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East Asian Economic Integration: Korea's Perspectives*

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Abstract

In recent years, the growing interdependence in East Asia through trade and financial cooperation heightened the need for East Asian Economies to engage in regional economic cooperation and integration. This paper attempts to discuss emerging economic integration efforts in East Asia with special reference to bilateral and regional FTAs. It discusses backgrounds for recent developments of East Asian regionalism in terms of deepening intra-regional economic dependence and financial cooperation, and Korea's position towards FTAs with major trading partners as well as East Asian economic integration. Important issues and challenges for an East Asian FTA are presented.

Key Words : FTA, Economic Integration, Financial Cooperation, East Asia

JEL Classification : F15, F11, F33, O53

I. Introduction

* This is an extension of Ahn and Cheong (2004). The early draft of the paper was prepared at the Joint Session under the theme of "East Asian Economic Cooperation and Integration" of the Korea-America Economic Association and the American Economic Association at the Nineteenth Annual Meeting of the Korea- America Economic Association, San Diego, California, January 3-5, 2004. The authors appreciate valuable comments by participants at the session, although any remaining errors are authors'.

¹ In this paper, East Asia implies ASEAN and Northeast Asian economies of China, Japan and Korea (CJK).

The 1990s witnessed a global wave of free trade agreements (FTAs), but East Asia largely ignored the proliferation of regional trading arrangements (RTAs) and the subsequent regional integration phenomenon.¹ Until recently, East Asian economies, especially those in Northeast Asia, had not developed any meaningful economic cooperation schemes. However, intra-regional interdependence in trade and investment has been deepening in Northeast Asia due to geographical proximity and sheer market forces. If East Asia accepts the newly emerging international trade environment, regional economic cooperation such as FTAs must be in order.

In recent years, the growing interdependence in East Asia through trade and financial cooperation heightened the need for East Asian Economies to engage in regional economic cooperation and integration. The Asian financial crisis triggered a rising sense of East Asian identity, and in November 1999, the ASEAN+3 (China, Japan, and Korea) Summit released the Joint Statement on East Asian Cooperation that outlines a wide range of possible areas for regional cooperation.²

In addition to the existing ASEAN Free Trade Agreement (AFTA), the three major Northeast Asian countries – China, Japan and Korea – recently joined the FTA bandwagon. Furthermore, the 1997 Asian financial crisis brought about consensus among East Asian countries for regional economic cooperation to avoid a recurrence of another regional financial crisis. In particular, the framework for financial cooperation was consolidated in May 2000 by the ASEAN+3 Chiang Mai Initiative (CMI), which involves a regional currency swap to provide self-help and support mechanisms.

This paper attempts to discuss emerging economic integration efforts in East Asia with special reference to bilateral and regional FTAs. Section II describes backgrounds for recent developments of East Asian regionalism in terms of deepening intra-regional economic dependence and financial cooperation. Section III presents recent FTA developments in East Asia and Korea's position and policy direction. Section IV discusses some important issues and challenges for an East Asian FTA, especially viewed by Korea. Section V concludes with some broad policy implications for East Asian economic integration.

II. The Rise of Intra-Regional Economic Dependence and Financial Cooperation in East Asia

As East Asian countries have experienced disadvantages from the effects of regionalism in other regions, countries in East Asia have lately begun to consider

² The areas for cooperation were diverse, including trade, investment, technology transfers, e-commerce, agriculture, small and medium-sized businesses, tourism and the development of the Mekong river basin.

establishing its own regional trade bloc, realizing that without their own FTAs, they would be at a disadvantage compared to North America and Europe. The 1997 financial crisis led East Asian countries to realize the need to strengthen regional economic cooperation. The relationship between East Asia's financial crisis and regionalism can be seen in studies by Bergsten (2000), Cheong (2002), Eichengreen (2002), Yamazawa (2001) and Yip (2001).

Yamazawa (2001) asserts that the turning point in East Asian regionalism was the Asian financial crisis. "Through the experience of that awful time, policy makers in this region acknowledged that they were not equipped to prevent and manage such a crisis. They were irked by their helplessness and undue dependence on the international financial institutions in Washington, and they began to toy with the idea of resolving their problems for themselves within Asia." Yip (2001) states, "on the monetary side, the single greatest push for East Asian regionalism was the financial crisis of 1997-1999. Many East Asians felt that they were let down by the West during the crisis. In their view, western banks and other financial institutions had created and exacerbated the crisis by pulling out their funds from the region." Bergsten (2000) suggests that "another motivation for Asian regional initiatives is the failure of the existing international economic institutions to provide East Asia with a role consistent with its economic progress."

1. Rising Dependence in Intra-Regional Trade and Investment

Given the already institutionally integrated ASEAN FTA (AFTA), we focus on integration efforts in Northeast Asia, which shares roughly 90 percent of East Asian GDP. As seen in Table 1, East Asia accounts for about one-third of the world's population and slightly greater than one-fifth of the world's GDP and trade volume (and about 14.3 percent of global FDI). In terms of population, GDP and trade orientation, East Asia is evaluated to have a similar economic potential as the EU and NAFTA in the years to come, provided that the region is properly integrated.

Table 1: Economic Profile of East Asia in the World (2002)

| | Population | GDP | Trade | FDI(inflow) |
|-------------------|-------------|-------------|-------------|-------------|
| East Asia* | 32.6 | 21.0 | 23.6 | 14.3 |
| Northeast Asia** | 23.6 | 17.8 | 12.8 | 9.8 |
| ASEAN | 8.6 | 1.9 | 5.8 | 2.1 |

(Unit: %)

| | | | | |
|--------------|-------------|-------------|-------------|-------------|
| EU | 6.1 | 26.7 | 37.2 | 57.5 |
| NAFTA | 6.8 | 36.5 | 20.6 | 9.9 |
| Other | 54.5 | 15.8 | 18.6 | 18.3 |
| World | 100.0 | 100.0 | 100.0 | 100.0 |

* East Asia is defined as ASEAN plus three (China, Japan and South Korea), Hong Kong and Taiwan.

** Northeast Asia is defined to include China, Japan and South Korea.

Sources: IMF. 2004. *Direction of Trade Statistics Yearbook*.

Globalinsight. 2004. *World Overview*.

UNCTAD. 2002. *World Investment Report 2002*.

Table 2 shows the economic importance of key Northeast Asian countries in the world in 2002 and the relative importance of each country in terms of trade. It is evident that China, Japan and Korea are key players in any integration process for East Asian economies. Northeast Asia occupied 17.8 percent of the world GDP in 2002. Adding Hong Kong to these three countries, its share reached 18.3 percent.

Table 2: Global Share of GDP and Trade of Northeast Asia Countries (2002)

(Unit: %)

| | GDP | Intra-trade | Trade | Exports | Imports |
|-----------------------------------|------|-------------|-------|---------|---------|
| Korea | 1.7 | - | 2.4 | 2.5 | 2.3 |
| China | 3.8 | - | 4.7 | 5.1 | 4.4 |
| Japan | 12.3 | - | 5.7 | 6.5 | 5.0 |
| Korea, China, Japan | 17.8 | 22.4 | 12.8 | 14.0 | 11.7 |
| Korea, China, Japan, Hong Kong | 18.3 | 33.6 | 15.9 | 17.1 | 14.8 |

Source: IMF. 2004. *Direction of Trade Statistics Yearbook*.

Globalinsight. 2004. *World Overview*.

Trade among Northeast Asian countries shared 12.8 percent of the world trade total (exports - 14.0 percent, imports – 11.7 percent) in 2002. When adding Hong Kong to Korea, China and Japan, they occupied 15.9 percent (exports – 17.1 percent and imports – 14.8 percent respectively). Intra-trilateral trade between Korea, China and Japan shared 22.4 percent of their total trade with the world in 2002. With Hong Kong included, intra-regional trade reached 33.6 percent.³

The deepening trade interdependency even in the absence of an institutional frame of regional cooperation within Northeast Asia is even more distinct when we look at the trade intensity index (Table 3). The trade intensity index of a country is usually used to estimate the degree of trade linkage with another country.

³ Countries have performed trade transactions with China through Hong Kong; therefore, each country's inter-regional trade might be overestimated.

Table 3: Dynamics of the Intra-Regional Trade Intensity Index in East Asia

| | Year | China | Japan | Korea | ASEAN |
|--------------|------|-------|-------|-------|-------|
| Korea | 1980 | 0.08 | 2.39 | - | 1.97 |
| | 1985 | 0.06 | 2.23 | - | 1.56 |
| | 1991 | 0.78 | 2.61 | - | 2.02 |
| | 1996 | 2.84 | 1.88 | - | 2.03 |
| | 2001 | 3.22 | 1.98 | - | 1.92 |
| China | 1980 | - | 2.90 | 0.12 | 2.00 |
| | 1985 | - | 3.30 | 1.01 | 3.20 |
| | 1991 | - | 2.17 | 0.32 | 1.16 |
| | 1996 | - | 3.17 | 0.79 | 0.88 |
| | 2001 | - | 3.21 | 2.02 | 1.19 |
| Japan | 1980 | 3.71 | - | 3.59 | 3.05 |
| | 1985 | 3.18 | - | 2.47 | 1.98 |
| | 1991 | 1.52 | - | 2.79 | 2.41 |
| | 1996 | 1.88 | - | 2.57 | 2.63 |
| | 2001 | 1.98 | - | 2.86 | 2.59 |
| ASEAN | 1980 | 1.02 | 3.64 | 1.42 | - |
| | 1985 | 1.63 | 3.61 | 1.90 | - |
| | 1991 | 1.12 | 2.71 | 1.54 | - |
| | 1996 | 1.12 | 2.18 | 1.28 | - |
| | 2001 | 1.40 | 2.45 | 1.71 | - |

Note: 1. The trade intensity index of country i is defined as

$$TII_{ij} = \frac{X_{ij} / X_i}{M_j / M_w}$$

where X_{ij} is export from country i to j, X_i is total export of country i, M_j is total import of country j,

M_w is world total import. TII_{ij} compares export from country i to j divided by total export of country i to the ratio of import of country j divided by total world import. If TII_{ij} is greater than 1 then country i and j are related more closely than others. The index was computed using IMF, *Direction of Trade Statistics Yearbook* (various issues).

2. ASEAN data represent Indonesia, Malaysia, Philippines, Singapore and Thailand.

As shown in Table 3, the trade intensity index of Korea with China was 0.08 in 1980. After the diplomatic normalization between China and Korea in 1992, the figure increased rapidly from 0.78 in 1990 to 2.84 in 1996 and 3.22 in 2001, continuously intensifying the economic cohesion between the two countries.

However, the trade intensity index between Korea and Japan declined from 2.39 in 1980 to 1.98 in 2001, showing that the intensity between the two countries has slightly weakened over time. The trade intensity index of Japan with Korea continued to fall, eventually stagnating: starting from 3.59 in 1980, the index fell to 2.47 in 1985, stagnating at 2.79 in 1991 and 2.86 in 2001. The trade intensity index of Japan with China also shows a drastic decrease and stagnation: starting from 3.71 in 1980, the

indexes declined to 3.18 in 1985, 1.52 in 1991 and were stagnant at 1.88 in 1996 and 1.98 in 2001.

ASEAN's trade intensity with Japan, China and Korea remained nearly unaltered except for a substantial decrease between ASEAN and Japan. The intra-regional trade intensities among the three countries were all greater than one, indeed very high in absolute magnitude. This high trade intensity among the three countries is due to the intensified interdependence in terms of intra-regional trade.

Table 4 and Figure 1 compare the intra-regional trade shares of main economic blocs including Northeast Asia. NAFTA increased its intra-regional trade share from 37.2 percent (1990) to 45.8 percent (2002). MERCOSUR (customs union in South America) recorded gradual growth of intra-regional trade share. At the same time, Northeast Asia saw an increase of intra-regional trade share from 12.7 percent to 22.4 percent during 1990 to 2002. The EU's intra-regional trade had the highest ratio among the main regional economic blocs with around 60 percent over the last two decades (Table 4 and Figure 1). However, the EU's intra-regional trade decreased slightly from 1990 to 2002 due to recent economic stagnation within the region. If East European countries join the EU, then intra-regional trade is likely to increase once again.

Table 4: Main Economic Blocs' Share of Intra-regional Trade

(Unit: %)

| | EU | | | NAFTA | | | Northeast Asia | | | MERCOSUR | | |
|-------------------|------|------|------|-------|------|------|----------------|------|------|----------|------|------|
| | 1980 | 1990 | 2002 | 1980 | 1990 | 2002 | 1980 | 1990 | 2002 | 1980 | 1990 | 2002 |
| Intra-regional | 57.3 | 64.5 | 61.7 | 33.2 | 37.2 | 45.8 | - | 12.7 | 22.4 | 9.7 | 11.0 | 13.8 |
| Rest of the world | 42.7 | 35.5 | 38.3 | 66.8 | 62.8 | 54.2 | - | 87.3 | 77.6 | 90.6 | 89.0 | 86.2 |

Note: 1) EU: Fifteen Western European countries

2) NAFTA: United States, Canada and Mexico

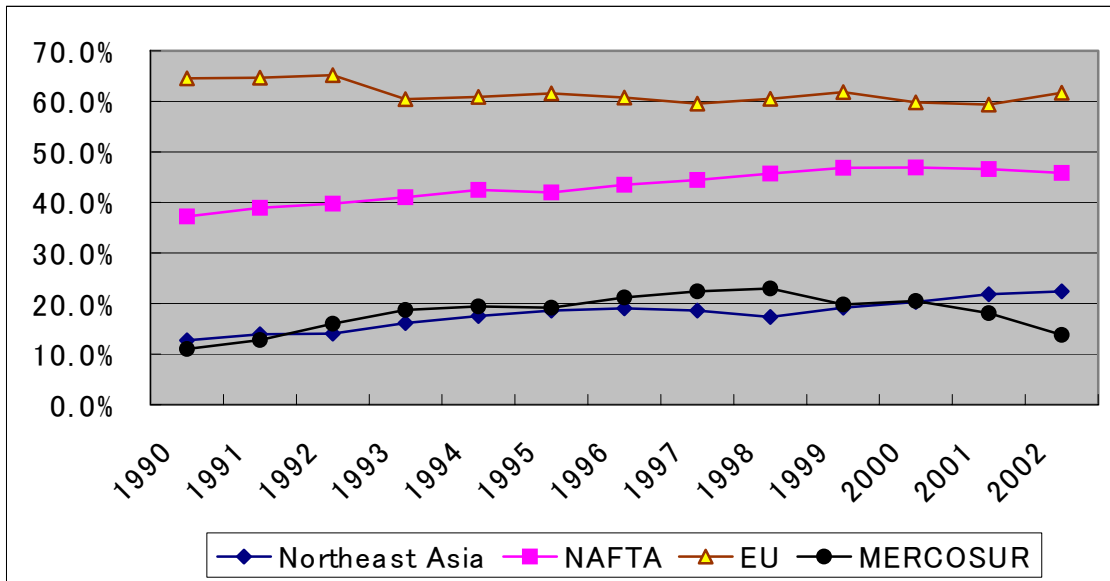
3) Northeast Asia: Korea, China and Japan

4) Mercosur: Brazil, Argentina, Uruguay and Paraguay

Source: IMF, *Direction of Trade Statistics Yearbook*, historical and 2004.

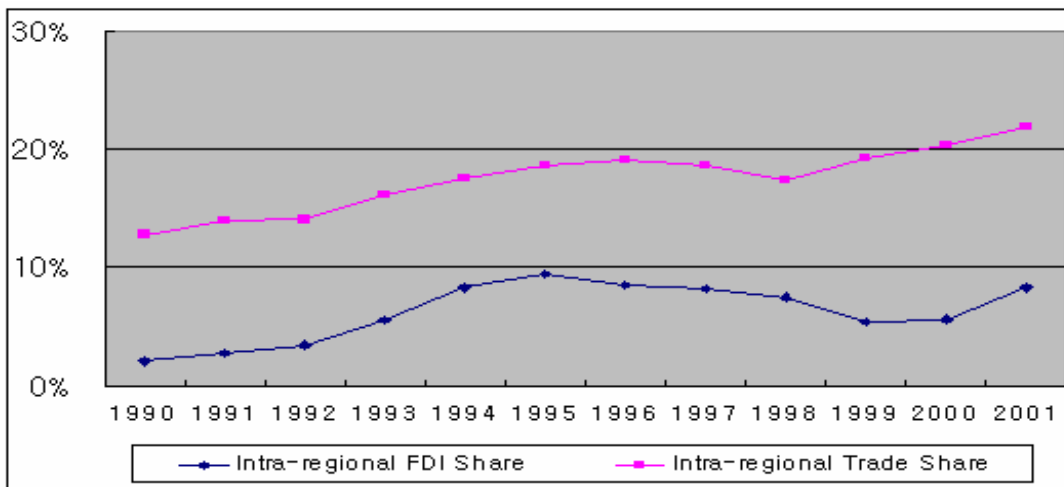
Figure 1 shows that the intra-regional trade shares in Northeast Asia and Mercosur increased rapidly in the 1990s. Compared to EU and NAFTA at 60 percent and near 50 percent, respectively, which were nearly constant in the late 1990s, the intra-regional trade shares in Northeast Asia as well as MERCOSUR are still quite low. As Scalapino's (1991) natural economic territory states, when formal economic agreements such as FTAs are introduced in Northeast Asia, intra-regional trade and the subsequent economic gains are expected to increase due to trade diversion effects and augmented investment on the basis of geographic proximity and expected reduction of logistic costs.

Figure 1: Intra-Regional Trade Share of Main Economic Blocs



Source: IMF, *Direction of Trade Statistics Yearbook*, 2004.

Figure 2: Intra-Regional FDI and Trade Share among Korea, China and Japan



Source: MOCIE, *Trends of FDI*, 2002; Bank of Korea, *FDI Statistics*, various issues; Office of External Trade and Economic Cooperation, *Yearbook of External Economy & Trade*, various issues; China Statistics Press, *China Statistical Yearbook*, various years; UNCTAD, *World Investment Report*, various issues; IMF, *Direction of Trade*, 2002; [www.jetro.go.jp/ec/j/trade].

As another indicator of increased economic interaction in Northeast Asia, intra-regional direct foreign investment (FDI) has also increased to take advantage of reduced production costs and to secure shares of the expanded market. Figure 2 shows that after 1990, FDI among China, Japan and Korea increased rapidly until the mid-1990s but declined during the Asian financial crisis. Since 1999, however, trilateral FDI have risen

again. It is worthwhile to note that the cross-border movement of trade and investment in Northeast Asia seems to be mutually reinforcing one another. Therefore, the introduction of regional FTAs and follow-up market expansion will not only increase intra-regional FDI, but will also attract foreign investment outside East Asia.

2. Financial Cooperation in East Asia

In addition to the rise of the functional integration process in trade and investment by sheer market forces, there has been a remarkable development in the area of financial cooperation in East Asia. The Asian financial crisis has provided East Asian economies with a new perspective on regional cooperation matters. As a self-help and support mechanism for regional financial cooperation, the CMI was a significant turning point. The search for a regional cooperation mechanism that could forestall future crises is now gathering momentum and opening the door to possible significant policy-led integration in East Asia (Henning, 2000).

Bergsten (2000) foresees that because of the financial crisis and the nondiscriminatory nature of financial cooperation, East Asia's organized economic cooperation or potential integration movement might come first in the financial area. As a follow-up to the ASEAN+3 CMI, there is a critical need for East Asian countries to establish an institution that allows mutual consultation regarding exchange rates, interest rates and foreign exchange reserves.

As during the Asian Financial crisis, if the channels of contagion cannot be blocked off through multilateral cooperation at an early stage of crisis, countries with insufficient foreign reserves might not be able to survive financial crisis. Without sound financial institutions and adequate regulatory regimes, Asian financial markets will remain vulnerable to external shocks. Therefore, regional policy dialogue should contribute to strengthening the restructuring of financial markets and institutions in East Asia. In this regard, it is equally important that East Asian countries continue to undertake respective financial sector restructuring and development.

In this context, three pillars of liquidity assistance – monitoring, surveillance and exchange rate coordination – are essential elements for regional financial and monetary cooperation. However, the development of regional financial cooperation and its related institutions will be evolutionary, as evident in the case of European monetary integration. A shallow form of financial cooperation may comprise no more than a common foreign reserve pooling or mutual credit arrangement such as bilateral swaps. In connection with regional trade facilitation, some kinds of shallow financial cooperation are conceivable without any commitment to exchange rate coordination

under which exchange rates of the participating countries are pegged to each other or vanish through the adoption of a common currency. East Asian countries presently appear to pursue this form of financial cooperation. Although a full-fledged form of monetary integration is not viable at this stage, East Asia may begin to examine the feasibility and desirability of cooperation and coordination in exchange rate policies.

After the Asian financial crisis, Fischer (1999) suggested that greater exchange rate flexibility would be desirable in the future, while others suggested more stable exchange rates against the yen might be preferable (Ohno, 2000). However, McKinnon (2001) suggested a modified East Asian dollar standard to curb hot money inflows while observing a resurrection of the East Asian dollar standard and continuing stability of the dollar exchange rate in the post-crisis period. In order to facilitate further ongoing intra-regional trade in East Asia, a stable and coordinated exchange rate mechanism must be in order. However, at the same time, region-wide financial sector restructuring and coordination must be again a fundamental prerequisite.

In order to expedite the CMI process, Japan has been playing a leading role in terms of both the number and amount of bilateral swap agreements (BSAs): Japan concluded six agreements (with Korea, China, Indonesia, Malaysia, the Philippines and Thailand) and is currently negotiating another agreement with Singapore. Korea, which concluded four agreements with China, Malaysia, the Philippines and Thailand in addition to the Japan-Korea BSA, is also expected to conclude BSA negotiations with Indonesia (see Table 5).

Table 5: Progress on the Chiang Mai Initiative

(as of September 30, 2003)

| BSA | Currencies | Conclusion Dates | Amount (US\$) |
|-------------------|-------------------|-------------------------|------------------------|
| Japan-Korea | USD/Won | July 4, 2001 | \$7 billion (a) |
| Japan-Thailand | USD/Baht | July 30, 2001 | \$3 billion |
| Japan-Philippines | USD/Peso | August 27, 2001 | \$3 billion |
| Japan-Malaysia | USD/Ringgit | October 5, 2001 | \$3.5 billion (a) |
| PRC-Thailand | USD/Baht | December 6, 2001 | \$2 billion |
| Japan-PRC | Yen/Renminbi | March 28, 2002 | \$3 billion equivalent |
| PRC-Korea | Won/Renminbi | June 24, 2002 | \$2 billion |
| Korea-Thailand | USD/Baht | June 25, 2002 | \$1 billion |
| Korea-Malaysia | USD/Ringgit | July 26, 2002 | \$1 billion |
| Korea-Philippines | USD/Peso | August 9, 2002 | \$1 billion |
| PRC-Malaysia | USD/Ringgit | October 9, 2002 | \$2 billion |
| Japan-Indonesia | USD/Rupiah | February 17, 2003 | \$3 billion |
| PRC-Philippines | USD/Peso | Negotiation completed | \$1 billion |

| | |
|-----------------|---------------------|
| Japan-Singapore | Under negotiation |
| PRC-Indonesia | Under negotiation |
| Korea-Indonesia | Under consideration |

Note: (a) The US dollar amounts include the amounts committed under the New Miyazawa Initiative – \$5 billion for Korea and \$2.5 billion for Malaysia.

Most East Asian countries that are willing to participate in regional financial cooperation agree in principle that the CMI needs to be supported by an independent monitoring and surveillance system. The system should be able to 1) monitor economic developments in the region, 2) serve as an institutional framework for policy dialogue and coordination among the members and 3) impose structural and policy reform on the countries drawing from the BSAs.

As East Asian economies grow more open and interdependent, they are becoming vulnerable to international disturbances, given the high degree of capital mobility across countries in the world. The spread of capital mobility makes it difficult for a single small country to keep its pegged exchange rates. Forming a single currency region may be desirable. Currently, such a currency area is a very distant prospect. The lack of political commitment and experience with political cooperation in East Asia are decisive factors against the formation of a common currency area in the near future.

Then, a transition process, say to form a quasi-monetary bloc, remains a viable option for East Asia. Kwack, Ahn and Lee (2003) suggest that a new organization be formed to assess necessity and desirability and coordinate and implement the steps necessary for the formation of a quasi-monetary union. The coordinating institution should provide the framework for implementing unified systems for flexible exchange rates and flexible inflation target to all member countries. At present, however, flexible exchange rate systems together with flexible inflation targets are suitable to attain the objectives of lowering the costs of external shocks and keeping inflation low. In addition, the coordinating institution should monitor the progress of financial reforms and development. The financial system should be improved and good fiscal performance should be attained.

If the systematic implementation of financial coordination and the coordinating institution can establish a quasi-monetary bloc, it may lead to political and economic convergence among the East Asian countries. Greater political and economic convergence is a necessary process toward establishing common monetary standards. Increasing intra-regional trade, a regional FTA and capital investment will work toward the formation for a common currency area, as discussed in Kwack, Ahn and Lee (2003).

China and Japan have been and continue to be important economic and political leaders in East Asia, and each has problems that will need to be resolved before

asserting economic and political leadership in Asia. Both will play a leading role, with neither dominating the Asian transition process. An absence of single clear leadership or coordinated dual leadership might hamper East Asia from forming a common currency block, but there will still be room for the pursuit of regional monetary and financial cooperation.

III. Recent Developments toward FTAs in East Asia

Recently, there has been growing interest in FTAs in East Asia while experiencing a rapid functional integration process. The newly emerging enthusiasm on FTAs in East Asia can be attributed to a set of factors: proliferation of regionalism worldwide, the intensified integration process of EU and NAFTA, the East Asian financial crisis, East Asia's awareness of the need to boost its economic cooperation, China's WTO accession, competitive FTA initiatives by China and Japan and the expansion of East Asian policymakers' networks through various meetings.

There are approximately 184 cases of various regional trade agreements in the world today. Of the total existing arrangement, 153 cases were established after 1990, 119 of which were established after the WTO (January 1995).

Table 6. Number of FTAs in the World

| | 1955-60 | 1961-70 | 1971-80 | 1981-90 | 1991-95 | 1996-2000 | 2001-2003 |
|------------|---------|---------|---------|---------|---------|-----------|-----------|
| New | 3 | 3 | 15 | 10 | 34 | 91 | 28 |
| Cumulative | 3 | 6 | 21 | 31 | 65 | 156 | 184 |

Note: As notified to WTO and effective as of May 5, 2003.

Source: WTO CRTA.

Until recently, East Asian countries, especially Northeast Asian countries have pursued multilateral free trade regimes under WTO. Japan's FTA with Singapore came into effect in February 2002. In January 2002, China and ASEAN announced to establish an FTA within 10 years. China offered tariff reduction to less-developed ASEAN members effective 2004 on 500 agricultural products under the Early Harvest Package. Korea and Chile began to implement their FTA in April 2004, and Korea is pursuing bilateral FTAs with Singapore and Japan, respectively.

The main regional trade agreement in East Asia is the AFTA. Initially composed of six member countries including Malaysia, Indonesia, Thailand, the Philippines, Singapore and Brunei, AFTA was formed as a result of the fourth ASEAN Summit

meeting in 1992. With Vietnam joining in 1995, Myanmar and Laos in 1997 and Cambodia in 1999, AFTA developed into a regional trade agreement overseeing the entire Southeast Asian region.

The possibility of an East Asian FTA has been actively discussed at ASEAN+3 meetings. An East Asian FTA was proposed by the East Asian Vision Group (EAVG)⁴ in a report to the ASEAN+3 Summit in 2001, and the issue is expected to be at the top of the agenda at future ASEAN+3 Summit meetings. The East Asian Study Group (EASG), which was assigned to follow up the proposals by the EAVG, also proposed mid to long-term cooperative measures and additional subjects for study in its final report at the ASEAN+3 Summit at Phnom Penh in 2002. Some of the measures proposed in the report are the transformation of the ASEAN+3 Summit to the East Asia Summit, the establishment of an East Asia Investment Area and an East Asian FTA. Through the official studies by EAVG and EASG, the members of ASEAN+3 began to realize the need for an FTA as a means of promoting economic integration in the region in the long-term in response to the ever-deepening economic integration in North America and Europe and to introduce institutional measures for trade and investment liberalization in the region.

Recently, ASEAN members have been discussing bilateral FTAs with China, Japan, India and CER (an FTA between Australia and New Zealand), and it is known that the United States is considering an FTA with ASEAN countries.⁵

The most dramatic change in the FTA policies of Northeast Asian countries took place at the Singapore ASEAN-China Summit in November 2000, when then Chinese Premier Zhu Rongji proposed the possibility of an FTA with ASEAN. China is also actively promoting a bilateral FTA with ASEAN. China proposed tariff reductions on 500 agricultural items for ASEAN countries and announced its desire to conclude an FTA with ASEAN by 2004 at the Phnom Penh ASEAN-China Summit. Meanwhile, Japan also made it clear that it plans to promote an FTA with ASEAN within the next 10 years. It seems that “Japan, playing catch up with China, seeks a piece of the Free Trade Area pie.”⁶ In other words, instead of playing a leading role in promoting East Asian regionalism, Japan was reacting passively to China's FTA policy. Table 7 summarizes a

⁴ The East Asian Vision Group was composed of 26 representatives from 13 member countries (two representatives per country) and was assigned to produce a report for East Asian economic cooperation. The Vision Report was reported to the ASEAN+3 Summit held in Brunei Darussalam in November 2001. The report recommends that East Asia should pursue economic integration through the liberalization of trade and investment, developmental and technological cooperation, and information technology (IT) development.

⁵ The United States announced a new trade initiative with ASEAN, implying the possibility of bilateral FTAs with some ASEAN countries (see “Fact Sheet: Enterprise for ASEAN Initiative,” [www.whitehouse.gov]).

web of FTAs in progress in East Asia.

Table 7: Progress of major FTAs in East Asia (2004)

| FTA | Stages of Evolution | | | | |
|-------------------|---------------------|-------------|-------------|--------|----------------|
| | Discussion | Joint study | Negotiation | Signed | Implementation |
| ASEAN | | | | | |
| ASEAN FTA | | | | | X |
| ASEAN-China (CEC) | | | | | X |
| ASEAN-Japan (CEP) | | | | X | |
| ASEAN-India | | | | X | |
| ASEAN-U.S (EAI) | | | X | | |
| ASEAN + 3 | | X | | | |
| ASEAN-South Korea | | X | | | |
| ASEAN-CER | | X | | | |
| ASEAN-EU | X | | | | |
| Japan | | | | | |
| Japan-Singapore | | | | | X |
| Japan-ASEAN | | | X | | |
| Japan-Mexico | | | | X | |
| Japan-Malaysia | | | X | | |
| Japan-South Korea | | | X | | |
| Japan-Philippines | | | X | | |
| Japan-Thailand | | | X | | |
| Japan-Chile | | X | | | |
| Japan-Canada | X | | | | |
| Japan-Taiwan | X | | | | |
| Korea | | | | | |

⁶ Quoted from the editorial of the New Straight Times in Singapore on November 6, 2002.

| | | | | | |
|-------------------|--------------------------|---|---|---|---|
| Korea - Chile | | | | | X |
| Korea - Japan | | | X | | |
| Korea – ASEAN | | | X | | |
| Korea – Mexico | | | X | | |
| Korea - China | X | | | | |
| Korea - Singapore | | | | X | |
| Korea – Canada | X | | | | |
| Korea - US | X | | | | |
| Korea – EFTA | | X | | | |
| Korea – India | | X | | | |
| China | | | | | |
| China-ASEAN | | | X | | |
| China-Hongkong | | | | | X |
| China-Malaysia | | | X | | |
| China-Philippines | | | X | | |
| China-Macao | X | | | | |
| China-New Zealand | X | | | | |
| China-Australia | X | | | | |
| Singapore | | | | | |
| Singapore-CER | | | | | X |
| Singapore-U.S | Signed TIFA with the U.S | | | | X |
| Singapore-EFTA | | | | | X |
| Singapore-Japan | | | | | X |
| Singapore-Canada | | | X | | |
| Singapore-Mexico | | | X | | |
| Singapore-India | | | X | | |
| Singapore-S.K | | X | | | |
| Singapore-Taiwan | X | | | | |
| Thailand | | | | | |
| Thailand- Bahrain | | | | | X |
| Thailand-Peru | | | | | X |

| | | | | | |
|---------------------|--------------------------|--------------------------|---|---|---|
| Thailand-India | | | | | X |
| Thailand-China | | | | | X |
| Thailand-BIMSTEC | | | | | X |
| Thailand-Australia | | | | X | |
| Thailand-U.S | Signed TIFA with the U.S | | X | | |
| Thailand-Japan | | | X | | |
| Thailand -Korea | | X | | | |
| Thailand-N. Zealand | | X | | | |
| Thailand-S. Africa | | X | | | |
| Other FTAs | | | | | |
| Taiwan-Panama | | | X | | |
| Taiwan-US | X | | | | |
| Taiwan-Japan | X | | | | |
| Taiwan-Singapore | X | | | | |
| Taiwan-Costa Rica | X | | | | |
| Hongkong-China | | | | | X |
| Hongkong-Macao | | | | X | |
| Hongkong-N.Zealand | | | X | | |
| Philippines-China | | | X | | |
| Philippines-Japan | | | X | | |
| Philippines-US | X | Signed TIFA with the U.S | | | |
| Malaysia-China | | | X | | |
| Malaysia-Japan | | | X | | |
| Malaysia-U.S | X | | | | |
| China-Japan-S.K | X | | | | |
| Pan-East Asia FTA | X | | | | |

Source: Cheong (2003) and Updates

One of most important development towards an East Asian FTA is China's progressive approach to East Asian regionalism. The biggest advantage for China regarding its FTA policy is that once China's leaders promote an FTA within a certain region, the government can make rapid progress under its socialist system of centralized

decision-making. This contrasts with Japan and Korea, where FTA negotiations could be obstructed by vulnerable industries and diverse interest groups. When China realizes the economic necessity of an FTA and believes that the internal and external conditions are ready, it will promote FTAs with its neighboring countries in addition to ASEAN. The on-going trilateral study⁷ on an FTA between China, Japan and Korea will be an important momentum for Korea's FTA policy in addition to that of China.

Japan had not paid serious attention to the formation of preferential trading blocs until 1998, emphasizing its consistent efforts to maintain free trade under the multilateral trading system. Korea's Ministry of Foreign Affairs (MOFA) had also held a negative position toward regionalism until 1998. MOFA (1998) emphasized the problems of regional trading blocs and underlined the importance of strengthening the multilateral trading system. However, as Korea and Chile announced their plan to proceed with an FTA and China and ASEAN suddenly agreed to launch FTA negotiations within a concrete timeframe, Japan began to show a strong interest in entering into an FTA with Korea. Japan established its first FTA with Singapore in January 2002 and is near completing an FTA with Mexico.

The development of leaders' networks has been an important factor in accelerating recent talks on East Asian regionalism. The ASEAN+3 Summit first took place in 1997 when former Malaysian Prime Minister Mahathir unofficially invited the political leaders of China, Japan and Korea to ASEAN's 30th anniversary. This event sparked the acceleration of discussions on intra-regional economic cooperation and consolidation in East Asia.

After the financial crisis, East Asian countries realized the limit of an export-oriented developmental policy, mainly targeting the U.S. market (Ahn, 2001, 2003). Being heavily dependent on a major export market (such as the United States) made East Asia vulnerable to negative effects stemming from the depression of the U.S. economy and growing U.S. trade deficit and a stagnating world economy. Regarding this aspect, Munakata (2001) points out that the East Asian regional market should be integrated to stimulate regional demand. While East Asian countries are concerned about the "hollowing out" of industries triggered by China's industrialization, they hope to make the most of China's economic growth. Moreover, as the stagnation of the world economy causes a substantial reduction of East Asia's exports to other regions, the incentive for East Asian countries to expand exports to China is growing.

While promoting an East Asian FTA, East Asian Economies are likely to face tricky

⁷ Korea Institute for International Economic Policy (KIEP), China's Development Research Center (DRC) and Japan's National Institute for Research Advancement (NIRA) have undertaken a three years' joint study on the economic impact of trilateral FTAs, beginning in 2003.

issues at hand, such as the economic gap between member countries and a leadership issue over the region. The ASEAN+3 Summit recognized the continuous global expansion of regionalism, leaders discussed the possibility of an East Asian FTA in future ASEAN+3 meetings. China and Japan have different interests and hence different strategies for economic integration in East Asia. Cheong (2002) states that differences in the economic and military status of the two countries suggest that even if they manage to reconcile their troubled memories of the past, China and Japan may find it difficult to work together as equal partners for regional integration in East Asia.

IV. EAST ASIA COMMUNITY: LONG-TERM GOAL OF EAST ASIA

At the Hanoi ASEAN+3 Summit in November 1998, thirteen East Asian countries decided to organize a research group, East Asia Vision Group (EAVG), composed of 3 experts from each member country in order to come up with a comprehensive long-term vision on economic, social and political cooperation.⁸ They set the East Asian community as the long-term goal of East Asia.

The Vision Group envisions East Asia moving from a region of nations to a bona fide regional community where collective efforts are made for peace, prosperity and progress. The economic field, including trade, investment, and finance, is expected to serve as the catalyst in this community-building process. The East Asian community will be based on cooperation and openness. It will be pursued with the purpose of contributing to what is good not only for the region but also for the world.

In proposing the formation of an East Asian community, the group seeks the following goals: Preventing conflict and promoting peace among the nations of East Asia; Achieving closer economic cooperation in such areas as trade, investment, finance, and development; Advancing human security in particular by facilitating regional efforts for environmental protection and good governance; Bolstering common prosperity by enhancing cooperation in education and human resources development; and Fostering the identity of an East Asian community.

⁸ East Asian Vision Group was composed of twenty-six representatives from thirteen member countries (two representatives per country, and the chairman was Han, Sung-joo of Korea, a professor of Korea University) and they prepared a Vision Report through five meetings. The report was presented at ASEAN+3 Summit held in Brunei Darussalam in November 2001.

The EAVG report proposes an East Asia FTA, which is a mid-level form of economic cooperation designed to promote the end-goal of an East Asian Community. The purpose of East Asia FTA is to relieve trade barriers among East Asian countries step by step, ultimately abolishing them in order to liberalize the movement of goods and services across borders. By doing so, regional resources would be distributed effectively and welfare benefits would be shared. This FTA should be driven by the long-term goal of building an East Asian Community. As is well known, East Asia has risen to become one of the three axes of the world economy, accompanied by Europe and North America. An East Asia FTA should be pursued in consideration of East Asian regional economic integration of equal footing with Europe and America.

There are various forms of regional integration: The most inclusive form to date has been achieved in Europe in the form of the EU. The EU has developed regional integration not only in the economic arena, but also in politics and administrations. In contrast, NAFTA is a form of regional integration limited to economics with the potential to develop into a higher level of integration, bearing in mind that the EU started as a Custom Union.

An East Asia FTA should be promoted first to realize regional integration such as that created by NAFTA and developed into a region with equal power to Europe and America. Therefore, although East Asian integration will not be as inclusive as the EU, it should be a form that guarantees the free supply and consumption of goods and services within the region. As a latecomer behind the two regional agreements, East Asia should set a goal similar to NAFTA, which has relatively low level of integration. However, it will be necessary to keep the possibility open of passing the NAFTA level by following NAFTA as a “minimal goal,” that is, an East Asia FTA should aim for NAFTA-plus.

NAFTA plus means not only the economic benefits of integration, but also the pursuit of common prosperity and peace on the basis of mutual trust among all the countries in East Asia. To achieve this, member countries should have complementary industrial structures with a horizontal division of labor to balance regional trade. It would be difficult to build mutual trust if the benefits of economic integration are distributed unfairly, thus equal economic benefits must be a focus of a China-Japan-Korea FTA.

This would make possible for an East Asia FTA to contribute to the peace of the East Asian region as well as economic gain. An East Asia FTA should take an important

role in easing political and military tensions and pursuing common prosperity and peace in the region. For this, people in the region should have opportunities to exchange and understand each other’s culture and history. Through these activities, East Asians could ensure that they share a common culture and tradition, forming a firm basis for developing an East Asian community with common interests and values.

To actualize the ideal picture of an East Asian community, economic disparity, the absence of mutual trust and security on the Korean peninsula should be solved. However, these old problems would be difficult to settle in the short term. Thus, a systematic and strategic approach is necessary for effective solutions to these problems. The figure below schematizes the systematic approach for East Asian community-building. The three steps of East Asia economic integration are as below.

Figure 3: Systematic Approach for East Asian Community Building

| | | | |
|---------------|---|--|---|
| Step 3 | East Asian Community | | Building Infrastructure for inclusive integration |
| Step 2 | East Asia FTA | Economic development Policy cooperation | |
| Step 1 | Infrastructure for Industrial cooperation | | |

The East Asia FTA should start by building mutual trust. This trust building could be made by successfully building infrastructure for industrial cooperation. The excess production facilities in East Asia are pointed to frequently as one of the many factors that led to the 1997 financial crisis. That is, East Asian countries enlarged facilities excessively and competitiveness in goods market was unnecessarily overheated and led to the financial crisis. Whether this assertion is true or not, it is true that East Asian countries are in strong competition, pursuing similar industrial structures. In the case of Korea and Japan, the rate of operation has fallen and the number of idle facilities has increased in some industries, while ASEAN and China have enlarged their vast facility investment in the same industries to improve self-sufficiency. This phenomenon is shown in petro-chemistry and steel industries and will extend to shipbuilding, automobiles and electrics.

The second step of East Asian community building is a CJK FTA. The process of East Asian economic integration through an East Asia FTA needs the cooperation of East Asian countries in adjusting their industrial structures. However, for an East Asia

FTA, basic conditions should mature and cooperation projects should be put in place beforehand. An East Asia FTA should be driven to maximize cooperation in industry and trade on the basis of common industrial structure provisions.

Policy cooperation among East Asian countries should include general economic policy (macro and financial policy) and a wide scope of fields (long-term development strategy, and industry and trade policy). So far, China, Japan, Korea and ASEAN countries have signed bilateral swap agreement to prepare for a possible recurrence of the 1997 financial crisis. In addition, they have the option of forming currency and financial policies on the basis of East Asian values. If they extend the range to macro and financial economic policy (inflation, interest and exchange rates), it would increase mutual trust. This spirit of economic cooperation will promote an East Asian Community.

Common industrial structure adjustments, investment agreements and FTAs are forms of cooperation focused on the economic field. However, to materialize more advanced regional integration such as NAFTA-plus, only economic cooperation is insufficient. Namely, for real regional integration and economic cooperation, mutual trust among the economic bodies of the region is critical. To achieve this, a firm foundation should be built to integrate East Asian countries toward the same direction.

V. Conclusions and Policy Implications

Although it is regarded as one of the three major economic pillars in the world, East Asia has still the lowest level of economic cooperation and integration when compared to the EU and NAFTA. Economies in East Asia should therefore recognize the need for strengthening regional economic cooperation to utilize a “partnership from differences.”

The East Asian countries have been remarkably successful in nurturing manufacturing sectors able to compete in international markets under export-led development regime. Recent East Asian enthusiasm for regional FTAs is likely to enhance regional manufacturing efficiency. East Asian economies were less successful in developing the financial sector; hence financial weakness persisted even during the years of high performance. To make the current recovery more permanent and proved a buffer against external shocks in the future, East Asian countries have to strengthen their

financial markets (Ito, 2001).

The Asian financial crisis in the late 1990s ushered in a new era for East Asian economic cooperation. The CMI has already set the tone for regional financial cooperation. Regional FTAs in East Asia that have been completed and are in progress are likely to add renewed momentum to the on-going integration process. The two forces will accelerate the “long march” toward an East Asian Community. Although East Asia embarked upon a regional economic integration process lately compared to the integration process of EU and NAFTA, both the Asian financial crisis and the subsequent restructuring and on-going regional FTA initiatives are likely to reinforce each other. To make this happen, East Asia’s quest for regional integration should proceed following the WTO regime.

East Asia has great potential to match the EU or NAFTA provided that East Asian countries with their huge diverse economic and political backgrounds can reconcile whatever differences they may have to achieve region-wide growth dynamism within a sustainable framework. Indeed, FTAs are international agreements of like-minded countries. Any possible “spaghetti bowl” or “noodle bowl” effects due to the possible complexity of FTA hubs and spokes or competitive hegemonic economic leadership need to be avoided. In particular, a China-led FTA and a Japan-led FTA in an uncooperative fashion is likely to generate a hub-spoke bilateralism in East Asia. East Asia should work out an ASEAN+CJK FTA that could set the tone for East Asian integration from a long-term perspective.

In order to adjust to the rapidly changing economic map of Northeast Asia, Korea has developed the concept of making a Northeast Asian business hub. By fully exploiting its geoeconomic location, Korea can serve as a bridge between the Japan-led “Pacific-Oceania economy” and the China-led newly emerging “continental economy.” Moreover, Korea’s vision for a business hub and its serious commitment to becoming a transparent and “international best practice” economy will be an essential ingredient for East Asian regionalism (Ahn, 2003).

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