

# **Indonesia and Japan: Economic and Political Relations and Implications for Southeast Asia**

by

**Mr. Asanuma Shinji**  
**Dr. Ed Lincoln**  
**Dr. Djisman Simandjuntak**  
**Dr. Marvin Ott**

**Erland Heginbotham** (moderator): As we well know, bilateral relationships of course function within a broader regional and global context. In today's program, our speakers will note the truly dramatic changes in the context of the Indonesia-Japan relationship over the past ten to fifteen years, changes that greatly influenced the shape and potential of this relationship today and its future.

One change is the shift from the regionally dominant economic influence that Japan exerted in Southeast Asia, especially in 1986 to 1992, to its progressively diminishing role as its more than a decade long economic slump and policy introspection has progressed.

A second change involved the economic and political turmoil and internal preoccupations in Indonesia following the '97-'98 economic crisis that separated it from the preceding decades of impressive economic development and regional leadership in Southeast Asia.

A third is the dramatic emergence from near isolation of the stunningly dynamic Chinese regional trade, investment and energy role, especially after 1992, and again in conjunction with its WTO accession in 2001, along with its diplomatic and charm offensives in Southeast Asia.

Together, these three changes have made inescapable the extensive reconsideration and redefinition of almost all bilateral and multi-lateral relationships, within and without the region, and inform our discussion very heavily today. It's useful to keep these three particularly powerful changes in mind as we hear and benefit from the different perspectives of our four speakers.

**Asanuma Shinji:** I'd like to thank the Sasaki Peace Foundation USA and USINDO for inviting me to participate in this seminar.

In considering future economic relations in the East Asia region—and I define East Asia as inclusive of Southeast Asia and Northeast Asia, following the World Bank's definition—I think it is well for us to put what happened in the past three decades or so into perspective. Three big things happened.

## **East Asian Miracle**

Number one, the East Asian miracle, which we witnessed in the past three decades or so up to the Asian crisis. All of you must have read lots of books and articles on the East Asian miracle; a cottage industry has sprouted on this issue and we have an enormous amount of research, discussion, and analyses.

There is one factor which has not been focused on enough, which has not been given proper weight. That is the role of the U.S.

and Japanese market expansion and FDI flows to East Asia, which are the drivers of the miracle. During this period, the U.S. market expanded quite rapidly. U.S. economic growth was not that high, but as I remember at the beginning of the '60s, the ratio of U.S. imports to GDP was around 5%. Towards the end of this Asian miracle period, it went up to almost 15%. The U.S. market for foreign goods and services expanded very rapidly. On top of that, if you look at the pattern of U.S. growth, the weight shifted from the East Coast to the West Coast. This was the time when the West Coast economy was growing very rapidly.

Japan had a very high growth through the first oil shock of 1973, but after that its import composition changed quite radically. Japan used to import quite a bit of machinery and other technology-embodied products from the United States and Europe. But during this period, after the oil shock, Japan started importing quite a bit of consumption goods. There was change, actually, in the composition, and these two forces—the market expansion of the United States and that Japan really exerted a strong demand effect on the industrialization process over East Asian economies—are a part of all these studies, which have not been emphasized enough.

### **Indonesia Benefited from Economic Changes in East Asia**

Indonesia benefited from this environment and what was happening in East Asia tremendously. Indonesian development records are enormously good during this period, as seen by high growth, employment generation, poverty reduction, tremendous agricultural development, and later semi-industrialization, which made Indonesia a semi-industrialized country by the end of this miracle

period. The Asian crisis came after that in 1997. Once again, cottage industries sprouted on these issues.

We cannot discuss that fully, but one can say that the East Asian crisis was a manifestation of the inadequacy of the international financial architecture. It was due largely to and triggered by the enormous volatility of international capital flows and the inherent instability in the financial architecture at that time in the world economy. But at the same time, the Asian economic crisis revealed that Asia's many economies had vulnerabilities—vulnerabilities in their institutional make-up. Indonesia's vulnerabilities were quite great, so Indonesia suffered the most in this episode of East Asia's crisis.

The third major phenomenon in East Asia during this period is Japan's loss in a decade and a half. It was really a long and severe economic slump, and lots of discussions resulted on the causes and the consequences and all that, which I cannot get into today.

### **New East Asian Economic Environment**

Looking ahead, we have an entirely new environment in East Asia for the future, for the coming decades, maybe two or three decades. The happy days of the Asian economic miracle are now over and we are looking at the post-party scene here. One factor in this is the kind of negative legacy of the Asian crisis. Looking at many East Asian countries, we have built up national debt and still have a dysfunctional financial sector.

In the case of Indonesia, we have added problems. Firstly, the regime change in Indonesia is giving an enormous number of uncertainties to the Indonesian economy, and part of this is the diffusion of power, which happened after the regime change. By diffusion of power, I not only mean the distri-

bution of power among three branches of the government, but also between the central government and the local government, as a result of the decentralization policy. On top of that, the government itself is a coalition government. We have lots of uncertainties coming from the result of the regime change.

The second factor which we see in this new environment is the weakened role, as Professor Heginbotham mentioned, of the U.S. and Japanese markets. These two markets used to be the engine of growth for East Asia and are no longer. They are still quite strong, but their economic or market expansions are not as vigorous as in the previous three decades or so. Japan is no longer in the position of being the “lead goose in the geese-flying pattern” over East Asian industrialization.

The U.S. market itself is not such an easy place for the East Asian economies to enter. Other developing countries have woken up to the good opportunities of globalization and therefore competition in the U.S. market itself is quite fierce today.

### **Fierce Economic Competition**

These two factors are basically minus factors for East Asian economies. There is a plus factor. I don’t know whether it is a plus or minus on a net basis, but at least we have seen the emergence of China, and to a lesser extent the emergence of India, as economic giants in the East Asian region. It is a plus factor for trade with other East Asian economies. We are witnessing enormous increases in trade volumes between China, for example, and East Asian economies. But I don’t think we can say that China and India are replacing the Japanese and the American markets, because China and India are also fierce competitors for markets, for capital and

technology coming from developed economies. There is tremendous competition, and I’m quite sure that this one-takes-all situation will not last for long, and yet this presents a tremendous problem to a country like Indonesia.

The fourth factor we have to consider is the ongoing and continuing mega-trend of globalization. In this environment, what would be the agenda for East Asian economies, especially Japan and Indonesia? Every country has different policy issues, and we have to look at them separately, but I think there are some common goals here.

Number one, each economy in East Asia, Japan and Indonesia particularly, must strive for growth acceleration and higher employment generation, and in the case of Indonesia, resumption of poverty reduction, as in the past. Particularly in the case of Indonesia, one should pay a lot more attention to this employment issue because, if left alone, the increase in unemployment will become a cause of social problems and probably would set back the poverty reduction achievements of the past. At the same time, Japan—I think everybody is crossing their fingers to see that Japanese growth at least has recovered a little bit, but everybody sort of doubts its robustness—really should be getting out of the structural recession and should not become a drag on the rest of Asia.

Looking at all these common goals, I think we can phrase the common strategic agenda as this question: Can we construct well-functioning market economies, well integrated, regionally and internationally, in this area? It’s a general phrase that doesn’t have much meaning if we don’t define them more precisely. By well-functioning market economies I mean that results or outcomes should be the criteria for judging whether

we have well-functioning economies or not, and that the critical outcomes for such judgment should be growth, employment generation and poverty reduction.

I would like to focus on the issue of regional and international integration. We are seeing that in the past we had the geese flying pattern. It is a kind of hub-and-spokes relationship between the U.S. and Japanese economy and the rest of the East Asian economies. Are we going to live in the multi-polar situation that I talked about? In this situation there will be some instability, because of competition and all that, and if it is left totally unregulated and uninstitutionalized, I think we'll see increased volatility, unpredictability and uncertainty.

Therefore, we have to move from the market-led integration to institution-based integration. Efforts of governments in East Asia to form regional and bilateral FTAs, including the WTO accession, can be regarded as setting up a better institutional framework for regional and international integration.

### **Key to Economic Integration**

When we come to think of integration, the key to economic integration is the transaction costs and volatility. When we talk about institutions, we are talking about a framework which would reduce those transaction costs and reduce volatility thereof. And here, the government can play quite a large role in setting up a regulatory framework, doing institution-building, which includes governance issues and economic and social infrastructure.

Japan, as one example, is trying to forge all these economic partnership agreements, which transcends just mere free trade agreements there. It is very important for all these governments to try to establish regional in-

stitutions, including FTAs and so forth, but I guess more important would be the reforms these governments would have to carry out domestically in order to come up with the enabling conditions for creating well-functioning regional markets. In the case of Indonesia, it has to make more efforts to improve its investment climate, instituting the rule of law, and also reversing the trend of a deteriorating infrastructure.

Japan, of course, has enormous problems in tackling agriculture. It is time for the Japanese government to formulate a good immigration policy, because regional integration means also integration in the labor market, to some extent. Japan's ODA—and this is a whole different subject—but the ODA strategy in Indonesia has to be reinforced, has to be designed in such a way as to reinforce the Indonesian government's efforts in this respect.

We have a common agenda which can be defined as building up well-functioning market economies, well-integrated regionally and internationally, and in this respect, we have to move to institution-based economic integration. We have to cooperate in building up regional institutions, and more importantly, each country in the region has to carry out reforms, to create enabling conditions for such economic integration. Thank you very much.

**Ed Lincoln:** I'd like to talk a little bit more about the theme that Professor Asanuma has started us on: East Asian economic integration and regionalism. There is absolutely nothing that he has said with which I would disagree. But I would suggest that he has presented to you the broad picture, the broad vision of things that need to be done across the region. Let me talk a little bit more specifically about some of the results that have

come out of my recent research on these issues.

If we look generally at East Asia—he and I define it the same way—over the past two to two and a half decades there has been a gradual rise in intra-regional trade, that is, the percentage of imports and exports that are traded within East Asia, as opposed to with the rest of the world. That has been one of the facts cited by many people around the region in talking about the need for new East Asian regional institutions. Looking at that somewhat more closely, however, we see what I think are three very important trends that have occurred, particularly in the past decade, but to some extent since the early 1980s.

### **Relative Decline of Japan**

One trend has been the relative decline of Japan. Again, Professor Asanuma talked to you about the decade and a half of economic problems in Japan. As a result of that, Japan has become a less important trading partner, in a relative sense again, so a smaller percentage of imports and exports are with Japan for the rest of East Asia. This is also true for the United States' trade with Japan. Japan has also become a less important source of foreign direct investment. There was something of a boom in Japanese direct investment in Southeast Asia, for example, in the late 1980s and early 1990s, corresponding to the so-called bubble era in Japan when companies were flushed with cash. But they weren't so flushed with cash in the rest of the 1990s and on into this decade. At least relative to other foreign investment—to that of the Americans and Europeans—the Japanese have diminished somewhat.

This is more dramatic if we look at commercial loans by banks. The official data

collected in Switzerland for the Bank for International Settlements indicates that the outstanding value of Japanese loans from commercial banks to the rest of Asia has dropped by 70% since its peak in 1997. That's an enormous decline in lending. That figure leaves out Hong Kong and Singapore, which are money centers. Japanese lending to those two has dropped 90% since the mid-1990s. Again, this is because Japanese banks were particularly damaged by what was happening domestically in Japan in the 1990s.

Finally, even Japan's foreign aid budget has been shrinking since the mid-1990s. There was a little bump up after the Asian financial crisis, with the New Miyazawa Plan to provide some additional resources, but over all ODA has been falling. I mention this because if we had been having this meeting, say, a dozen years ago, the discussion would have been all about how Japan was becoming the center for regionalization in Asia. Indeed, there was a book to that effect—Walter Hatch and Kozo Yamamura published a book called *Asia in Japan's Embrace*. No one would write that book today, because all of the elements that are in that view from a dozen years ago have been reversed.

### **China's Rapid Expansion**

The second major conclusion or trend about what's happened in the region is that as Japan has declined relatively, China has expanded. This is mostly the case if we look at trade. Obviously China is not a source of direct investment; it is not a source of commercial bank loans, but it is a trading partner and it has expanded very rapidly because of both rapid Chinese economic growth and China's opening up to the outside world. I say "world" here for a reason. My interest in the research I was doing was to look at what's happening in the region, but it's im-

portant to remember that China's emergence has been on a global stage, not just on a regional stage. China's become a much more important trading partner for the United States as well.

Recently, when I meet with Japanese, they'll say, "Japan now imports more from China than it does from the United States." The same thing is true for the United States. We import more from China now than we do from Japan. For everybody, including Indonesia, China is going to continue to become more important.

### **U.S. Continues to be Major Player in the Region**

The third major conclusion is that the United States continues to be a major player in the region, even as there is discussion of the region coming together within itself. An important feature is that American engagement through trade and investment has not changed very much. We are still a very important trading partner; we may be down a little bit in the last few years, but we are still critical as a trading partner and we are an important source of foreign direct investment.

So, what to do? There's certainly been lots of talk in the region about coming together. It's important to have a vision of where the region is going. There are a couple of obstacles or reasons to be cautious about what is likely to happen, say, in the next decade within East Asia.

First of all, there are a number of factors in the region that slow down the process of getting together, however it is that we want to integrate. There are enormous differences in economic size, enormous differences in population size between, say, China and Singapore; tremendous differences in the level of economic development—relatively

poor countries like Indonesia, versus very rich countries like Japan; differences in history, in culture and in religion that certainly broadly divide Northeast Asia from Southeast Asia. Unlike Europe, where there was a flow of trade, investment, ideas, language, culture and religion from at least the time of the Roman Empire, from southern parts of Europe as far north as Scandinavia, that's not as true of Asia. There is a legacy of not being quite as tied together as the Europeans were when they began their integration process seriously, after World War II.

The second point is that we're all global players, and again, Professor Asanuma emphasized the process of globalization that has been going on. As we think about what we want to do regionally, it's always important to remember that we're all global players. It's not sufficient to deal only with one's neighbors; we need the market, we need the financial flows more broadly.

### **Global Institutions Must Be Emphasized**

With that as background, a couple of final thoughts on where we ought to be going. The first is that we ought to emphasize, primarily, our global institutions. Japan, Indonesia, the United States—we all work best when we are working through the IMF and the World Bank. I think, in fact, that this point is appreciated in the region.

Despite the anger that was created during the Asian financial crisis about initial mistakes that the IMF made—and those that the U.S. government made in pressuring the IMF around bilateral decisions—the solution to that is not to go off and create a separate Asian Monetary Fund that might compete with the IMF as a source of fixing problems in the region, but to fix the problems at the IMF. I think that governments in the region understand this, because if you look at the

Chang Mai Initiative, which was the first and one of the only major policy decisions made so far by the ASEAN Plus Three group, the Chang Mai initiative encouraged central banks to go out and negotiate expanded bilateral swap arrangements whereby one central bank, say, the Bank of Japan, could lend money to Indonesia to help Indonesia defend its currency if there were another run on the currency, ala 1997.

All of those agreements specify that only 10% of the money that is being put up can be put in play without explicit approval from the IMF. The other 90% is dependent upon the two central banks going to Washington and asking the IMF for permission to go ahead. It has kept the swap arrangements clearly under the overall umbrella of leadership of the IMF and I think that's appropriate. Maybe the IMF still needs some reforms in the decisions that it makes, but let's work on that, rather than moving away from it.

### **APEC Represents a Better Approach than ASEAN Plus Three**

The second conclusion that I reached is that at a regional level, in general terms, I think APEC represents a better approach than ASEAN Plus Three. I'm not suggesting that Indonesia and Japan should drop out of ASEAN Plus Three. Certainly, there are times where neighbors simply decide to get together among themselves, but I'm a little concerned that ASEAN Plus Three leaves out several governments that ought to be at the table, if you believe that it is the strength of economic ties that gives regional players an incentive to get together among themselves. Those players are Australia, New Zealand, Taiwan and the United States.

I think that irregardless of me wanting the U.S. in simply because I think U.S. ought to

be part of what goes on in Asia, I think it's equally important that these other governments are not at that particular table either. For example, on exchange rate policy, why would you leave out a Taiwan when it has lots of foreign exchange reserves that might be useful to mobilize in bilateral swap arrangements with the central bank? They're sitting on a pile of reserves as well.

I would prefer working with APEC. We all know APEC has had some problems, but again, maybe we should work together to try to make APEC a more effective institution, particularly to work on Professor Asanuma's agenda for institutional change. APEC is not going to produce a free trade area, but it can work on issues such as assisting the developing countries in the region to create more robust financial sectors. We have lots of financial expertise in the United States, Japan, Australia, and Canada to bring to bear in that discussion, on the APEC side.

My final point would be that as we move forward, be wary of bilateral and sub-regional free trade areas. I know they are the flavor of the day; my own government has moved rapidly down this road, and as you saw in Professor Asanuma's presentation, so has Japan. ASEAN, obviously, is reaching out and wants to negotiate more as a group with the outside world, including Japan and China. Such agreements do create economic distortions. I am a globalist; I would prefer that we lower barriers around the world in a way that does not create new trade distortions that we're going to have to deal with down the road. Be cautious as you think about negotiating free trade agreements. Thank you.

**Djisman Simandjuntak:** Your excellencies, ladies and gentlemen, I would like first of all to extend my gratitude to USINDO and the Sasakawa Peace Foundation USA. It's al-

ways a good feeling to have friends around that you can depend on while facing the turbulent times like the one that Indonesia is trying to sail through after the financial crisis of 1997.

The first two speakers almost left me nothing to talk about, but perhaps I can add a kind of emphasis here and there, and of course, I'll be talking about ASEAN and Japan, rather than Indonesia and Japan. Mari Pangestu apologized because she couldn't make it here today because her mother needs her presence in Jakarta, but I hope I'll be an imperfect substitute and still can contribute to our discussion.

### **Japan – ASEAN Relations Benefited Both Sides for Thirty Years**

Let me emphasize that Japan-ASEAN relations over the last thirty years or so have been very good relations, benefiting both sides, of course. We trade a great deal and our trade goes beyond electronic gadgets, natural gas and oil. We also trade soft things like cartoon products. If you watch Indonesian TVs nowadays, you see Tom and Jerry competing with Pokemon from Japan. Unfortunately, there are very few local cartoons that you can watch on our TV, but my point is this: our trade is not really a simple array of goods. It goes far beyond goods.

We also trade some services, and even in services; it's more than just financial services, and we trade in accordance with the so-called dynamic comparative advantages. This applies not only to Indonesia and Japan.

We can draw the so-called product life cycles in each product category, and we will see that each of the ASEAN countries and Japan occupy different states in the product life cycle. In some products, it is Japan that

leads, but in some others, it may be Korea, some others may be China and some others may be Indonesia. This type of relationship opens opportunities for everybody. Of course, there are problems with the new members of ASEAN, like Laos and Myanmar, who are yet to catch up, but I think if we are consistent in opening our economies, even Laos and Myanmar will some day find positions that are attractive enough in the so-called "flying geese" model of East Asian economic development.

Of course, we have had a long history of a strong FDI presence of Japan in all of the ASEAN countries. Japanese investment functions as a kind of strange attractor or, if I borrow the term from chaos theory, a kind of glue to the economy of South Asia. But of course, the U.S. also plays that kind of role in Southeast Asia. Japan is the largest source of official capital to south Indonesia. Whether we talk about Indonesia, or whether we talk about the Mekong River countries, Japan is always the number one provider of official capital to Southeast Asia. In one word, it is a relationship which has been proven over time and has proven also to be very beneficial to both sides in Southeast Asia, as well as to Japan.

In recent times, we have started to question the pattern of the relationship between Japan and Southeast Asia. Perhaps Southeast Asia is not an optimal region. If you believe in statistics—and as an economist, I believe in statistics—perhaps the proper region for us is East Asia, in the sense of Southeast Asia plus Northeast Asia, rather than Southeast Asia proper. Whether one talks about trade in goods, trade in services, labor movement or capital movement, and foreign direct investment, of course, East Asia seems to be the optimal region for the part of the world.

But, of course, we should not leave Hong Kong out; we should not leave Taiwan out; we should not leave out, in my view, Australia and New Zealand. To me, Australia and New Zealand have a closer economic relationship to the members and belong to East Asia. And we should not forget, even if East Asia is the true region, these complicated networks of trade, investment, and other flows between Southeast Asia, East Asia and the rest of the world.

Europe remains a very important partner for us. I just came from Europe attending conferences in Munich, Brussels and Lisbon, where we emphasized the importance of the relationship between Europe and East Asia. China has been talked about, of course, as the new darling of the world. It has a closer economic relationship with Australia, New Zealand, and the U.S.

The first exercise I was involved in, in regional cooperation in the Asia Pacific, was actually an ASEAN-U.S. initiative. We did it together with the University of Hawaii and we did it in the early 1980s. We already entertained the idea of having to explore the possibilities of closer economic relationship between Southeast Asia and the U.S. Even then, we cautiously reconvened a free trade relationship between Southeast Asia and the United States. A relationship between Japan on that score came later.

### **Perceived Problems in Relationship between Japan and Southeast Asia**

There are problems—at least, perceived problems. Number one, of course, is Japanese agricultural protection. If Japan is truly willing to lead East Asian integration, it should not treat agriculture in an enigmatic way. It has to be part of the exercise. You have, of course, a Singapore-Japan free trade agreement already, but there is no agriculture in

Singapore. That's why it was easy to agree upon. But the rest of East Asia counts on agriculture while seeking to become part of the global economy.

Number two, Japan is perceived to be too stingy in terms of technology transfer. This is a popular perception. I don't share this. The first one I share, but not the one on the stinginess of Japan, in respect to technology transfer. I don't buy this, but it is the popular perception.

Number three, Japan prefers not to let Southeast Asia come to Japan. The Japanese prefer to export the industries to the rest of Asia, but are very restrictive in terms of flows of people. I think if Japan truly has a dream about East Asia, this particular policy needs to be relaxed. How? It needs to be discussed later, but I think leaving out the labor movement in any integration initiative puts the process in a difficult position from the outset.

There is also this perception of latent resentment against Japan among Southeast Asians. When we get into difficulties, we keep referring to World War II. I think it's time to bury those things—but this, of course, is less of a problem with Southeast Asia than compared with China and Korea. How can we move forward if we keep referring to the past, and if the past stands in our way to the future?

Why this demand for regionalism in East Asia? Remember, Japan has never entertained the idea of becoming part of regional integration up until recently. For Korea, it's the same thing; for China, the same thing. The three have done so well in the absence of regional integration.

## **Japan a Reluctant Champion of Regionalism in East Asia**

Lately, Japan has become a kind of reluctant champion of regionalism in East Asia. We have a kind of tower of Babel in regional integration nowadays. Hundreds of RTAs are there and it's hard to comprehend. There are so many of them. We don't know yet what this East Asian integration is likely to include, but preliminary suggestions indicate that it is going to be very comprehensive. That's why the term "comprehensive economic partnership" exists.

In the WTO, regional integration is very clear, very transparent—see Article 24 of the WTO. But recent initiatives on regionalisms vary from one place to another, and do not necessarily comply with Article 24 of the WTO. In a way, I think this is a problem, because we create a kind of lack of transparency in the world trading system.

The architecture is yet to be decided, but one of the basic ideas is to have free trade agreements between Japan and ASEAN thoroughly negotiated by 2005, which will then be implemented by around 2015. That's the basic idea, and the FTA in goods and services, investment area, trade and investment facilitation, labor movement, knowledge and skill formation and development cooperation, are truly an all-encompassing agreement, and covers what is possible to cover under the sun. It may be a good thing, but there is a problem with this type of approach: we know how APEC has performed so far. Partly, it's because of the lack of focus in the agenda.

As an economist, I would suggest that we focus our attempts from the outset. For instance, let's focus attention on the FTA, rather than covering all of the issues from the outset. What is the goal? The Europeans

had a goal when they got together after the war: no more war in Europe. And then they agreed on the coal and steel community.

But in the case of Asia, this dream is lacking. Where are we heading? We have been known all along as a very pragmatic people that work from day to day without committing ourselves to a grand design. But I think for East Asian communities, we need this type of dream. Of course, we have this Singapore-Japan FTA, and it's not likely to be the model for ASEAN-Japan comprehensive cooperation. As I said, negotiating with Singapore on free trade is very simple, because Singapore does not have any important protections, whether one talks about goods, services or even investment.

### **Comprehensive Economic Partnership**

What are the likely impacts? Suppose there is this clause of comprehensive economic partnership between ASEAN and Japan. What are the likely impacts? Perhaps the most important one is that the gravity of East Asia would be raised but, as I said, East Asia is not only Japan or ASEAN, but it has to be Southeast Asia, plus Northeast Asia, plus Hong Kong, plus Taiwan, plus Australia and New Zealand.

This comprehensive economic partnership will further deepen the division of labor between Japan and Southeast Asia, but also, of course, with the rest of East Asia. It may also lead us to new sources of economic growth, other than the effect of consumption, on which we have been relying on all along, while trying to push our economic development. Perhaps it will also help us to create new non-zero interactions, different types of non-zero interactions. Competition usually is understood as a quasi-zero sum game. If you get 80k, I get 20; if I get 40, you get 60. But a civilization actually is a

function of non-zeros, in which both sides can benefit. It can also lead us to recombination.

Mention was made of the diversity of East Asia. I think it's not a liability. The question is how to manage diversity, but after all, we are not as diverse as we appear at first glance. Of course, there are Malays like me, or some Chinese—the majority of East Asians, of course, are Chinese, Korean, Japanese and Australians, but the differences I think are very superficial, skin deep. If you go to 10,000 years ago, we were not that different, and I don't see any reason why we have to limit our attention to the present. We should also go back to the past to realize that we are not as different as we appear to be. Once again, I consider this diversity an asset, rather than a liability. The U.S. became the U.S. because of diversity, rather than because of homogeneity.

The impact also will depend on the difference between, or the differential between the comprehensive partnership treatment and MFN treatment. If we look at East Asian integration this way, the immediate impacts are bound to be very limited, because protection in all the members has been reduced to a very low level. Even in Indonesia, the level of protection has gone down to a very minimal level. The initial condition, I think, is preferable for a deeper integration, but we also have to consider reactions of the rest of the world, as expressed among others by Dr. Lincoln just now.

If you have NAFTA in the Americas, if Europeans have the European Union in Europe, I think it's not a bad idea of having a similar thing in East Asia provided, of course, that the design is not exclusive, that it is kept open, as we keep saying in the Asia Pacific. It also depends on the future developments of the world economy and the ben-

efits or costs that arise from the free trade agreements between Japan and East Asia.

We have a number of tail winds working in our favor, but also head winds, and both will have to be taken into account while designing the agreements. Once again, the speed at which East Asian integration will develop in the future depends on many factors, but I would single out the issue of leadership.

East Asian integration right now is, in a way, left to ASEAN. In a way, ASEAN Plus Three—which, in reality, is ASEAN plus one, plus one, plus one right now—but I wonder if ASEAN can play this role. I think it will have to be Japan. It will have to be China who champions East Asian economic integration, if we are to come forward. ASEAN, of course, can play a role of mediation, but the leadership will have to come from Japan and China. Thank you, Mr. Chairman.

**Marvin Ott:** I came in usual fashion with a 20-pound load trying to cram it into a 10-pound sack, and I think our time is fleeting, so I'm going to try and cram it into a 5-pound sack and maybe leave a few things out. But I will try to be very brief and at least hit a few thoughtful highlights.

For a conference devoted primarily to economic issues and issues of economic integration, I think it's nevertheless appropriate that there be at least an acknowledgment that the security environment in which economic relationships play out interacts importantly with the economics on multiple dimensions, and in complex ways. It is worth spending a couple of minutes trying to take a quick overview of that security environment.

The picture I'll try to paint for you, again, very briefly, is one that strikes me as being highly dynamic, and it's remarkably open-

ended and problematic, given the scale of the actors that we're talking about and the deeply-rooted cultures and economies and so on of the region. It is a remarkably problematic and open-ended environment.

### **More Threatening and Complicated Security Environment Today**

If we were holding this meeting quite recently, say, in 1996, and we were trying to look at the security environment, which is painted in very glowing terms, basically, to bring it to a single sentence, never had Asia been so prosperous, so secure, so peaceful, so optimistic, so integrated in all recorded history. There was every reason to think that this extraordinary, positive trajectory in security terms would be sustained indefinitely. Holding the same meeting today is a very different picture. It's a picture of a security environment that is more threatening, more precarious, more complicated in multiple ways:

The Asian financial crisis; the political upheaval in Indonesia; dangers of separatism within the archipelago; the rise of militant Islam; the growth of piracy; other sorts of transnational symptoms of state and authority breakdown, and then, whether they are positive or negative—again I'll use the word "problematic"; the remarkable change in the geo-political environment in which Southeast Asia exists; the rise of China; the relative decline of Japan; Chinese emergence as a major energy consumer; the U.S. as an episodic in-and-out strategic player—more recently back in, in response to terrorism problems, but focused on a single issue and not a broad spectrum player, the sort that China has increasingly emerged as.

The trends within Indonesia tend to mirror the kinds of trends that have occurred in the security picture in East Asia, generally the

simultaneous political, economic and societal transition: the decline of the Suharto autocracy, the remarkable rise of democracy, the devolution of authority to outside Java, and societal empowerment on a variety of dimensions. It's a picture of extraordinary, simultaneous, multi-dimensional transitions which, under the best of circumstances, is going to create a degree of instability and uncertainty when you then add to that picture the dramatic rise of militant Islamic organizations—JI and other groups—and the things that have played into that, like Saudi money, the *pesantran* (madrasahs), a picture that you're all familiar with, the most dramatic and negative manifestation of the series of major bombings in Indonesia, Bali, Marriott, and most recently, the Australian Embassy.

The economic problems within the archipelago tend to, of course, interact with the security environment and the relatively anemic economic growth. And the failure of FDI to recover to pre-Asian financial crisis sorts of levels interacts with and tends to exacerbate the deteriorating, or at least, again, problematic security environment. The instability within Indonesia and the uncertainties, of course, interplay and interact with the region in important ways as Indonesia is, by any measure, the keystone state in Southeast Asia and in Southeast Asia's future.

### **Rise of China a Remarkable Historical Development**

I will turn to the geo-political pattern for just a second. The rise of China has been a remarkable historical development. A country which historically, over two millennia, has exerted a kind of cultural quasi-political primacy, episodically captured in the term the "tribute system," has now emerged as a major emerging central great power in East

Asia, economically, militarily, and I would argue also in terms of strategic ambition.

That ambition coincides with a moment in history when the historic threats that have kept China on the strategic defensive from Japan and the East, and from Russia in the West and the North, have basically faded to insignificance, given China's strategic planners; China does have strategic planners who do, in fact, know what they're doing, giving these people a relatively free hand to focus their ambitions for China in the direction of which they naturally gravitate, to the south.

The contrast between the rise of China and the relative decline of Japan has been talked about at some length, and is, I would argue, in geo-political terms, pretty dramatic, in the sense that it's happened so quickly. If we had this meeting well within sort of recent memory, we would have painted a very different picture of Japan's strategic position in Asia, if we were looking forward. In part, this is because Japan's strategic interests in the region are so obvious: It is dependent on the sea lanes, the Malaccas Strait and the South China Sea for lines of communication; it is a source of ODA; it is a major trading partner; it is a source of foreign investment; its role in Southeast Asia and its strategic stake in the future of the region is incontestable.

### **Japan's Stake in Southeast Asia Is Under Threat**

If you were then to add to that what Richard Cronin has called the rising security consciousness in Japan in recent years—in response to the Taepodong missile shot of North Korea, in response to the relative rise of China, in response to threatening developments on the Korean Peninsula and increasing questions about the Taiwan Straits

—for a whole series of reasons, Japan's existing stake in Southeast Asia is increasingly put under some sense of threat. One would expect under that environment fairly robust developments, in terms of strategic thinking in Japan about Japan's role in the region, Japan's stake, and how Japan responds in security terms to these developments, but what's striking is the almost complete absence of that.

### **China Trying to Bring Southeast Asia into its Embrace**

China, I would argue, has a very clear strategic vision for Southeast Asia, and where Southeast Asia fits into growing Chinese ambition. And I would argue—some things I have skipped over but I have to go back to—that recent years have witnessed a supremely skilled Chinese diplomatic campaign which has already begun to pay off on multiple dimensions, to gradually bring Southeast Asia not into Japan's embrace, but into China's embrace. Japan, by all evidence, lacks any sort of comparable concepts or strategic vision of its own relationship to Southeast Asia.

Let me conclude with a couple of comments about ASEAN perceptions, at least as I would read them, in response to these developments. I'll try to reduce this to three or four “bumper stickers” or slogans. For China, from ASEAN's perspective, the game or the task is to make this a positive sum game relationship with China, to integrate China into the region, to make China's growing economic capacity a positive for the region and to neutralize Chinese strategic ambition and harness it to a broader vision of Asian stability.

Having said that, what remains within the minds of most ASEAN security and political thinkers are questions, particularly on the

security side, with regard to China's long-term intentions. Southeast Asians note, for example, that there are many sorts of symptoms or indicators of this kind that the Chinese, for all their positive diplomatic initiatives with regard to the South China Sea, for example, have done nothing to change in China's bedrock claim that the South China Sea is, in fact, entirely and rightfully sovereign Chinese territory.

With regard to the U.S., the name of the game is to keep the U.S. in the game. Efforts towards that end span a spectrum, from Singapore's building of a carrier pier, to servicing U.S. aircraft carriers, to Thailand's hosting of the Cobra Gold military exercises, to all sorts of mutual agreements with regard to ship visits and things of that kind.

With regard to Japan, the effort is to get Japan into the game. Constant efforts to try to encourage and stimulate Japan to become a more active player, not just economically, but politically and strategically as well, while at the same time ASEAN will be residually nervous about the potential Chinese reaction to a more active and strategically ambitious Japan.

Finally, with regard to China, with regard to the U.S., in the case of the U.S., it's stay in the region, but please stay at arms length. Please don't be too obvious and forward-leaning with regard to your security initiatives. Look most recently at the reaction in the region toward Hawaii's proposal for a regional maritime security initiative, RMSI, and how the Singaporeans, the Indonesians, the Malaysians, the Thai, and so on reacted to that. Stay in the region, but don't be too forward-leaning.

But the one area where there is no ambiguity, where there's no reservation, from an ASEAN perspective, is the need for an en-

couragement of multilateral security initiatives, the RAF, the ASEAN Plus Three, the ASEAN dialogues, the South China Sea code of conduct, the anti-piracy and maritime security agreements, and the variety of agreements that have been negotiated between China and Japan and are in prospect.

All of this is designed from an ASEAN standpoint to basically achieve two things: one is to leverage external players to assist in the domestic construction, economic performance of the Southeast Asian countries, the ASEAN countries, and at the same time, to capture that phenomenon. We use Southeast Asians' favorite term, "resilience"—to build resilience for the Southeast Asian countries on the one hand, and on the other hand, to create a geo-political environment which, to use an old-fashioned term, constitutes the "balance of power" in which the major geo-political players—Japan, China, and the U.S., potentially India, possibly Korea—begin to offset one another.

## Q&A

**Heginbotham:** I have two questions which relate closely to each other, and I detected, toward the end, that more and more we are looking toward what is the U.S. role in Asia, even though that's not explicitly part of the subject today.

The first question is: Professor Asanuma and Dr. Lincoln agree that Japan is less important, but they sharply disagree on the U.S. role; while Professor Asanuma maintains the U.S., along with Japan, is no longer the lead goose in the geese flying, Dr. Lincoln asserts that the U.S. continues to be an important factor. Will the two of you please reconcile your views?

**Asanuma:** I have emphasized the role that the U.S. market expansion played in East

Asian development; I'm convinced that role of the United States will remain there. But at the same time, I think we have to take note of the fact that the U.S. market is not part of the region; also, the U.S.'s international geopolitical leadership is that of a global nature. At the same time, Japan is a predominantly regional economic giant, and if Japan is going to play non-economic roles, such as in security and in more political roles, for the time being Japan won't be a global player, but will remain as a regional player. For that reason, I would like to differentiate the roles Japan and the U.S. play in East Asia somewhat separately—the global player versus the regional player.

That is the reason why I think I cannot agree with Dr. Lincoln's emphasis on APEC over other regional institutions. My vision includes overlapping, multiple, regional institutions, where each one of them has a separate purpose for separate issues, but APEC cannot work as a kind of umbrella organization for enhancing regional integration.

**Heginbotham:** Dr. Lincoln, could you also comment on Dr. Ott's point that the U.S. is an episodic and sporadic player?

**Lincoln:** Let me start with the economic side. Over the course of the 1990s, my impression is that actually the U.S. continued to play a strong role in terms of fairly rapidly rising imports from East Asia as a whole. Relatively speaking, fewer imports came from Japan, but a lot more came from China. It was the rapid growth of the U.S. market in the second half of the 1990s that helped East Asian countries who had been hit like Indonesia by the Asian financial crisis to recover after that, when they were able to expand exports from the United States quite quickly.

However—and here's what I thought perhaps Professor Asanuma was referring to in

his initial remarks—we then experienced a recession in 2001, so our role as an absorber of imports has certainly slowed down. I haven't looked at the recent data, but we have experienced slower growth, and perhaps, in fact, the imports have continued to go up since we've built up a much larger trade deficit. But ultimately, that trade deficit is not sustainable economically, and so future import growth will be limited by our overall economic growth. This may just be a cyclical thing, but certainly for the last couple of years our role as driver for the region has been somewhat reduced.

### **U.S. Has Had Trouble Focusing on Southeast Asia**

In a policy sense, I absolutely agree with Marvin Ott that the United States has had trouble focusing, not so much on Northeast Asia, but certainly on Southeast Asia. And for all of our engagement, for all of our importance—from the perspective of Southeast Asia in trade and investment terms—from a U.S. standpoint, as Professor Asanuma pointed out, we are a global player and have to admit that Southeast Asia isn't that big economically, relative to the rest of the world.

Southeast Asia is just not big enough to get a lot of attention in Washington. And that spills over, I think, on the strategic side as well. It takes a big crisis, like the war on terrorism and discovering that there are elements related to the crisis in Southeast Asia. That gives us an incentive to say, "Oh boy, we need to talk with Asian governments." But absent that, it's sometimes difficult to get the attention of policymakers in Washington.

**Heginbotham:** A very nice follow-up question for that is for both of you, again. Where does the U.S. fit into East Asian regional economic integration? Is it an integral part,

or simply a major external player? And what are the barriers to full integration? Let's take the first part of that one.

### **Objective of FTAs**

**Asanuma:** Let's think about it this way: we talked about FTAs, regional or bilateral, but the basic objective of an FTA is to reduce the cost of international transactions between countries which are involved in this framework.

There are other transaction costs. If you look at shipping and insurance costs, they will probably come to 10% of the value of the transaction, which is often larger than the artificially-imposed import duties, which are also costs. There are also trade facilitation costs. There are other costs involved, in terms of the infrastructure and all that of the exporting and importing countries.

When we look at these issues and then try to construct a well-functioning regional market, for example, bilateral or otherwise, then other things are involved other than just the FTAs, as well as other things which are rules of the game for trade transactions. For example, I would envisage in the region some sort of infrastructure community; it's a phrase which is not readily understandable. But then if we, for example, establish an infrastructure community which would facilitate trade transactions along—and, of course, I'm talking about the future, distant or near, when North Korea is also integrated in Asia—the Northeast corridor of China, through the Korean Peninsula and through Kyushu. Establishment of that kind of economic corridor would involve infrastructure investments for economic activities in this zone. That would then require the putting together of China, the two Koreas, and Japan in some way.

If you look at the regional integration in this way—overlapping regional institutions—then the U.S. will find itself in a too far away place. In addition to the fact that it is a global player, it is outside the region, in that sense.

**Lincoln:** I have no particular objections to this description of overlapping regional institutions. Certainly, we do that. We have global institutions, regional institutions, sub-regional institutions, bilateral arrangements, and the world will continue to operate that way. The important thing, as we go forward, is that we not end up in a world such as that envisioned some 15 years ago, where we have a European block, and an American block, and an Asian block that exist somehow in a separate relationship. We are in a global world, but if, indeed, to some extent the institutional developments can be East Asian or even sub-regional Northeast Asian, through the Korean Peninsula, then at a broader level we all remain open to one another. In that sense, the U.S. is a player, it is part of the region simply because we are an important part of the trade and investment flows that occur within that region. And there's no particular reason for governments in East Asia to want to bias themselves away from that.

**Ott:** I can't resist just interjecting the kind of thought that I'm afraid would be cynical, that a sort of strategic perspective tends to bring something like this. It's probably fair to say that for almost all of us in the room regional integration and economic institutions designed to achieve that are a good thing and are seen largely, or almost exclusively in terms of their economic benefit.

If I'm a security strategist working for the central committee in Beijing, I'll look at those same institutions quite differently. I look at them as instrumentalities of Chinese

influence and power. When we build a web of interconnections between Southeast Asia and China, the assumption has been in Southeast Asia for the last 20 years or so that that's a good thing, because it binds China to the region, it binds China to the economic status quo, it integrates China into the existing institutions, and so on.

### **Institutions May Bind Southeast Asia to China**

There's another way of looking at it. If I'm a Chinese strategist—and there's increasing evidence that the Chinese will see it this way—I see the same institutions that I initially viewed with great suspicion because they were multilateral, and they brought together all sorts of other voices that tend to interfere with China's agenda; I now begin to see China as so capable that these same institutions can be used not to bind the region together, but to bind the region to China.

**Djisman:** Whatever happens to formal integration schemes in East Asia, I think the integration of the economies between the western and east Pacific is going to continue because we live under a global production system. Let's for instance remember that in 1990, 90% of China's exports of medium and high tech products were exports of FDI companies. It's not Chinese export proper, and the same applies to us. Our export of electronic products are mainly exports of Sony Corporation, Samsung, Matsushita, etc. And for imports it's also the same thing. I think this pattern is going to continue. This is the benefit of globalization.

Point number two: the U.S. will continue to be an integral part of the equation, Japan will continue to need the United States, and I think even the role of the U.S. is deeper than just a trader. The largest producer of

science and engineering doctorate graduates is the United States and we should not forget that. That's important to the deepening of integration in the region.

Finally, I think the U.S. can run a policy that relies on deficit all the time. This is uniquely a U.S. policy, because the U.S. can follow what is called in economics and business "asset-based development." If you have a deficit, you finance that deficit with your assets, and the rest of the world is eager to have a share in your assets. We cannot do it from Southeast Asia, so perhaps the U.S. is truly unique in this relationship. Don't worry about your deficit.

**Heginbotham:** On that comforting note, I think we should quit right there. We have a couple of related questions, actually three. There are some people in the audience who are clearly concerned about being left out and so I have the following questions. First, please discuss East Asian integration with your Asia as a whole, your Asian land bridge and related projects.

And then a closely related question: given the political and diplomatic realities of Chinese diplomacy, increasingly backed by its own economic might, how could Taiwan be included more in bilateral swap arrangements or even in APEC, where both it and China are members? Won't politics trump economics?

And the third related question: how can politically-unacceptable Taiwan play its role in Southeast Asia economically? Those are all closely-related questions, and let's take volunteers. Who would like to volunteer our first shot at that?

**Lincoln:** I'll take one shot. Let me start with the Taiwan question. Indeed, we have a very major political issue because the Chinese

government consistently works to exclude Taiwan from any kind of multilateral discussions. My belief is that the broader the group, the harder it is for the Chinese government to prevail so that, for example, in the Asian Development Bank, we got both China and Taiwan into the Asian Development Bank, I think in 1989.

I'll continue with my broad conclusion, even if my facts are not correct. When you have a broad multilateral organization with a lot of other big powers like Japan, the United States, maybe the Europeans, it's a little bit easier to tell the Chinese that they can't participate unless they let the Taiwanese be in there. It gets more difficult when you're dealing with small groups. I'm a little bit unhappy that the ASEAN Plus Three Group hasn't been able to stand up and say, "We want Taiwan in there, too." Certainly, we hear both the Japanese and people from Southeast Asia from time to time saying, "We ought to include Taiwan," but somehow no one seems to be willing to really challenge the Chinese government on that issue.

**Ott:** Sort of related to that and on the question of politics trumping economics, and then I'll come to my theme about Chinese strategic ambition. I meant to actually have the quote with me and I don't. Somebody in the room may remember it. Recall very recently, Lee Hsien Loong, just prior to becoming Singapore's prime minister, made a visit to Taiwan, unofficially.

In fact, there is a history of these kinds of visits. Singapore anticipated that there would be a sort of *pro forma* objection from Beijing and that would be the end of it. Instead, to the Singaporean's surprise—and there's nobody better at reading the Chinese than the Singaporeans—they got an angry, sort of sledgehammer kind of reaction from

the Chinese, which basically boiled down to: "Singapore better remember its place and better remember how to behave properly." And it was, for people like me who watch these relationships, one of those moments when the curtain parted just a little bit and you saw something behind it.

**Heginbotham:** Dr. Djisman, could you comment on the Euro-Asian land bridge? Is that in your view of an integrated Asia?

### **Indonesia Experiencing Re-Europeanization of Strait**

**Djisman:** Not that particular question on the bridge, but I think Indonesia, in spite of the so-called strengthening integration of East Asia, has been experiencing a kind of re-Europeanization of its strait. This is perhaps unique to Indonesia among ASEAN, and we can never over-emphasize the importance of Europe to our future development. I think the rest of Southeast Asia also understands very well the importance of Europe to future development. Thailand also is very much reliant on expanding trade and investment relations with Europe.

It is good to have this kind of pluralism in our economic development. If you have Japanese investors in Indonesia, American investors and European investors, it is going to be for the benefit of all. In certain sectors, for instance, the U.S. is occupying the leading role. No one is challenging the U.S. in the oil sector of Indonesia, but when it comes to electronics, it's Japan; perhaps for certain automotives, it's Europe. So we will continue to emphasize the importance of this, what we call a triangular relationship between Europe, East Asia and the Americas, particularly the United States.

On the Taiwanese, we feel it as well. China has been getting tougher lately, but I think it

also has something to do with the internal political developments within Taiwan.

**Asanuma:** Taiwan has been quite well economically integrated in the region. No doubt not based on any sort of institutions, but on market forces. I think cross-straits economic relations have been becoming denser, and the bilateral relationships Taiwan has with Japan and other countries have been on the increase.

Taiwan is an anomaly in terms of the geopolitics of the region, and whatever regional integration we would be able to achieve based on institutions can be extended bilaterally by major economies to Taiwan. Unfortunately, Taiwan is a political anomaly and it has to live that way, but I don't know for how long. Taiwan is not even a part of international organizations like the IMF and the World Bank; the Asian Development Bank is a big exception. That situation will probably continue for the foreseeable future.

**Lincoln:** People have been talking about what a great thing it would be if we somehow had this huge pipeline of road or railroad from Europe across to Asia. I'm not sure what it would carry, but I guess the idea is that the two end points benefit, like Japan and maybe China exporting and importing with Europe. It never seems to quite happen and to be sure, I think there actually are some goods that move in that way. After all, the Cold War is over; the transportation network is there, more rail than road, I guess, but certainly it's there.

And one of the problems we're dealing with here may simply be economics. It's a lot cheaper to move something by ship from Yokohama to France than it would be to move it by ship to the Asian mainland, put it on a train, and then move it across Asia. Sea transportation is incredibly cheap, and if you

need to get something there faster, you can fly it. The cost of air transportation has dropped dramatically in the last 30 years. That leaves this rail and road link kind of stuck in between these two end points: slow and cheap, or fast and more expensive. What is left is going to move over this land bridge.

Over the years, the optimism about what could be accomplished with such a land bridge has been somewhat exaggerated. That said, what's important about it probably is the integration of the Central Asian states back both to Europe and toward China. Their economic development needs a better transportation network. They are all land locked, smallish countries, and for them to develop they need to be able to get their goods out to markets in China and Europe.

**Heginbotham:** Facetiously, one might ask if Burma is the first link in the Euro-Asian land bridge. I think that Dr. Djisman has brilliantly answered this question, but perhaps another panelist will have another take. The question is, is East Asia prepared for the emerging collapse of the U.S. dollar debt bubble? "Bring it on" may not be the entire answer.

**Asanuma:** I'm not as optimistic as Dr. Djisman about the U.S. deficit. At one point or another, adjustments will have to be made, and hopefully adjustments will be made in the manner of a soft landing, rather than a hard landing.

In the mean time, East Asian countries have to seriously consider what would be the best exchange rate regime for themselves. Sufficient attention has not been given to that issue. Each country has to think about how to go about it, and I guess the answer in many of the East Asian countries is finding out how to fix the exchange rate or create a totally free or floating exchange rate regime.

Indonesia, for example, is finding that probably the best way of managing the exchange rate would be to continue with the managed float, the dirty float. That would require enormous policy skills on the part of the central bank and the government. And increasingly, people will move towards this, not towards the Asian currency unit, or common currency, or some such thing—that would still be a pie in the sky—but increasingly towards managing one's exchange rate in such a way as to take into account the weights of various other currencies, which would be used for their trading and investment relationships.

**Heginbotham:** In the manner you described earlier, perhaps one can envisage a sort of overlapping set of agreements that gradually expands the scope of cooperation; for example, the swap arrangements and the notion of an Asian bond fund. All of these would contribute to a broadening of cooperation, while not really constituting a currency viewpoint or attitude.

**Asanuma:** I think financial integration—if one includes common currency, the common capital market, and so forth—would take a really long time to come into existence in a functional way. But at the same time, in talking about, for example, Asian monetary funds or some such thing, I, for one, do not understand that there was such an opposition to the creation of that institution.

Recently, I read Secretary Rubin's memoir, and a government finds itself in an extremely difficult position in coming up with financial assistance to other countries at a very short notice. And I would have thought that this Asian Monetary Fund is a mechanism whereby everybody pre-commits himself to providing some financial assistance at a time when one can take a long time in persuading the Congress, the Parliament and everybody

else, that for the sake of the financial security of the region and in the neighborhood, probably some taxpayers' money has to be committed in that fashion.

**Heginbotham:** Given Mr. Asanuma's call for increased reliance on regional institutions, what role do you envision for existing regional institutions, such as the Asian Development Bank? Would anyone like to comment on that?

### State of APEC

**Lincoln:** I've actually suggested that there may be ways to increase the relationship between APEC and the Asian Development Bank. First of all, remember that the Asian Development Bank has a broader scope than simply the East Asia that we've been talking about today. It includes Central Asia, for example. I have suggested that if we want to invigorate APEC, then we should do more to work on the so-called "ecotech" part of APEC which, for those of you who are not into APEC acronyms, is not about ecology.

Its meaning is economic and technical cooperation. It's essentially the development agenda for APEC, which has had a whole array of projects and issues that they've talked about, and not in a terribly well-coordinated manner. I think that APEC could do a lot if we had that agenda somewhat more focused and then used APEC to go to the Asian Development Bank to get some of the financial resources to finance ideas and projects that come out of the APEC process.

**Djisman:** Just briefly, a comment on this debate on the new architecture still going on in the division of labor between regional institutions and global institutions, particularly the IMF. Whatever comes out of this idea on Asian Monetary Fund, it's not going to be designed as an alternative to the IMF. It's

going to be complementary to the IMF. It so happens then that the crisis, the financial crisis that we have been witnessing in the last few years is increasingly enormous in magnitude. I think no regional arrangement is capable of facing it alone, so the idea is, among others, to have a kind of second line of defense, rather than a substitute for the IMF.

As to the Asian Development Bank and the World Bank, perhaps its developmental roles should be truly emphasized. We should not venture too much into, let's say, macro-economic surveillance and the like. Let's leave it to the Indonesia monetary funds or, if available, regional arrangement.

### **Opposition to Asian Monetary Fund**

**Lincoln:** Could I answer Professor Asanuma's question about why the U.S. was so opposed to this Asian Monetary Fund idea when it was put forth by the Japanese government in the fall of 1997? I think it's important to remember the context in which all of these occurred. Here was this emerging financial crisis, which at that moment in time was still perceived as being Thailand and Indonesia. And the IMF response to that was to say, "Yes, we can help." But there is heavy conditionality to IMF support and, of course, there was a very negative response as to the nature of that conditionality—as to whether it was appropriate or not, given the causes of the situation.

Right in the middle of this, the Japanese government—and, frankly, it really came down to one individual in the Japanese government in a high level post—proposed a new institution. Well, proposing a new institution in the middle of a crisis isn't very clever diplomatic thinking. And in particular, given the nature of the personality of this individual, I think there was a fairly natural

suspicion on the part of the U.S. government that this was not intended to be a cooperative venture to work with the IMF, but something to be separate from it, and something to help Asia get out from under the oppressive policies of the IMF.

Given that timing and the personalities involved—one could go on about the American personalities involved at the same time—it's not at all surprising to me that the U.S. government ended up with a very negative response, from which I think they've somewhat backed off. But the more recent discussion of this general idea—discussions in which I think the Asian side has been a lot more clear about saying, "No, we don't want a separate competitive institution, but something that would be supplementary to the IMF"—has taken the discussion a very different direction.

**Asanuma:** One word about ADB, the Asian Development Bank. Around the middle of the 1980s, I would have thought that the ADB could be managed increasingly "by the Asians, for the Asians and of the Asians." I haven't changed my mind about that. Today, on the coattails of globalization that is going on, rationalization is happening, too. The regional markets are there, the regional economic activities are there. One problem is this enormous diversity, as Dr. Lincoln mentioned. There is not only diversity, but there are all kinds of "divides" in the region, be it an IT divide, or be it different economic development stages they are at, for example.

I would have thought that the ADB's role was to come in and try to bring the late-comer members of the region up to speed so that they would be able to benefit from the globalization trend, regional market trends, and so forth—that would be Indochina and Myanmar, when Myanmar comes onto the

scene, and North Korea and other smaller and less developed economies.

**Heginbotham:** I'm going to conclude in an unusual way by asking a question that cannot be answered because we don't have time. I lodge the question because I think it's an important question and an interesting question. I'm going to elaborate it just a bit. It seems there isn't enough movement or sympathy toward Asian regional integration among the general public in Asia, but it cannot be achieved without public consensus. What kind of policy should the Asian governments take toward this problem?

I would add, one of the things that interests me about the panel today is the dog that did not bark. From an historic perspective, the leadership in East Asia toward integration

has always been with the business community and the academic community in concert, sort of pulling and tugging the political leadership along. The discussion today has sort of started out more on what the governments need to do, but really, it's hard to see any real leadership there. It seems to me the challenge for East Asia is to mobilize, focus, encourage, and maybe recreate the spirit of the 70s and 80s, when academics and business leaders around the community began a very far-reaching exploration of the issues and tried to contribute papers and to shape matters in very fruitful and constructive ways—and then they would drag the political leaders slowly and reluctantly along.

Thank you enormously for this superb panel and excellent audience questions, and a very memorable day.

## Luncheon Talk

with

### Ambassador Soemadi D.M. Brotodiningrat

**Ambassador Soemadi Brotodiningrat:** Please allow me to begin by expressing first my sincere appreciation to the Sasakawa Peace Foundation USA and USINDO for their joint initiative to organize this half-day seminar on Indonesia and Japanese economic and political relations and the implications for Southeast Asia. This is a subject that brings me back to the realm of nostalgia, since I had the privilege of being entrusted by the Indonesian government to be the man on the spot, to take care of Indonesia-Japan relations from late 1998 to early 2002.

Therefore, let me thank our host for inviting me and even for pressuring me to share with our audience my somewhat rusty recollec-

tion and audited experience, which perhaps are still relevant to this morning's excellent discussion. I have been here since the morning and I witnessed how high the quality was of the presentations and the discussion. So I am afraid that this is going to be an anti-climax to what happened this morning, because what I'm going to share with you is just a shallow recollection of experience and a loosely conceptualized empirical observation.

I served as ambassador in Tokyo in the wake of the Asian economic crisis, in the early stages of Indonesia's own political transformation. It was a seriously difficult period, yet in retrospect, what I can say about my Tokyo assignment by quoting the famous

line of President Lincoln is: “Not bad, not bad at all.” In saying this, by no means do I claim a personal success. It should rather be seen as a testimony on my part to the solidity of the root and foundation of Indonesia-Japan relations to withstand the whirlwind of crisis and transformation.

### **Indonesia and Japan Have Enjoyed Good Relationship Since Sukarno Era**

Indeed, as I once stated in Japan—and I quote myself now—“Indonesia has always enjoyed a good relationship with Japan.” Looking back at recent history, we shall find that Indonesia-Japan relations have been good since the old order under President Sukarno. They continued to be good during the new order under President Suharto, and I do not foresee any reason why this good and friendly relationship will not prevail in this era of *reformasi*. We can see the foundation of the friendship between our two countries is solidly anchored in the geo-static strategic mutual interest in their economic complementarity, and in the mature attitude of both sides not to interfere in each other’s internal affairs and not to embarrass each other in the international scene.

I have also come to pleasantly realize, after being in Japan, and still quoting myself, that “There is also a strong interest in understanding and cooperating in the cultural and social fields which represent excellent requisite for the promising development of people-to-people relationships.” Of course, this extensive multidimensional relationship between Indonesia and Japan has kept me busy, with various activities ranging from conferring medals of honor, organizing cultural performances, arranging business links and matches, to preparing for summit meetings between the leaders of the two countries—which occurred several times during my tenure.

But under the circumstances of the time, three priorities could be singled out, and these are: one, strengthening cooperation in efforts to come out of the economic crisis; two, ensuring understanding and support toward Indonesia *reformasi*; and three, helping to secure a dignified solution to the East Timor problem.

### **Importance of Japanese Cooperation During Indonesia’s Economic Crisis**

Ladies and gentlemen, the importance of Japanese cooperation in helping Indonesia directly or indirectly to come out of the economic crisis cannot be overstated. At the bottom of the crisis in 1998 when our economy suffered from a 13.2% contraction, Japan came up with food aid and humanitarian assistance to help strengthen our social safety net. Japan’s position as the largest bilateral donor in the framework of the CGI, and subsequently, its support of our quest to secure debt rescheduling did not only give us badly needed breathing space, but also helped our attempt to put our economy back on track. As important trading partners, after a year of self-decline due to the crisis, the trade volume between the two countries quickly registered a market upturn. By the year 2000 Indonesian exports to Japan increased by over 29%, while its imports from Japan increased even more substantially, reaching 54% compared to the previous year.

The drop of the value of our currency, the rupiah, also triggered the increase of Japanese tourists coming to Indonesia, surpassing 600,000 in the year 2000. Seeking a mutually satisfactory solution to the problem of financing the arrangement of unfinished big projects has not been an easy exercise. But in the end, agreements were reached amicably, the latest being the well-known case of the Chandra Asri project. None has become

a court case. Since the drop because of the crisis, I still have not seen a notable return of Japanese enthusiasm in investing anew in Indonesia. It was practically felt in Indonesia, because Japan had been our largest investor. Securing understanding from the Japanese government and public about Indonesia's *reformasi* was not too difficult a task to discuss. Being itself a democratic country, Japan did not only understand what was going on in Indonesia, but it also readily welcomed the political transformation. Japan's positive stance towards Indonesia's *reformasi* has also been consistently expressed in financial assistance to support activities inherent in the democratization process, such as the implementation of the general election.

Still, when one used to deal with the same leadership for more than three decades, following well-accepted systems and practices, radical change like the one in Indonesia did necessitate some adjustment on the part of the partner. For instance, with the empowerment of the Indonesian parliament, approaches directed solely to the executive branch no longer became effective, and suddenly, forums like the Japan-Indonesia parliamentary league became substantially more important. The LDP that used to have a close relationship with Golkar had to face the changing Indonesian political landscape, characterized by a more genuine multiparty system. Businessmen had to deal with more powerful local government, following the implementation of the decentralization policy. It was thus desirable for us to provide some facilitation in order to help such adjustment.

### **East Timor One of the Most Difficult Tasks for Indonesian Diplomacy**

Handling the East Timor issue prior to and around the time of popular consultation in

1999 was, without doubt, one of the most difficult exercises in the history of Indonesian diplomacy. Not long after my arrival in Tokyo, it became increasingly clear that the turn of events in East Timor was no longer in our favor, and rather than forcing ourselves to reverse the tide, our efforts were then redirected towards ensuring a dignified exit. In this context, one important consideration was the choice of the participants in the international task force and subsequently, the UN operation in East Timor.

Japan was undoubtedly one of the suitable authorities for us, one with whom we were comfortable to cooperate on this issue, in their willingness and their capacity to get actively involved, and yet at the same time respect and always be mindful of our sensitivity. To my knowledge, Japan never failed to consult Indonesia on every initiative and on each action it had taken in the framework of that involvement.

Ladies and gentlemen, as you may notice, the three priorities in Indonesia-Japan relations and cooperation during my ambassadorial tenure that I have just highlighted were mostly bilateral in nature. This should be understandable, considering Indonesia's predicament at the time. Domestic problems were so overwhelming that the cooperation we sought from an important partner country like Japan was mainly focused on addressing those domestic preoccupations. It is to be recalled in this context that one important initiative taken during that period was the establishment of a Japan-Indonesia advisory network, which later on was changed to become a policy-direct support team, with the main purpose of advising both governments on how best to cooperate in addressing Indonesia's problems.

It did not mean that regional matters were completely forgotten, but obviously circum-

stances pushed them temporarily to the side. It seemed that under such circumstances, consciously or unconsciously, we came back to the basics by applying our long-time belief that national resilience determines regional resilience.

All this was about to change toward the end of my term, and the reason being not only the improvement of Indonesia's domestic situation but also, in particular, a crucial international event, the 9/11 terrorist threat. From then on, regional and international issues, old and new, found their place back alongside the bilateral items in the forefront of Indonesia-Japan relations.

### **Fight Against Terrorism Brought to Forefront**

Ladies and gentlemen, it is obvious that one single international issue that has come to the forefront was the fight against terrorism. In fact, acts of terrorism were not entirely new for both countries. Japan had once known terrorism such as those conducted by the "Red Brigade" and Asahara's Aum Shinrikyo. Indonesia, too, has some experience with terrorism, but it was the 9/11 terrorist attack on the United States that, without a doubt, propelled us to fight against international terrorism at the center of the global agenda, including in our part of the world.

I still remember that Japan, as a treaty ally of the U.S., immediately stated its strong support of the United States. It would actively engage itself in the combat against terrorism—which is regarded as Japan's own security issue—and would react in concert with the United States and other countries around the world. For its part, Indonesia, through President Megawati, issued a joint statement with President Bush on the 19th of September, 2001 in Washington, DC, that condemned the 9/11 attack on the U.S., pledged

to strengthen existing cooperation in the global effort to combat international terrorism, and underlined the importance of differentiating between the religion of Islam and the act of violent extremists.

Terrorism has been dealt with more seriously since Indonesia became itself a direct victim of terrorism with the Bali bombing. Since then, Indonesia and Japan have been cooperating in the fight against terrorism at all levels. At the bilateral level, Japan assisted Indonesia in capacity-building by training and sending equipment and experts to the Indonesian police.

At the regional level, apart from cooperating on the framework of ASEAN, Japan is also an active participant in the Indonesia-Australia sponsored Bali ministerial process on counter-terrorism. On the occasion of President Megawati's state visit to Japan in June 2003, the two governments signed a joint announcement on fighting against international terrorism. Due to the nature of the problem and the vulnerability of Southeast Asia to terrorism, it is expected that the fight against terrorism will be a long-term cooperation.

Close to the issue of terrorism is the problem of piracy and sea robbery, which was a long-standing concern of Japan, even during my tenure in Tokyo. Already, in November 1999, the late Prime Minister Obuchi proposed a regional conference on combating piracy and armed robbery on ships, which would take place in April of 2000. This initiative was then followed up by then Prime Minister Mori, by holding the Asian Cooperation Conference on combating piracy and armed robbery in October, 2001. Those two conferences managed to share information and analysis on piracy in Asia to introduce counter-measures taken by each participant

and to discuss medium and longer-term regional cooperation frameworks.

### **Involvement of Indonesia Against Piracy and Sea Robbery**

In view of its geographic set-up and because of the location of frequent incidents, the involvement of Indonesia in the combat against piracy and sea robbery became crucially important. Even though this issue managed to assert itself into the regional agenda, the progress for cooperation to address it has been influenced by several factors, such as Japan's constitutional constraint on providing assistance considered to be of a military nature or to military institutions, and also the steadfast position of countries like Indonesia—that any cooperation of this kind covering territorial waters in the Malaccas Strait should not compromise their status and other relevant provisions under the UN Convention on the law of the sea. Subsequent efforts to institutionalize cooperation to combat piracy through the establishment of an information-sharing center were still hampered by the lack of agreement on its venue.

Lately, the piracy issue with the Malaccas Strait status overtone has been further compounded by a new initiative taken out of concern over unchecked proliferation of weapons of mass destruction, especially nuclear weapons. This brings me to the next point.

The sole commitment of both Indonesia and Japan not to become nuclear weapon states is unquestionable: Japan, by virtue of its constitutional mandate, and Indonesia, by demonstrating a consistent track record, both at the global level and at the regional level, as the main initiator of the Southeast Asia nuclear weapon-free zone. In this context, the two countries have always been coop-

erating very closely, particularly recently, where the international community is preparing for the 2005 preview conference of the non-proliferation treaty.

### **Japan and Indonesia's Cooperation on Nuclear Weapons Initiatives**

Indonesia is privileged to chair the preparatory committee and Japan is very supportive towards Indonesia in this role. To help facilitate the work of the preparatory committee, the two countries jointly organized a workshop last March in Jakarta. Both countries attach importance to the strengthening of the NPC through the consistent application of the comprehensive test ban treaty or CTBT, and the speedy implementation of the Fissile Material Cut-Off Treaty (FMCT). For its part, Indonesia wants to see a more serious fulfillment of the responsibility and obligations of the nuclear states under the NPT.

In the mean time, the United States has recently spearheaded the launching of the more narrowly-focused proliferation security initiative (PSI) to prevent the transfer of nuclear hardware or capability into the hands of the terrorists. Japan immediately became a core member of the initiative. As for Indonesia, while not *a priori* opposing the initiative, it is still weighing its position by studying the consistency between the PSI and the MPT, as well as other relevant multilateral conventions. In any event, Indonesia hopes that the PSI will not unduly divert the attention of the international community away from the 2005 review conference of the non-proliferation treaty.

Speaking about nuclear weapons in the context of Indonesia-Japan relations, one cannot keep from touching upon the North Korean nuclear issue that very recently has been further compounded by the over-curiosity of some South Korean nuclear scientists. Here

again, Indonesia and Japan have the same position on the de-nuclearization of the Korean Peninsula. In the framework of past efforts, both countries were participants of the KEDO project.

With the current aggravation of the problem, both countries are in favor of seeking a peaceful solution. Japan is, of course, participant of the current six-party talks, while Indonesia, although not included, does not just stay as a passive observer; with the good relationship it maintains with North Korea, Indonesia stands ready to be useful in every way it can to advance the talks. Indonesia is also among members who consider the ASEAN Regional Forum or ARF, as a useful supplementary forum to help facilitate the sought-for solutions to the North Korea nuclear problem. Lately, related to a more specific twist of this problem, Indonesia has had to be involved in the sensitive case of a family reunion between Hitomi Soga and her husband Charles Jenkins.

### **Realignment Shaped Region in Past Ten Years**

Ladies and gentlemen, the last point that I would like to make is about the realignment that has been shaping the region during the past ten years. First, and certainly the most important for us was the enlargement of ASEAN. Between 1995 and 1999, four new members joined in, making ASEAN identical with the geography of Southeast Asia. This enlargement was a fulfillment of ASEAN founding fathers' idea, and no doubt in the long run it will make ASEAN stronger politically and economically.

But in the short run, the different levels of economic development and diverse political orientation among the enlarged membership may extract a cost in terms of ASEAN cohesion. For Japan, this membership enlarge-

ment should have been a positive development in its partnership with ASEAN. For its part, a large ASEAN needed enhanced cooperation with Japan to help deal with some problems of cohesion, such as to narrow the developmental gap among ASEAN members.

Another development in the region—as was discussed much this morning—is the remarkable rise of China as a regional power. From outside the region, many tend to view this development as a zero sum game, to the detriment of neighboring countries, particularly the Southeast Asians. Conversely, countries in the region tend to believe that this development could be directed towards a positive nature. As also said this morning, trade volume between China and most of the neighboring countries keeps increasing both ways. And it reflects the determined efforts of both sides to sustain and capitalize the positive development that ASEAN and China have decided to have a free trade agreement. There are many views and analyses about Japan's reaction to this development. We discussed it this morning, so I shall refrain myself from adding confusion to it.

On the other hand, I shall wrap up my observation on this regional realignment with the development of the ASEAN Plus Three. As you may recall, Asian Plus Three started in December, 1997 in Kuala Lumpur as a leaders' forum among ASEAN plus China, Japan and South Korea for policy coordination in confronting the ASEAN financial crisis. It was established out of the disappointment of the ASEAN members over the reluctance and inability of APEC to deal with the crisis of a financial nature. It was also a reaction to the U.S. opposition to the creation of the Asian Monetary Fund. As such, the first products of ASEAN Plus Three were all in the financial area—the Chang Mai initiative and also the Asian bond market initiative. Subse-

quently, cooperation within this framework has progressed and diversified and again proven to be effective in confronting the common threat of the SARS epidemic.

Japan seemed to show a growing interest in the development of ASEAN Plus Three, in part as a way to help pull itself from what it felt as a lost decade, and in part as a means to address the China factor in a positive way. And for China, its role in contributing to the development of ASEAN Plus Three, towards a more concrete cooperation scheme, was facilitated by its entrance to the WTO, with all the necessary adjustments that it had to make. With all this encouraging progress during the last summit in Bali in October last year, some members suggested that ASEAN Plus Three could be further developed into a more integrative East Asian community.

As a main initiator, ASEAN as a whole, in principle, supports the further development of ASEAN Plus Three toward a more integrated East Asian community. The question that has currently arose, as discussed this morning, is whether the component of that community will be ASEAN Ten plus Japan, China and South Korea, or ASEAN Ten plus Northeast Asian or East and Southeast Asian Thirteen. For the moment, it seems that the appropriate answer to that question is still being subject to careful consideration, to borrow the jargon of practitioners like me.

Those are catalogues of some old problems, as I knew them then, and some new issues that I see now that I would like to share with you today; the list is by no means exhaustive. But limited and selective as it may be, I find it solid enough to support my conclusion that even, or precisely with the current shift of substantive priorities and the ongoing realignment of the Asian regional configuration, cooperation and partnership be-

tween Indonesia and Japan will remain, if not become even more essential, be it in the interest of each and both countries, as well as for the good of the whole Asian region. Thank you very much.

## Q&A

**Ambassador Alphonse La Porta** (moderator): Thank you, Excellency. I think we have some time for some comments and questions. We also may have some follow-up on some of the points that were not addressed, but why don't we see if they have any questions.

**Questioner:** Thank you very much, Ambassador, for an excellent survey of this very important relationship. I wonder if, on the security side, you could elaborate a little more on what role you might see Japan playing in the region? I have in mind the very strong, very negative reaction from several of the ASEAN countries about a statement by a U.S. admiral that the United States would play some role in security in the Malaccas Straits. Would you see Japan perhaps playing some such role, or how would you see it fitting into this important issue?

**Ambassador Soemadi:** You know better than I do that security is always a very dilemmatic problem for Japan because of its constitution, but we expect that Japan will play a larger role. I don't know how they could address that domestic problem, but, for instance, the rigidity in which Japan's assistance could be implemented is really an obstacle for cooperation like this.

For instance, Japan would like very much in the context of the fight against piracy to assist Indonesia in the development of a coast guard, but it's stuck, because a coast guard is still in the realm of the armed forces, where Japan cannot do anything if this

is institutionally stated in the realm of the armed forces. This kind of thing creates a problem. But certainly, for instance, as I said in my presentation, we had an experience where Japan played a very positive role in the case of East Timor, because they know very well our sensitivity, so we can cooperate more comfortably with Japan on that score. I hope this experience with cooperation, with Japan taking into account the sensitivities, can also be translated into cooperation in the fight against terrorism. We hope that the Japan who showed understanding during the East Timor issue can also show the same understanding in the sensitivity related to the fight against terrorism, for instance.

On the question of the Malaccas Strait, apart from the problem they are still facing on the creation of a coast guard, for instance, perhaps our Japanese colleagues can seek an answer on how Japan can increase their assistance to the smaller states without violating their constitution, because what we need, for instance, is hardware assistance from Japan. But they are still being constrained by their constitutional problems.

**Questioner:** Ambassador, did I hear you say correctly that Indonesia can contribute to resolving the Korean Peninsula issues? Could you elaborate on those particular steps as to how Indonesia can get involved in the North Korean nuclear issues?

**Ambassador Soemadi:** We don't pretend to solve the problem per se, but because of our good relationship with North Korea, and especially the chemistry between the leadership of the two countries, we can help in creating a more conducive atmosphere for the North Koreans to be more forthcoming on the six-party talks, for instance. What I said is that we don't pretend to contribute in addressing the problem per se, because we are

not even included in the talk. But because of our good relationship with North Korea, we can help create a more conducive atmosphere toward the advancement of the talks and solving the problem.

**Questioner:** Mr. Ambassador, the Chinese have been investing in Indonesia and other countries in Southeast Asia on far more favorable terms than are demanded by Japan and the United States, in terms of using local resources, and in terms of trade, use of local currencies, and so forth. What is your reading on whether or not Japan and the United States may learn from that approach, rather than the more onerous ones that they are demanding now for FDI?

**Ambassador Soemadi:** Japan and the United States are much longer investors in our part of the world, including Indonesia and, to be honest, I fail to understand how Japan and the United States will learn from China, as far as investment in our part of the world is concerned. Of course China, being a new entrant in the investment business there, is perhaps trying to show more favorable terms, but in the end investment is also like trade: competition will prevail. So if China is really competitive in the investment market, then I think by then old investors like the United States and Japan will learn from China. I think it's too soon to say now whether there is a need for old, more experienced investors like Japan and the United States to learn from an early-stage investor like China.

**Ambassador La Porta:** I would like to say, on behalf of all of us at USINDO, that it's been a very privileged opportunity to cooperate with the Sasakawa Peace Foundation USA. And I would also like to thank His Excellency, Ambassador Soemadi, and all of his wonderful folks at the Embassy for their cooperation on this and many other

programs. I would also like to thank, in particular, Erland Heginbotham and our panelists, for a very interesting discussion.

I was very interested, on a personal basis, to see how the discussion shifted very rapidly to a discussion of the relative merits and implications for Asian regional institutions, and I suspect that we can all take away that message as being the pointer for the future.

I would also like to say that—again, a personal observation—I was in Jakarta until early last week. I left before the bombing, but then I went to Singapore and I attended the first day of an Institute of Southeast Asian Studies seminar that was actually on Malaysia's relations with the region. It was very interesting to observe from the speakers how much they talked about Indonesia's role in the region, and the sum of those discuss-

ions was whether Indonesia, under a new administration—or after the election on September 20<sup>th</sup> and the formation of a new government and parliament—would resume an active leadership role, not only in ASEAN, but also in the ARF and in other regional institutions.

So, I guess that is probably the question mark. We have a pointer toward the Asian regional institutions; we have a question mark as to Indonesia's role. And I think that only time will tell. On that basis, I would again like to thank Ambassador Soemadi for his remarks. I thank you also for broadening the discussion into a number of areas that we did not put on the table in the earlier panel, but nevertheless are very important. Thank you very much.

[END]

## About the Panelists

### Main Speakers

**Mr. Asanuma Shinji** is Professor and Director of the Asian Public Policy Program, Graduate School of International Corporate Strategy at Hitotsubashi University. Previously, he was Director of Budget and Planning and Country Director, Asia I Department at the World Bank. He has also been an investment banker with Kuhn Loeb & Co. and the head of S.G. Warburg's Tokyo Office. Mr. Asanuma received his bachelor's degree in economics from Hitotsubashi University. His publications include "International Development Assistance" in *Toyo Keizai Shinposha* (1974), and articles on Asian economics and international development assistance.

**Dr. Ed Lincoln** is a Senior Fellow for Asia and Economic Studies at the Council on Foreign Relations. An expert on the Japanese economy and U.S. economic relations with Japan and Asia, he has worked at the Brookings Institution and the American Embassy in Tokyo as a Special Economic Advisor to Ambassador Walter Mondale. A frequent public speaker and television commentator, Dr. Lincoln writes a regular column for *Newsweek Japan*, and his articles have appeared in *Foreign Affairs*, *Nihon Keizai Shimbun*, *The Brookings Review*, and elsewhere. He received his B.A. from Amherst College and his M.A. and Ph.D. from Yale University. Dr. Lincoln is the author of *Arthritic Japan: the Slow Pace of Economic Reform* (2001) and several other books, as well as a project director of the Council-sponsored Independent Task Force on Japan.

**Dr. Djisman S. Simandjuntak** is the Chairman for the Board of Trustees for the Center for Strategic and International Studies (CSIS) Jakarta and the Executive Director for the Graduate School of Management, Prasetiya Mulya in Jakarta. A member of the Indonesian National Research Council, Dr. Simandjuntak is active in the Trade Policy Forum of the Pacific Economic Cooperation Council (PECC). He also teaches economics at University of Indonesia and the Atma Jaya University in Jogjakarta. Dr. Simandjuntak received his bachelor's degree in business economics from the Catholic University of Parahyangan in Bandung. He received his masters in monetary economics and public finance, as well as his Ph.D. in trade economics from the University of Cologne, Germany.

**Dr. Marvin Ott** is Professor of National Security Policy, National War College and Faculty Fellow at the Institute for National and Strategic Studies, National Defense University. Dr. Ott has held a number of professional positions before coming to the National War College, including adjunct professor at Johns Hopkins and American University, senior East Asia analyst at the CIA, chairperson for Southeast Asia at the Foreign Service Institute (U.S. State Department), and most recently as Deputy Staff Director of the Senate Select Committee on Intelligence. He holds an M.A. and Ph.D. from the School of Advanced International Studies of The Johns Hopkins University.

### Moderator

**Mr. Erland Heginbotham** is currently Professor of Asian Economic Development at the Johns Hopkins University, School of Advanced International Studies (SAIS). An East Asian economics specialist, he also teaches at the National Foreign Affairs Training Center (Foreign Service Institute) in Arlington, Virginia. A retired diplomat from the U.S. Foreign Service, he has served at several Ameri-

can embassies in Indonesia, Vietnam, Liberia and Korea. He is also a former Deputy Assistant Secretary of State for East Asia and the first Director-General of the U.S. Foreign Commercial Service. Mr. Heginbotham founded Gateway Japan, a print and on-line clearinghouse of information on Japan and Northeast Asia, co-sponsored by the National Policy Association and the University of Maryland. He has authored several books and numerous articles on East Asia. His country specialties are China, Japan, Korea, Indonesia and Vietnam. He is presently engaged in writing a book on *Asian Economic Development and Dynamics*.

**Luncheon Speaker** **Ambassador Soemadi D.M. Brotodiningrat** is the Ambassador of the Republic of Indonesia to the United States. He has had a distinguished career with the Department of Foreign Affairs since 1965. He has also been Ambassador to Japan and to the Federated States of Micronesia. Ambassador Brotodiningrat's previous positions include Director General for Foreign Economic Relations, Department of Foreign Affairs, Ambassador Extraordinary and Plenipotentiary, Permanent Representative of the Republic of Indonesia to the United Nations and other International Organizations in Geneva, Switzerland, and Minister Counselor, Indonesian Permanent Mission to the United Nations in New York. He received his bachelor's degree from Gajah Mada University, Indonesia, and a graduate diploma in diplomacy from the Institute International d'Administration Publique, France.

**Moderator** **Ambassador Alphonse F. La Porta** is President of USINDO. Previously, he was the political advisor to the U.S. Commander-in-Chief of the Regional Headquarters Allied Forces in Southern Europe in 2000-2003. He served as U.S. Ambassador to Mongolia in 1997-2000. Ambassador La Porta retired from the U.S. Foreign Service in 2003 after 38 years of service. He also served in Indonesia from 1967-1970 and 1978-1981, as well as Malaysia, Turkey, and New Zealand. He was President and Vice President of the American Foreign Service Association in 1995-1997. Ambassador La Porta is a graduate of the National War College, Georgetown University and New York University.

# Changing Economic Relations in Asia: Agenda for Indonesia and Japan

Shinji Asanuma  
Hitotsubashi University

*SPUSA/USINDO Seminar  
September 13, 2004, Washington, D.C.*



# Changing East Asia in Perspective

- East Asian Miracle
  - Role of U.S. and Japanese market expansion and FDIs as a driver of the Miracle
  - Indonesian development records
- East Asian Crisis
  - Volatility of international capital flows, and instability inherent in the international financial architecture
  - Vulnerabilities in Asia's institutional make-up
  - Indonesia's vulnerabilities
- Japan's Lost Decade and Half

# New Environment in Asia

- Negative Legacy of Asian Crisis
  - Build-up of national debt and dysfunctional financial sector
  - Regime change in Indonesia, and diffusion of power (three branches of government, central-local government relationship, coalition government)
- Weakened Role of U.S. and Japanese Markets
  - As growth engine and the *lead goose in the geese flying pattern of industrialization*
  - Fiercer competition in U.S. markets
- Emergence of China and India
  - As trading partners: *plus* factor for East Asia
  - As competitor for market, capital and technology
- Mega-trend of Globalization

# Strategic Agenda for East Asia

- Different policy issues, and common goals
  - Growth acceleration, employment generation and (poverty reduction)
  - Indonesia: Unemployment should not be let to become a social problem and setback to poverty reduction
  - Japan: Getting out of structural recession and not becoming a drag on Asia
- Can we construct well-functioning market economies, well-integrated regionally and internationally?

# Economic Integration in Asia

- From the Geese Flying Pattern (i.e. Hub-and-spokes Relations) to Multi-polar Relations
  - U.S. and Japan vs. China and India
  - Market-led integration to institution-based integration
  - Institutional framework and rules-based relations, i.e. FTAs, WTO accession: Competition as disturbance factor
  - Robust market institutions: to avoid uncertainty, volatility and unpredictability
- Key Factor in Economic Integration: Transaction Costs and Their Volatilities
  - Important supporting role of government: regulatory framework, institution building, governance structure and infrastructure

# Japanese Initiatives for Asian EPAs

Singapore	Concluded
Korea	Negotiating for 2005 conclusion
Thailand	Negotiating for 2004 conclusion
Philippines	Negotiating for 2004 conclusion
Malaysia	Negotiating for 2004 conclusion
ASEAN	Preliminary negotiations for 2012 conclusion
India	Preliminary negotiations to start in 2005

# Constraints and Reform Needs

- Reform Needs: Enabling Conditions for Creating Well-Functioning Regional Markets
  - Trade, Investment, Finance and Labor
  - Indonesia: Improved investment climate, rules of law, and infrastructure
  - Japan: Agriculture, immigration policy
  - EPA: also Infrastructure Community?
  - Japan's ODA strategy for Indonesia: Growth, investment, and employment

Mr. Asanuma Shinji - Slides

# Conclusion

- Common agenda for all East Asian countries
  - Build up well-functioning market economies, well-integrated regionally and internationally
  - Institution-based economic integration: regional institutions
  - Reform needs to create enabling conditions for economic integration

**JAPAN-ASEAN  
TRADE RELATIONS AND  
FREE TRADE AGREEMENTS  
(FTAs)**

**ASEAN-JAPAN  
GOOD RELATIONS**

**HIGHLY BENEFICIAL  
TO BOTH SIDES**

**TRADE IN GOODS AND SERVICES  
ACCORDING TO  
DYNAMIC COMPARATIVE ADVANTAGES**

**LONG HISTORY OF A STRONG  
FDI PRESENCE OF JAPAN**

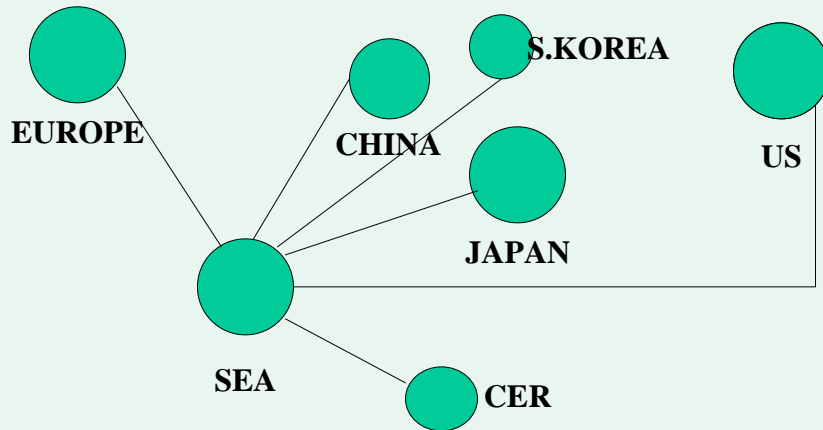
**JAPAN IS LARGEST SOURCE OF  
OFFICIAL CAPITAL TO SEA AND IS A  
DEPENDABLE PARTNER IN TIME OF CRISES**

**THE EAST ASIAN DREAM**

**SEEN FROM CURRENT AND  
HISTORICAL FLOWS SEA IS NOT  
AN OPTIMAL REGION, NOR IS JAPAN  
ALONE**

**THE OPTIMAL REGION SEEMS  
TO BE EAST ASIA =  
SEA + NEA (INCLUDING TAIWAN  
AND HONG KONG) AND  
AUSTRALIA AND NEW ZEALAND**

## LINKS TO THE ROW



## PERCEIVED PROBLEMS

**JAPAN'S AGRICULTURAL  
PROTECTION**

**RESTRICTIVE POLICIES  
ON TECHNOLOGY TRANSFER  
ON THE SIDE OF JAPANESE TNCs**

**JAPAN'S VIRTUALLY PROHIBITIVE  
BARRIERS TO LABOR MOVEMENT**

**LATENT RESENTMENT AGAINST  
JAPAN AMONG SOME SOUTHEAST ASIANS**

**PUNCTUATED CHANGES  
AFFECTING JAPAN-ASEAN  
RELATIONS**

**THE RISE OF CHINA**

**DEEPENING GLOBALIZATION:  
PHASE TWO**

**PERCEIVED INERTIA  
IN MULTILATERAL TRADE  
NEGOTIATIONS/WTO**

**PROLIFERATION OF  
RTAs, INCLUDING “SUPER-REGIONS”:  
EUROPE, THE AMERICAS**

**CLARIFICATIONS**

**TRADITIONAL FTA: FREEDOM OF GOODS  
TO MOVE AMONG MEMBERS, BUT NATIONAL  
POLICIES TOWARD ROW**

**HYBREED FTA: GOODS,  
SERVICES, INVESTMENTS, IPRs,  
LABOR MOVEMENT**

**CUSTOMS UNION:  
FTA + CX TRADE POLICY**

**ECONOMIC COMMUNITY:  
CU + FREE MOVEMENT OF FACTORS**

**ECONOMIC UNION:  
EC. COMMUNITY + MACRO COORDINATION**

**ASEAN-JAPAN  
COMPREHENSIVE  
ECONOMIC PARTNERSHIP**

**ARCHITECTURE IS YET TO BE DRAWN:  
TO BE NEGOTIATED BY 2005**

**ISSUE COVERAGE:  
FTA IN GOODS AND SERVICES, INVESTMENT AREA,  
TRADE AND INVESTMENT FACILITATION,  
LABOR MOVEMENT, KNOWLEDGE AND  
SKILL FORMATION, DEVELOPMENT  
COOPERATION**

**GOAL:  
EAST ASIAN COMMUNITY?**

**SINGAPORE- JAPAN FTA IS NOT  
A GOOD MODEL BECAUSE OF THE LACK  
OF AGRICULTURE IN SINGAPORE, LACK OF  
SERIOUS OBSTACLES TO TRADE IN  
SINGAPORE, AND SMALL DISTANCE  
BETWEEN THE TWO ECONOMIES**

**IMMEDIATE  
STATIC IMPACTS  
ARE VERY LIKELY TO  
BE LIMITED**

**GRAVITY  
RAISED**

**AJCEP OF A DEEP TYPE  
WOULD INCREASE THE “MASS”  
OF THE REGION AND  
ATTRACT STRONGER  
INTEREST AMONG TRADERS  
AND INVESTORS**

**IMPACTS ?**

**FURTHER CONSOLIDATION  
OF INVESTMENT IN THE  
REGION**

**DISCOVERY OF NEW  
SOURCES OF GROWTH**

**FORMATION OF TRUST AS  
BASIS FOR NON-ZEROs**

**“RECOMBINATION” OF MEMES**

**IMPACTS?**

**AJCEP TREATMENT  
VERSUS MFN**

**INITIAL CONDITIONS  
IN THE INTEGRATING REGION**

**REACTIONS OF  
THE ROW**

**FUTURE DEVELOPMENTS  
IN THE WORLD ECONOMY**

## **MARGIN OF PREFERENCES**

**APPLIED RATES OF TARIFF  
GENERALLY VERY LOW THANKS TO  
MTN AND UNILATERAL INITIATIVES**

**FEW IMPORTANT EXCEPTIONS  
OF SENSITIVE SECTORS**

**ROOM FOR SUBSTANTIAL MARGIN  
IN TRADE IN SERVICES**

**ENORMOUS SPACE  
FOR FUNCTIONAL COOPERATION**

## **TAIL WIND**

**GROWING ECONOMIES AND  
ATTRACTIVENESS**

**DIFFERENT ENDOWMENTS WITH  
NATURAL RESOURCES, POPULATION,  
ACCUMULATED KNOWLEDGE AND SKILLS,  
DIFFERENT POSITIONS ON THE  
DEVELOPMENT LADDER**

**MARKET-DRIVEN DEEPENING  
OF ECONOMIC INTEGRATION IN EAST ASIA:  
GLOBAL PRODUCTION SYSTEM**

**BUSINESS-FRIENDLY POLICIES  
AND PRAGMATISM**

## **HEAD WIND**

**POLITICAL DISTANCE BETWEEN  
MEMBERS**

**DEBRIS OF THE FINANCIAL CRISIS  
OF 1997/1998**

**TAINTED REPUTATION:  
TERRORISM, DICTATORSHIP**

**LIMITED INVENTIVE CAPACITY**

**LACK OF A SHARED DREAM  
AMIDST HIGH DIVERSITY OF NATURE  
AND CULTURAL HERITAGE**

## **FUTURE OF EAST ASIAN INTEGRATION**

**EA = SEA + NEA + CER**

**ISSUES OF  
LEADERSHIP**

**PEOPLE TO PEOPLE  
RELATIONSHIP**

**PRE-COMMITMENT  
TO A GOAL**

**SUPPORT FROM THE ROW**