

MEMORANDUM NO. 3

POLICY RECOMMENDATIONS

ON

**STRENGTHENING THE PILLARS
OF EAST ASIAN COMMUNITY BUILDING**

BY THE

NETWORK OF EAST ASIAN THINK TANKS (NEAT)

21 - 23 AUGUST 2006

**LE MERIDIEN HOTEL
KUALA LUMPUR**

Part I

Introduction

1. The Network of East Asian Think-Tanks (NEAT) Fifth Country Coordinators Meeting and its Fourth Annual Conference were held from 21-23 August 2006 at Le Meridien Hotel, Kuala Lumpur, Malaysia. To highlight the approaching tenth anniversary of inter-governmental cooperation in East Asia and to set the stage for further development, the theme of the Conference was “East Asia Cooperation: The Next Ten Years”. A total of 66 participants from the 13 NEAT countries attended.

2. The attention of participants focused on two areas. The first area of focus was the submissions made by NEAT countries for the Second Joint Statement on East Asia Cooperation to be adopted by the ASEAN Plus Three (APT) governments in 2007. This follows from the decision taken at the Sixth APT Foreign Ministers Meeting held in Vientiane, Laos, on 27 July 2005 to ‘take into consideration recommendations made by APT mechanisms, such as the Network of East Asia Think-Tanks (NEAT), East Asia Forum (EAF) and others’. Part II contains the summary of NEAT inputs to the Second Joint Statement.

3. The second area of focus was the reports of NEAT Working Groups in the areas of:-

- Intra-regional exchange rate stability & prevention of financial crisis in East Asia;
- East Asian financial cooperation;
- Trade-foreign direct investment-technology linkages in East Asia;
- East Asian investment cooperation;
- Energy security cooperation in East Asia; and
- Overall architecture of community building in East Asia (Regional architectures for non-traditional security and environmental cooperation in East Asia).

Part III of this document summarises the Working Group policy recommendations. The full background and rationale of the recommendations can be found in the various reports.

4. This Memorandum of Policy Recommendations was formulated, discussed and approved at the Fifth NEAT Country Coordinators Meeting (CCM) and presented to the Fourth Annual Conference. The CCM wishes to place on record its deepest appreciation to all the researchers and institutions that have led, participated or otherwise contributed to NEAT activities.

Part II

Inputs to the Second Joint Statement on East Asia Cooperation

5. APT governments should consider a Declaration or Agreement on East Asia rather than simply a Statement. This would convey strong political will, mutual trust and firm commitment to work cohesively towards the long-term objective of community building.

6. **Vision, goals & objectives.** The Declaration or Agreement should focus on community building for the next ten years.

7. The goal of community building in East Asia should be to promote the welfare and well-being of the people, and realise the East Asian vision of 'Peace, Prosperity and Progress.' An East Asian community should promote peace by building trust and confidence as well as ensuring the mutual security. The community should promote prosperity by increasing interdependence of trade, investment and technologies and making strong efforts to narrow the development gap in the region. An East Asian community should also promote progress by improving governance, enhancing protection of basic human rights and advancing the quality of life of people.

8. The long-term vision of East Asian cooperation could be an East Asian community that is based on three pillars, viz. (1) an East Asian Economic Community, (2) an East Asian Security Community, and (3) an East Asian Socio-Cultural Community.

9. **Principles and values.** Community building should be based on universal values including good governance, the rule of law, democracy, human rights, international law and norms. East Asian countries should promote these values as a common goal.

10. The countries of East Asia should cooperate comprehensively on the basis of sound and universally accepted principles including:-

- Equality;
- Consensus;
- Mutual benefit;
- Transparency;
- Openness;
- Inclusiveness; and
- Mutual trust.

11. **Modalities.** The process of East Asian community building should continue to be evolutionary and progressive. Cooperation should remain functional and gradually be bolder and more ambitious. Plans of action, working roadmaps, concrete timeframes and proper funding strategies should all be devised in order to implement areas of cooperation.

12. Asean must be the driving force in promoting and managing regional community building. It is therefore essential to maintain the APT Summits and all other APT mechanisms.

13. The Declaration or Agreement on community building should recall and reaffirm the decisions of the APT and EAS Declarations made in Kuala Lumpur in 2005.

- APT process will be the main vehicle for the realisation of the East Asian community in the future;
- EAS is an open and inclusive forum, with Asean as the driving force, for broad strategic, political, economic issues of common interest and could play a significant role in community building in this region;
- APT and EAS processes should move on parallel tracks without overlapping and complement one another as well as other regional processes.

14. There should be ongoing discussion of modalities that give a greater sense of ownership to China, Japan and Korea. The EAS should also evolve in a balanced and complementary way to the APT process. All countries should be comfortable with the EAS process.

15. In order to build the East Asian community, it will be necessary to involve political organisations, government officials, academics, the private sector, the media and civil society.

16. The East Asian community should also cooperate with countries, regional and international organisations that share its vision and are prepared to make positive contributions to the process of community building in the region.

17. Closer Northeast Asian cooperation among China, Japan and Korea is an essential foundation of an East Asian Community. The three countries should tighten Northeast Asian cooperation by further utilising the trilateral summit on the occasion of the APT, and consider additional meetings to be regularised.

18. Productive institution building is essential for further promotion of community building in East Asia. For this purpose, the APT Unit in the Asean Secretariat should be strengthened.

19. Governments should seriously consider the early establishment of an East Asia Community Development Fund which can be used to support mutually agreed programmes, projects and activities, including the NEAT and the East Asia Forum.

20. **Areas of cooperation.** The APT should aim to consolidate and strengthen the foundations for East Asia community in the next decade. Common interests of East Asian nations should be identified, developed and maximised wherever and whenever possible.

21. In view of the disparities in economic development and the diversity of cultures, political systems and security perceptions, regional cooperation should, for the present, be centred on promoting cooperation in the areas of economics, environment, health, energy and transnational issues.

22. Countries should explore the possibility of establishing an East Asia Economic Community where there is free flow of goods, services, investment and capital. To a large extent, this will depend on the faithful and speedy implementation of EASG and NEAT Working Group initiatives.

23. East Asia should also explore the possibility of eventually establishing an East Asia Security Community taking into account the evolution of the Asean Security Community. This Community would explore new modalities for confidence-building, preventive diplomacy, and conflict resolution. There should also be efforts to strengthen regional mechanisms for cooperation on non-traditional security issues and cooperation on human security.

24. In the next decade, the APT should focus on establishing the East Asia Socio-Cultural Community binding East Asia together as a community with a common identity. East Asia must have a strong social agenda in the next 10 years to ensure continuing stability and to counter criticisms that it is only interested in economics.

Efforts should be made to pursue an active and ambitious agenda that is people-oriented, which complements the economic and political dimensions, and contributes towards more holistic human development.

25. Diversity, a characteristic feature of the region, should be respected and seen as an asset. Cross-cultural dialogue should be encouraged and enhanced.

26. The nations of East Asia also share many common values, which will help develop a community identity. While diversity is respected, common values should be enhanced. The norms developed over years by Asean, including cooperation, consultation, consensus and comfort level, should be the basis upon which closer ties may be strengthened for building a harmonious East Asian community.

27. In the process of forming the East Asia Socio-Cultural Community, the APT should further strengthen networks of researchers and scholars by promoting Track II activities to support official processes in East Asia, and connect the existing network in the region through regional activities and research.

Part III

Intra-Regional Exchange Rate Stability & Prevention of Financial Crisis in East Asia

28. With regard to the future direction of financial cooperation, NEAT has reached a broad consensus that one of the most important long-term objectives is to establish a stable exchange rate mechanism in East Asia. This is essential because economic interdependence through trade and investment has risen and is expected to increase further with the creation of free trade areas among APT countries. A stable exchange rate mechanism is indispensable to maintaining sound and sustainable economic growth while avoiding financial instability that may lead to financial crisis in an environment of high capital mobility.

29. **Regional currency basket.** There should be a major study of the various options for regional currency units with a view to establishing a common currency basket and avoiding the problems that arise from a dollar peg. (See, also Para 37.) A joint study between the public and private sectors would provide an opportunity to explore suitable exchange rate mechanisms, while deepening public understanding of this complex subject. The study should include lessons and experiences of the European Union.

30. **Capital account liberalisation & currency convertibility.** As each component currency in the regional basket should meet certain criteria so as to ensure confidence in the basket, East Asian governments should, in addition to maintaining sound macroeconomic management, carefully study the pros and cons of gradually liberalising their capital accounts and establishing currency convertibility.

31. It is important to carefully evaluate the impact that capital account liberalisation and currency convertibility can have on domestic monetary and financial markets. It is also critical to consider the proper sequence of liberalisation. This will usually begin with the current account and proceed to the capital account, from domestic transactions to cross-border ones, and from foreign direct investment to short-term portfolio capital flows.

32. **Surveillance.** NEAT believes that regional surveillance mechanisms should be significantly enhanced. The Economic Review and Policy Dialogue (ERPD) of the Chiang Mai Initiative (CMI) should be strengthened as it is imperative that regional governments exchange information on capital flows in order to deepen coordination of macroeconomic and exchange rate policies.

33. **Permanent secretariat.** In order to expedite and streamline the regional surveillance mechanism, it is essential to establish a permanent secretariat in APT countries. This secretariat should draw up a roadmap that can be used to set targets, review progress and initiate consultations among member countries.

34. **Roadmap to a regional regime.** A roadmap towards a regional exchange rate regime should be drawn up so that members can review the progress achieved. The proposed permanent secretariat should be tasked with drawing up the roadmap which can be used for consultations among members from time to time.

35. **Central bank governors.** Since the central banks in the region play an important role in maintaining stable exchange rate regimes, their participation in the APT Finance Ministers Meeting as regular members is strongly recommended.

36. **Global imbalances.** East Asian countries should actively seek to play a role in multilateral dialogue that will be called to find a way to solve global imbalances and mitigate the adverse impact that any possible adjustment may have on the regional exchange rate regime as a whole.

East Asian Financial Cooperation

37. **Monetary system.** East Asian countries should study how to compute and use an East Asian currency unit. The initial focus should be on the currencies to be included and their shares in the regional basket. The relationships between component currencies and the basket must also be examined. This could be followed by research into ways to use the currency basket to stabilise East Asian currencies, and the possibility of having an Asian dollar market. Finally, there should be an in-depth study of policy dialogue and surveillance mechanisms.

38. A careful study should be made on how to promote the multilateralisation of the CMI mechanism and also the feasibility and roadmap for the CMI to be upgraded fully into a regional monetary fund.

39. The interactions between regional economic processes and economic globalisation, including major international financial institutions and other actors outside the region, should be explored and the positive and negative impacts such interactions may have on regional financial cooperation studied.

40. **Bond market.** In order to develop the East Asian bond market, the use of credit guarantees and investment mechanisms should be established and promoted. APT finance ministers should look into effective use of existing institutions such as the ADB, the various business models and organisational options. For example, a new East Asian Bank concentrating on credit guarantees and investment may be the subject of study and discussion.

41. Governments should create a business environment where the private sector can initiate the sale of financial products similar to the Asian Bond Fund (ABF) and Asian Bond Fund 2 (ABF2). Products that make sense in terms of improving the infrastructure of financial markets should be explored. At the current stage, investors' understanding of, and investment in, the ABFs should be further enhanced and facilitated.

42. Countries, particularly less developed ones, should actively seek technical assistance from various sources and build up their capabilities in bond market infrastructure, transaction platforms, settlement systems, taxation and fiscal incentives, credit rating institutions, bond market intermediaries, laws, regulations, and supervisory mechanisms.

43. Countries should step up regional cooperation on settlement and transaction systems and supervision standards. They should work out consistent market standards and enhance their cooperation on taxation and foreign exchange regulations in order to facilitate investment in one another's bond markets.

44. Bonds denominated in an East Asian currency unit should be issued as soon as possible.

45. ***East Asian Finance Association.*** To promote regional financial cooperation and integration, an East Asian Finance Association (EAFA) should be established and made up of representatives from central banks, financial supervisors (such as securities and exchange commissions), and private financial institutions.

46. The EAFA, together with subsidiary bodies in banking, securities, insurance, etc., should promote cooperation among financial supervision institutions, banks and other financial institutions, and build a regional settlement system.

Trade-FDI-Technology Linkages in East Asia

47. Production networks in East Asia enable firms to separate out processes and reallocate them across the region based on relative endowments of capital, skill, labour and physical and institutional infrastructure. The resulting efficiency gains have been enormous and NEAT recommends that East Asian governments undertake two types of policies, viz., those designed to lower service-link costs, facilitate technology transfer and promote trade and investment, and those that seek to increase real returns on assets.

48. ***Production networks, FDI flows & technology transfer.*** Governments should seek to lower service-link costs to facilitate the functioning of the value chain between geographically separated production blocks. Policymakers should focus on strengthening infrastructure such as:-

- Highways, ports, and airports;
- ICT infrastructure;
- Container yards; and
- Market-supporting institutional infrastructure such as enforcement of laws, information on vendors, enforcement of private contracts, corporate governance, and legal remedies when firms violate intellectual property rights agreements.

49. Developing countries should move up the value chain and not remain engaged in labour intensive activities. Technology transfer is an essential element of this process and transfer of managerial technology from foreign companies to indigenous workers is expedited when workers are highly educated. A strong local knowledge base is also essential if firms are to become involved in engineering and design. To build this knowledge base, high quality education in science and mathematics at secondary school level and scientific training at university level is needed.

50. R&D policy should take into account each country's level of technological innovation. Domestic R&D supported by public research institutes can help indicate what technologies are most appropriate to import while public-private cooperation can help countries advance from imitation to assimilation and, finally, innovation and leveraging new technological capabilities.

51. In order to facilitate the long tenure of foreign investments, it is necessary to sustain FDI-friendly environments including consistent and coherent enforcement of laws and regulations at all governmental levels as well as stable macroeconomic fundamentals.

52. **Free trade agreements.** East Asian governments should facilitate labour mobility and the movement of firms from losing to gaining sectors by providing retraining and upgrading for workers displaced through trade liberalisation and by reducing entry barriers to new firms and facilitating exit through structural reform. Sector-specific protectionist policies should be abandoned and competition policy strengthened.

53. To enhance the benefits and quality of free trade agreements (FTA), it is crucial to reduce the scope of sensitive items and to enlarge the area covered by FTAs.

54. **Bilateral investment treaties.** High quality bilateral investment treaties (BITs) should be used to attract and retain foreign investors in host countries. They should ideally provide for:

- Investment protection (compensation for expropriation and fair and equitable treatment to avoid wrongful termination of government contracts);
- Investment facilitation (transparency of relevant laws);
- Investment liberalisation (freer market access and national treatment); and
- Dispute settlement.

55. **Appropriate policy mix.** The combination of fixed exchange rate regimes (or heavily managed floating regimes), coupled with current account surpluses in several East Asian developing countries, has resulted in large accumulation of foreign exchange reserves. This suggests that more flexible exchange rates are desirable. Greater exchange rate flexibility in the context of a multiple currency basket reference rate with a band would be preferable.

56. In addition, although the management of foreign exchange reserves is the sovereign matter of each government, those countries should study further the ways to invest more efficiently their reserves which include those prepared for a capital account crisis while paying maximum attention to risks and liquidity.

57. East Asian countries should offset any recessionary impact of currency appreciation by adopting demand stimulating policies. These include employing fiscal

and structural policies to build both physical and human infrastructure (particularly in rural areas), using deregulation to promote competition and productivity growth in the non-tradable sector, and strengthening social safety nets so that consumers would have lesser need for precautionary savings.

East Asian Investment Cooperation

58. ***Institutional framework.*** Joint research by governments, business communities and academic circles on investment cooperation in East Asia should be carried out under the framework of East Asian Free Trade Area, with NEAT as the coordinator.

59. A single and integrated East Asian investment promotion centre should also be set up, together with an integrated service network for East Asian investment cooperation within the APT framework. The function is to coordinate the work of many existing similar institutions.

60. There is also need to establish a dispute management centre to deal with frictions and disputes during the investment cooperation process.

61. ***Financing channels.*** Enhanced capacity-building of the Asian bond market, including infrastructure, transaction platforms and clearing systems should be undertaken.

62. In addition, a uniform clearing system, regulatory framework, and market standards are required to promote the integration of bond markets within East Asia, while cooperation in taxation needs to be strengthened.

63. An East Asian investment cooperation fund should also be set up. Money could come from governments of East Asian countries and the fund should be operated by a single body to provide financing guarantees for small and medium enterprises and agricultural investment.

64. Finally, there could be an East Asian investment bank which functions as a bank to provide preferential long-term credits for priority areas.

65. ***Priority areas.*** Efforts should be placed in four priority areas, viz. the promotion of investment cooperation:-

- ***Investment in energy security and environment protection.*** It is recommended that an investment cooperation mechanism be established under the APT framework that includes a 24-hour disaster monitoring system, an East Asia Fund for disaster prevention and relief, and control projects against desertification in East Asia.
- ***Investment in infrastructure development.*** Priority should be given to cooperation in building pan-Asia railway, road and waterway, with a view to building a pan-Asia transportation network.
- ***Investment in development of small and medium enterprises.*** It is advisable to set up investment promotion agencies and an investment fund for these enterprises.
- ***Investment in agricultural development.*** It is thus necessary to increase investment so as to accelerate agricultural development in East Asia.

Energy Security Cooperation

66. **Energy conservation.** The countries of East Asia should set national targets of energy efficiency with a view of catching up with the world's best standards in the long run. Governments should also expand existing energy conservation efforts, including energy audits and inspections, minimum energy consumption efficiency standards, energy efficiency demonstrations, public education on energy efficiency, energy-efficiency labelling programs and international technical exchange.

67. East Asian states should also pay attention to energy-saving activities by introducing (mandatory or voluntary) energy efficiency standards for common household products such as air conditioners, heaters, cooking appliances, water heaters and other electrical appliances.

68. Governments should promote energy conservation efforts in the consumption of oil (especially gasoline and diesel) in the transport sector and develop policies which ensure that the increasing numbers of vehicles on the roads use fuel as efficiently as possible. Manufacturing industries should also adopt more efficient methods of production by using less energy per unit of output.

69. Countries in the region should hold regular energy conservation campaigns which educate people about the relative quantities of energy they use and waste in the home and at work each day, and instil in them the imperative of practicing energy-conserving behaviour at all times.

70. **Energy security.** The more developed East Asian countries should consider providing material or technical assistance to the less developed littoral states. Besides patrol boats and training ships, these countries could help such states build a surveillance radar network to cover the Straits of Malacca.

71. East Asian countries should participate and cooperate actively in ReCAAP (Regional Cooperation Agreement on Combating Piracy and Armed Robbery against Ships). There should also be multilateral exercises to handle environmental disasters caused by oil spillage from tankers, tugs and barges in the Straits of Malacca and provide humanitarian assistance by mounting search and rescue operations. These initiatives can be regarded as confidence building measures as they aim to boost mutual trust and confidence, reduce suspicion and develop a spirit of cooperation among countries.

72. Countries in the region should build on the June 2006 proposal by Malaysia for a Southeast Asian Disaster Relief Centre to provide humanitarian assistance and handle environmental disasters. This proposal can be expanded to cover the Straits of Malacca and potential maritime disasters with the participation of APT countries.

73. The more developed countries are encouraged to transfer energy conservation technology and know-how to less developed members, which should introduce policy and regulatory framework to absorb them. Thus, APT countries can share all their energy-efficiency experience for mutual benefit and enhance trust within the East Asian Community.

Regional Architecture for Non-traditional Security & Environment Cooperation in East Asia

74. **Transnational crime.** There is a need for regional cooperation in addressing transnational crimes, above all human trafficking (including the trafficking in women and children), drug trafficking, and money laundering. Two areas that need to be addressed are (1) the varying perceptions and priorities of different countries and (2) the differences in state capabilities in implementing statements and declarations.

75. The APT framework should serve as the main process for regional cooperation, along with others, especially in formulating general principles for regional law enforcement based on respect for sovereignty and mutual trust. The Asean Secretariat should serve as the program coordinator of the region's attempts to narrow the above gaps.

76. Civil society should play a more important role in combating transnational crime and Track II should facilitate their efforts. It may be possible to propose extra sessions in the Asean People's Assembly on these issues.

77. Specific issues that need to be addressed as part of the APT process include sharing of information and intelligence, extraterritoriality and the harmonisation of legal systems.

78. General common principles that address not only crime but also issues such as poverty alleviation, protection of labour, assistance to developing countries, immigration, law enforcement, fostering mutual trust, establishment of databases and central strategic research and coordination of information exchange need to be developed.

79. The creation of a Centre for Transnational Crime would be useful. Its missions, including capacity building in general, trust-building, and information exchange, should be clear.

80. East Asian cooperation builds on what the Asean has achieved. An Asean Ministerial Meeting on Transnational Crime is the appropriate mechanism for promoting cooperation on counterterrorism and the APT unit in the Asean Secretariat should be strengthened and closely follow such cooperation.

81. **Terrorism.** It is also important to develop a common position among East Asian countries so that they can work together to support the UN conventions on terrorism.

82. It is crucial to promote constructive values through a country's education system so as to curb extremist influences on the younger generation. It must be ensured that school texts do not promote a culture of hate and chauvinism.

83. Terrorism should not be associated with any race, culture or religion. The war on terrorism must not only address the symptoms but also their root causes.

84. **Maritime security.** Littoral states should be encouraged to take initiatives to reach a common agreement with user countries on the norms and rules of maritime security in the Straits of Malacca and in creating a framework for burden-sharing between littoral and user countries. Multilateral mechanisms for dealing with issues such as oil spills and search and rescue operations should be put in place.

85. **Pandemic threats.** Containing the avian flu should be dealt with as part of the APT and other processes to promote cooperation among members. Countries in the

region which have practical experience should be encouraged to stock-take, share good practices and build a capacity to contain the threat.

86. Policy priority should be given to global and regional problems, especially global warming, deforestation, and marine and river contamination, since they cannot be properly addressed without regional and global cooperation.

87. **Environment.** In promoting East Asian cooperation:-

- Emphasis should be placed on technical and scientific approaches;
- Existing bilateral or sub-regional frameworks for cooperation should be broadened into a regional framework;
- Common guidelines for environmental management, assessments and common codes of conduct should be produced by an Experts Group of APT and institutional platform for cooperation;
- Regional agreements to address trans-boundary environmental problems among governments of APT, of which Northwest Pacific Action Plan (NOWPAP) can serve as a model, should be concluded; and
- Technical knowledge obtained from developed countries.

88. The goal of sustainable economic development should be promoted. Joint academic research and the development of the new technology in the field of environmental protection should be promoted.