

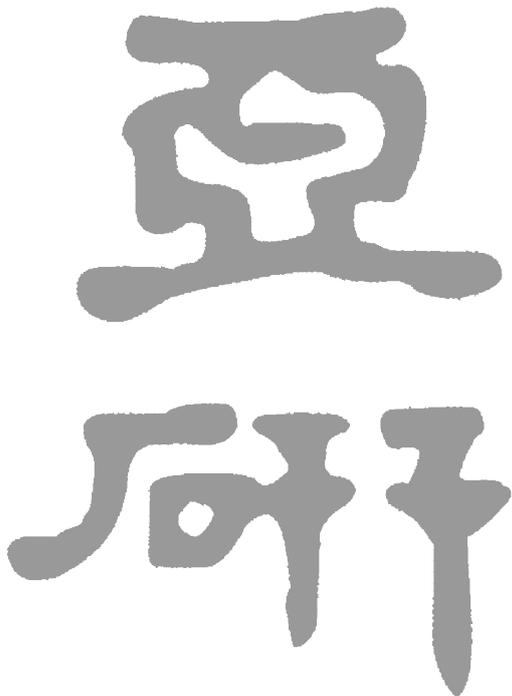
# Prospects for Economic Cooperation and Community Building in East Asia

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# Prospects for Economic Cooperation and Community Building in East Asia

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Few topics are of greater interest in East Asia today than regional integration. This interest is found in the policy-making community as well as among scholars and civil society groups. Many initiatives are on the agenda with an emphasis on the economic sphere. They include expansion and diversification of traditional trade and investment relations, newer innovations in monetary and financial arrangements, as well as the increasing use of foreign assistance to help incorporate less developed countries into regional networks. Some of these trends have been going on for decades, while others got their impetus from the Asian financial crisis. Although there seems to be a common desire to move ahead into broader and deeper integration in the region, the way forward is not entirely clear.

This paper will argue that political and institutional development is an essential requirement for more extensive economic cooperation and community building and that the European Union has some interesting lessons that might be considered in this respect. Three such lessons stand out when studying the European experience over the past half century and comparing the situation there with that in East Asia. All three are intimately interrelated. First, a way is needed to improve relations between China and Japan, similar to the reconciliation that took place between Germany and France in the postwar European context. Second, there is need to construct a set of institutions – especially in the executive and judicial areas – that will help to consolidate and promote integration. A third requirement is a willingness to cede some degree of authority to these institutions and to limit the traditional norm of non-interference in the affairs of neighbors. Some may say that these propositions are an unwarranted intrusion, an attempt to impose a “western” way of operating onto an Asian context.<sup>2</sup> If this is thought to be the case, then some functional equivalent must be sought if progress is to be made.

The paper consists of four sections. Section 1 provides a brief history of East Asian integration, focusing on two separate strands that co-existed until they were combined as a result of the financial crisis. Section 2 presents data on intra-East Asian economic trends, including trade, foreign direct investment, and foreign assistance. It also reviews the current status of the main financial mechanisms: the Chiang Mai Initiative and the Asian Bond Fund. Section 3 elaborates on the three proposals that derive from the European Union’s experience and their implications for East Asia. Section 4 concludes.

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<sup>2</sup> See Ravenhill’s (200x) mention of this type of criticism. For a discussion on western versus Asian models of integration, see Dunn, Nyers, and Stubbs (2010).

## **1. Historical Background of East Asian Regional Integration**

During the 1960s, two potentially complementary processes began to take shape in the region, but they generally operated in isolation from each other. One was what some academics now call “regionalization,” that is, the de facto integration of some of the economies of East Asia through economic activities, especially trade and investment. In the mid-1970s, for example, around one third of Asian exports went to other Asian countries; by the early 1980s, the figure had risen to 42 percent (IMF, Direction of Trade Statistics). Although governments played a role behind the scenes, the main actors were private firms.

The key paper that tried to make intellectual sense of the process was Akamatsu (1962), who introduced the concept of the “flying wild geese” model.<sup>3</sup> Based on theories of dynamic comparative advantage, the model postulated that East Asia would catch up with the west through the transfer of production technologies from leader to follower nations. In the 1960s, of course, the leader was Japan and the followers were the four East Asian newly industrialized economies (NIEs) – Korea, Taiwan, Hong Kong, and Singapore. Later, other generations of followers would be incorporated.

Also in the early 1960s, the Southeast Asian countries began to work on the creation of a sub-regional institution. In contrast to regionalization as embodied in the flying wild geese concept, the Southeast Asians were pursuing “regionalism,” or politically constructed integration. The ASEAN (Association of South East Asian Nations) treaty was signed in 1967. The association had five founding members: Indonesia, Malaysia, Philippines, Singapore, and Thailand. Initially ASEAN was more concerned with political and security goals rather than with the economy. The five countries were preoccupied with conflicts among themselves as well as with the Vietnam War and the spread of communism in the region.

The modus operandi of the ASEAN countries, deriving from cultural norms in the region and past experience with colonialism, emphasized informal discussion and autonomy among members. After 40 years of practice, the “ASEAN way” was codified in the ASEAN Charter signed in 2007. In its preamble, the charter said that integration would go forward “respecting the fundamental importance of amity and cooperation, and the principles of sovereignty, equality, territorial integrity, non-interference, consensus and unity in diversity.” These norms led to a weak organization with few institutions – although these did proliferate to some extent over time as we will discuss later. The importance of this approach among the minor players in the region is that it has come to characterize broader East Asian discussions as well.<sup>4</sup>

After the 1985 Plaza Accord, which raised the value of the Japanese yen vis-à-vis the dollar and also impacted the other currencies of the region, Japan and the four NIEs began to

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<sup>3</sup> For other important contributions on this topic, see Yamazawa (1990) and Ozawa (2005).

<sup>4</sup> See Stubbs (2008) on how China’s greater involvement in the region has strengthened the ASEAN approach, but Ba (2009) suggests that relations with the large Northeast Asian countries were viewed as problematic by ASEAN.

invest heavily in Southeast Asia (Chia 1993). Thus the flying wild geese model expanded into ASEAN countries as a second generation of economies, but the two types of regional integration continued to operate on separate tracks. It would not be until after the 1997 financial crisis that they would come together in a significant way when a broader regional institution would take up various economic challenges.

In the meantime, however, the increasing presence of China began to place new strains on both regionalization and regionalism in East Asia. Initially many thought that China – together with Cambodia, Laos, Myanmar, and Vietnam – would simply be a third generation within the flying wild geese formation. But soon it became clear that China’s economic and political power would disrupt the regional economic model and have profound ramifications for political relations as well. China became a magnet for the foreign direct investment that had previously gone to ASEAN countries, and it began to compete with them in exports (Lardy 1994, 2002). Moreover, its new economic power – together with its military might and international influence – meant that China also rose in political importance in the region. Increasingly, it began to compete with Japan for regional leadership (Bergsten et al 2008).

The 1997 crisis was a watershed that changed both political and economic processes in East Asia (Park 2006). First, it cemented China’s economic position in the region, when its government did not devalue the RMB and thus became a source of stability for its neighbors. China’s position was further enhanced as Japan continued in the recession it had suffered since the end of the 1980s (Pempel 1999: chp. 10; Noble and Ravenhill 2000: chp. 7). Second, it convinced East Asian governments that they could not rely on the international financial system, with the IMF as lynchpin, to rescue them from future economic problems. Rather, they would have to develop their own mechanisms (Lee 2008). And third, as a consequence of the second, institution building came onto the agenda and ASEAN was broadened into ASEAN +3 (Japan, China, and Korea). ASEAN+3 was especially important in the monetary sphere, which came to complement the region’s trade and investment links, but it assumed more general coordination and decision-making functions as well (Stubbs 2002; Terada 2003).<sup>5</sup>

In summary, at the beginning of the second decade of the 2000s, the core of the East Asian region is constituted by 12 countries: Japan, China, and Korea at the top of the pyramid; the original five ASEAN countries in the middle; and other countries that had joined ASEAN later (Cambodia, Laos, Myanmar, and Viet Nam) at the bottom.<sup>6</sup> The group operates at political and economic levels. The main political forum is ASEAN+3. Economic processes continue to focus on trade and investment, but economic assistance has become important as

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<sup>5</sup> ASEAN+3 has competition in ASEAN+6, which includes Australia, New Zealand, and India plus the others in ASEAN+3. In local jargon, the two groups are also known as APT and the East Asian Summit, respectively. The larger group is part of the leadership struggle between Japan and China, where the former wants to include the three democracies to partially dilute China’s influence.

<sup>6</sup> Brunei is also a member of ASEAN, but as a small, wealthy oil exporter, it plays a minor role in the region. Taiwan is also a geographic (and economic) part of East Asia, but it has been excluded from the political processes because of its conflict with China.

are monetary and financial relations. Separate security institutions also exist, but these are not part of our interests in this paper.<sup>7</sup>

## **2. Trends in Regional Integration Indicators in East Asia**

Trade remains the most fundamental economic link within regional integration schemes around the world. Not surprisingly, then, the best data are available on trade, so it is easier to compare across regions in this area than in others. It is useful to begin with an overview of how East Asia ranks among regional groupings in terms of the share of total trade that is carried out with partners in the region. Table 1 presents information on the European Union (EU); two groups in the Western Hemisphere – the North American Free Trade Area (NAFTA) and the Southern Common Market (MERCOSUR); and several alternative regional groups in East Asia for the period 1980 to 2008. It shows that the EU still has the largest share of intraregional trade by either of two definitions. In the old EU-15, 60 percent of total trade is carried on within the region, while the figure is 66 percent for the EU-27. For the North American partners in NAFTA, intraregional trade represents 44 percent of the total, far above the 16 percent in the South American group. Several of the East Asian groupings exceed the NAFTA share, but none is as high as the EU. The only Asian group that is a formal organization, like those in the other regions, is ASEAN. The ASEAN-10 members, however, carry on only 27 percent of their trade with other members. The highest share of the informal groups in Asia is the group of 18 – ASEAN+6, Hong Kong, and Taiwan – where 58 percent of trade is carried on within the group.

### **[Table 1 here]**

The other interesting point in Table 1 concerns trends. Only the Asian groups have continued to expand intraregional trade. In the original EU, by contrast, intraregional trade reached its peak in 1990 and has shrunk since then. The enlarged EU, of course, peaked later. Likewise, intraregional trade in both of the Western Hemisphere groups reached its highest level soon after their establishment and has since declined. In East Asia, while some shrinkage has occurred in the last few years, overall intraregional trade has been a more dynamic process than in other parts of the world. Why has intraregional trade continued to expand in East Asia while it has not done so elsewhere? Two possible answers suggest themselves. On the one hand, the free trade agreement (FTA) movement came late to East Asia, and so may have provided recent impetus to trade among neighbors. On the other hand, the new regional division of labor in East Asia has probably been an impulse for intraregional trade – although the fact that final goods are sold in the west places a limit on the ratio as long as this model continues.

While the United States, the EU, and several Latin American countries had been signing FTAs since the 1980s and 1990s, it was only in the 2000s when this trend reached East Asia.<sup>8</sup> Most of the agreements have been bilateral and concentrated on providing preferential access

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<sup>7</sup> See Pempel (2010) on the separation between economic and security issues in East Asia.

<sup>8</sup> The exception was the ASEAN Free Trade Agreement (AFTA) that was signed in 1992, but this was a different sort of agreement than the recent batch.

to markets for goods, although the more advanced treaties also include services, investment, procurement, and intellectual property. The first bilateral FTA in East Asia, between Singapore and Japan, was not signed until 2002 (Terada 2006). Many others have followed so that by the beginning of 2009, 45 had been signed and a similar number were under negotiation (Ravenhill 2010). Interestingly, the majority have been with states located outside of East Asia itself (Katada and Solis 2008). The most important FTAs in the region have been signed individually by China, Korea, and Japan with ASEAN. China took the lead, as part of its diplomatic strategy in the region, and Korea and Japan felt obliged to follow suit. Individual ASEAN members have also signed agreements with the larger countries. The potentially most important treaty – between China, Korea, and Japan – remains no more than a declared intention as does a region-wide agreement (Kawai and Wingaraja 2007, Chia 2010, Lee 2010, Ravenhill 2010). In addition to the FTAs, another source of trade dynamism in East Asia is regional production networks and the regional division of labor that has become more important in the last decade or so since China acceded to the WTO. The process centers on China as the assembly point for industrial goods. Japan and the NIEs export both capital goods and inputs to China and frequently set up plants there as well. Thus much of the intra-East Asian trade concentrates on intermediate goods, unlike trade in other regions such as Europe and the Americas where final goods are much more prominent (Ozeki 2007). After the intermediate goods are assembled in China, some are sold in the Asian home countries, but most are exported to the United States and Europe. This combination, then, gives China large trade surpluses with the United States and Europe and smaller deficits with East Asia (Borrus, Ernst, and Haggard 2000; Gaullier, Lemoine, and Únal-Kesenci 2005, 2006; Ozeki 2007; Athukorala 2010).

Two other economic trends have been going on in the East Asian region that complement and stimulate intraregional trade. The first is foreign direct investment (FDI). As was indicated in our brief historical sketch, regionalization in East Asia was very much a result of the combination of trade and FDI. The link had various manifestations. One was investment abroad to obtain raw materials that were in short supply in Northeast Asia. A second type of trade and investment link was to take advantage of cheap labor; increasingly it was also to outsource “dirty” processing industries. The final products were then shipped back to the home country. A third was the gradual development of the regional division of labor that was just discussed.

Table 2, which shows intraregional investment in three of the Asian groups that were discussed for trade, indicates that the intraregional share of FDI is somewhat smaller than trade in the most recent period, but it has been growing much faster and is much more volatile. FDI data, which are harder to measure than trade data, go back only to 1990 and the most recent figures are for 2005. FDI in ASEAN countries is the most volatile and has grown the least between 1990 and 2005. ASEAN+3 and some of the larger groupings have expanded more rapidly in this same period. FDI among the ASEAN+3 economies increased more than five-fold, while the East Asia 15 saw a six-fold jump. The regional division of labor is arguably the main explanation for the dynamism of FDI, especially in the larger groups.

**[Table 2 here]**

A final type of economic flow that we want to highlight is foreign assistance and especially Official Development Assistance (ODA). In the Asian context, ODA, FDI, and other commercial flows are not separated as they tend to be in the west. Rather they are frequently seen as parts of a package. This package is offered to the least developed countries of the region as a way of incorporating them into the regional economy. Particular targets in the 2000s have been the CLMV economies: Cambodia, Laos, Myanmar, and especially Vietnam.

The main ODA donors in the region are Japan, Korea, China, and the Asian Development Bank through its subsidiary, the Asian Development Fund (AsDF). These donors have demonstrated a different pattern of ODA than western donors in the East Asian region. First, as can be seen in Table 3, they provide a much larger share of their aid to the region (38.5 percent) compared to western donors that give only 6 percent to the region. The Asia figures do not include China for lack of information.<sup>9</sup> Equally striking is the sectoral difference between East Asian and western donors in terms of ODA to East Asia. Over half of ODA from the former (51 percent) is allocated for economic infrastructure or production facilities. For western donors, the share is less than a quarter (24 percent) since the majority of their aid goes for social projects. These differences can be explained by a different philosophy of aid in Asia. The idea is to promote economic growth and especially industrialization, with the assumption that social (and political) development will come later. This approach derives from the successful experience of the more advanced East Asian countries themselves, which they are eager to export to the less developed economies of the region (Stallings 2010).

**[Table 3 here]**

While trade and investment flows were virtually the only elements of East Asian economic integration outside ASEAN before the 1997 crisis, this is no longer true. Two potentially significant coordination initiatives in the monetary and financial area emerged as a result of the crisis. The most important was the Chiang Mai Initiative (CMI), which was a fallback from a much more ambitious Japanese proposal for an Asian Monetary Fund (Lee 2008). When the latter failed because of opposition from China and the United States, a more modest agreement was concluded in 2000 to expand a set of existing bilateral swaps to provide foreign exchange liquidity if currency crises recur. Participants were the ASEAN+3, with most of the resources to come from Japan, China, Korea; drawing rights were linked to IMF programs. In addition to the swaps, three other elements were mentioned in the CMI agreement, although they were not implemented to any significant degree: regional surveillance, capital-flow monitoring, and training of personnel to carry out these functions. In the initial version, no central authority was in charge; no role was given to regional institutions; and no pooling of resources was envisioned. Negotiations were between individual pairs of countries (Henning 2002: chp. 3).

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<sup>9</sup> Recently China has published a white paper on foreign aid, the first official document on the subject, but the paper provides little statistical information.

In the following years, the CMI was expanded, especially with regard to the amount of money involved. The major innovation, however, came in 2009 when the CMI was transformed into the Chiang Mai Initiative Multilateralized (CMIM). The CMIM converted the bilateral scheme into “a multilateralized self-managed reserve pooling scheme governed by a single contractual agreement.” The size was set at \$120 billion with 80 percent contributed by Japan, China, and Korea. Fundamental issues were to be decided by consensus, but individual lending decisions would be made by majority vote. A regional surveillance office (the ASEAN+3 Macroeconomic Research Office, AMRO) was to be set up in Singapore (Sussangkarn 2010; Grimes 2011). Rathus (2010) notes that “[the CMIM] will represent the first successful regionalist project of the ASEAN+3 grouping,” but offers several criticisms. First, it is not clear whether China or Japan will control the scheme; second, disagreements exist between borrowers and lenders; third, the CMIM is too small to handle significant crises; and fourth, conditionality is too strict. Sussangkarn (2010) makes the last point more specific, objecting to the CMIM funds being linked to IMF conditionality. He also says there is need for a full-time staff to help member countries.

The other financial innovation was the Asian Bond Fund Initiative (ABFI). Much smaller and more specific than the CMI, the ABFI aims to facilitate the development of capital markets in East Asia. Established by regional finance ministers in 2003, the program has been supported from the beginning by the Asian Development Bank. Five years later, a New ABFI Roadmap was adopted to reinvigorate the bond market initiative, which had not made much progress in part because the huge accumulation of international reserves in the region seemed to make it redundant. The roadmap set up a new structure including a steering committee plus several task forces and working groups to make proposals in specific areas. More recently a mechanism was established to provide credit guarantees to help firms get access to the bond markets. Complementary to the ABFI were two Asian Bond Funds with a small amount of seed money from regional central banks, but management by the private sector. The first (ABF1), begun in 2003, was to invest in dollar-denominated bonds issued by sovereign issuers in eight member countries. A second (ABF2) was initiated in 2004 to purchase local-currency bonds (Yam 2005, Ito 2008, Kawai 2009, Jang 2011).<sup>10</sup>

### ***3. Toward Greater Cooperation: Lessons from the EU?***

Despite the extensive economic interactions among East Asian countries, integration remains fairly shallow and dependent on the initiative of private firms. The FTAs are clearly state-to-state, but these are generally bilateral arrangements and may even undermine region-wide integration (Solis, Stallings, and Katada 2009: chp. 12). The Chiang Mai process is important, but is limited to the monetary sphere. The experience of the most successful postwar integration process, the EU, suggests that much more emphasis needs to be put on three tasks: reconciliation between leading regional powers, the construction of strong region-wide institutions that can push the economic processes forward, and the willingness to cede

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<sup>10</sup> A third financial project in the region was discussion of a common currency unit. Despite studies of the issue, no action has been taken.

greater power to the new institutions if a joint regional project is to go forward as most seem to wish.<sup>11</sup>

#### *China-Japan Reconciliation*

A first issue that stands out in East Asia in contrast to Europe is the failure to overcome the animosities resulting from World War II and prior historical periods. In the case of Europe, the integration process itself was largely motivated by the desire to anchor Germany in the region.<sup>12</sup> Indeed, the Franco-German reconciliation was one of the most successful examples of peacemaking in the modern era and set the stage for the resurgence of Europe as an economic power in recent decades. Much has been written on this reconciliation. Heo (2008) distinguishes between reconciliation factors (especially external circumstances and domestic political leadership) and reconciliation processes (both government-to-government and people-to-people).<sup>13</sup> The United States and other European countries provided important support, while a small group of leaders in Germany and France – especially Adenauer, de Gaulle, and Schuman – pushed the rapprochement forward. Government-to-government processes included not only treaties and joint declarations, but concrete economic steps including the founding of the European Coal and Steel Community that eventually led to the EU. People-to-people processes were equally important, especially in the education and cultural spheres.

Japan and China have not had such reconciliation. This was not very important in the earlier postwar years since China was either shut off from the world economy (pre-1979) or still very underdeveloped. In the last 15 years or so, the situation has changed dramatically as China's economy surged while Japan's was mired in recession. Moreover, as long as integration depended on private-sector initiative, disagreements among states were less important, but poor Sino-Japanese relations have now become a major impediment to moving ahead in the new era of state-constructed regionalism in East Asia. To make the situation more complicated, and to make the similarity to Europe clear, the difficult relations between the two powers are based not just on rivalry and competition, but on Chinese (and other East Asian) resentment over Japanese colonial aggression.

Authors writing on this subject agree that the East Asian situation is more complex than that of Europe (Fukuyama 2005, Heo 2008, Shu 2008, Lan 2010). Among the issues mentioned with respect to the East Asian case are greater cultural heterogeneity, a bigger income gap, different political systems, less willingness to deal openly with historical memories, and a lesser willingness by the United States to support an all-Asian solution. Nonetheless some positive lessons have been suggested, such as those coming out of a recent

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<sup>11</sup> The idea that East Asia can learn from the EU is hardly a new one. See, for example, Moller and Severino (2006), Plummer (2006), Park and Wyplosz (2008), Hirashima (2009). Capannelli and Filippini (2010) suggest reciprocal lessons. An interesting attempt to test the idea of lessons was a Carnegie Endowment conference in Beijing in May 2009 (see Shi 2009).

<sup>12</sup> Likewise, part of the motivation for the establishment of MERCOSUR was to reconcile Brazil and Argentina.

<sup>13</sup> Feldman (1999) presents somewhat similar categories: history, institutions, leadership, and international context.

workshop sponsored by ASEM (Asia-Europe Meeting). These include the need to define common values, conduct formal apologies and forgiveness, concentrate on areas where solutions may be found, use informal channels, and take small steps.<sup>14</sup> A complementary approach focuses on joint activities in the region to increase confidence among the major players. Nabers (2007, 2008), for example, argues for a focus on the role of Japan and China in building institutions together, to which we now turn.<sup>15</sup>

### *Institution Building*

A second issue, then, has to do with the construction of institutions. It may well be argued that the EU has too many institutions, depending on how the term is defined. When defined as rules, the EU's *acquis communautaire*, which specifies the rights and responsibilities among members, runs to thousands of pages. New members must agree to implement all of them with careful monitoring involved to guarantee their adoption. The general areas of concern were defined in the 1990 Copenhagen Criteria: a candidate must have a democratic government, a market economy, and the ability to meet all of the items in the *acquis*.

If institutions are defined as organizations, then the EU also has a vast array that are a combination of supranational autonomous organs and intergovernmental ones where decisions are negotiated by member states. The best known is the executive organ, the European Commission, which is made up of 26 portfolios, plus the secretary general. They include political, economic, social, and administrative positions; all have significant powers over member states, their citizens, and entities operating within the boundaries of the EU. Other organs include the Council of the EU (Council of Ministers), the Court of Justice, and the European Central Bank that regulates monetary policy for countries that have adopted the Euro. The European Parliament is elected every five years by EU citizens. The so-called European Council, by contrast, is the informal gathering of heads of government who decide many of the crucial and most contentious issues. The European Council fits in with the idea of "subsidiarity," whereby the EU only decides things that cannot be decided at the individual state level.

Which of these institutions are essential for East Asia in the coming years, and how can they be constructed? Probably the most important are an executive and a dispute-settlement mechanism. A legislature is unlikely given the lack of domestic legislatures in many of the countries, and a central bank is only relevant in the case of a common currency. The ASEAN+3, which now serves as a coordinating institution for the 13 member countries, relies on the ASEAN institutions, so that is one place to start. An alternative, which will be discussed below, is for the "Plus Three" to take the lead.

Former ASEAN Secretary-General, Rodolfo Severino, argues that ASEAN should take the lead in creating and managing East Asian institutions. Interestingly, this approach has also been followed by the Plus Three countries themselves. Severino explains (2008: 452): "It is not without reason that the East Asia process is called ASEAN+3. This is to emphasize that the process is, and has to be, led and managed by ASEAN. ASEAN has assumed this role partly by its astute diplomacy and partly by default. That role cannot be carried out by Japan or China. Leadership by one would be opposed by the other."

An ASEAN-centered approach would rely on existing ASEAN institutions, which include

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<sup>14</sup> A summary report is available at <http://www.euforasia.eu/reports?q=node/42>.

<sup>15</sup> A different perspective is that of a former secretary-general of ASEAN, who says that regionalism in East Asia is necessary *because of* the Sino-Japanese tensions and rivalries to avoid them becoming so great that they disrupt economic integration (Severino 2008).

the ASEAN Summit (heads of government); Ministerial Councils (coordination, political-security, economic, and socio-cultural); Secretariat, located in Jakarta; and Committee of Permanent Representatives, also located in Jakarta. As of 2003, a small section of the Secretariat has supported ASEAN+3 initiatives. While the institutions themselves are typical, if minimalist, the more controversial aspect concerns the rules of engagement. Thus, decision-making is by consultation and consensus, and dispute settlement is through dialogue, consultation, and negotiation. Unresolved disputes are referred to the Summit – which also operates through consensus. It is these rules that have been strongly criticized as leading to a very weak organization that cannot make important decisions (e.g., Ravenhill 2008, Singh 2008, Katada 2009).

An alternative approach has been proposed by Moon (2010), who says: “Establishing a core network among the [Plus Three] countries, separately from the ASEAN, is a precondition for the successful launch of Asia-wide regional trade and financial arrangements.” His argument is that Japan, China, and Korea are the economically and politically dominant countries in the region, and no major initiative can be undertaken unless they are the driving force. Since the first two cannot cooperate, Moon’s main proposal is that Korea should take the lead both in facilitating regional integration and acting as a sub-regional hub (“global gateway”) among East Asia, the United States, and the EU. Given its central geographical location, strong international ties, and acceptable relations with Japan and China, he argues that Korea is in a position to facilitate further integration, including an FTA among the three and the region as a whole. Moreover, Korea’s open economy would help guarantee an open East Asia rather than one based on protectionism.

#### *Ceding Authority*

Finally, for these institutions to succeed, there is the need to cede some amount of authority to them and to limit the norm of non-interference in the affairs of neighbors. This move has not occurred either within ASEAN, nor among the ASEAN+3. The EU has a useful lesson to offer on this topic. Contrary to popular opinion, an all-or-nothing solution is not necessary. Although the EU has gone further than any other integration scheme in centralizing sovereignty at the regional level, this move is far from complete. The European Council, where heads of state or government negotiate on an informal basis over the most important decisions pertaining to the EU, together with the principle of subsidiarity, clearly reflect the European countries’ decision to leave basic elements of sovereignty at the national level. Moreover, the decision to let countries “opt out” of certain EU decisions and programs suggests further ways in which partial authority can be granted to a supranational set of institutions.

In one instance, such a compromise has already appeared in the East Asian context. The recent multilateralization of the CMI, as mentioned earlier, will have basic decisions (such as the size of the swap package, contributions, borrowing multipliers, membership, terms of lending) made by consensus, but practical lending issues (lending, renewal, default) will be decided by majority vote (Sussangkarn 2010). The new AMRO (ASEAN+3 Macroeconomic Research Office) will also likely embody a similar compromise, especially if it moves beyond research into the surveillance area. A creative exercise in modifying existing ASEAN institutions in this way could be a powerful step forward toward greater regional integration in East Asia.

#### **4. Conclusions**

This paper has analyzed the past history, current situation, and future challenges of economic integration in the East Asian region. It has traced out the way that the largest countries have expanded their economic reach throughout the region, while the smaller ones have created a (weak) political entity. This combination, together with antagonistic relations among the two largest economies, has produced a stalemate as far as deeper regional integration is concerned. Some small but significant steps have been taken as a result of the shock of the Asian financial crisis, but most observers and participants agree that more needs to be done.

This paper argues that political-institutional progress is essential for moving the integration process forward. Drawing on the EU experience, it identifies three tasks and some guidance on how to carry them out. First is a better relationship between China and Japan as the two largest economies in the region. Second is the construction of a minimal set of institutions based on rules that will permit efficient decision-making. Third is the willingness to cede some amount of authority to these institutions, which is closely related to the question of rules. With these three advances, it is possible that new impetus can be provided for the creation of an East Asian regional entity. It will obviously not look like the EU, but a more coherent set of institutions could enable East Asia to enjoy some of the benefits that Europe has enjoyed in recent decades.

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Table 1. Intraregional Trade Share, 1980-2008 (percent)

Region	1980	1985	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
ASEAN (10)	17.9	20.3	18.8	24.0	24.7	24.1	24.4	26.6	26.7	27.2	27.2	26.9	26.7
ASEAN+3 (13)	30.2	30.2	29.4	37.6	37.3	37.1	37.9	39.0	39.2	38.9	38.3	37.7	37.8
ASEAN+3 + HK + Taiwan (15)	36.8	39.0	43.1	51.9	52.1	51.9	53.8	55.4	55.9	55.4	54.5	53.8	52.3
ASEAN+6 (16)	34.6	34.8	33.7	40.8	40.5	40.6	41.3	42.4	43.0	43.1	42.6		
ASEAN+6 + HK + Taiwan (18)	40.5	42.7	46.3	54.5	54.6	54.5	56.3	57.7	58.5	58.4	57.6		
NAFTA (3)	33.8	38.7	37.9	43.1	48.8	49.1	48.4	47.4	46.4	46.1	44.3		
MERCOSUR (4)	11.1	7.2	10.9	19.2	20.3	17.9	13.6	14.7	15.2	15.5	15.7		
EU (15)	60.7	59.8	66.2	64.2	62.3	62.2	62.5	63.0	62.2	60.4	59.5		
EU (27)	61.5	60.0	66.8	66.9	66.3	66.7	67.4	68.1	67.6	66.2	65.8		

Sources: ADB data bank for ASEAN, ASEAN+3, ASEAN+3 + HK + Taiwan; Masuhiro Kawai and Ganesan Wignaraja, "ASEAN+3 or ASEAN+6?" Working Paper 77, ADBI, 2007 for other regional groups.

Table 2. Intra-regional Investment Share, East Asia , 1990-2005 (percent)

Region	1990	1995	2000	2001	2002	2003	2004	2005
ASEAN (10)	11.5	17.3	16.0	13.8	64.2	58.0	10.3	17.9
ASEAN+3 (13)	5.5	32.3	28.3	25.3	43.1	49.2	39.6	30.7
ASEAN+3 + HK + Taiwan (15)	8.5	50.4	49.7	50.0	68.0	86.0	48.1	50.8

Source: ADB database.

Table 3. Geographical Distribution of ODA by East Asian and Other Donors (gross disbursements), 2008

Recipients	Japan		Korea		AsDF		Other donors <sup>a</sup>	
	\$mn	%	\$mn	%	\$mn	%	\$mn	%
All bilateral ODA	14697	100.0	579	100.0	2330	100.0	114315	100.0
Africa	1910	13.0	107	18.5	0	0.0	43770	38.3
Asia (East)	4429	30.1	201	34.7	571	24.5	7065	6.2
Asia (South and Central)	3195	21.7	75	13.0	1734	74.4	12980	11.4
Europe	520	3.5	15	2.6	0	0.0	6209	5.4
Latin America	769	5.2	70	12.1	0	0.0	8826	7.7
Middle East	2069	14.1	31	5.4	0	0.0	12877	11.3
Oceania	167	1.1	3	0.5	25	1.1	1350	1.2
Unspecified	1638	11.1	76	13.1	0	0.0	21238	18.6

Source: OECD/DAC Online Statistics (Creditor Reporting system).

<sup>a</sup> All donors, bilateral and multilateral, except Japan, Korea, and AsDF.