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## Résumé

*La coopération économique en Asie orientale a été poursuivie activement ces dernières années, en particulier depuis la crise financière asiatique. Plusieurs accords bilatéraux ou multilatéraux de zones de libre-échange ont été conclus ou sont en cours de négociation. Le rapport du Groupe de vision pour l'Asie orientale (East Asia Vision Group), récemment publié, offre des indications plus concrètes pour l'établissement d'une Communauté économique est-asiatique. La zone de libre-échange de l'Association des nations d'Asie du Sud-Est (AFTA) est devenue une réalité après une période de dix ans de réduction des tarifs douaniers. L'ASEAN+3 (Asie du Sud-Est, Japon, Chine, Corée du Sud) a également proposé de créer une zone de libre-échange de l'Asie orientale (EAFTA). Le Japon a signé un accord de libre-échange avec Singapour, tandis que la Chine et l'Asie du Sud-Est ont prévu de créer une zone de libre-échange d'ici dix ans. Sur le plan financier, l'initiative de Chiang Mai a permis la création d'un fonds monétaire régional, en étendant l'accord existant sur les échanges de devises à l'ensemble des pays membres de l'ASEAN, et en l'augmentant d'accords bilatéraux entre l'ASEAN et la Chine, le Japon, la Corée du Sud. Les pays d'Asie orientale ont aussi établi un mécanisme de veille de leurs performances économiques respectives. Mais il reste plusieurs obstacles au développement de la coopération économique régionale. L'hétérogénéité politique, économique et culturelle de l'ensemble des pays d'Asie orientale fait partie des problèmes structurels. Les faibles légalisation et efficacité d'institutions régionales imbriquées les unes dans les autres rendent difficile l'approfondissement de la coopération régionale. L'instabilité interne des pays d'Asie du Sud-Est peut aussi ralentir cette coopération. La rivalité du Japon et de la Chine dans la région doit être observée de près. La coopération économique est-asiatique ira en s'accéléralant dans un avenir proche. Depuis l'annonce d'accords de libre-échange entre l'ASEAN et la Chine, le Japon a cherché des alliances pour faire face à la montée en puissance chinoise, et pour maintenir sa propre influence dans la région. Les prochaines années verront l'apparition de nombreuses relations bilatérales ou multilatérales, financières et commerciales, en Asie orientale.*

## Abstract

*East Asian economic cooperation has been actively pursued during the past few years, especially after the Asian financial crisis. A number of bilateral and multilateral Free Trade Area (FTA) agreements were concluded or are being negotiated. The recently published East Asia Vision Group Report provides a more concrete roadmap for an East Asian economic community. The ASEAN Free Trade Area (AFTA) became a reality on January 1, 2002, following a 10-years tariff reduction schedule. AFTA aims not only at trade facilitation but at inducing more investment. An ASEAN+3 (i.e. Japan, China and South Korea) FTA was also suggested to build an East Asian Free Trade Area (EAFTA). Japan signed an FTA with Singapore of ASEAN, while China and ASEAN agreed to create FTA within 10 years. On the financial side, the Chiang Mai Initiative created a regional liquidity fund by expanding the existing ASEAN Swap Arrangement to include all ASEAN members and augmented it by a network of bilateral swap arrangements among the ASEAN countries, China, Japan and South Korea. East Asian countries have also established a surveillance mechanism to monitor their economic performance. However, there are many obstacles in further enhancing regional economic cooperation. Structural problems involve political, economic, and cultural heterogeneities among East Asian countries. Low legalization and effectiveness of overlapping regional institutions render deeper regional cooperation difficult. Domestic instability of the ASEAN countries may hamper rapid regional cooperation. Regional rivalry between Japan and China should be an important object of observation. East Asian economic cooperation will be accelerated in the near future. Since the announcement of the ASEAN-China FTA agreement, Japan has attentively sought alliances to vie with growing China and to maintain her influence in the region. The next few years will see the emergence of a number of new bilateral and multilateral relations, both in trade and finance, in East Asia.*

# Building an East Asian Economic Community

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## Regional Cooperation in East Asia

Regional cooperation in East Asia has become one of the most frequently discussed issues in recent years. A number of bilateral and multilateral Free Trade Area (FTA) agreements have been established or are being negotiated. The ASEAN Free Trade Area (AFTA) already constituted a subregional trade linkup, and an ASEAN+3 (i.e. Japan, China and South Korea) FTA has also been proposed to build an East Asian Free Trade Area (EAFTA). On the financial side, progress has been made since the Asian financial crisis in 1997. A number of bilateral swap agreements have already been signed and many more are being negotiated. Many East Asian countries, especially ASEAN member countries, have established a surveillance mechanism to monitor their economic performance.

The post-Cold War world has increased the importance of economic power *vis-à-vis* ideological, political and security issues<sup>1</sup>. Since the 1990s, ASEAN has increasingly been looked upon as a vehicle for deepening regional economic cooperation. Northeast Asian countries did not want to be left out of worldwide regionalization and actively joined in the regional cooperation process. East Asian economic integration is expected to accelerate economic development by increasing the flow of capital and technology while expanding production and export capacity. It would also bring a convergence of business cultures and set common « rules of the game »<sup>2</sup>.

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<sup>1</sup> Chang Li Lin, Ramkishan S Rajan, « Regional Responses to the Southeast Asian Financial Crisis: A Case of Self-Help or No Help? », *Australian Journal of International Affairs*, Vol. 53, n°3 (November 1999).

<sup>2</sup> Dajin Peng, « The Changing Nature of East Asia as an Economic Region », *Pacific Affairs*, Vol.73, n°2 (Summer 2000).

Political cooperation is a more challenging task. The most visible progress is the ASEAN Regional Forum (ARF) in which Korea, Japan, China, and European representatives participate with ASEAN countries. It endeavors to increase influence on the stabilization of regional security. At the private level (track II), the Council for Security Cooperation in Asia-Pacific (CSCAP) accompanies the ARF framework.

There are currently multiple institutions and forums to deal with regional cooperation in East Asia. A number of cooperative bodies - ASEAN, ASEAN+3, APEC, ASEM, and ARF - overlap in East Asia. Most East Asian countries belong to different regional groups and organizations, and they are party to several regional trade arrangements<sup>3</sup>. ASEAN worked toward the broad goals of regional cooperation laid out by the « Vision 2020 », which is a roadmap for ASEAN in the 21st century<sup>4</sup>. APEC has been moving towards implementing the programs aimed at achieving the 2010/2020 targets for free trade and investment in the Asia-Pacific region. More recently, the East Asia Vision Group (EAVG) has provided a roadmap for an « East Asia community », and subsequently the East Asia Study Group (EASG) has worked to implement the suggestions from the EAVG Report<sup>5</sup>.

## **Evolution of ASEAN+3 Cooperative Framework**

ASEAN+3 has become the most active regional institution in recent years. While ASEAN consists of 10 Southeast Asian countries, ASEAN+3 includes three major countries from Northeast Asia - China, Japan and Korea - and thus represents the entire « East Asia »<sup>6</sup>. The ASEAN+3 summit provides an opportunity for a series of bilateral and multilateral summits between the heads of state. ASEAN+3 has a further advantage, at this stage, of not including Hong Kong and Taiwan, which would complicate ties with China in other groups such as the APEC<sup>7</sup>.

The first ASEAN + 3 summit meeting was held in Kuala Lumpur on December 16, 1997, and the leaders discussed ways to cope with financial problems. At the second summit meeting in Hanoi on December 16, 1998, the creation of a regional financial mechanism, including the Miyazawa Plan, a Japanese proposal to create an Asian monetary mechanism to prevent future crises, were discussed. The establishment of the East Asian Vision Group was decided in this summit. At the third summit meeting held in Manila on

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<sup>3</sup> Bowles labels this phenomenon a « multiple regionalism »: Paul Bowles, « ASEAN, AFTA and the "New Regionalism" », *Pacific Affairs*, Vol.70, n°2 (Summer 1997).

<sup>4</sup> « The People's ASEAN », Report of the ASEAN Eminent Persons Group (EPG) on Vision 2020; Lin and Rajan, *ibid*.

<sup>5</sup> Both EAVG and EASG were proposed by South Korean President Kim Dae-Jung. EASG is a government-level organization to discuss further regional cooperation while EAVG is composed of non-governmental experts.

<sup>6</sup> The geographical boundary of East Asia is quite debatable. In this paper, East Asia means Northeast Asia and Southeast Asia.

<sup>7</sup> Pierre Goad, « Asian Monetary fund reborn », *Far Eastern Economic Review* (May 18, 2000).

November 28, 1999, a Joint Statement on East Asian Cooperation was adopted, and the leaders agreed to hold ASEAN+3 ministerial meetings<sup>8</sup>. The Manila meeting has particular significance in that the leaders from three Northeast Asian countries began to hold a tripartite summit<sup>9</sup>. At the fourth summit meeting in Singapore on November 24, 2000, the leaders discussed the ways to advance East Asian cooperation in the region, including ways to turn the ASEAN+3 meeting into an East Asian summit<sup>10</sup>. The most recent ASEAN+3 summit held in Brunei on November 4-6, 2001, dealt with regional cooperation to counter terrorism, acceleration of regional economic cooperation and bridging development gaps. In this meeting, the leaders examined an EAVG report and expressed appreciation to the EAVG members for their efforts. The three Northeast Asian countries decided to hold regular economic ministers meetings and to create a tripartite business forum in which private entrepreneurs will participate<sup>11</sup>.

## Plan of Study

This paper examines the efforts to build an East Asian economic community. However, East Asian economic cooperation cannot be explained solely in terms of economic logic. The dynamics of regional economic cooperation also necessarily entail political elements. While this paper examines recent developments of regional economic cooperation in East Asia, the scope of this paper will expand to the political arena, and in doing so I will emphasize the significance of a « politically sustainable » regional economic community.

The paper also focuses on the evolution of ASEAN+3 framework and the EAVG Report to explain the recent developments of East Asian cooperation. Part II and III examine the progress of East Asian economic cooperation - trade and finance. Part IV reviews the vision and economic agenda in the EAVG Report that proposed an « East Asian community ». Part V evaluates ongoing East Asian economic cooperation and discusses major obstacles and problems faced during the regional cooperation process. Part VI envisages the prospect of East Asian economic cooperation in terms of new geopolitics in the region.

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<sup>8</sup> The Joint Statement covers major areas of East Asian cooperation: economic cooperation, monetary and financial cooperation, social and human resources development, scientific and technical development, culture and information, development cooperation, political security and transnational issues.

<sup>9</sup> At the Singapore meeting in November 2000, they agreed to make this three-way Summit Meeting an annual event.

<sup>10</sup> Lee, Chang-Jae, « China, Japan and Korea Facing the Challenge of Worldwide Regionalism », Paper presented at the International Symposium on Strengthening Trade Relations between China, Japan and Korea: Assessment and Prospects, held in Seoul, on September 24, 2001, p. 25.

<sup>11</sup> Press Statement by the Chairman of the 7<sup>th</sup> ASEAN Summit and the 5<sup>th</sup> ASEAN+3 Summit (November 5, 2001).

## TOWARD A COMMON MARKET IN EAST ASIA

Regionalization of trade has become a worldwide phenomenon in recent decades. Recent regionalization of global trade originated partly from the disappointment from the existing multilateral agreements such as the WTO and partly from the United States' conversion from a devoted multilateralist to an ardent regionalist pursuing NAFTA and FTAA<sup>12</sup>. There has been a series of debates on whether a regional trade regime is beneficial to free trade. For advocates of regionalism, removal of trade barriers, no matter how it happens, is good for free trade. They think that regionalism has a largely benign effect on the multilateral system. Trade liberalization through regional trade agreements is politically easier to achieve than multilateral or unilateral liberalization<sup>13</sup>. Those who are against regionalism argue that the member countries of trade blocs will be less interested in multilateral liberalization talks and that this will pose a serious threat to the world trading system. Regionalization may even provoke an inter-bloc trade war. They also point out that small countries will be at a disadvantage when they negotiate with a large country<sup>14</sup>.

Despite these debates, most countries have begun to think that joining regional trade agreements would be beneficial at least to themselves<sup>15</sup>. East Asia was not an exception in this trend. Richard Baldwin explains this proliferation and expansion of regionalism with the domino theory. If the bloc enlarges, the cost to non-members increases, since they now face a cost disadvantage in an even greater number of markets. This second-round effect will bring more pro-regional political activity to non-members and thus may lead to further enlargement of the bloc<sup>16</sup>.

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<sup>12</sup> Richard Baldwin, « The Causes of Regionalism », *The World Economy*, Vol. 20, n°7, (1997).

<sup>13</sup> Jeffrey A. Frankel, ed., *The Regionalization of the World Economy* (Chicago: The University of Chicago Press, 1998); World Trade Organization, *Regionalism and the World Trading System* (1995); « Regionalism and the World Trading Systems » in Larry Summers ed., *Policy Implications of Trade and Currency Zones* (Federal Reserve Bank of Kansas City, 1991).

<sup>14</sup> The Bhagwati school emphasizes this discriminatory liberalization. Jagdish Bhagwati, Pravin Krishna and Arvind Panagariya, eds. *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Arrangements*. (Cambridge: The MIT Press, 1999); Arvind Panagariya, « The Regionalism Debate: An Overview », *The World Economy*. Vol. 22, n°4, (1999); Jagdish Bhagwati and A. Krueger, *The Dangerous Drift to Preferential Trade Agreements* (Washington: American Enterprise, 1995).

<sup>15</sup> Although Bhagwati thinks that the revival of regionalism is unfortunate, given its political appeal and its likely spread, he believes that it is important to contain and shape it in such a way as to maximize its usefulness and minimize its damage, and make it consonant with the objectives of arriving at multilateral free trade for all. Jagdish Bhagwati, « Regionalism and Multilateralism: An Overview », in Jagdish Bhagwati, Pravin Krishna and Arvind Panagariya, eds. 1999. *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Arrangements* (Cambridge: The MIT Press, 1999), pp. 26-27.

<sup>16</sup> Richard Baldwin, « A Domino Theory of Regionalism », in Jagdish Bhagwati, Pravin Krishna and Arvind Panagariya eds., 1999. *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Arrangements* (Cambridge: The MIT Press, 1999), p. 500; Richard Baldwin, « A Domino Theory of Regionalism », in R. Baldwin, P. Haaparanta, and J. Kiander eds., *Expanding Membership of the European Union*, (Cambridge: Cambridge University Press, 1995).

Economically, regional FTA can create a larger market, a more competitive environment, and more economic efficiency. FTA can be a political instrument to help lock in domestic reform policy. As shown in the European experience after the Second World War, economic cooperation can also be used as a strategic means to prevent a regional conflict.

## **Development of ASEAN Free Trade Area (AFTA)**

The Association of Southeast Asian nations Free Trade Area (AFTA) has been by far the most advanced effort to create a common market in East Asia. AFTA was launched in 1992 at the Fourth ASEAN Summit in Singapore to eliminate tariff barriers among Southeast Asian countries. Over the course of the next few years, the program of tariff reductions was broadened and accelerated. From 1993 to 1997, the intra-ASEAN trade volume almost doubled, from less than US\$44 billion to more than US\$85 billion, or from less than 21 percent to almost 25 percent of total trade<sup>17</sup>. These figures dropped (to US\$71 billion and 22 percent in 1998) due to the financial crisis in 1997 but rose again in 1999 and stayed well above the pre-AFTA levels. The financial crisis has caused more difficulties for some specific industries in individual ASEAN countries but the funds for the relief of such industries were strictly limited in scope, timeframe and other conditions.

The AFTA initiative received a further boost at the ASEAN summit in Bangkok, December 1995, when the ASEAN countries signed framework agreements for the intra-regional liberalization of trade in services. The ASEAN leaders also decided to advance AFTA's completion date to the beginning of 2003. Subsequent to the December summit, an industrial complementation scheme designed to encourage intra-regional investment was approved, and discussions were held on creating an FTA within the region. ASEAN also adopted the ASEAN Industrial Co-operation scheme, (AICO), through which products of companies operating in two or more countries would enjoy full AFTA treatment immediately. "AFTA Plus" activities were initiated, and they included efforts to eliminate non-tariff barriers and quantitative restrictions and to harmonize customs nomenclature, valuation, and procedures. At their summit in December 1997, the leaders of the ASEAN countries issued « the ASEAN Vision 2020 » statement. They committed themselves « to moving towards closer cohesion and economic integration » and resolved to « advance economic integration and co-operation » by fully implementing the AFTA<sup>18</sup>. At their summit in Hanoi in 1998, ASEAN leaders again advanced the completion date of AFTA to the beginning of 2002 for the six original signatories to the AFTA agreement, with the later signatories given a few more years to adjust to regional free trade.

Common Effective Preference Tariff (CEPT) was aimed at reducing tariffs on manufactured items between the ranges of 0 to 5 percent by the year 2002 (see Table 1)<sup>19</sup>.

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<sup>17</sup> Intra-regional export rose from 30.9% in 1986 to 49.5% in 1994 while the export dependency of East Asia on the US fell from 34% to 22.8% in the same period. If imports are also included, intra-regional trade in East Asia already exceeded 50% in 1995. Peng, *ibid*.

<sup>18</sup> » The People's ASEAN, », Report of the ASEAN Eminent Persons Group (EPG) on Vision 2020.

<sup>19</sup> The CEPT is the mechanism by which tariffs on goods traded within the ASEAN region which meet a 40% ASEAN content requirement will be reduced to 0-5% by the year 2003 (2006 for Vietnam, and 2008 for Laos and



It was also aimed at reducing tariffs to a minimum of 90 percent of the tariff lines by the end of 2001 for the original six members. Raw agricultural goods were to be phased in by a target date of 2010. Members submit tariff lines to be included or excluded from the CEPT scheme, with an increase of 90 percent of intra-regional trade covered by the CEPT<sup>20</sup>. By 2010, all tariffs among the original six are to be abolished. By 2015, the other four newcomers are expected to do the same.

The Hanoi Plan of Action was adopted at the Sixth ASEAN Summit<sup>21</sup>. The Hanoi Plan is the first in a series of plans of action leading to the actualization of ASEAN Vision 2020, adopted in the Second ASEAN Informal Summit held in December 1997. The Hanoi Plan of Action includes the following objectives:

1. Strengthen macroeconomic and financial cooperation;
2. Enhance economic integration through measures such as acceleration of the implementation of AFTA and implementation of the Framework Agreement of the ASEAN Investment Area;
3. Promote science and technology development and develop information technology infrastructure;
4. Protect the environment and promote sustainable development;
5. Strengthen regional peace and security;
6. Enhance ASEAN's role as an effective force for peace, justice, and moderation in the Asia-Pacific and the world;
7. Promote ASEAN awareness and its standing in the international community;
8. Improve ASEAN's structures and mechanisms.

The Hanoi Plan has a six-year time-frame stretching from 1999 to 2004. However, no such follow-up actually seems to have taken place as yet and skepticism regarding the usefulness of the Hanoi Plan abounds<sup>22</sup>.

Following a 10-year tariff reduction schedule, AFTA was finally put into effect on January 1, 2002. At present, only 1,683 items (3.8%) out of 44,060 in the CEPT-included list of the original six are not in compliance with this target. Vietnam is expected to reach its tariff elimination target in 2006, Laos and Myanmar in 2008 and Cambodia in 2010<sup>23</sup>.

The attempt to establish AFTA stemmed from the changes in the international economic

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Myanmar). The tariff reductions are moving ahead on both the « fast » and « normal » tracks. Tariffs on goods in the fast track will be reduced to 0-5% by the year 2000. Tariffs on goods in the normal track will be reduced to this level by 2003. Currently, about 81% of ASEAN's tariff lines are covered by either the fast or normal track.

ASEAN members have the option of excluding products from the CEPT in three cases: 1) Temporary exclusions; 2) Sensitive agricultural products; 3) General exceptions. The CEPT scheme will cover nearly 98 percent of all tariff lines in ASEAN by the year 2003; by then, the only products not included in the CEPT Scheme will be those in the General Exceptions category and sensitive agricultural products. <http://www.us-asean.org/afta.htm>.

<sup>20</sup> Jeffery Heinrich and Denise Eby Konan, « Prospects for FDI in AFTA », *ASEAN Economic Bulletin* (August 2001).

<sup>21</sup> « Hanoi Plan of Action », *ASEAN Economic Bulletin*, Vol. 16, n°1 (April 1999).

<sup>22</sup> Lin and Rajan, *ibid*.

<sup>23</sup> « Markets move toward zero rates », *International Herald Tribune*, 1.31.2001.

environment during the 1980s. In most of the 1960s and 1970s the four largest ASEAN nations (i.e. Indonesia, Malaysia, the Philippines and Thailand) had pursued import substitution policies. The world economic slowdown in the early and mid-1980s, the reduction of capital transfers, the rise of protectionist sentiment in the US posed fundamental challenges for the ASEAN countries. All of the ASEAN-4 needed to find ways to boost exports and maintain foreign exchange earnings.

In 1986, the Philippines formally proposed to expand intra-ASEAN trade through further cooperation measures, including a phased reduction in intra-ASEAN tariffs and an external common tariff (i.e. a customs union). However, this proposal did not invite favorable reaction from other ASEAN member countries. Indonesia rejected the proposal on the grounds that no deadlines should be involved and Singapore objected to a customs union on the grounds that it did not want to raise its external tariffs.

Economic cooperation schemes and the Preferential Trading Agreement were attractive to ASEAN countries because they offered the possibility of a larger market to support domestic industries, but they were also problematic in that each nation wished to guard its internal market for its own firms, and cooperation schemes were often bogged down at the implementation stage<sup>24</sup>.

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While AFTA initially targeted tariff reduction and trade liberalization, a concurrent goal was to attract inflows of foreign direct investment (FDI) to ASEAN by enhancing market access and creating a more attractive market environment<sup>27</sup>. Individual countries adopted

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<sup>24</sup> Paul Bowles, « ASEAN, AFTA and the "New Regionalism" » in *Pacific Affairs*, Vol. 70, n°2 (Summer 1997), p. 221-222.

<sup>25</sup> *Ibid.*

<sup>26</sup> *Ibid.*

<sup>27</sup> Tariff reductions are not enough to provide a sufficient rationale for deeper economic integration. In fact, the welfare enhancing benefits of trade creation are of little relevance in Southeast Asia. Intra-ASEAN trade is a relatively minor proportion of total ASEAN trade. It accounts for less than 20 percent of total ASEAN trade and considerably less if Singapore's trade is omitted. For details of intra-ASEAN trade, see P. Bowles and B. MacLean, « Understanding Trade Bloc Formation: The Case of the ASEAN Free Trade Area », *Review of International Political Economy*, Vol. 3, n°2 (Summer, 1996); A. Panagariya, « East Asia and the New Regionalism in World Trade », *The World Economy*, Vol. 17, n°6 (1994).

policies more favorable to FDI in an effort to attract the foreign capital needed to spur continued industrialization.

Since the mid-1980s, the primary economic objective of ASEAN trade cooperation has no longer been trade creation but the avoidance of investment diversion to other parts of the world economy. ASEAN faced increased competition for increasingly scarce global capital. Bigger economies in Asia - China, Japan, and South Korea - were all opening up to foreign investment, providing stiff competition. Southeast Asia needed to invest more in infrastructure, technology and human capital resources. The need for a regional trading arrangement became more compelling in that the ASEAN countries as a group could offer investors more advantages that no member individually possessed<sup>28</sup>.

An awareness that FDI contributes to industrial performance, growth, competitiveness, and human capital development began to prevail. In 1987, ASEAN countries adopted the Agreement for the Promotion and Protection on Investments and guaranteed ASEAN-based firms fair and equitable treatment. The agreement also protected regional firms from expropriation and guaranteed the unhindered repatriation of capital and earnings<sup>29</sup>.

In December 1995, the ASEAN summit endorsed the concept of an ASEAN Investment Area (AIA) in which barriers to intra-regional investment would be lowered and removed, regulations would be liberalized, streamlined and made more transparent, and incentives would be offered to boost regional investment. The basic concept was to substantially increase the flow of investment into ASEAN from both ASEAN and non-ASEAN sources by enhancing the region's competitiveness. The AIA would encompass three broad principles, namely, cooperation, facilitation, and liberalization. ASEAN officials have indicated that the AIA may be modeled along the CEPT lines, wherein different sectors would be opened to investment and national treatment on different time-frames, depending on each country's particular situation<sup>30</sup>.

The stated objective of the AIA is to attract greater FDI into the region from both ASEAN and non-ASEAN sources with the goal of a liberal and transparent investment environment for ASEAN investors by 2010 and all investors by 2020. Under the ASEAN Investment Area agreement, each ASEAN country opens itself to investments from other ASEAN countries and extends national treatment to those investments.

An enlarged market would attract investments much more effectively than the much smaller national domestic markets. It would thus be a further stimulus for growth. It would also raise, for ASEAN members, the stakes in one another's purchasing power and economic progress<sup>31</sup>. By forming AFTA, the ASEAN countries were not only able to offer

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<sup>28</sup> Bowles explains the necessity of building preferential trade arrangements in terms of inducing more investment. « T[he] increase in capital flows since the mid-1980s has led to the situation where capital importers and capital exporters are in need of institutional mechanisms to facilitate the continued flow of capital across their borders... Regional trading arrangements between capital-exporting and capital-importing countries are one way of bringing developing countries into this process. Such arrangements are an institutional mechanism for reducing the risks of investment by providing multi-country credibility to regulations concerning trade and capital flows », Bowles, *ibid.*, p. 229.

<sup>29</sup> Heinrich and Konan, *ibid.*

<sup>30</sup> <http://www.us-asean.org/afta.htm>.

<sup>31</sup> Rodolfo C. Severino, « Regional economic integration: The challenges ahead », *ASEAN Economic Bulletin* (August 2001); Rodolfo C Severino, « The ASEAN free trade area: Moving ahead on regional

multinational corporations a larger regional market for production and consumption but also increased the credibility of their commitment to trade openness by providing a joint guarantee of this<sup>32</sup>.

ASEAN countries also attempted to strengthen the industrial infrastructure in AFTA. These measures included a more efficient customs system, transportation and energy supply. Attention has also been directed to enhancing the investment climate, such as governance, the rule of law, the judicial system, and transparency.

## Beyond AFTA

While intra-ASEAN trade volume is not high compared to ASEAN's total global trade volume as stated above, the trade volume between ASEAN countries and China, Japan and South Korea grew by 27.5 percent between 1999 and 2000, or from \$158.2 billion to \$201.7 billion<sup>33</sup>. AFTA can be a more effective regional trading arrangement when linked to Northeast Asia through bilateral arrangements (i.e. ASEAN-China, ASEAN-Japan, ASEAN-Korea) or within the framework of ASEAN+3<sup>34</sup>.

At a bilateral summit held in November 2001 on the sidelines of the ASEAN+3 summit, ASEAN and China agreed to create a Free Trade Area within 10 years. ASEAN-China trade totaled \$39.5 billion in 2000. ASEAN's share in China's foreign merchandise trade has been continuously on the rise, increasing from 5.8 percent in 1991 to 8.3 percent in 2000. Meanwhile, the share of China in ASEAN's trade has grown from 2.1% in 1994 to 3.9% in 2000. China - including Hong Kong - is now ASEAN's fourth biggest trading partner<sup>35</sup>. The establishment of an FTA between ASEAN and China will create an economic region with 1.7 billion consumers, a regional GDP of about \$2 trillion and a total trade volume estimated at \$1.23 trillion. It will also tie Southeast Asia even more closely to China.

Japan is stepping up FTA negotiations with ASEAN. Japanese Prime Minister Koizumi wants to keep pace with China in forging FTAs in East Asia. Japan and the ASEAN agreed to establish an expert group to examine comprehensive economic cooperation, including FTA. As a first step toward a closer Japan-ASEAN relationship, Japan signed an FTA with Singapore in January 2002. This FTA agreement is rather symbolic because Singapore has no agricultural exports and does not threaten Japan's powerful agricultural lobby. However, Japan hopes that this agreement will facilitate the signing of FTAs with other

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integration », *ASEAN Economic Bulletin* (August 2001).

<sup>32</sup> Bowles, *ibid.*

<sup>33</sup> « Beyond AFTA: Where does Northeast Asia fit in », interview with Han Sung Joo, *International Herald Tribune*, 1.31.2002.

<sup>34</sup> *Ibid.*

<sup>35</sup> The biggest trading partner of ASEAN is the United States. Japan and the EU are the next. China is currently a distant fourth. South Korea is also an important trading partner next to China. <http://www.aseansec.org/menu.asp?action=4&content=16>.

ASEAN countries, including agricultural exporters such as Thailand<sup>36</sup>.

South Korean President Kim Dae-Jung proposed an East Asian Free Trade Area (EAFTA), which was suggested in the EAVG Report, as a medium- and long-term objective of trade facilitation in East Asia. Korea is actively seeking FTA partners among ASEAN countries and is examining the feasibility of an ASEAN-Korea FTA.

## Northeast Asian Cooperation

Economic cooperation in Northeast Asia - China, Japan and Korea - is another key for foreseeing the future of East Asian cooperation. In terms of economic volume, the three countries represented 19.8% of the world's total GDP in 2000. With regard to trade volume, their share of the world's total trade amounted to 11.8% in 1999. Under the framework of ASEAN+3, the three countries' shares in terms of GDP and trade volume were 91.2% and 67.9%, respectively, in 2000<sup>37</sup>.

Since the ASEAN+3 summit meeting in Manila in November 1999, the leaders of China, Japan and Korea have held the three-way summit meeting. These summit meetings will be reinforced by economic ministers' meeting and business forums as agreed in the recent ASEAN+3 summit in Brunei (see Table 2).

China, Japan and Korea have begun to show interest in forming an FTA in recent years. In particular, Korea and Japan have started negotiations to create an FTA between the two countries. Apart from these official negotiations, there are many proposed FTAs involving Japan, Korea and China at different stages of development.

During the past 10 years, trade among the three countries has steadily increased. The share of intra-regional trade between China, Japan and Korea grew substantially from 14.1% in 1992 to 20.2% in 1996. It fell abruptly to 16.9% in 1998 after the Asian financial crisis, and then made a remarkable rebound to 20.0% in 1999 before falling slightly to 19.8% in 2000 (See tables 3 and 4)<sup>38</sup>.

However, formal economic integration in Northeast Asia seems hard to achieve in the near future despite the burgeoning interest in regional cooperation. The particularities of Northeast Asia such as diverse political and economic systems, lingering thorny political issues, historical remnants and disparate levels of economic development are restricting and setting conditions to the nature of Northeast Asian economic cooperation. Given these considerations, no serious attempt has been made to consider Northeast Asian economic cooperation as a case of formal economic integration<sup>39</sup>.

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<sup>36</sup> Robyn Lim, « Japan re-engages Southeast Asia », in *Far Eastern Economic Review* (January 24, 2002).

<sup>37</sup> Lee, « China, Japan and Korea Facing the Challenge of Worldwide Regionalism », p. 27.

<sup>38</sup> *Ibid.*, p. 28. However, the intra-regional share between the three countries remains small compared to other regional economic entities. In 1999, the intra-regional share of MERCOSUR was also 20.0%, while the shares of ASEAN and NAFTA were 21.6% and 46.5%, respectively. In 1999, the simple intra-regional concentration rate of China, Japan and Korea (1.69) is lower than those of NAFTA (2.15), ASEAN (3.64) and MERCOSUR (14.61). *Ibid.*, p. 30.

<sup>39</sup> *Ibid.*

## FINANCIAL COOPERATION IN EAST ASIA

The Asian financial crisis in 1997 revealed the need for closer financial cooperation among East Asian countries. East Asian economic cooperation is actually proceeding more rapidly on financial issues than on trade, unlike the European Union and other big precursors. Monetary agreements can proceed without discrimination against outsiders while trade arrangements are politically difficult and slow to organize. Besides, financial problems are more vividly remembered by many East Asian people<sup>40</sup>. Finance ministers in the region have regular meetings at APEC, ASEM, ASEAN+3 meetings and central bank governors have already held meetings since the early 1990s.

Events in other parts of the world provided an impetus for East Asian countries, especially Japan, to enhance regional financial cooperation<sup>41</sup>. The successful launch of the euro pushed the Japanese currency down to a distant third place after the dollar and the euro. To give itself a bigger voice in the new international financial architecture, Japan has to raise the status of the yen in the East Asian region. The successful introduction of the euro after decades of monetary cooperation provided a role model for regional monetary and financial cooperation.

There have been some substantive regional initiatives proposed in response to the crisis in East Asia, preventive as well as curative in nature. Financial cooperation in East Asia includes measures to prevent future crises by preparing sufficient liquidity as well as to strengthen macroeconomic fundamentals at the regional level. Financial cooperation has been discussed in various mechanisms, including the ASEAN, ASEAN+3, APEC, ASEM and other ad hoc bilateral frameworks. The Asian Monetary Fund (AMF) and the Miyazawa Plan represented the Japanese initiative to help the crisis-hit Asian economies recover. The Chiang Mai Initiative, which is associated with bilateral swap agreements, is by far the most visible achievement in the establishment of a regional financing arrangement. Discussions on regional surveillance systems and exchange rate coordination constitute additional pillars of financial cooperation. The ASEAN Action Plan on Social Safety Nets and the APEC (Manila) Framework for Enhanced Asian Regional Cooperation to Promote Financial Stability are also being discussed in the context of regional financial cooperation.

### Chiang Mai Initiative

The creation of a regional liquidity fund has been the first step for the enhancement of the region's ability to weather financial crises. It also aims to provide a functional basis for further cooperation. In fact, East Asia has the financial means to implement a regional

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<sup>40</sup> C. Fred Bergsten, « Towards a Tripartite World », *Economist*, vol. 356, n°8179, 2000, p. 23.

<sup>41</sup> Kwan Chi Hung, « The Possibility of Forming a Yen Bloc Revisited », *ASEAN Economic Bulletin*, Vol. 17, n°2 (August 2000); « The Theory of Optimum Currency Areas and the Possibility of Forming a Yen Bloc in Asia », *Journal of Asian Economics*, Vol. 9, n°4 (Winter 1998).

liquidity fund. In March 2000, the central banks of the ASEAN countries, together with China, Japan and South Korea, collectively had foreign reserves of well over \$800 billion. Including Taiwan, this figure tops \$900 billion<sup>42</sup>. By introducing the ability to mobilize liquidity in the region, East Asia could significantly improve the regional capacity to deal with financial crises. The region has been on a rapid learning curve since the financial crisis<sup>43</sup>.

The ASEAN+3 finance ministers launched the Chiang Mai Initiative and financial self-help and support mechanisms at the regional level at their meeting held in Chiang Mai, Thailand, in May 2000. The Chiang Mai Initiative expanded the existing ASEAN swap arrangement to include all ASEAN members<sup>44</sup> and augmented the ASEAN swap arrangement by a network of bilateral swap arrangements and repurchase agreement facilities among ASEAN countries, China, Japan and South Korea<sup>45</sup>. These mechanisms aim to provide liquidity support to members in the event of temporary balance of payment difficulties. Bilateral swap arrangements (BSA) would be complementary and supplementary to IMF facilities. The terms and modalities of the BSA would take into account the different economic fundamentals, specific circumstances and financing needs of individual countries.

The progress of the Chiang Mai Initiative was reported to the heads of state at the ASEAN+3 Summit in November 2000. The Fifth ASEAN Finance Ministers' Meeting held in Kuala Lumpur in April 2001 and the ASEAN+3 Finance Ministers' Meeting in Honolulu in May 2001 reconfirmed the progress of the Initiative<sup>46</sup>.

Japan has taken the lead in this initiative<sup>47</sup>. China itself has no urgent need for additional liquidity from the region but participated in this framework. Together with Hong Kong's

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<sup>42</sup> Heribert Dieter, « Asia's monetary regionalism », in *Far Eastern Economic Review* (July 6, 2000).

<sup>43</sup> *Ibid.*

<sup>44</sup> Only 5 ASEAN countries (i.e. Indonesia, Malaysia, Philippines, Singapore and Thailand) have been the signatories of the existing ASEAN Swap Arrangement. Under the Chiang Mai Initiative, Brunei Darussalam has agreed to join the ASEAN Swap Arrangement. For Cambodia, Lao PDR, Myanmar and Vietnam, some flexibility were given for their gradual accession into the ASEAN Swap Arrangement. Details on this phasing-in mechanism shall be worked out later.

<sup>45</sup> Under the existing currency swap agreement among the five original members, each country contributes \$40 million for a total of \$200 million. In times of emergency, countries can withdraw up to twice their input in foreign currency funds. The total swap amount was increased to \$1 billion under the Chiang Mai Initiative.

<sup>46</sup> Agreed and ongoing Bilateral Swap Agreements:

- . Japan-Korea: \$5 billion (April 1999), \$2 billion (July 2001)
- . Japan-Malaysia: \$2.5 billion (April 1999), \$1 billion (October 2001)
- . Japan-Thailand: \$3 billion (July 2001)
- . Japan-Philippines: \$3 billion (August 2001)
- . Japan-Singapore (under negotiation)
- . Japan-China (under negotiation)
- . Korea-China (under negotiation)
- . Korea-Thailand (under negotiation).

<sup>47</sup> Bilateral Swap Agreements were made between the dollar provided by Japan and local currencies of recipient countries. It shows that Japan is in the position of donor country.

monetary authority, its central bank has reserves of \$250 billion, more than enough for an economy that enjoys the additional safety net of comprehensive capital controls<sup>48</sup>.

The Chiang Mai Initiative removed two important roadblocks to closer economic cooperation in Asia. Now China is on board and a credible framework for future discussions is in place<sup>49</sup>.

## Japanese Proposals

Since the outbreak of the Asian financial crisis, Japan has taken a pro-active approach in responding to the crisis. About one-third of bank loans to Southeast Asia, on average, have been made by Japanese banks, and Japan has been the single largest country contributor to the IMF-orchestrated financial assistance packages to the crisis-hit Southeast Asian economies.

The AMF proposal in August 1997 suggested creating a pool of available funds to be quickly disbursed to alleviate acute selling pressure from the regional currencies, as well as to provide emergency balance of payment support to the crisis-hit economies. The AMF proposal was never realized due to a strong objection from the US and the IMF.

In the following year, Japanese Finance Minister Kiichi Miyazawa announced a \$30 billion package of measures to aid the crisis-hit Southeast Asian economies. The (New) Miyazawa Plan was expanded to include Vietnam and possibly other transition economies in Southeast Asia. Compared to the earlier AMF proposal, it is primarily funded by Japan on a bilateral basis. The US, other G-7 countries and international economic agencies have all supported the measures this time.

At the Hanoi Summit in December 1998, Prime Minister Keizo Obuchi announced, the establishment of a special facility amounting to \$5.15 billion over three years with preferential interest rates. Japan also announced that it will contribute some \$4.2 million to a UN human security fund to help the region overcome the social aftermath of the economic crisis.

In total, Japan has pledged about \$44 billion of ongoing aid since 1997, and it has been very generous on paper. However, the effectiveness of those aids is doubtful since there have often been an extremely long time lag in implementation<sup>50</sup>.

## The Financial Surveillance Process

The financial surveillance process became an effective mechanism for monitoring the economic and financial developments in the region. The ASEAN surveillance process was

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<sup>48</sup> Heribert Dieter, « Asia's monetary regionalism », in *Far Eastern Economic Review* (July 6, 2000).

<sup>49</sup> Goad, *ibid*.

<sup>50</sup> Lin and Rajan, *ibid*.



active while discussions on regional surveillance mechanisms were going on in APEC, ASEM, and ASEAN+3 meetings.

Since 1999, the ASEAN finance ministers have exchanged views on the recent economic developments and discussed key policy issues to prevent the recurrence of a crisis. The ASEAN finance ministers have set up a surveillance mechanism through which the ASEAN governments could monitor macroeconomic developments in the region and encourage one another, through a process of peer review, to strengthen their economic fundamentals and to push for necessary economic reforms such as consolidating the fiscal budget and restructuring private corporate debt.

The surveillance process was envisaged also to examine the regulatory and supervisory functions in the financial sector, corporate governance issues and various measures of external indebtedness<sup>51</sup>. Technical capacity, human resource training, transparency and timeliness of economic data were also important issues of discussion. The finance ministers also reached an agreement to initiate an early warning system (EWS) in the region, as proposed by South Korea in November 1999.

To support surveillance activities, capacity-building measures were also strengthened with the establishment of local surveillance units in some ASEAN countries in addition to the continued strengthening of the ASEAN Surveillance Coordinating Unit at the ASEAN Secretariat. ASEAN's commitment to further strengthen macroeconomic and financial stability in the region is well reflected in the various activities under the ASEAN Finance Work Program. Since the program was implemented in 1999, considerable progress has been made in the areas of insurance, liberalization of financial services, corporate governance, and capital market development. Negotiations on financial sector liberalization under the ASEAN Framework Agreement on Services (AFAS) have progressed. Efforts to develop the infrastructure, institutions and instruments that will deepen capital markets in ASEAN have also been intensified. However, the ASEAN Secretariat's inability to manage and supervise the mechanism, and the reluctance by some member countries to reveal too much information and data, have been the primary reasons for slow progress<sup>52</sup>.

## **APEC Measures for Financial Cooperation**

APEC has focused on trade and investment liberalization, business facilitation and economic-technical cooperation. At the Fifth APEC Summit in Vancouver in November 1997, the APEC leaders endorsed and called for quick implementation of the « Manila Framework for Enhanced Asia Regional Cooperation to Promote Financial Stability ». The Manila Framework includes 1) a cooperative financing arrangement that would supplement IMF resources; 2) enhanced economic and technical cooperation, particularly in strengthening domestic financial systems and regulatory capacities; and 3) a mechanism for regional surveillance to complement the IMF's global surveillance. However, no substantive steps seem to have been taken since to follow up on the implementation of

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<sup>51</sup> *Ibid.*

<sup>52</sup> *Ibid.*

any of these initiatives. Apart from vague statements about the need to strengthen the international financial architecture, little else has been achieved that is directly related to the regional financial cooperation<sup>53</sup>.

### **Ad Hoc Unilateral and Bilateral Measures**

The lack of formalized institutional structures has led East Asia, especially Southeast Asia, to depend heavily on ad hoc unilateral and bilateral relations to solve problems. For instance, Singapore provided financial and in-kind humanitarian aid to Indonesia during and after the financial crisis. The Malaysian and Filipino central banks signed a bilateral trade payment arrangement. Malaysia has attempted to reach similar bilateral payment agreement schemes with Indonesia and Thailand. While these measures are well-intended, they are really more symbolic than substantive<sup>54</sup>.

### **Toward Deeper Financial Cooperation**

Most financial cooperation measures in East Asia have been focused on recovery from the financial crisis and prevention of its recurrence. The Chiang Mai Initiative has most notably increased this capacity by providing a regional liquidity fund. However, these measures are far from sufficient to enhance the overall level of financial capacity within the region. The Chiang Mai Initiative is a rather loosely connected swap agreement and the amount of the fund is far short of what is needed to deal with financial crises. Efforts to strengthen financial fundamentals through a regional surveillance system and capacity-building measures did not produce the intended outcome, either.

Successful financial cooperation beyond the level of crisis management requires substantial macroeconomic coordination and a synchronization of business cycles. Several proposals of monetary integration have been made and a series of studies are being conducted to examine whether East Asian financial cooperation can move to exchange rate coordination and ultimately to an economic and monetary union such as the EMU. Although ongoing research shows diverse results, the overall degree of economic heterogeneity in East Asia seems much higher than that of the EMU. Macroeconomic coordination among East Asian countries is still at an inchoate stage. Although financial cooperation in East Asia is proceeding quite successfully, financial integration will take much more time and might not even be possible. Forming a monetary union like the EMU seems unrealistic at the current stage.

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<sup>53</sup> *Ibid.*

<sup>54</sup> *Ibid.*

## THE EAVG REPORT: A ROADMAP FOR AN EAST ASIAN COMMUNITY

### Activities of the East Asia Vision Group

The East Asia Vision Group was established to help chart the future of East Asian cooperation. Originally proposed by President Kim Dae-Jung of South Korea at the ASEAN+3 Meeting in Manila in 1998, the first EAVG meeting was convened in the following year in Seoul, Korea<sup>55</sup>. Composed of prominent scholars, former high-level government officials and entrepreneurs, the EAVG has sought for the suggestions which would provide a roadmap for East Asian cooperation. The EAVG meetings were held five times, twice of which were in Seoul, and one each in Shanghai, Tokyo, and Bali. The final EAVG Report was adopted after the fifth meeting in Seoul in May 2001 and was submitted to ASEAN+3 summit held in Brunei, November 4-6, 2001<sup>56</sup>.

### The Vision of East Asian cooperation

- . The EAVG aims at building an *East Asian community*.
- . The EAVG Report stipulates three main objectives of an East Asian community - regional peace, common prosperity and human progress.
- . The Vision Group sees East Asia as moving from a region of nations to a *bona fide* regional community with shared challenges, common aspirations, and a parallel destiny. The economic field, including trade, investment and finance, is expected to serve as a catalyst in the comprehensive community-building process.

### Guiding principles

- . Inclusiveness
- . International Norms
- . Regional Thinking
- . Progressive Institutionalization
- . Harmony with the Global System

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<sup>55</sup> The EAVG proposal reflected Korean aspiration to increase her diplomatic role in East Asia. It also reflected President Kim's interests in regional cooperation. Korea and other East Asian countries had participated in a number of similar vision group activities - APEC, ASEM - and the EAVG could be a relatively easy and practical step to enhance discussion on East Asian cooperation.

<sup>56</sup> « Toward an East Asian Community, » East Asia Vision Group Report, 2001.

## **Background of East Asian cooperation**

. East Asia is quickly becoming a distinctive and crucial region of the world. In the new millennium, irrevocable trends such as globalization, the information revolution, and growing interdependence among nations will present East Asia with new challenges and opportunities for regional collaboration.

. Globalization of the world economy, together with the trend towards regional trading blocs, brings new challenges such as the need to define global standards, harmonize regulations and engage in multilateral trade negotiations. These issues call for more deliberate regional cooperation and coordination as well as a united voice to advance the region's common interests.

. In the past, political rivalries, historical animosities, cultural differences and ideological confrontation posed barriers to cooperation among East Asian nations. Disparities in stages of development, trade and economic policies and financial and legal frameworks have also impeded closer economic cooperation. In the social and cultural realms, significant poverty and illiteracy still plague the lives of millions in the region.

. However, East Asian nations share geographical proximity, many common historical experiences, and similar cultural norms and values. Human resources.

. In particular, the Asian financial crisis of the recent past has provided a strong impetus to strengthen regional cooperation. This has given rise to the recognition that East Asia needs to institutionalize its cooperation to solve similar problems and prevent new ones. (regional solution) But East Asia lacks an institutional framework for region-wide dialogue and cooperation. There is a growing awareness among East Asian countries of the need for a framework at the regional level to manage the dynamic changes ahead.

## **Agenda for Economic Cooperation**

### *Objective*

. The progressive integration of the East Asian economy, ultimately leading to an East Asian economic community.

### *Trade*

. The formation of an East Asia Free Trade Area (EAFTA) and liberalization of trade well ahead of the Bogor Goal set by APEC.

. The establishment of a ministerial committee to oversee the development of an EAFTA.

. The establishment of GSP status and preferential treatment for the least developed countries in the region.

### *Investment*

. The establishment of an East Asian Investment Information Network (EAIIN) to stimulate

intra-regional investment and to improve the transparency of investment-related regulations.

- . The establishment of an East Asia Investment Area (EAIA) by expanding the Framework Agreement on ASEAN Investment Area (AIA) to cover East Asia as a whole.

#### *Developmental and Technological cooperation*

- . The joint development of resources and infrastructure for growth areas in the region and the expansion of financial resources for development.

- . Greater cooperation and assistance be extended to countries at lower levels of development in three priority areas: infrastructure, information technology and human resources development.

- . Technology transfers and joint technology development.

#### *New Economy*

- . The creation of a large pool of well-educated, adaptable and innovative human resources in the New Economy

- . East Asian Internet Project

- . Trans-East Asian Information Superhighway

- . Regional Software Technology Development and Multimedia Content Centers

- . East Asian Venture Capital Network

- . Harmonization of Internet and e-commerce issues.

### **Agenda for Financial Cooperation**

#### *Objective*

- . A staged, two-track approach towards greater financial integration: one track for establishing a self-help financing arrangement and the other for coordinating a suitable exchange rate mechanism among countries in the region.

- . In the long run, the Vision Group envisages the possibility of East Asia evolving into a common currency area, if and when economic, political, social and other linkages develop to a point where tighter forms of monetary integration become feasible and desirable.

#### *Regional Financing Arrangements*

- . The adoption of necessary steps toward the establishment of a full-fledged regional financing facility such as the East Asian Arrangement to Borrow or an East Asian Monetary Fund.

- . The reinforcement of the regional monitoring and surveillance process within East Asia, which would supplement the IMF's global surveillance and Article IV consultation.

### *Regional Exchange Rate Coordination*

- . A more closely coordinated regional exchange rate mechanism.
- . East Asian countries should work out in stages an appropriate exchange rate regime consistent with not only financial stability but also economic development.
- . Flexible but stable exchange rates are more compatible with long-term steady economic development than a pure float.
- . Much closer macroeconomic policy coordination on the monetary and fiscal policy.

## **DISCUSSION: MAJOR ISSUES OF EAST ASIAN ECONOMIC COOPERATION**

### **Obstacles in East Asian Cooperation**

It will undoubtedly take time for East Asia to convert its desires and proposals into meaningful institutional arrangements. Common market and currency unions require both extensive technical cooperation and sustained political determination. However, the actual regional integration in East Asia does not seem to follow the track of an exclusive regional bloc, either *de jure* or *de facto*, but to move toward an open economic region. Can East Asian countries overcome the enormous obstacles confronting the cooperation process? The obstacles in East Asian cooperation can be categorized into structural and institutional problems.

Structural problems include political and economic rivalry, dependence on the US, differences in political and economic systems, cultural and social differences, etc. First, China and Japan are competing with each other for leadership in East Asia. Korea and Taiwan, Hong Kong and Singapore are economic rivals. Countries view one another largely as economic competitors rather than potential collaborators. Second, the US influence has critical importance in East Asia. Many East Asian countries have looked to the United States for markets, investment and protection rather than banding together to provide these by themselves. Heavy reliance on the US in political and economic affairs has made the US intervene directly or indirectly in East Asian cooperation. The negative US response obstructed Mahathir's EAEG proposal a decade ago and the AMF proposal more recently. The US would resist excessive « Asianization » to secure her national interests in this region. Third, differences in political systems, which vary from democracy to authoritarianism and socialism, also hamper efficient East Asian cooperation. Differences in economic system are often related to North-South problem within East Asia. Fourth, cultural and social differences among countries delay regional cooperation. Cultural heterogeneity also extends to much broader categories like consumer behavior, business practices, management methods, and so on<sup>57</sup>. Moreover, security tension still

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<sup>57</sup> Peng, *ibid*.

remains in many parts of East Asia, and historical antipathy among the participating countries still lingers. Together, these heterogeneities in the region result in trade resistance. Furthermore, the informal nature of trade barriers in the region renders formal institutions rather weak in dealing with these trade barriers<sup>58</sup>. All these structural problems are as many obstacles that East Asian cooperation must overcome.

The high level of heterogeneity increased transaction costs of building formal regional institutions for economic integration. Political diversity stems from the differences in political systems<sup>59</sup>. Economically, the level of development varies among East Asian countries.

Institutional problems involve the effectiveness and legalization of regional institutions in East Asia. It was not the lack of institutions itself but the lack of clear goals and visions as well as proper functioning of these institutions that hindered further regional cooperation in East Asia.

Institution building accompanies a redefinition of the traditional concept of state in a new regional context<sup>60</sup>. Interaction within these institutions creates path dependence and vested interest in these settings and arrangements where priority is attached to process and social learning through iteration<sup>61</sup>. In this sense, institutions are important to Asians as a kind of socio-political cement that mitigates self-interest and opportunism.

The biggest problem of East Asian economic cooperation would be the lack of a strong and centralized institution which has a proper mandate and legal capacity. Among the multiple regional cooperative bodies, none has the capacity or mandate to play a central role like the European Commission does. The idea of developing the ASEAN+3 summit into East Asian summit and establish a permanent secretariat is still under discussion.

AFTA has been criticized for its inefficient decision-making system. The veto power of an individual country often has delayed and blocked the discussion of sensitive issues and limited the agenda for discussion. Due to the lack of proper institutional structures, no clear guidelines or binding legal framework has been provided to the member countries.

APEC, one of the region's focal institutions, has revealed a need for a much clearer definition and demarcation of its roles. The overlapping of membership and lack of clear demarcation of responsibilities has resulted in some confusion. APEC is still a rather loose, young and geographically elusive organization. The non-binding nature of APEC limited the institutional development of the regime. Due to the increase of member states, decision-making became more difficult. Open regionalism, which is what APEC stands for, precluded any discriminatory function toward outside countries and dissipated the regional tint<sup>62</sup>. As a result of these institutional weaknesses, the relative effectiveness of the global

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<sup>58</sup> *Ibid.*

<sup>59</sup> So far, all free trade agreements have been reached among countries of similar political systems.

<sup>60</sup> Institutions are, according to the widely accepted definition, « organized rules, codes of conduct and structures that make gains from co-operation possible over time by solving collective actions problems ». Axelrod R. and Keohane, R.O., « Achieving Cooperation under Anarchy: Strategies and Institutions », in Kenneth Oye ed., *Cooperation Under Anarchy*, Princeton, Princeton University Press, 1986.

<sup>61</sup> Richard Higgot, « The International Political Economy of Regionalism: The Asia-Pacific and Europe Compared, », in William D. Coleman and Geoffrey R.D. Underhill eds., *Regionalism and Global Economic Integration: Europe, Asia and the Americas*, London & New York, Routledge, 1998.

<sup>62</sup> It has been said that open regionalism was introduced by the US to prevent the Japan-dominating East

institutions has often obviated these regional institutions.

Regional institutions in East Asia have so far shown low legalization and an aversion to legalization. The density of institutions spanning the region remains far lower than that in Europe or the Americas. The regional institutions constructed with significant East Asian participation have remained highly informal and lacked a legal framework in their design. Formal rules and obligations are limited in number; codes of conduct or principles have been favored over precisely defined agreements; and disputes are settled without delegation to third-party adjudication<sup>63</sup>. Without regional institutions with supranational authority, East Asian economic cooperation has been led by intergovernmental negotiations rather than by the leadership of centralized regional authority<sup>64</sup>. Regional economic integration has often been achieved by informal means such as regional production networks, ethnic business networks and subregional economic zones.

National choices for or against legalization vary according to the context of bargaining. Only ASEAN has embraced increased legalization. Other institutions such as APEC, ARF, and ASEM all lack the elements of legalization. Regional cooperation in East Asia has represented the development of similar discursive strategies by different groups of actors with multi-level regional agendas<sup>65</sup>.

East Asian governments need to make clear their willingness to employ legalized global institutions to resolve both economic and political disputes<sup>66</sup>. The institutionalization of East Asian cooperation should also be accompanied by the development of policy communities encompassing key elite actors from the corporate, government, and research communities.

## Implications From European Integration<sup>67</sup>

Proposing regional integration is much easier than its implementation. It took almost four decades for the Europeans to launch a common market and half a century to introduce a common currency. Considering that European countries have shared more economic,

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Asian economy.

<sup>63</sup> Miles Kahler, « Legalization as Strategy: The Asia-Pacific Case » *International Organization*, vol. 54, n°3 (Summer 2000), p. 549.

<sup>64</sup> For a discussion on intergovernmentalism, see Andrew Moravcsik, « Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community », *International Organization*, vol. 45, 1991; « Preferences and Power in the European Community: A Liberal Intergovernmental Approach », *Journal of Common Market Studies*, vol. 31, n°4, 1993; « Liberal Intergovernmentalism and Integration: A Rejoinder », *Journal of Common Market Studies*, vol. 33, n°4 (1995).

<sup>65</sup> Higgot, *ibid.*, p. 58.

<sup>66</sup> Kahler, *ibid.*, p. 550.

<sup>67</sup> Jae-Seung Lee, « In Search of East Asian Monetary Cooperation: Implications from the European Monetary Integration (in Korean), » *IFANS Policy Research*, n°6 (January 2002).



political and even religious similarities, East Asian integration will be much harder to achieve. More differences than similarities can be found between the experiences of European integration and East Asian cooperation.

The East Asian case is quite different from the European case in targeting trade liberalization and its implementation. While Europe has pursued synchronized regional trade liberalization, East Asian trade liberalization is based on concerted unilateral trade facilitation. While Europe has pursued « across the board » liberalization, East Asian trade liberalization will likely be a sectorally differentiated one. In removing tariff and non-tariff barriers, European trade liberalization was far more comprehensive. While European trade liberalization has been achieved under a legal framework, the East Asian case is still based on peer pressure. Finally, while the European common market was based on free movements of persons, labor migration is still limited in East Asia<sup>68</sup>.

As for financial cooperation, the European experience can hardly be transferable to East Asia, either. First, heterogeneity in East Asian economies is much larger than that in the EU. The emergence of asymmetric shocks<sup>69</sup> will directly test the credibility of exchange rate binding in East Asia. Second, no Asian currency is prepared to take the anchor currency role so that any monetary arrangement in East Asia could gain enough credibility from the market. Third, the East Asian labor market is not flexible enough to buffer asymmetric shocks. In fact, East Asian economies do not seem to sufficiently satisfy the major elements of an optimal currency area-- homogeneity, flexibility, mobility, and fiscal transfers.

Two important implications can be drawn from the experience of European integration. First, fast regional economic integration would be extremely hard to achieve in East Asia and it is strongly recommendable to adopt less ambitious strategies in which feasibility might be the key to enhancing regional cooperation - a « community » with small « c ». Future East Asian cooperation may look more like NAFTA or Mercosur rather than the EU. Second, East Asian cooperation would be advanced largely by a political rationale rather than economic interests<sup>70</sup>. That is, an East Asian community should be a « politically sustainable » economic community. An economic rationale is not sufficient to replicate European economic integration in East Asia. Regional cooperation is impossible without proper political will, even with proper economic reasons. Therefore, a series of political dialogues (ASEAN+3, APEC, ASEM, etc.) is needed to build an East Asian economic community<sup>71</sup>.

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<sup>68</sup> Jae-Seung Lee, « In Search of East Asian Monetary Cooperation: Implications from the European Monetary Integration (in Korean) », *IFANS Policy Research*, n°6 (January 2002).

<sup>69</sup> Rolf J. Langhammer, « Regional Integration APEC Style: Lessons from Regional Integration EU Style, » *ASEAN Economic Bulletin*, April 1999.

<sup>70</sup> The stronger likelihood of asymmetric shocks resulting from the current account and the capital account-« Dutch disease » problems.

<sup>71</sup> *Ibid.*

## Who Will Take the Lead in East Asian Cooperation?

Japan used to be regarded as the leader of the East Asian community. Japan is still a dominant player in East Asia. Japan alone accounts for 70 percent of East Asia's aggregate gross domestic product<sup>72</sup>. Japan's \$4.7 trillion economy is eight times larger than all ASEAN economies combined and it is almost five times larger than the Chinese economy. Japan is the top aid donor to ASEAN members - Malaysia, Indonesia, Thailand, Burma, Cambodia, the Philippines, Vietnam and Laos - and to China. Even after a decade of slow growth, Japanese firms invested more than \$2 billion in the ASEAN economies in 2000<sup>73</sup>. Japan also proposed the AMF and other regional financial institutions.

However, the slump in the Japanese economy, especially the huge volume of bad loans, is posing a threat to its regional leadership. Japanese investments in ASEAN have decreased in value, and their share in total foreign direct investment flows into ASEAN has diminished. This downturn has had an impact on trade between ASEAN and Japan. Its share of ASEAN's trade has diminished since the early 1990s. By 1999, Japan had slipped to the third place among all of ASEAN's trading partners, behind the United States and the European Union. Even in financial cooperation, Japanese leadership does not always have a positive resonance.

« Paradoxically, Japan appears to be both the driving force for monetary regionalism in East Asia and its main opponent. Japan wants to lead the region, but it is only able to supply hollow leadership. Rather than providing the framework for genuine and deep integration, Japan wishes to maintain its status in the region, while at the same time, not provoking criticism in Washington. Such ambivalence, being neither a part of the West nor a widely accepted player in Asia, might have worked in the past. Today, Japan's approach to regionalism, characterized by its preference for hierarchy and its negligence of its neighbours' demands, won't work »<sup>74</sup>.

Instead, the weight has moved to China quite rapidly in recent years. China occupies the central geographical position in East Asia and possesses size as well as demographic weight. With its steady growth, massive market, cheap labor and recent entry into the World Trade Organization, China certainly poses a challenge to the Japanese dominance in the region. The recent figures released by the United Nations Conference on Trade and Development show that foreign investment in China has continued to grow strongly since its accession to the World Trade Organization<sup>75</sup>.

It is important to note that ASEAN declared its first FTA with China at the last ASEAN+3 meeting in Brunei. Chinese membership in WTO will also increase her influence in the Southeast Asian region while Japan is still suffering from a decade-long economic

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<sup>72</sup> David Druger and Murray Hiebert, « Battered but still on top », in *Far Eastern Economic Review* (January 24, 2002).

<sup>73</sup> *Ibid.*

<sup>74</sup> Heribert Dieter, « East Asia's Puzzling Regionalism », *Far Eastern Economic Review*, Hong Kong, July 12, 2001, p.29.

<sup>75</sup> « Markets move toward zero rates », *International Herald Tribune*, 1.31.2002.

recession. Koizumi's recent visit to Southeast Asia attests the growing strategic tension between Japan and China. Fearing the erosion of Japan's influence, Koizumi sought to remind the region that China is not East Asia's only great power<sup>76</sup>. Koizumi has proposed an East Asian community that would include Australia and New Zealand as core members. Japan may have to enlist the U.S. on its side. It is becoming clear that Japan would be able to exert influence in East Asia through its alliance with the U.S. An offshore Japan may not be able to balance Chinese power on its own.

ASEAN is an important actor comprising 10 Southeast Asian countries. However, ASEAN has been far inferior economically compared to the three Northeast Asian countries. The ASEAN countries have enthusiastically sought for investment, but since ASEAN+3 cannot last forever simply as a « financial lender » to ASEAN countries, ASEAN countries need to make an effort to restructure their own markets to attract more private investors from other East Asian countries. To meet the economic challenges of China's attractiveness to foreign investment, the ASEAN countries had to combine their markets in an ASEAN Free Trade Area. It will be tough to compete against a homogenous China that is likely to grow rapidly in the foreseeable future.

Domestic instability among the ASEAN member countries is a big problem that must be solved. Indonesia, ASEAN's de facto leader, has been so plagued by internal political problems that it is unable and seemingly unwilling to be in a position to lead Southeast Asian integration. Singapore may not be able to be more assertive due to its size and various geographical considerations. Singapore had played an active role in launching ASEM. However, Singapore has to go through internal discussion and approval of ASEAN countries to make a proposal at the ASEAN+3 level, which could refrain Singapore from making an aggressive proposal. Malaysia's troubled national car industry and the presence of Islamic fundamentalism may hamper its active participation in accelerating economic integration in Southeast Asia.

South Korea has taken a number of initiatives and is still very active in enhancing regional cooperation. South Korea expects several kinds of benefits from regional integration - bigger market, trade facilitation, financial stabilization, etc. South Korea also wants to increase her diplomatic capacity in East Asia. Even though the economic size and political influence of Korea may not be equal to Japan and China, the role of South Korea is important in that both China and Japan are not in a position to assume overt leadership. They fear each other and other East Asia countries do not want to see a regional superpower. Co-leadership of China and Japan might be necessary in the future (like France and Germany), but it is still premature to project a picture of these co-leaders. There still remain tensions and conflicts between the two countries and the difference in economic and political systems between the two further complicates the problems. Under these circumstances, South Korea may be in a better position to make proposals and facilitate future regional cooperation. Another advantage for South Korea is her geopolitical ties with the US. The US does not want to see any significant progress toward united East Asia where the US is excluded as an outsider. The US objection to the Malaysian proposal of regional cooperation (EAEC) a decade ago is a good example of this policy line. Prime Minister Mahatir's reaction to East Asian financial crisis further complicated this matter. Since South Korea has maintained a firm alliance with the US during past few decades, the South Korea proposal of regional cooperation may avoid over-sensitive reactions from the US *vis-à-vis* the proposal from Malaysia.

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<sup>76</sup> Lim, *ibid.*

## CONCLUSION: NEW GEOPOLITICS IN EAST ASIA

East Asian cooperation will be accelerated in the next few years with dynamic negotiations on trade liberalization and financial cooperation. FTA negotiations will follow as the most visible progress in the future. Financial cooperation also deserves closer observation. Once again, the role of China and Japan, and which of the two countries ASEAN prefers, will be the keys to driving East Asian regional cooperation. As ASEAN revealed its preference for China at the last ASEAN+3 summit, Japan is vigilantly seeking a new alliance to vie with the ASEAN+China bloc. Korea, Singapore, Hong Kong, Taiwan « the four East Asian NIEs - would be indispensable partners for Japan. Meanwhile, these four NIEs will also seek an enhanced relationship with China and the ASEAN countries. East Asian economic cooperation will bring a new geopolitical structure in the region.

The ambitions of Asia's two largest economies would prevent either one from taking the lead in regional economic cooperation. China has long been suspected of wanting to increase its political hegemony in the region and is not willing to cede regional economic leadership to Japan. South Korea, too, is unwilling to play second fiddle to either Japan or China<sup>77</sup>. For Southeast Asian countries, which have been variously colonized, invaded, or pushed around by China or Japan in the past, the prospect of either country expanding influence in the region is a highly sensitive issue<sup>78</sup>.

East Asian cooperation will be activated at the sub-regional level as well<sup>79</sup>. In sub-regional cooperation, the cost of negotiations is minimal and participants can reach a consensus more easily. Considering the limited negotiation capacities of East Asian countries, sub-regional cooperation will be a very feasible agenda. Favorable public opinion for regional cooperation will be an important precondition and will constitute a background for sustainable development of the East Asian community. However, it is crucial to achieve at least certain « tangible » and « substantial » progress in regional cooperation at the beginning. Without this, East Asian cooperation will just be a feast of rhetoric.

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<sup>77</sup> Goad, *ibid.*

<sup>78</sup> Paul Markilie, « Survey: South East Asia: Living together », *The Economist* (February 12, 2000).

<sup>79</sup> Sub-regional level, here, means a specific area smaller than entire East Asia but possibly larger than a single country. It may indicate a more functional economic region. The Mekong River Project might be an example of sub-regional cooperation.

## **Tables**

**Table 1**  
**ASEAN CEPT Tariff Rates**

Average CEPT Tariff Rates						
	1998	1999	2000	2001	2002	2003
Brunei	1.35	1.29	1	0.97	0.94	0.87
Indonesia	7.04	5.85	4.97	4.63	4.2	3.71
Laos	5	5	5	5	5	5
Malaysia	3.58	3.17	2.73	2.54	2.38	2.06
Myanmar	4.47	4.45	4.38	3.32	3.31	3.19
Philippines	7.96	7	5.59	5.07	4.8	3.75
Singapore	0	0	0	0	0	0
Thailand	10.56	9.75	7.4	7.36	6.02	4.64
Vietnam	6.06	3.78	3.3	2.9	2.89	2.02
ASEAN	5.37	4.77	3.87	3.65	3.25	2.68

**Source:** ASEAN Secretariat. Quoted from <http://www.us-asean.org/afta.htm>

**Table 2**  
**Economic importance of China, Japan and Korea in East Asia (%)**

	Share of GDP		Share of Trade	
	World	ASEAN+3	World	ASEAN+3
China	3,5	16,2	3,2	21,6
Japan	14,8	68	6,4	33,7
Korea	1,5	7	2,3	12,6
China+Japan+ Korea	19,8	91,2	11,8	67,9

**Sources:** Calculations for share of GDP based on data from Standard & Poor's DRI, World Economic Outlook, First Quarter, 2001; those for share of world trade based on data from IMF, Direction of Trade, Yearbook 2000; and those for share of ASEAN+3 based on data from IMF, Direction of Trade, Quarterbook June 2001. Quoted from Lee, "China, Japan and Korea Facing the Challenge of Worldwide Regionalism," p.28.

**Table 3**

**Correlation of Trade Structure in East Asia**

	Korea	Taiwan	Hong-Kong	Singapore	Indonesia	Malaysia	Philippines	Thailand	China	Japan	U.S.A.
Korea	1										
Taiwan	0.89	1									
Hong-Kong	0.57	0.82	1								
Singapore	0.34	0.46	0.08	1							
Indonesia	-0.33	-0.09	0.28	-0.53	1						
Malaysia	-0.17	0.11	-0.05	0.78	0.01	1					
Philippines	0.43	0.63	0.9	-0.29	0.59	-0.26	1				
Thailand	0.32	0.66	0.76	0.28	0.57	0.46	0.72	1			
China	0.45	0.71	0.91	-0.07	0.61	0.01	0.96	0.89	1		
Japan	0.63	0.35	-0.02	0.39	-0.92	-0.26	-0.27	-0.43	-0.33	1	
U.S.A.	0.51	0.71	0.46	0.92	-0.42	0.63	0.07	0.48	0.25	0.39	1

Source: Kwan Chi Hung, "The Possibility of Forming a Yen Bloc Revisited," ASEAN Economic Bulletin, Vol.17, n°2 (August 2000).

**Table 4**

**Trade Structures Between Major Regions. (Unit: 100 million, %)**

Import/Export	World	EU	NAFTA	East Asia
World	54,754 (100)	19,210 (35.1)	11,549 (21.1)	12,339(22.5)
EU	20,479 (100)	12,196 (59.6)	1,813 (8.9)	1,644(8.0)
NAFTA	10,100 (100)	1,554 (15.4)	4,964 (49.1)	2,076(20.5)
East Asia	13,870 (100)	1,987 (14.3)	3,344 (24.1)	6,599(47.6)

**Source:** Park Bum Soon and Yoo Jin Suk, "The Measures to Reconstruct Asian Economy" (in Korean), Samsung Economic Research Institute (SERI), 1999.