

EXECUTIVE SUMMARY AND POLICY RECOMMENDATIONS

I. New challenges

1. Over the past two decades, East Asia has become a growing force in global production, trade, investment and finance. And the region will become the biggest stakeholder in an open trading system, a stable financial system, and a sustainable environment. However, to realize the Asian Century scenario, the region must tackle daunting policy, institutional and governance challenges. The Asian Century is complicated by the less benign global economic environment, and domestic economic, political and social constraints. The global environment holds trade imbalances, threats of protectionism and the need to rebalance away from export-led growth towards domestic and regional demand; there are international financial instability and volatility; and there is increasing concern over food and energy security, climate change and environmental deterioration and lack of sustainability. On the domestic front, East Asia is confronted with growing economic, political and social constraints that could lead to the ‘middle income trap’, to and political-social instabilities. Unless the constraints are resolved, the Asian Century will not materialize, and large parts of East Asia will remain low and middle income economies. Nonetheless, East Asia has already become a global economic and financial power to be reckoned with. In particular, it has the opportunity to play a larger role in international economic and financial institutions such as the WTO, IMF, World Bank and G20. East Asia has to bear in mind its increased responsibility to act as a cooperative global power so that its continuing prosperity would not be a threat to the rest of the world but would facilitate global growth, stability and prosperity.

2. The export-oriented development strategy in East Asia has been the most successful model of development since World War II, and even in a longer term. It has been accomplished against the background of an open global economy, and in particular of economic globalization. Following the recent global financial crisis, the implementation conditions for an export oriented strategy in East Asia have greatly changed, including a decline in demand from the U.S. and Europe, weak external demand brought about by a prolonged slump in their economic growth, and pressure for readjustments and changes of the global economic balance. However, these will neither reverse the entire trend of globalization of market economy development, nor rule out the rational choice of international trade. China's restructuring and upgrading of its trade strategy are the most important part of the export-oriented strategy adjustment in East Asia at the moment and for the foreseeable future. In meeting the new challenges, East Asia should unequivocally support globalization, oppose trade protectionism and promote the economic recovery process. East Asia is both a global dynamic production and processing base and the world's largest potential market. The regional integration process can tap an enormous internal market potential in East Asia, making up for the lack of external demand. It can also improve the export competitiveness of East Asia and stabilize the foundation of the export strategy.

3. The developing economies of Asia are confronted by serious environmental problems that threaten to undermine future growth, food security, and regional stability. They certainly will not be solved by growth, nor will "rebalancing" or moving to a "green growth" paradigm an easy fix. Seven general principles may be useful across the board: a focus on co-benefits; an emphasis on stakeholder participation; a commitment to scientific research; an emphasis on long-term planning; pricing and broader economic reform; tackling corruption, in addition to generally bolstering institutional capacity with regard to environmental regulation;

and a strengthening of regional approaches and international support. It is clear that the current trajectory of environmental degradation in Asia is unsustainable. Policy makers around the region acknowledge the importance of environmentally sustainable growth and are already acting, but much more will need to be done. Neither the region nor the globe can afford Asia as a whole to retain any vestiges of a “development first-environment later” mindset. Asia’s diverse environmental problems share the characteristic of being “wicked”. That is, they are dynamic and complex, they encompass many issues and stakeholders, and they evade straightforward, lasting solutions. Tackling environmental problems in Asia requires sustained regional cooperation, strong implementation capacity, and the ability to tackle domestic vested interests and compensate affected parties. All of these present serious challenges to even the best-intentioned government.

4. The big challenge facing many countries today is the growing imbalance between economic development and social development, which causes the potential conflict and social crisis, hampering development. Despite their economic achievements, socio-economic disparities still exist in ASEAN countries. The challenge facing ASEAN countries is how to sustain rapid economic growth that reduces poverty and is socially inclusive. Import demand from outside the region is not likely to play the buoyant role as it did in the past decade. The region will have to identify new drivers for growth, to compensate for the anticipated reduction in demand from traditional export markets. Each country will have to address its own specific needs and constraints and exploit opportunities for strengthening growth and achieving its Millennium Development Goals. In order to become more resilient, they need to spend more on basic social services, social protection and basic infrastructure, as well as measures to boost the income of the poor. It is crucial to promote intraregional trade and investment flows that benefit the landlocked developing countries. Social imbalances are pervasive in many countries in the region, where

large majorities of the people live under the poverty line. Reducing poverty and ensuring an equitable sharing of economic prosperity thus constitute important agenda for mitigating social imbalances in these countries. The limited availability of infrastructure constrains the contribution that infrastructure can make to economic growth. Closing the infrastructure gaps in these countries is therefore a necessary condition for their balanced and inclusive development. The resource requirements for bridging or even narrowing the infrastructure gaps are substantial, and appropriate financing mechanisms are therefore needed. ASEAN member countries need to become more regionally integrated in order to generate rapid inclusive and sustainable growth. To boost regional economic integration, they need to address a wide spectrum of constraints in institutional and physical infrastructure, as well as in their policy agenda. This requires concerted actions for the evolution of a broader framework for economic integration, at the regional level, to ensure equitable economic and social benefits for all countries, the development of regional transportation networks, and the improvement of trade facilitation and strengthening of connectivity through wider use of information and communications technologies.

II. New Strategy and Policy

5. China has achieved rapid economic growth since the introduction of reform and the opening up of the economy. However, many factors that supported China's growth in the past three decades are about to change. The global financial crisis and the EU sovereign debt crisis harbingered huge changes in China's external demand environment and inevitably led to a slowdown of China's exports. Domestically, conditions for development will also experience a fundamental change. Many factors that supported past high growth, such as export growth, abundant and cheap labor and capital supply will no longer exist. And China's growth is increasingly constrained by rising social and environment tensions. Faced with new challenges, China needs to search for a new approach for development. The key components of

the new approach may include: a coordinated social and economic development strategy, an innovation-centered industrial restructuring strategy, a consumption-centered domestic growth strategy, a resource and environmentally sustainable strategy, and a balanced external economic strategy. To turn to the new approach, China needs to push reform further in key areas. Among other things, the role of government and the way government runs the economy should be reformed; the new round of liberalization of land and financial markets should be pursued; further state-owned enterprise (SOE) reform is also needed.

6. India has emerged as a high-performing economy with a vibrant external sector and a rapidly expanding domestic sector. There are, however, many issues which need to be examined. Is the present development paradigm inclined towards export-led growth or domestic demand-led growth? India has entered into the group of middle income countries, and some of the advantages, which India used to enjoy earlier as a low income country, are likely gradually to be lost. This amounts to loss of comparative advantage in both domestic production and export sectors. India retains, however, export competitiveness in a large number of sectors of the world economy. It will continue to rely on an export-led growth strategy as long as it has not fully exhausted its global competitiveness. India will continue to focus on the simultaneous use of the key policies of domestic demand-led growth, as well as export-led growth to shape its development strategy in the long run. This policy mix would contribute to the integration of the Indian economy with the East Asia Summit framework.

7. To realize the idea of inclusive development, both Indonesia and ASEAN as a whole now are facing a new challenge, or have a new role to play, namely to promote rapid and sustainable economic growth with high quality: growth which is environmentally friendly and generates equal opportunities for all individuals in

member countries. The success of economic development in Indonesia has already shown itself in a large number of achievements in past years, but needs to be maintained and further developed. Indonesia must improve the welfare of its people, enhance the justice sector, apply better governance, raise the quality of democracy and improve the maintenance of national unity and security. In increasing regional economic cooperation, the role of ASEAN in realizing inclusive development is to increase welfare for all members of communities in member countries, not just to expand trade and investment activities and to achieve higher rates of national economic growth.

8. Thailand is now facing many challenges. The first is to ensure that future growth will not be too low compared to its past performance. Specifically, the country needs to escape from the middle-income trap, in which it seems already to have been struggling for more than a decade. One of the causes of this recent slow economic growth is the country's low resilience to economic crises, both home-grown and imported. On the social front the country does quite well in many areas and can claim to have achieved a satisfactory level of economic-social development balance. These areas include the alleviation of poverty, basic and advanced health-care and basic education. There are, however, some social areas showing significant development delay. Economic and social inequality stands as a top priority problem for the country. Environmental sustainability is also problematic. The quality of human capital is also lagging, as indicated by the low performance of the education system and labor skills. The three fundamental problems hindering the development of a more balanced society in Thailand (human development, unequal society, and environmental challenges) can only be overcome with strong institutions, as they are problems that cannot be entirely dealt with by using market mechanisms. However, to realize its potential the country needs strong economic and social institutions that would steer the politicians to a more balanced, productive and sustainable path of

future economic and social development.

9. To achieve more inclusive growth and sustainable development, and narrow the development divide in ASEAN and East Asia, the CLMVs, their private sectors and development partners must focus on: hard and soft infrastructure for connectivity; economic diversification and private sector development; agricultural development, diversification and productivity; trade, transport and investment facilitation; regional integration and the capacity to implement domestic policy for the cross-border movement of goods, services and people, particularly education and skills development responsive to the labor market; institutional strengthening and governance; aid effectiveness and graduation from aid dependency. CLMVs need to focus on the following reform policies for regional economic convergence and cohesion; human capital formation; a conducive investment climate and sound macroeconomic fundamentals; distribution of land ownership and mitigation of asset inequality. The strategic coordination of GMS, ASEAN and ASEAN+3 regional integration initiatives is imperative for the CLMVs, with better coordination, resourcing, investment in long term reform and institutional capacity building in transport, connectivity, trade and investment facilitation and customs reforms. There is also need for greater awareness of and engagement with their private sectors in regional integration mechanisms and their potential opportunities. The Regional Comprehensive Economic Partnership (RCEP), initiated at the ASEAN summit in Bali in 2011 to facilitate and resource regional economic and development cooperation, and recommitted to by ASEAN leaders at the 2012 ASEAN Summit, should be reconfigured at the 2012-13 ASEAN+3 Summits as an ASEAN+3 or East Asian Convergence and Development Fund, as a building block for an East Asia Free Trade Area and eventual East Asian Community, involving ASEAN +3 as its core but inviting the participation and support of other ASEAN regional dialogue and

development partners.

10. After the global financial crisis and the European fiscal crisis, East Asia is expected to become the engine of growth for the world economy. In order to meet such high expectations, East Asia should maintain its economic dynamism by raising its economic efficiency as well as by enlarging its internal market. In order to realize a region-wide FTA in East Asia, East Asian countries need to overcome existing obstacles and meet the new challenges. There have been two impediments to forming a region-wide FTA in East Asia: one was a pending issue and the other was a fundamental obstacle. The former is the initial membership issue of ASEAN+3 vs. ASEAN+6. The latter problem is the lack of FTAs between China, Japan and Korea. New developments on both fronts have recently been seen. A region-wide FTA is urgently needed. Ideally, if the East Asian countries want to realize it within a relatively short period of time, they should start with the EAFTA among ASEAN+3 countries, because it would be relatively simple, unless the three Northeast Asian countries were unable to form FTA(s) among themselves. In this case, the three Northeast Asian countries should be aware of the fact that a prompt realization of a CJK FTA would greatly facilitate the formation of a region-wide FTA in East Asia. Furthermore, they should also have the EAFTA in mind when they negotiate the trilateral FTA, especially regarding the rules of origin. In order to realize a CEPEA, or now under RCEP, along with efforts to prepare its formation among ASEAN+6 countries, one possible approach is to consolidate 5 ASEAN+1 FTAs. In this case, ASEAN FTA partner countries should strive to conclude bilateral FTAs among themselves. In addition to FTA(s) among the three Northeast Asian countries, the following missing links should be completed: an India-China FTA, an India-Australia FTA, an India-New Zealand FTA, an Australia-China FTA, an Australia-Japan FTA, an Australia-Korea FTA, a New Zealand-Japan FTA and a New-Zealand-

Korea FTA.

11. Institution-building in East Asia is still at an early stage, and its role in managing regional relations, regional integration and cooperation and providing effective public goods seems limited. There are many challenges and difficulties that need to be dealt with and overcome. The new challenges to East Asia do not simply stem from the global economic crisis but also derive from its own problems, ranging from the export-led growth and the imbalance of social-economic structure to sustainable development. East Asia needs to do more on moving toward a new model of economic and social development, for example toward domestic demand-led, rather than export-led growth, and toward a green and sustainable development, rather than a traditional “catching-up model”. To succeed, it is vital for each individual country to put a new strategy on the top of its agenda and for regional cooperation to make joint efforts to move toward a new East Asia. Real progress in institution-building in East Asia has become crucial for ensuring economic dynamism and political stability and peace. However, East Asia’s institutional building should not be inward-looking since the regional economies are highly integrated into the world economy and they should play an active and strong role in global governance. Considering the great need for restructuring the economic development model, it is highly desirable that East Asia moves from an FTA/CEP to an economic community. This seems possible since ASEAN will realize its Community by 2015 and the negotiation on a broad regionally based FTA/CEP will also be completed (RCEP). An East Asia Economic Community will be helpful for policy coordination and cooperation on stimulating regional demand, and moving toward a social-economic balanced development structure. Within a Community, the institutions could be more effective in regional economic governance.

12. East Asia’s economies have benefitted from the regional production networks. To

further utilize the mechanics of production networks, development strategies and industrial policies have to be considered together. For instance, innovation in industrial agglomeration is necessary. Small and medium sized enterprises (SMEs) should play an important role in forming industrial agglomerations, and thus SME-related policies must be reviewed; better access to technology, better access to finance, fostering human resources, and establishing industrial organization may be helpful for their involvement in the industrial agglomeration. It is also important to identify and resolve bottlenecks that prevent participation in production networks. International connectivity and new business models need to be considered, particularly to further deepen the regional production networks. East Asia is strongly connected to the outside economies through the production networks, in addition to the countries in the region. Deepening regional integration and enhancing connectivity certainly require open-minded policies, rather than protectionism, and various development strategies and regional cooperation. While East Asia's integration has been market-driven, now that free trade agreements (FTAs) must be one of the tools for further trade and investment liberalization and facilitation and cooperation. This is a big challenge, but whether each economy in East Asia can implement the necessary strategies and policies, depending on its stage of development and involvement in the production networks, will certainly influence whether regional production networks and regional integration/cooperation are successfully enhanced, and whether further economic development in the region is achieved.

13. Moving toward a new and sustainable development mode, it is necessary to build a recycling society. The sluggish recovery from the global financial crisis of 2008 in affluent markets has affected exporting countries and prompted consideration of ways to increase domestic demand. Mining the waste stream for recyclable materials

offers prospects of both stimulating domestic activity and securing supplies of some rare and expensive materials. The experience of New Zealand in evolving waste management and recycling policy over recent decades, primarily for the purposes of environmental improvement, provides a valuable model for moving toward a sustainable future. Institutional changes in both general legislation and specific waste policy have contributed to reductions in waste disposal, but the economic stimulation is more difficult to measure and has probably been rather small. There are complementary roles to be played by small consumer markets and larger producing countries in the effective recycling of materials across the region.