

AN INTEGRATED ROADMAP FOR EAST ASIAN ECONOMIC INTEGRATION

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Abstract

Since the mid 1990s, there has been a rise in awareness about East Asia a geographical entity and in East Asian regionalism. This is manifested in regional dialogues, specific bilateral and regional free trade agreements, and enhanced financial cooperation among East Asian countries. Because of great diversity in economics, history, and culture among the countries of this region, non economic factors as well as non-state actors have played important role in East Asian regional economic integration. Following the Asian financial crisis, the “flying geese” pattern of development has been replaced with one in which regional clusters form around each new technological breakthrough. Rapid changes in international and regional environment have necessitated drastic policy and structural changes among countries in East Asia. Specialization and division of labor based on comparative advantage resulted in strong linkages in regional trade which has been facilitated by strong investment flows. Establishment of regional institutions such as APEC, ASEAN and ASEAN + 3 has facilitated the market driven forces. East Asian regional integration faces not only economic but also security and political challenges. The latter include the importance of the US in the area, the traditional rivalry between China and Japan, and the potential role of smaller and medium-sized countries. In absence of an accepted regional benevolent great power, East Asian regionalism should be driven by issues and not by political power. Economically, it is critically important that development objectives for less developed economies and liberalization of trade and investment regimes are promoted based on market forces, and in a coherent and consistent manner, and are WTO consistent or WTO-Plus. By being WTO-consistent, the trading arrangements in the region can minimize or avoid the “spaghetti bowl” syndrome that may otherwise result from overlapping and duplication of bilateral trade arrangements.

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1.1 Introduction

The trend towards globalisation and regionalism were felt more strongly after the end of the Cold War. However, since the mid-1980s there were several forces that have strengthened economic integration and led to the liberalisation of trade and investment regimes of many East Asian countries, increasing foreign direct investment into Southeast Asia, stronger economic involvement of Newly Industrialised Economies (NIEs) and the emergence of China as an economic powerhouse. In recent years, however, there is a rise in consciousness of East Asia a geographic entity and a greater sense of East Asian regional cohesion. This effort comprised of regional dialogue, specific bilateral or regional free trade agreements and enhanced financial cooperation.

There are global trends towards liberalisation and deregulation and a paradigm shift from industrial to information technology. Advances in information technology and the easing of national controls on the flow of goods, services and capital have made it possible for the rapid development of borderless and cross-border production networks. Trade and economic integration in the European Union (EU) and North American Free Trade Area (NAFTA) accelerated the global trends towards regionalism.

China as an emerging economic powerhouse, its accession to the World Trade Organisation (WTO) in November 2001 opened up tremendous opportunities, challenges to other East Asian economies of ASEAN, Japan and South Korea. Even before becoming a formal member of WTO, China was enjoying the benefits of the status of most-favoured nations (MFN) from the US and EU on a year to year basis. After becoming a WTO member, China is bound by its accession commitments for further liberalisation and de-regulation of its very rapidly growing economy.

The Asian financial crisis exposed the inherent financial and economic structural weaknesses of countries that were showing declining industrial competitiveness. The domino effect of the crisis led to the financial meltdown in several economies and the need for restructuring and upgrading of the affected economies. Most East Asian economies did not return to its pre-crisis economic dynamism. In 2000, discussions and initiatives for an East Asian Free Trade Area arose in the wake of the failure in negotiations at World Trade Organisation (WTO) in Seattle. As such, there is a departure from the previous strong stance against regionalism. The factors that draw East Asian nations together, however, are also factors that present challenges and problems to a regional integration of East Asia.

1.2 Non-Economic Regionalism

East Asia is economically, historically and culturally divided. The nations in the region vary in population, economic size, affluence, openness to trade and investment. Social and economic commonalities are largely almost non-existent. The great disparity in size and affluence in East Asian nations makes it more difficult to create a regional cohesion.

Creating an East Asian regional bloc would also counter the rise of Western trade blocs of EU and NAFTA. If the EU and NAFTA imply a rising amount of intra-regional trade among themselves, East Asian nations, which have a strong trade connections with both the US and Europe, would be hurt.

There is also some resentment over the response of the US and the International Monetary Fund (IMF) to the 1997 Asian financial crisis. On the one hand, there was concern over America's lack of interest in the region, despite the existence of APEC. On the other hand, when IMF became involved, dissatisfaction arose over the stringent conditions attached to IMF assistance.

East Asia faces a lack of leadership, although China and Japan are seen as natural candidates for regional leadership. However, their relationship is troubled by suspicion

and differences notwithstanding the high levels of investment that Japan has in China and the reasons are of course historical dating back to World War II. Japan's relationship with China is also complicated by Japan's dependency on the US alliance for its security, its own decade long recession and present attempt at reform.

The smaller- and medium-sized countries in East Asia as a collaborative group as ASEAN, may have a greater role to play than their size or power would normally dictate to fill in the gap for default leadership. This can be seen in the field of bilateral free trade agreements (FTA). Free trade negotiations with China on the one hand and Japan on the other have placed ASEAN at the centre of regional FTA efforts in East Asia.

The leadership of ASEAN may not be sufficient for an EAFTA. This is especially since the ASEAN needs much more efforts for further integration. The ASEAN+3 process that brought ASEAN together with three North East Asian countries (China, Japan and South Korea) has made progress in fostering cooperation in, for example, prevention of the recurrence of a financial crisis, addressing the spread of public health threats like severe acute respiratory syndrome (SARS). For ASEAN to continue to play its part in promoting a wider East Asian regionalism and an EAFTA (East Asia Free Trade Area), it is essential that member states of ASEAN proceed to broaden, deepen and quicken their own economic integration to form an ASEAN Economic Community (AEC). In this effort, the development needs of newer and less developed ASEAN member states of Cambodia, Myanmar, Laos and Vietnam (CMLV) must be addressed. Producing regional public goods by more developed East Asian countries are needed to ensure long term benefit to all.

Non-state actors also play an important role in regional economic integration. The cost-benefit calculations at the corporation level, cross-border state business dynamics has been a determinant to regional economic stability. The underlying market-driven forces of economic regionalisation suggest that to achieve economic stability, the interests of the

private sector should be incorporated. Access to technologies in the region is now the key factor to identify new sources of economic growth. Foreign direct investment (FDI) inflows and technology transfers are increasingly concentrated in a handful of economies.

Trans-border and non-traditional security issues caused by underdevelopment and economic inequality such as massive migration flows from relatively poor economies to neighbouring countries, trans-national crime, poverty and human security issues, were of wide concern among the region's economies during the post-crisis period. Although measures and approaches taken by different mechanisms such as ASEAN projects of poverty eradication through human development, the root causes of underdevelopment and economic disparity to regional stability have been seriously examined by regional efforts. In addition to the new security agenda, the changing patterns of regional cooperation toward a rule-based cooperation, the new geo-economic power structure in the region and the involvement of non-state actors in regional affairs have added new variables and elements to regional cooperation.

1.3 Economic Regionalism

In the aftermath of the Asian economic crisis, the "flying geese" pattern of development, i.e. there was a leader with a group of countries following behind at different rates of growth, became less relevant. The development pattern emerging in East Asia seems to be one in which regional clusters formed around each new technological breakthrough. The regional pattern of network based development driven by FDI and application of IT depends on the comparative advantages of each economy. The competitive advantages of an economy is gaining more prominence and influence and is increasingly influenced by the choice of policies and their implementation as well as by the networking activities of corporations, rather than mere factor endowments as was the case in the past. To compete in such environments, these economies need to have a flexible and productive

labour force, good public and corporate governance and an industrial structure that reflects the importance of information technology.

Economic globalisation and the IT revolution are reducing the competitiveness of the large vertically integrated industrial organisations. Networked organisations that utilise outsourcing and supply-chain management are more suited to the new IT environment than self-contained organisations such as chaebols, keiretsu and many industrial conglomerates in ASEAN countries.

Other fundamental changes that are taking place are liberalisation and deregulation. These measures are intended to enhance industrial efficiency by eliminating distortions in the allocation of resources. The Asian economic crisis seemed to have significantly accelerated the liberalisation of those economies but the pace is slow due to slow growth and lack of structural reforms. Many elements of competitive advantage can be shaped by government policies by developing physical and regulatory infrastructure and by initially subsidising investments to enhance industrial clusters.

Rapid changes in international and regional environment have necessitated drastic policy and structural changes among countries in East Asia. Mature and relatively more developed economies in the region have to continually upgrade and restructure otherwise these economies would be experiencing “de-industrialising” (hollowing effect) and creating important domestic resistances towards regional trade and investment liberalisation. With each country pursuing its own industrialisation policy without a certain regional coordination, it was difficult to promote cooperation when similar industries are involved.

As ASEAN implements the ASEAN Free Trade Area (AFTA) through tariff reduction, market liberalisation inevitably leads to industrial adjustment and upgrading among ASEAN countries. Without a region-wide consistency in bilateral trade rules, there is a great risk of having a “spaghetti bowl syndrome” in East Asian FTAs. Thus it is argued

that there is a need to harmonise all existing sub-regional FTAs in order to move forward towards the formation of EAFTA (East Asia Free Trade Area).

2. Trade and investment linkages

2.1 Trade

The underlying forces of East Asian economic regionalism that emerged in the 1990s were the strong linkages between trade and investment. FDI was once largely induced by trade protectionism of host countries. In order to escape tariff and non-tariff trade barriers, multinationals were compelled to locate production facilities in host countries. With the increased globalisation of production, innovation and financing by multinationals, the internalisation of business now tends to be the result of multinationals' strategies to diversify risks, minimise costs and maximise performance. In East Asia, market forces in trade and FDI linkages have utilised productive resources region-wide and bound industries and firms across borders.

A large number of trade barriers across East Asia have already been lowered. Average tariff rates in most East Asian economies have fallen from their high levels of 30-40 per cent to 5-10 per cent recently. Some academics argued that easy gains from trade liberalisation have already been reaped however there is still a strong case to be made for trade liberalisation in East Asia and in particular through the mechanism of regional integration. There is still a marked difference in the level of openness between sectors. Most of the barriers that still remain for trade in goods lie in the sensitive sectors of each economy.

2.1.1 Sensitive goods

The range of market access barriers employed by countries consists mainly of three types – (a) tariffs, (b) domestic support (c) export subsidies. In terms of benefit, the lowering of tariffs has the greatest welfare effect but the benefits of the other two cannot be underestimated either. Reducing barriers in this area is particularly beneficial if pursued

by an EAFTA as opposed to smaller initiatives. For example, an EAFTA would raise the net agricultural exports of ASEAN and China.

In order for East Asian integration to be successful, it is necessary for economies to deal with such sensitive sectors. Doing so will help to significantly decrease regional income disparity and allow poorer economies better means to deal with economic restructuring and trade facilitation. Moreover, it is important that the competitive areas in sensitive sectors are liberalised. The tariff reductions for agriculture have largely been in non-competitive areas and hence gains from trade cannot be fully achieved.

There has been a large debate over the ambiguity of the expression “substantially all trade”. Should this phrase be interpreted as a quantitative issue and does it allow for the exclusion of entire major sectors such as agriculture? The WTO members failed to come to an agreement on this. At the APEC level, the guiding principles of “comprehensiveness” and “flexibility” are open to interpretation. A possible solution to such problems of ambiguities would be to develop broad and comprehensive inclusion lists with timetables such as in AFTA’s CEPT (Common Effective Preferential Tariff) scheme or the “Early Harvest” schemes in ASEAN-China FTA.

2.1.2 Services

Unlike liberalisation of goods, countries in East Asia are particularly resistant to liberalisation of service sectors. Initiative for service liberalisation in ASEAN came about after the 1995 ASEAN Bangkok Summit where ASEAN countries agreed to launch negotiations in seven service sectors namely banking, tourism, air and maritime transportation, telecommunications, construction and professional services. This was termed the ASEAN Framework Agreement of Services (AFAS). A positive list approach was used and members are required to place requests and offers on liberalising their respective service sectors.

AFAS has not been particularly successful and the actual commitments in General Agreement on Trade in Services (GATS) are only marginal. Restrictions such as barriers to market access including investment restrictions (i.e. control of foreign equity share in domestic enterprises), type of commercial establishment allowed, the scope of services and employment of foreign personnel continue to plague ASEAN members services sector. In areas where members are relatively competitive, high protectionist barriers in terms of non-tariff barriers (NTBs) such as customs procedures and technical standards, still remain.

Many service sectors such as telecommunications, transportation and utilities are still dominated by inefficient state-owned enterprises or monopolistic private operators who usually have significant political clout. This trend is gradually changing, largely due to the emergence of outsourcing and the effect of GATS in the developed economies of the region.

Liberalisation of services in East Asia can be better achieved if pursued at a regional level with a wider grouping such as the ASEAN+3. There is compelling evidence that points at large productivity gains associated with efficient services. Competitiveness in high value products, differentiated agriculture and in manufacturing is dependent on efficient services. Lowering trade barriers through regional trade agreements is a means to improve the efficiency of protected services sectors through regional exposure and hence reap the wide benefits in manufacturing and high value-added agriculture.

It is more beneficial for countries to expose the services sector to a wider region-wide group such as ASEAN+3 as opposed to bilateral groups to leverage on and maximise on the high costs related to and characteristic of the services industries. A wider regional arrangement can allow for greater policy space as it takes into consideration the diversity in the region as well as the socio-political and geopolitical issues that abound whilst still allowing for gains from liberalisation. It allows smaller states to have greater bargaining

power and a greater sense of security as well. It is also necessary to countries to institute reforms with broad development objectives in mind such as effective regulation in the event of market failure and pro-competitive regulation.

2.2 Investment/Trade facilitation

Trade facilitation can broadly be defined as an effort to pursue greater 'convenience' in international trade through the simplification of economic activities such as the movement of goods and services across borders. Simply put, this means a reduction and eventual elimination of non-tariff barriers through mechanisms such as customs procedures, standards and conformance, quarantine, government procurement, and e-commerce. Some preferential trade agreements also include provisions on anti-dumping, safeguards, countervailing measures, labour and environmental standards. Trade facilitation also includes 'behind-the-border' issues such as competition policy, intellectual property and harmonisation of business and tax laws. Agreements that contain these mechanisms and a wide coverage of facilitation measures have come to be termed as 'closer economic partnerships'.

In an analysis performed by APEC, results indicated that the effects of trade facilitation are far superior and more practical than the effects of trade liberalisation. According to the most conservative figures in a survey performed by APEC, a 50 per cent improvement in trade facilitation would result in an average trade cost reduction effect of 2.9 per cent for industrialised and newly industrialised economies and in the case of developing economies, the effect is 3.5 per cent. There are also several trends that can be observed. Firstly, relatively less developed East Asian economies that have smaller domestic markets and more dependent on regional export markets enjoy bigger gains from freer trade. The distribution of the beneficial effects of trade facilitation depends on intra-

regional trade share and trade dependency. The higher intra-regional trade share and the higher its trade dependency, the bigger its GDP growth gains from trade facilitation. Consequently, most East Asian economies including developing economies have experienced an increased dependency on regional trade. Poorer East Asian economies may have a smaller intra-regional trade share but may have higher trade dependency ratios than more developed economies in the region and therefore still make significant gains from trade facilitation.

3. Regional Institutions

3.1 Asia Pacific Economic Cooperation

Since its inception in 1989, APEC has become the major forum for broad regional dialogue. Each member government can choose to adopt or not, proposals made. Over the years, APEC has morphed into a bureaucratic machine and many doubt its relevancy and purpose in the wake of the 1997 Asian financial crisis. The general consensus is that APEC is still relevant and its vision remains one of the ways towards liberalised and open trade regime in the region. In 1994 in Bogor, Indonesia, the eminent persons group (EPG) of the members of APEC adopted the proposal for free trade which called for developed economies to achieve free trade status by 2010 and developing members by 2020. However, the Bogor Declaration aims to achieve “open regionalism” and “free trade. The 1995 Osaka Action Agenda laid out the blue print for achieving the broad goals of the Bogor Declaration and eliminating trade barriers. The 1995 Osaka agreement established a liberalisation process in the APEC Individual Action Plan (IAP).

In the 1996 Manila meeting, initial reports from all member countries on their individual action plans (IAP) to advance APEC goals were presented. Greater formality and clarity in the review of the IAPs in meeting in Shanghai in 2001 was a great step forward but APEC remains stuck with a trade liberalisation process in which unilateral action is the only aspect of EPG’s four-part recommendation that has been put in place. More importantly,

the annual ministerial meeting prior to the APEC summit meeting in Shanghai established a goal of reducing transaction costs associated with trade by 5 per cent in 2006.

APEC members also tried to jump start trade liberalisation process by approving an information technology agreement calling for complete elimination of tariffs on a wide range of information technology products to be endorsed and forwarded to WTO. However, no financial resources for implementing any project rely entirely on the voluntary action of donor countries to adopt them.

The limitations cited above are one of the reason members have turned to bilateral and sub-regional free trade negotiations. But there are four main achievements that continue to make APEC a relevant regional institution. First, APEC encourages government officials across the region in regular dialogue and promotes a specific action agenda. Specific accomplishments on APEC policy, especially reduction in tariffs, have been quite successful; the engagement of these officials in regular dialogue has a cumulative effect on their thinking about liberalisation.

Second, APEC appears to be making progress on the trade facilitation agenda, albeit the progress is not ambitious. The goal of voluntary 5 per cent reduction in transaction costs does represent a specific goal driving APEC discussions toward specific proposals and easing access to markets. Third, the Ecotech (Economic and Technical) agenda is worthwhile. APEC includes developed and developing nations and the opportunity to address development issues for the mutual benefit of all works to the advantage of all members. Fourth, the leaders' meetings are not always focused on the economic agenda as it also provides an opportunity for holding a number of bilateral meetings in addition to the formal group meeting.

3.2 ASEAN

ASEAN is being currently challenged to response to a developing number of FTAs with other countries and regions. Contemporaneously, ASEAN is pursuing a series of bilateral

FTAs with the same countries in the region and there is a danger that ASEAN will end up with a series of FTAs which could be inconsistent with each other and lead to negative implications. To achieve a regional trade agreement with ASEAN, ASEAN-China FTA emerged with a regional and bilateral component. ASEAN has also recently signed an agreement with Australia, New Zealand, the AFTA-CER Closer Economic Partnership. There is also an agreement to start the process towards realising an ASEAN-Japan Closer Economic Partnership. In October 2002, US also proposed an Enterprise for ASEAN Initiative which have bilateral trade, investment and facilitation agreements (TIFA) as the basis. In the ASEAN Summit Meeting in Bali in October 2003, India also proposed a free trade area with ASEAN.

The trend seems to indicate that ASEAN has inadvertently taken the route of developing economic co-operation through the ASEAN+1 framework, combined with a series of bilateral agreements. Therefore it would appear that ASEAN had been placed in the position for being the “hub” for East Asia regional co-operation. ASEAN has perhaps gained this position by default as there is a vacuum for leadership amongst the Northeast Asian countries.

Despite the proliferation of FTAs, the level of intraregional trade is low. ASEAN began with 12 per cent intra-regional trade when ASEAN was formed. In the 1980s, only 13 per cent of imports of the original five members of ASEAN came from within the group and only 17 per cent of exports were sent to group members despite their geographic proximity. This low level of intra-ASEAN trade explains why preferential trade agreements were not originally high on the ASEAN agenda. After the full implementation of AFTA at the beginning of 2003, intra-ASEAN trade remained around 20 per cent, partly because the margin of preferential between AFTA and the multilateral level is small and there are significant non-tariff barriers among ASEAN countries.

The other reason that held back intra-ASEAN trade cooperation for so long was the group's belief that its members' economic structures and trade patterns were more competitive than complementary. ASEAN eventually realised that the benefits of preferential trade arrangements might help raise its trade shares and work to the mutual benefit of members. ASEAN expanded its membership to include four new members - Cambodia, Laos, Myanmar, and Vietnam (CLMV).

The non-interference principle in the domestic affairs of individual members has prevented ASEAN from adopting a policy of discussing and occasionally criticising the performance and policies of member states. Therefore the group has no mechanism for maintaining mutual surveillance and pressure on individual members to pursue collective economic policies. For ASEAN to become more effective in the East Asian regionalisation process, there must be greater co-ordination and enhancement in political economic and social and cultural domains.

3.3 ASEAN+3

In 1997, the ASEAN+3 process was established to employ various measures geared towards the expanding and deepening cooperation between Northeast and Southeast Asia. ASEAN+3 leaders adopted a Joint Statement on East Asian Cooperation in 1999. In its wake, the East Asia Vision Group (EAVG) and East Asia Study Group (EASG) were set up to assess the viability of an East Asian Community. In the field of economic cooperation, EAVG suggested the formation of an EAFTA to be achieved well ahead of the Bogor Goal of trade liberalisation set by APEC. The formation of EAFTA would occur through the consolidation of all existing bilateral and sub-regional FTAs in the region.

A rough framework was also established to define the characteristics of EAFTA. It was proposed that CMLV countries would be given preferential treatment and GSP status. An East Asian Investment Information Network (EAIIN) was also proposed to facilitate intra-regional investment flows by providing comprehensive and up to date information on

investment opportunities in the individual East Asian economies. The EAIN would complement current information providing initiatives such as in ASEAN Investment Area (AIA) and the ASEAN-Japan Center activities. It was also proposed that AIA be expanded and possibly evolve to become an East Asian Investment Area (EAIA).

EAVG also proposed that East Asian economies would assist and cooperate in four priority areas: infrastructure, IT, human resources development and ASEAN regional economic integration. At this juncture, the notion of an East Asian Community is still in its embryonic stages. However, cooperation at the ASEAN+3 level has already begun to take concrete shape. One effort currently on the way is the Chiang Mai Initiative whose goal is to construct a regional financial mechanism geared at preventing a future financial crisis. This is a mechanism devised by the ASEAN+3 group to establish bilateral swap arrangements as a virtual safety. Although the first concrete measure has been established, the progression of a seamless market in East Asia in the form of the EAFTA is still wrought with multitudinous obstacles and challenges.

3.4 Challenges facing East Asian regionalism

There are a number of factors that are drawing East Asian together more closely, economically, culturally and socially. There are, however, other factors that stand as challenges or even obstacles to regionalism.

The first major factor is the importance of the US to the region as a whole and to certain countries in particular. The US is a very important source of foreign direct investment and export market to practically all East Asian economies and will continue to be for a long time to come, although at a decreasing rate. On security, the US presence has been the foundation pillar of security in the region. Japan and South Korea in Northeast Asian, Thailand and the Philippines and Singapore have close defence arrangements with the US. As the region becomes more developed economically and as China gradually becomes a major economic and military power in East Asia, how the perception and relationship

between the US and major regional countries would evolve is a vital issue to be addressed. Therefore, a mature and robust foreign policy is required by major individual governments in the region. Otherwise, the region would be involved with increased uncertainty and insecurity.

The second factor is China-Japan relations. The relationship is affected by suspicion and negative historical baggage. For the sake of East Asian integration and community, we must find a mechanism and framework whereby overtime the interest of both China and Japan would increasingly merge and provide synergy for the economic and political benefit of the region as a whole. In this respect, there is a potential role that ASEAN can play in harmonizing and converging potential rivalry between China and Japan into a regional positive sum-game. Such a possibility is more likely if ASEAN can play an effective and forceful “hub” (by default) in the region. In order to achieve this objective, it is also important that Japan continues its much needed reform, although its economy has showed vital signs of economic recovery, as suggested by the Japan 21st Century Commission’s report which calls for more radical reforms and “internationalization” of Japan.

The third factor is the potential role of smaller and medium-sized countries in East Asia, such as South Korea and those of ASEAN may have a greater role to play. This is linked to the idea that East Asian regionalism should be driven by issues and not by political power in the absence of accepted regional benevolent great power.

The fourth factor is that East Asian regionalism should be open, flexible and guided by functionality. These characteristics are needed to be able to manage and cooperate in the face of integration and globalization.

According to the established theory of regional integration, there are two pre-conditions in which regionalism can work. The first is that of “strong market pressures for integration” which will arise where there is significant potential for economic gains from market

exchange in the region. The second pre-condition is that of “undisputed leadership” in a sense there must be a “benevolent leading country” in the region that has the willingness and capacity to create regional public goods for the benefit of all constituent regional members. In the case of East Asian regionalism, there is a strong market pressures for integration but it is inadequate with respect to the necessary institutions and mechanism to harmonize and integrate these market forces. With the second pre-condition, the East Asian regionalism has even weaker existing condition to succeed. Therefore, the logical strategy is to strengthen and maximize the pressures of market forces to integrate and in the process of it a sense of regional identity and stakeholder will drive East Asia forward towards a “community of the willing” through a shared opportunity and destiny.

From an economic point of view, several studies have shown that such initiatives will bring greater benefits to its members if it involves a larger grouping. However, in practice, it might be difficult to achieve this, given the diverse economic interests. Even ASEAN+1 formats, although appearing to be more feasible than an overall arrangement amongst all ASEAN+3 members, yet a series of ASEAN+1 arrangements may be more difficult to manage and it may create an overlapping and duplicating trade and investment rules and regulations and thus increase the transaction costs of doing business in the region. The ASEAN-China FTA process is proceeding well and it is expected to be concluded on the goods sector sometime this year. While the ASEAN-Japan FTA process is still in early stage of negotiations.

In addition to ASEAN + 1 format, bilateral FTAs have been established and initiated by some East Asian economies. For example, Japan-Singapore Economic Partnership Agreement (JSEPA) was concluded in January and became effective in October 2003. Japan is currently undergoing negotiations on bilateral FTAs with Thailand, Malaysia and the Philippines.

Having such complex overlapping and possible duplication of regional and bilateral FTAs in East Asia, it is therefore of vital importance that the agreements meet Article 24 of the WTO and as much as possible they are WTO-consistent or better still WTO-Plus. Otherwise, East Asian FTAs would be afflicted with the “spaghetti bowl syndrome” whereby inefficiency, duplication and overlapping would increase transaction costs, trade and investment distortions and regional misallocation of resources.

4. Summary and Conclusions

East Asia is characterized with great diversity in political, social and economic dimensions. At the same time, it has the greatest potential to develop into a regional economic power as it has the resources, technology and market to achieve its potential and objective. The greatest challenge for the region is to manage its differences, especially in the short-run, and transform its diversity to create a regional competitiveness through increased intra-regional flows in trade and investment. East Asian has to harness its strong market pressure to integrate through the establishment of regional institutions and mechanisms based on comparative advantage and the principle of open regionalism.

Due to the absence of a regional structure of consensus in Northeast Asia, it is important that ASEAN, by default, becomes the “hub” of East Asian regionalisation, at least in the transition period, with the view to engage peacefully and productively the cooperation of China and Japan. In other words, ASEAN would smooth-out and “regionalise” the potential antagonism of China and Japan for the interest of East Asian political stability and common economic prosperity.

Because of the existence of many regional and bilateral FTAs arrangements in East Asia, it is vitally important that these arrangements adhere to a common framework and

principles with a view to standardised and harmonized overlapping FTAs agreement. At the same time, more developed economies in the region would provide development assistance and regional “public goods” in order to redistribute regional welfare and to reduce the gap between more and less developed economies in East Asia.

While it is correct to put more weight on economic benefits of regional integration in the early stage, social, cultural and security issues must gradually be discussed and integrated to increase a sense of regional identity and to cultivate the habit of working together towards an East Asian community building. Specifically, ASEAN has set the framework along this line by having ASEAN Economic Community at the same time setting up the foundation for ASEAN Security Community and ASEAN Socio-Cultural Community as embodied at the ASEAN Concord II agreement.

Economic cooperation in East Asia is political as much as economic, at least in the initial period. The ultimate aim of economic cooperation is to help participating economies to realize their full potential for sustainable growth. The initiative for economic integration is a crucial part of this effort. Reducing the costs and risks of international trade through reducing border barriers (liberalization) or making other economic policies more compatible (facilitation) is also an important means of promoting economic integration. Before the Asian financial crisis in 1997, East Asian economies relied more on multilateral trading arrangement under the WTO rather than regional and bilateral trading arrangements. Even, the ASEAN Free Trade Area (AFTA) which was initiated in 1992 and became fully operational by end of 2003 was not effectively operated as a regional economic cooperation mechanism. AFTA was intended more as an instrument to make ASEAN economies more attractive as foreign direct investment destination rather than as a primary vehicle to integrate ASEAN economies. The Asian financial and economic crisis changed dramatically East Asian economies from merely dependent on multilateral trading regime to also simultaneously promoting regional and bilateral economic cooperation. In

recent decades, the most powerful force for economic integration in East Asia has been the willingness of most of the regional economies to open-up to the outside world, encouraging international cooperation in domestic markets. In the context of generally non-discriminatory global trading system, this has allowed greater specialization in line with evolving comparative advantage. Another regional event that greatly stimulates regional economic cooperation is the emergence of China as an economic power which has accelerated the process of regional and bilateral economic cooperation and integration more effectively than other inter-governmental initiatives aimed to reduce formal border barriers to trade and investment.

Initiatives towards East Asian economic cooperation are seen as more than trading arrangements but as a larger goal to promote each others' economic prospects and boost capacity for development, creating more links between the region's transport, communication and energy infrastructure and efforts to reduce policy impediments to economic integration. In fact, the APEC process has aimed to strike an appropriate balance between efforts to reduce trade barriers and other means to boost the capacity of Asia-Pacific economies and to take full advantage of opportunities for growth created by changing technology as well as by movement towards free and open trade and investment regime.

In the past, East Asian economies have sought to place more emphasis on capacity-building than on liberalizing or facilitating trade and investment. Recent efforts towards economic cooperation have been dominated by free trade areas and comprehensive economic partnership agreements. However, it is far from clear that bilateral and regional trade policy objectives are being promoted in a coherent and consistent manner, using the policy options available, ranging from unilateral to multilateral policy choices in order to tackle a diverse range of impediments to economic integration. Indeed, theoretically, regional and bilateral trading arrangements are no substitute for the WTO principle of

Most-favoured Nations (MFN). Several studies have shown that such initiatives will bring greater benefits to its members, if it involves a larger grouping. In other words, the ASEAN + 3 framework should be more desirable than a series of ASEAN + 1 arrangements. However, in practice it will be difficult to achieve this, given the diverse economic interests involved. Therefore, the ASEAN + 1 format appear to be more feasible than an overall arrangement of ASEAN + 3. At the same time, it should be noted that a series of ASEAN + 1 arrangement are more difficult to manage and would more likely create duplication and distortions.

In such a scenario, ASEAN should maximize its strategic “hub” position by strengthening its role in developing the various agreements and in managing them. Without such a regional integrated framework, ASEAN will be left with a series of agreements that are very different from each other, particularly with the view that there are many bilateral FTAs being initiated and having been concluded between China, Japan or Korea with individual ASEAN countries. Therefore, it is imperative for ASEAN to be pro-active and to assert itself in crafting the arrangements to ensure that they are consistent and actually build upon each other as well as the building blocks for the multilateral trading system. Indeed, it should be in the East Asian common interest to have a broad or comprehensive agreement that can accommodate the interest of its diverse members. It is the comprehensiveness which implies the element of broad coverage, various instruments and variable depth in the trade agreement that provides the necessary flexibility to meet the diversity of the East Asian economic requirements. It is in this sense that free trade agreements in East Asia must have facilitation and cooperation focus in addition to reducing tariff rates and liberalizing trade regimes. Within this broader framework, progress in the FTA elements will be assessed as part of the overall development of economic cooperation.

The proliferation of bilateral FTAs in ASEAN raises the concern as to the extent to which such FTAs could complement or hinder the ongoing economic integration process in ASEAN. This concern is particularly relevant given the fact that prevailing economic diversity among ASEAN members calls for a concerted approach towards integration. In this context, one of the principal challenges for economic integration among ASEAN countries is to increase the pace of liberalization and undertake necessary structural and institutional reforms in member countries whenever required as this would make ASEAN members more competitive. In turn, domestic reforms could possibly facilitate individual ASEAN countries to improve upon their global competitiveness and hence complement economic integration in ASEAN and East Asia as a whole.

Since East Asia consists of a diverse group of economies who are also involved in regional-wide and bilateral FTAs, it is important to ensure a certain degree of consistency with respect to their terms of coverage of sectors, rules of origins and the depth of tariff reductions. Unless such consistency is achieved, it can lead to problems for East Asian economies in managing their external trade relation and will increase business cost instead. To avoid this situation, the best strategy would be to adopt some kind of a common framework agreement in East Asia that could form the basis for future region-wide and bilateral FTA negotiations. This common framework should focus on the sequencing and timing of the agreements, their nature and coverage of sectors, and the implementation mechanisms to be involved.

In general, most of the FTAs that have been signed or ongoing in East Asia appear to be comprehensive in coverage. This helps to accommodate the interests of a large and diverse group of participating economies. An important aspect in this context concerns the negotiations in the agricultural sector in a bilateral FTA involving ASEAN. In the Japan-Singapore Economic Partnership Agreement (JSEPA), it has not involved the agricultural sector in the agreement since this sector, though of importance to Japan, is not important

to Singapore. Thus, JSEPA is considered as being WTO-consistent. However, such exclusion would not be considered as WTO-consistent for other ASEAN members when negotiating their bilateral FTAs with Japan and Korea while China has given developing ASEAN members “early harvest” treatment in agricultural sector. As such negotiations of agricultural sector is likely to be a sensitive issue for East Asian economies when engaging bilateral FTAs and it would require reconciliation between domestic policies and external imperatives.

Basically, the main focus of a free trade agreement is to eliminate tariff and non-tariff barriers (NTBs) in order to enhance market access between trading partners, although trade facilitation and business cooperation are equally important in the case of East Asian economic integration. Tariff barriers and non-tariff barriers reductions on goods are considered priorities for trade negotiation, especially for agreements between developed and developing countries of the region. Several modalities have been adopted such as an early harvest mechanism, a sensitive list or even exclusion list, and a “positive list” or “negative list” approach. The complication of the modality depends on the tariff structure of the negotiating partners. This seems to be more of political issues than economic ones. In addition, a timeframe in which tariffs are phasing out needs to be determined.

The reduction of non-tariff barriers, such as quotas, export subsidies and domestic subsidies is a crucial feature in many FTA negotiations in other parts of the world as well as in East Asia. In addition, investment agreements and trade in services are very much absent in the regional FTAs. It is equally important to identify a common framework for the rules of origin as countries in the region moving towards more bilateral free trade agreements.

An efficient roadmap for economic integration in East Asia requires an integrated broad framework of trade and investment agreements that are of WTO-consistent and better still of WTO-Plus. This can be achieved more conveniently in East Asia as the preferential

tariff rates negotiated under region-wide and bilaterally are not much different with MFN rates. In addition, East Asia is an open region that is dependent on free flows of trade and investment with the United States and European Union. At this initial stage, the major impediment to East Asian economic integration does not lie in economic factors but more importantly in political challenges of reconciling China and Japan, the widening economic gap between Northeast and Southeast Asian countries and the importance of the United States to East Asia in economic and security terms.

Therefore, the logical strategy is to strengthen and maximize the pressures of market forces to integrate and in the process, a sense of regional identity and stakeholder will drive East Asia towards an East Asian Economic Community.

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