP but not in RCEP, China in RCEP but not in TPP
- Competition in negotiations

Positions in FTAAP

- FTAAP: Long-term goal of regional economic integration in Asia-Pacific
- TPP and RCEP are both pathways to FTAAP
- TPP and RCEP should be complementary

Issue Coverage

- TPP: comprehensive coverage not only trade in goods and services, and investment but also labor, environment, government procurement, intellectual property right (IPR), state-owned enterprises (SOEs), and cross-cutting "horizontal issues" such as regulatory coherence, and Small and Medium Enterprises (SMEs)
- RCEP: limited coverage, trade in goods and services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement, other areas

Tariff Elimination Ratios in the TPP

(% share of products, whose tariffs will be eliminated, in total number of products)

	Total	Agricultural products		Industrial products	
	Eventual elimination	Immediate elimination	Eventual elimination	Immediate elimination	Eventual elimination
Japan	95	51.3	81	95.3	100
US	100	55.5	98.8	90.9	100
Canada	99	86.2	94.1	96.9	100
Australia	100	99.5	100	91.8	99.8
NZ	100	97.7	100	93.9	100
Singapore	100	100	100	100	100
Mexico	99	74.1	96.4	77	99.6
Chile	100	96.3	99.5	94.7	100
Peru	99	82.1	96	80.2	100
Malaysia	100	96.7	99.6	78.8	100
Vietnam	100	42.6	99.4	70.2	100
Brunei	100	98.6	100	70.2	96.4

Expected Impacts of FTAs

- Trade and FDI expansion between and among FTA members
- Promotion of structural reforms
- Economic growth

III. Japan's Foreign Economic Policy in Asia-Pacific: Promotion of Regional Economic Integration

- Participate in comprehensive Economic Partnership Agreement (EPA) including trade and foreign direct investment (FDI) liberalization, facilitation, economic cooperation
- Export infrastructure such as transportation system and water supply system including hard and soft infrastructure
- Export agricultural products
- Attract foreign direct investment inflows and high skilled personnel
- Attract foreign tourists

Abenomics: Abe Economics

Three Arrows Strategy (Dec. 2012)

- 1) Aggressive monetary policy: radical quantity easing, inflation targeting
- 2) Flexible fiscal spending: large scale public works
- 3) Growth strategy (Japan Revitalization Strategy, Revised June 24, 2014): Strategy of global outreach :FTAs (TPP, RCEP, Japan-Australia, Japan-EU), Double Inward FDI stock by 2020, Increase exports of infrastructure system, etc

New Three Arrows Strategy (Sept. 2015)

1)Promotion of economic growth, 2) Increase birth rate, 3) Increase nursing facilities for the elderly

Current Status of Japan’s FTAs

- Enacted relatively a large number of FTAs, but
- Low country coverage in terms of trade: FTA coverage ratio
- Low tariff elimination: lower than 90% in terms of tariff lines, whereas for the US, Australia, other developed countries, higher than 95%

Japan's FTAs (as of February 2016)

	FTA Partners	Start of negotiations	Signing of agreement	Enactment of agreement
In action	Singapore	Jan 2001	Jan 2002	Nov 2002
	Mexico	Nov 2002	Sep 2004	Mar 2005
	Malaysia	Jan 2004	Dec 2005	Jul 2006
	Chile	Feb 2006	Mar 2007	Sep 2007
	Thailand	Feb 2004	Apr 2007	Nov 2007
	Indonesia	Jul 2005	Aug 2007	Jul 2008
	Brunei	Jun 2006	Jun 2007	Jul 2008
	ASEAN	Apr 2005	Apr 2008	Dec 2008
	Philippines	Feb 2004	Sep 2006	Dec 2008
	Switzerland	May 2007	Feb 2009	Sep 2009
	Vietnam	Jan 2007	Dec 2008	Oct 2009
	India	Jan 2007	Feb 2011	Aug 2011
	Peru	May 2009	May 2011	Mar 2012
	Australia	Apr 2007	Jul 2014	Jan 2015
Signed	Mongolia	Jun 2012	Feb 2015	
	TPP*	Jul 2013	Feb 2016	
In negotiation	South Korea**	Dec 2003**		
	GCC***	Sep 2006***		
	Canada	Nov 2012		
	Colombia	Dec 2012		
	China-Japan-S.Korea	Mar 2013		
	EU	Apr 2013		
	RCEP	May 2013		
	Turkey	Dec 2014		

Notes:

* TPP Negotiations began in March 2010. Japan joined the TPP negotiations in July 2013

** Negotiations with South Korea was suspended in November 2004.

*** Negotiations postponed in 2010.

Source: Ministry of Foreign Affairs and newspaper reportings.

FTA Coverage Ratios:
Share of trade with FTA partners in total trade (%), 2014

		Total	Exports	Imports
Japan		23.3	20.7	23.7
Australia		44.1	43.8	44.5
NZ		48.9	61.1	46.9
US		40.1	47.1	35.3
Canada		71.8	79.8	64.1
Mexico		81.0	92.5	69.6
Chile		90.9	89.0	93.6
Peru		91.4	89.5	92.4
EU	Total	75.6	77.2	74.1
	Extra-EU	28.7	31.4	26.0
Korea		41.1	43.1	39.0
China		18.7	15.3	22.8
India		17.2	19.9	15.3
Singapore		77.2	73.2	79.5
ASEAN		59.9	58.7	61.1

Source: JETRO, Report on World Trade and FDI 2015

FTA Trade Liberalization Ratio (%)

Japan-Philippines FTA				Australia-US FTA		
	Japan	88.4			Australi	100
Japan-Malaysia FTA					US	99
	Japan	86.8		US-Peru FTA		
Japan-Indonesia FTA					Peru	99
	Japan	86.6			US	98
Japan-Chile FTA				Korea-US FTA		
	Japan	86.5			US	99
Japan-Switzerland FTA					Korea	98
	Japan	85.6				

Motives

- Expand export market for Japanese firms
- Improve investment environment for Japanese firms
- Obtain energy and natural resources
- Promote structural reforms in Japan
- Improve and establish good relationship
- Provide economic assistance to developing countries

Impacts of TPP on Japanese Economy (GDP)

- Japan's Cabinet Office (2015):

  2.59% (TPP 12 countries)
- Petri, Plummer and Zhai (2012):

  2.0% (TPP 12 members)

  1.8% (RCEP)

  4.3% (FTAAP)
- Petri and Plummer (2016):

  1.9% (2020), 2.5% (2030),

  TPP 12 members

Simulation Scenario of the Cabinet Office Study

- Exogenous change: (1) Tariff reduction (elimination), (2) Trade facilitation: reduction of non-tariff barriers
- Assumed growth mechanism:
- (1) Trade expansion → Productivity increase
- (2) Productivity increase → Wage increase → Increase in employment
- (3) Increase in income → Increase in savings and investment → Increase in production capacity

IV. Concluding Remarks

- Faced with many difficult challenges, Japan has to open up its economy and implement structural reforms, in order to achieve economic growth and to maintain high living standard, and to contribute to economic growth in Asia-Pacific and in the world.
- WTO liberalization being stalled, free trade agreements (FTAs) are second-best solution for promotion of trade and FDI
- Japan can gain a lot from FTAs not only in East Asia but also with countries in other parts of the world such as the US, and the EU
- Japan contributed to a conclusion of TPP negotiations

- Japan needs to ratify the TPP as soon as possible
- Japan should contribute to the expansion of TPP members
- Japan should play active roles in establishing other region-wide mega FTAs: RCEP, Japan-EU FTA
- Then expand these FTAs by merging with other FTAs, leading to global trade liberalization
- FTAs face opposition from the agriculture sector
- Various measures including gradual phase-in liberalization, and temporary assistance (safety net) to negatively affected workers can moderate the negative impacts during the adjustment process
- Need strong political leadership to promote FTAs, good example was the TPP negotiation

3. Japan's Economic Relations with India: Trade, FDI, and Production Networks

- International Trade
- Japan's trade with India began to increase in the 21st century
- However, India's share in Japan's overall trade remains low: 1.4% (exports), 0.8% (imports), India's shares in world trade: 2.8% (exports), 1.4% (imports) (2012 figures)
- Trade structures of Japan and India are complementary: Japan exports machinery, while India exports natural resource-based products

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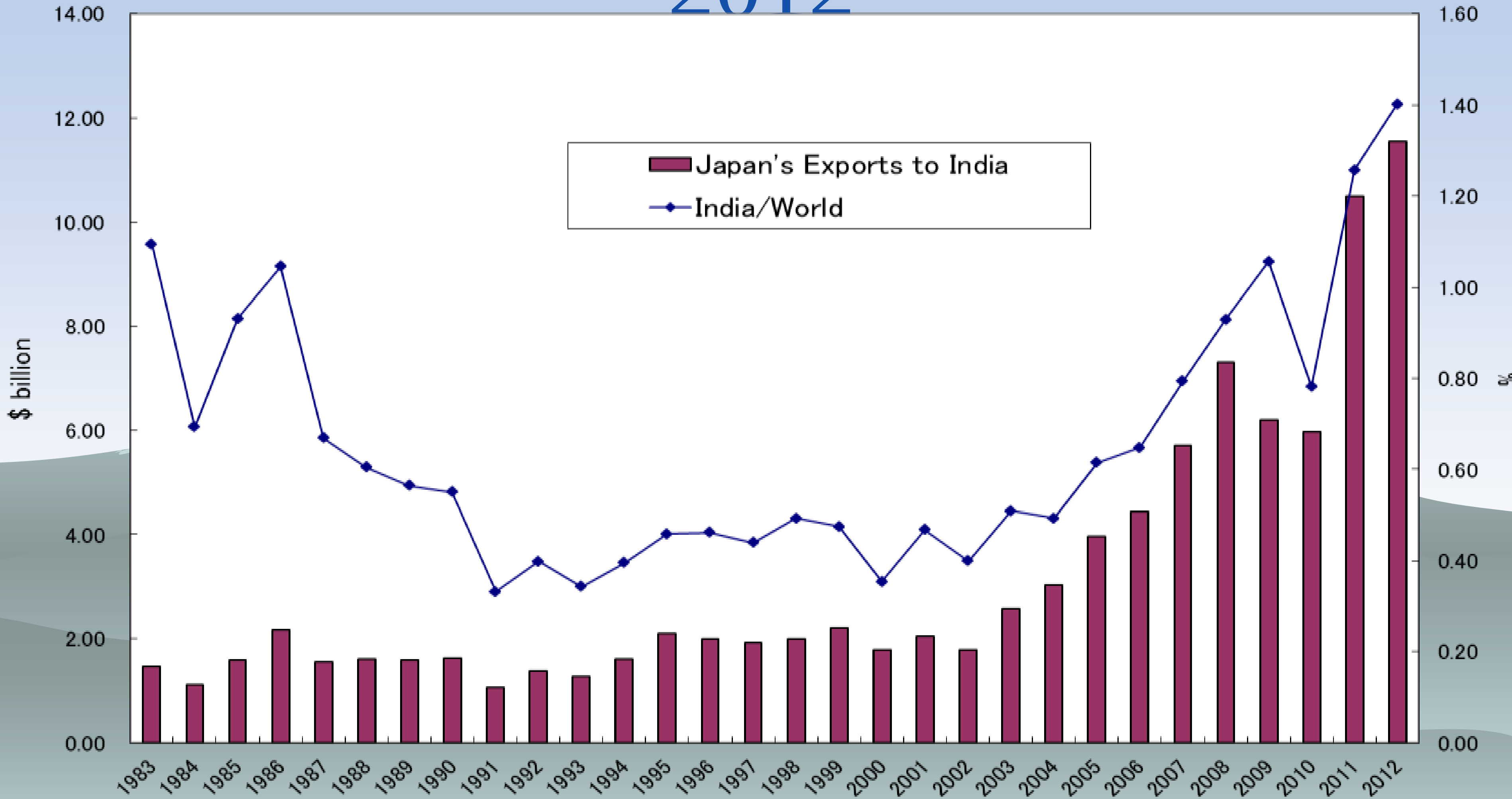
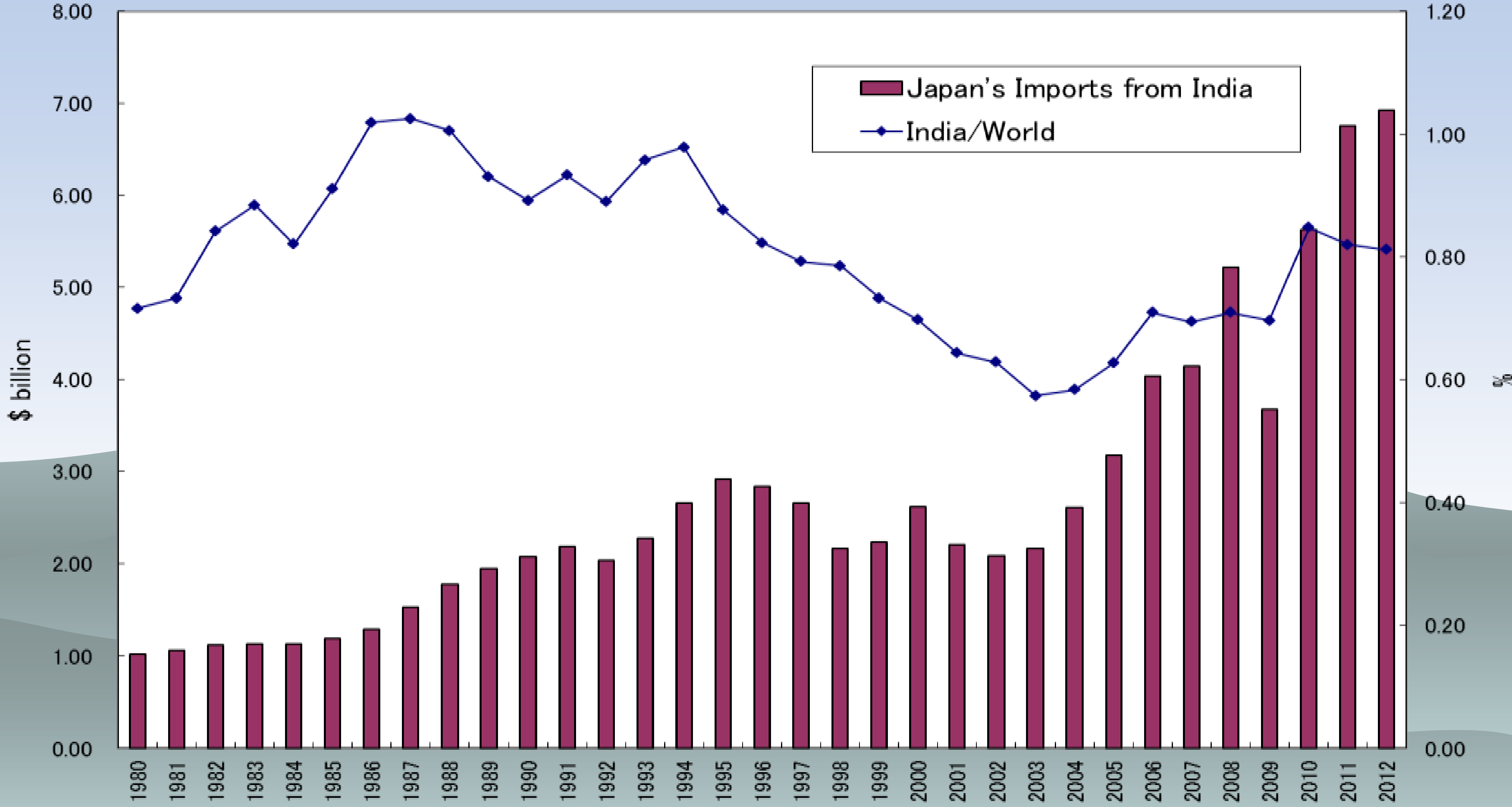
Japan's Exports to India, 1983-2012

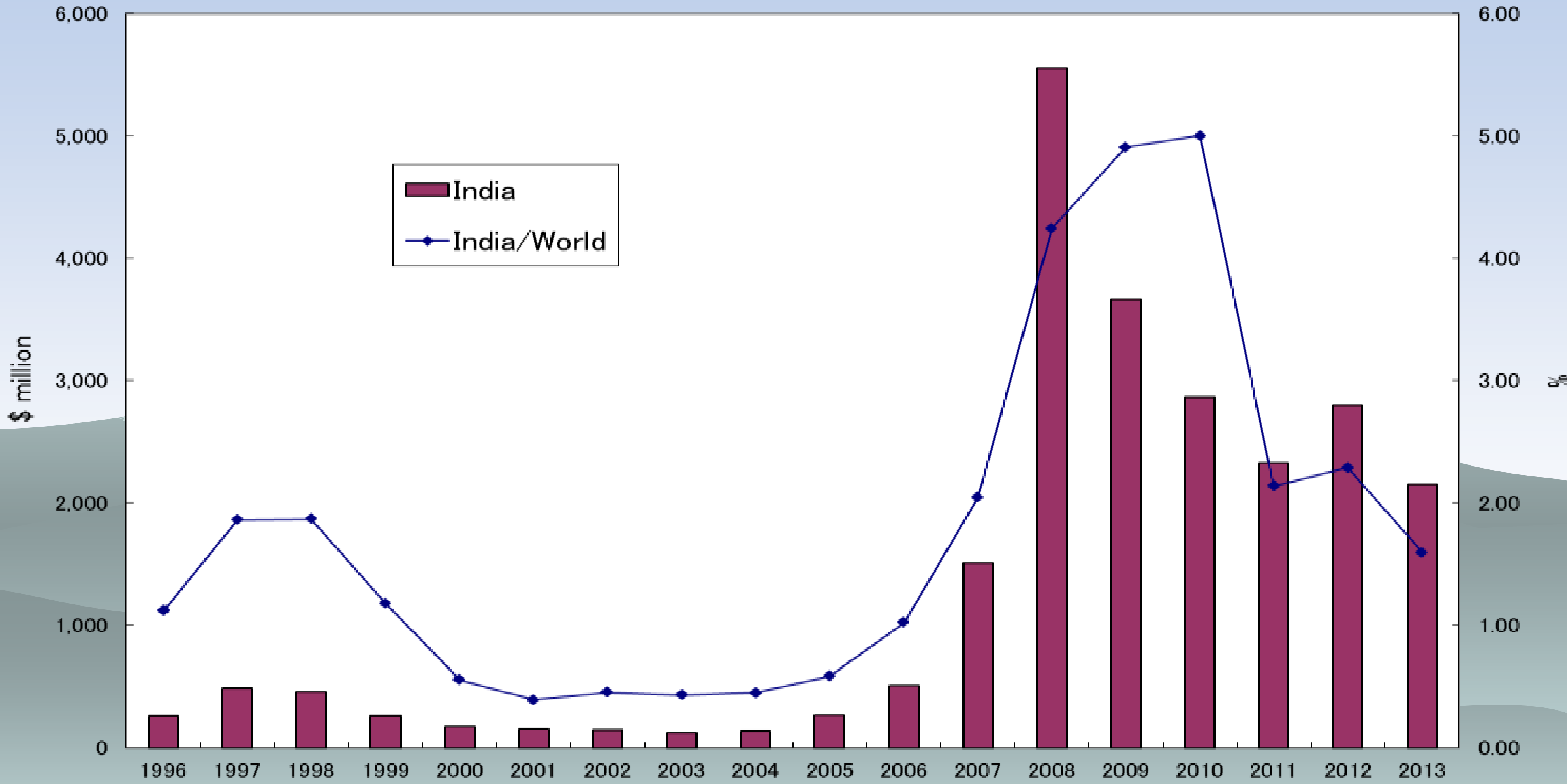


Japan’s Imports from India, 1980-2012



- <u>Foreign Direct Investment (FDI)</u>
- Japan's FDI rose sharply in the mid-2000s. After reaching a peak in 2008, it declined but remained high compared to the period before 2007
- India was second after China in 2008 in terms of Japan's annual FDI
- Industry composition of Japan's FDI in India: Manufacturing (transportation equipment), non-manufacturing (finance and insurance)
- <u>Motives</u>: large growing market, availability of low-wage labor, setting up a base for conduct business in Middle East and Africa, liberalization of trade and FDI policies, deregulation

Japan's Foreign Direct Investment in India, 1996-2013



Industry Composition of Japanese FDI Stock (per cent) in India at the end of 2013

Table 1 Industry Composition of Japanese FDI Stock (%) : at the end of 2013

Manufacturing	72.21	Non-manufacturing	27.79
Food	na	Farming and forestry	0.00
Textiles	0.35	Fishery and marine products	0.00
Wood and pulp	0.81	Mining	0.00
Chemicals and pharmaceuticals	8.66	Construction	0.44
Petroleum	0.00	Transportation	1.25
Rubber and leather	1.59	Communications	0.40
Glass and ceramics	1.52	Wholesale and retail	2.69
Iron, non-ferrous metals	3.61	Finance and insurance	21.13
General machinery	8.12	Real estate	na
Electric machinery	9.69	Servicies	1.17
Transportation equipment	35.53	Other non-manufacturing	na
Precision machinery	1.11		
Other manufacturing	na		

Bank of Japan, Balance of Payment Statistics

- <u>International Production Networks</u>
- Japanese firms have actively constructed international production networks, in order to conduct business efficiently
- Compared to East Asian developing countries, the extent of India’s involvement in international production networks has been limited.

Number of Affiliates of Japanese Firms in Asia, 2012

	World	Asia	China	ASEAN4				NIEs4				Vietnam	India
				Phillipines	Malaysia	Thailand	Indonesia	Taiwan	Korea	Singapore	Hong Kong		
Total	23,351	15,234	6,479	468	714	1,807	787	872	759	974	1,221	610	410
Manufacturing	10,425	7,962	3,879	259	403	1,071	516	382	315	217	263	402	197
Food and beverage	508	344	185	5	11	51	20	14	9	13	8	23	5
Textile	554	504	353	3	7	47	30	8	6	2	13	24	3
Wood, pulp, paper	155	120	64	3	13	14	7	3	-	1	2	13	-
Chemical	1,213	837	328	17	52	104	66	72	71	50	14	28	27
Petroleum and coal	52	37	15	-	5	3	3	1	3	4	-	1	1
Ceramic, stone and clay	269	207	102	3	16	20	11	18	13	4	-	13	4
Iron and steel	297	227	102	6	8	42	23	4	7	6	2	16	10
Non-ferrous metals	316	264	127	11	26	39	12	14	7	5	6	14	2
Metal products	528	456	226	15	20	64	29	17	12	18	23	25	5
General-purpose machinery	347	252	132	5	11	30	14	21	15	5	3	7	8
Production machinery	674	536	286	12	14	81	25	26	38	15	5	21	11
Business oriented machinery	381	263	127	16	13	20	6	15	16	10	19	14	5
Electrical machinery	667	535	306	15	12	72	15	22	19	16	20	23	13
IC electronics equipment	1,095	905	397	57	89	72	36	65	33	34	72	42	5
Transport equipment	1,950	1,310	530	55	42	278	132	55	43	7	4	69	83
Other manufacturing	1,419	1,165	599	36	64	134	87	27	23	27	72	69	15
Non-manufacturing	12,926	7,272	2,600	209	311	736	271	490	444	757	958	208	213
Information and Communications	786	514	278	26	13	31	9	19	31	32	17	30	19
Transport	1,322	684	250	29	33	78	42	28	22	74	70	30	18
Wholesale	6,381	3,825	1,308	52	147	388	103	292	252	418	679	65	112
Retail trade	705	430	179	3	20	39	12	49	36	37	38	8	5
Services	1,918	1,027	395	30	38	97	41	60	76	104	96	40	38
Other non-manufacturing	1,814	792	190	69	60	103	64	42	27	92	58	35	21

Future Business Prospects in India for Japanese Firms

- India: Most promising for investment (JBIC Survey, 2014 and 2015)
- Reasons for India being a promising FDI destination
- 1. Future growth potential
- 2. Availability of low-wage labor
- 3. Current size of the local market
- 4. Supply base fr assembly operations
- 5. Availability of capable human resources

- <u>Obstacles to Conducting Business in India</u>
- 1. Underdevelopment of infrastructure
- 2. Harsh competition with other firms
- 3. Lack of transparency in the implementation of the legal system
- 4. Complicated tax system
- 5. Social instability and insecurity

Comparison of Infrastructure among Selected Countries, 2013

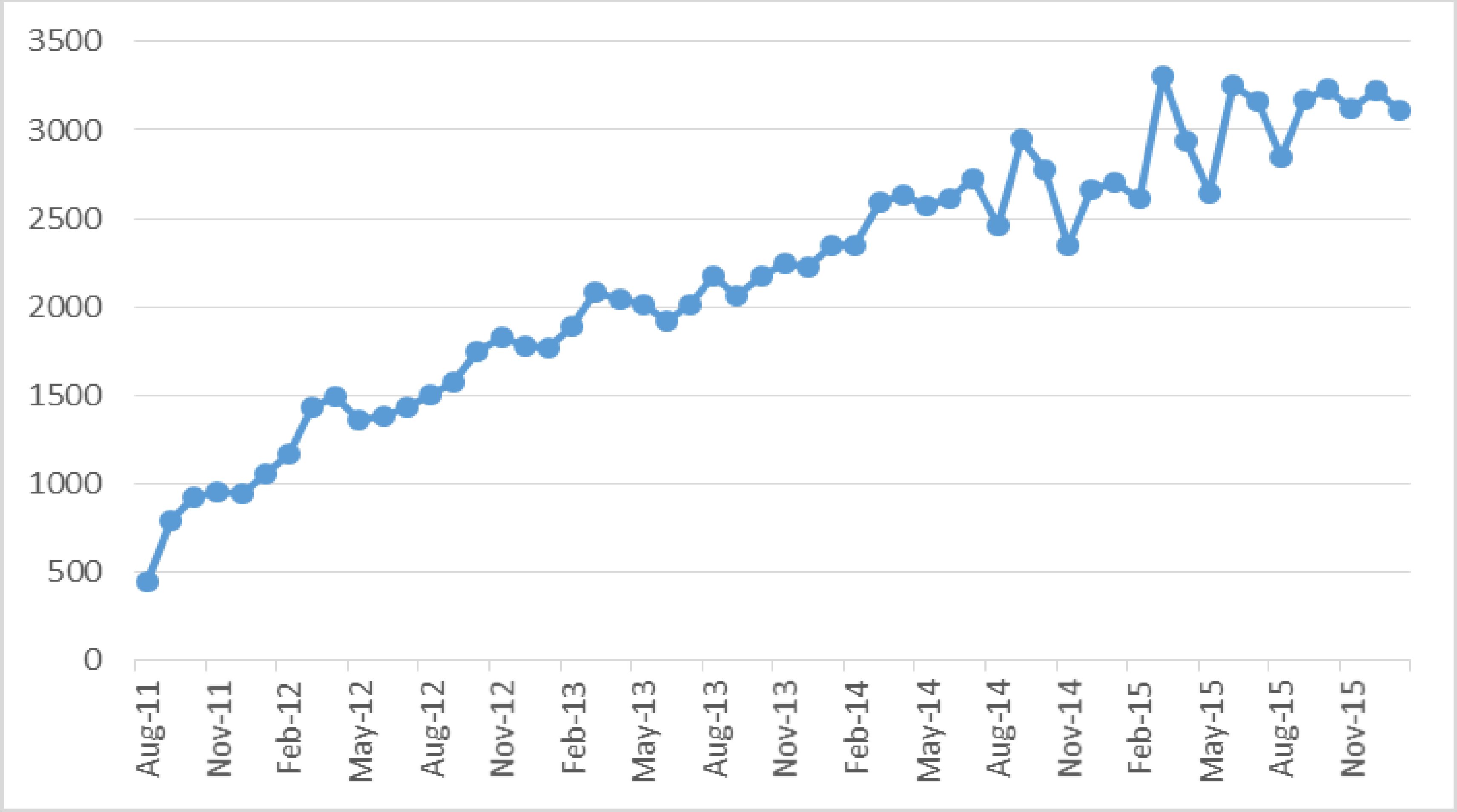
Country	Electric power consumption (KWh per capita)	Internet users (per 100 people)	Ease of Doing Business Ranking (189 Countries)										
			Overall	Starting a Business	Dealing with Construction Permits	Getting Electricity	Registering Property	Getting Credit	Protecting Minority Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving Insolvency
India	684.1	15.1	142	158	184	137	121	36	7	156	126	186	137
Indonesia	679.7	15.8	114	155	153	78	117	71	43	160	62	172	75
China	3298.0	45.8	90	128	179	124	37	71	132	120	98	35	53
Thailand	2316.0	28.9	26	75	6	12	28	89	25	62	36	25	45
Vietnam	1073.3	43.9	78	125	22	135	33	36	117	173	75	47	104

4. The Japan-India Comprehensive Economic Partnership Agreement

- Japan began forming free trade agreements (FTAs) in the 21st century
- Japan-India Comprehensive Economic Partnership Agreement (CEPA) in August 2011
- For Japan, Japan-India CEPA is 10th FTA
- Comprehensive contents with trade in goods and services, investment, government procurement, IPR, etc

- Important contents for Japanese firms:
- Liberalization and facilitation of trade in goods and services, and investment
- Goods. A large proportion of these tariffs on manufactured products will be reduced or eliminated in 10 years.
- Services: Higher liberalization commitments compared to the commitments in GATS
- Investment: liberalization of FDI in retail services, negative list approach in liberalization, ISDS, national treatment before and after the establishment of foreign investment
- Assessment so far: the use of FTAs judged from the COO (certificate of origin) issuance has been increasing significantly. The use of CEPA can increase if India simplifies the requirement for obtaining COO

The Number of Certificate of Origins issued for Japan's Exports to India under CEPA



5. Economic Cooperation

- <u>Economic cooperation by the Japanese government</u>:
- ODA: India has been the largest recipient of Japanese ODA in recent years: 9.1 percent of total Japanese ODA for the 2007-2013 period.
- Major areas: (1) promotion of economic development (infrastructure), (2) alleviation of poverty and environmental problems, (3) human resource development => attract FDI
- Provision of assistance for promoting FDI (JBIC, NEXI)

- Cooperation by Japanese and Indian business sectors:
- Joint R&D
- Provision of advice and recommendations to the governments
- Establishment of the India-Japan Business Leaders' Forum (BLF)
- Close collaboration and cooperation between the private sector and government is essential in dealing with the obstacles in conducting business