

# THE RISE OF CHINA AND EAST ASIAN ECONOMIC COMMUNITY

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## I. *Introduction*

The last couple of decades have seen tremendous increase in economic interdependence in East Asia, as can be seen from the very rapid growth in intra-regional trade and investment flows. However, the extensive economic interdependence in East Asia does not have the benefit of a formal institutional framework for policy cooperation. In other words, while regionalization is strong, until the last few years, there was hardly any regionalism for the region to run policy cooperation within the region and engage in inter-regional negotiations.<sup>1</sup>

As a major trading partner of both the United States and Europe, the East Asian region as a whole has also become an important global economic player. However, the lack of regionalism contrasts the region to other major economic area groupings. For example, Europe has a highly stable and established European Union, and the American continents, wherein integration started with NAFTA (North American Free Trade Agreement), is working towards a Free Trade Area of the Americas by expanding to include the countries in South America. The growth of the multilateral approach to a globalized world economic order shows that no one country, not even the United States, can unilaterally manage the system.

In East Asia, steps have been taken to move towards an East Asian Economic Community in recent years. ASEAN has expanded from an FTA only among the member countries established in 1992, to growing bilateral and multilateral free trade agreements with the major East Asian countries, China, Japan, and Korea. The process started with China's initiative to establish a FTA with the whole of the ten-country ASEAN. Japan and later South Korea have followed China's initiative. This group of countries, also called the ASEAN Plus Three (or ASEAN + 3), now engages in dialogues and concrete cooperation. In principle, leaders of these countries acknowledge that the economic stability of the region depends on its integration and the cooperation of all the countries in it. However, a complexity of institutional structures needs to be built in order to pursue formal regionalism among the ASEAN + 3.

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<sup>1</sup> Regionalization refers to extensive economic interdependence in the region in the absence of any formal framework of cooperation, while regionalism refers to formal arrangements for economic integration and cooperation through trade liberalization and through financial and macroeconomic policy cooperation.

This paper discusses the regionalization and regionalism of ASEAN and the three Northeast Asian countries in the light of globalization, the rise of China's economy, the Asian economic crisis, and regionalism in other parts of the world.

## II. *Sub-Regional and Bilateral Cooperation*

Established in 1967, ASEAN was, until 2001, the only regional framework for integration within the region. It became the hub of regional integration when it invited China, Japan, and Korea to become consultative partners in 1991, and dialogue partners in 1997. At the start of its organization, ASEAN's agenda began as being essentially political in nature.<sup>2</sup> But in 1992, against the backdrop of rapid globalization and the soaring growth of China, the ASEAN set up the ASEAN free trade area, or AFTA. Under the Common Effective Preferential Tariff Scheme (CEPT), member countries are committed to reduce intra-regional tariffs to within 0 to 5 of the tariff band within fifteen years. This timetable was accelerated twice and AFTA has been fully implemented since 2000. Under AFTA, trade cooperation of ASEAN countries also involves trade facilitation measures such as the harmonization of the tariff nomenclature, technical regulations and product standards.

Since the turn of the century, other sub-regional trading arrangements for ASEAN and bilateral arrangements for some of its member countries have been proposed. Some are still under study while others are in the negotiation stage. The first of these was the ASEAN-China FTA, deemed significant as it covers a population of 1.8 billion and total income of \_\_\_\_\_. Negotiations for it started in 2001 with the aim for formal implementation to take place in 2010. Japan followed suit with a Framework for Comprehensive Economic Partnership between Japan and ASEAN signed in October 2003. However, despite this framework, Japan focused more on bilateral agreements negotiations with the more developed countries. It signed a bilateral agreement of Closer Economic Partnership with Singapore in 2002. By 2004, it has proposed bilateral arrangement also with Malaysia, the Philippines, and Thailand.

ASEAN-Korea multilateral free trade arrangement has also started. A Framework Agreement was signed in December 2005 and negotiations on the proposed ASEAN-Korea FTA will start in 2007 and its realization in 2009, a year earlier than the target year for the ASEAN-China FTA.

Large economies in the south, which are geographically close to Southeast Asia, are also interested in establishing closer economic linkages with ASEAN through formal arrangements. ASEAN and the countries down under, namely, Australia and New Zealand, have been holding official discussions on building a Closer Economic Relations (CER) arrangement since 2000. Free trade negotiations started in 2005 and are expected to be concluded by 2007, with the hope that full trade liberalization will take place by

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<sup>2</sup> Its founding document "embodied a desire to shape the regional order" (Berger and Beeson 2003).

2017. Among the ASEAN countries, Singapore and Thailand already signed bilateral free trade agreements with Australia.

India, which is experiencing the benefits of its liberalization policy, is also interested in contracting trade agreements with other countries and economic groups. In late 2003, ASEAN and India signed a Framework of Agreement on Comprehensive Economic Cooperation with the goal of establishing an ASEAN-India Regional Trade and Investment Agreement by 2011. The target date for the four new member countries (Cambodia, Laos, Myanmar, and Vietnam) and the Philippines is 31 December 2016.

The ASEAN has an important role to play in East Asian regionalism. As the only sub-regional arrangement in the region, it is the driving force for regionalism of East Asia by default. Meanwhile, a proposal for free trade area for the three Northeast Asian countries, China, Japan, and Korea, is under study. Despite the historical and current political differences between China and Japan, and between Japan and Korea, the leaders feel that a trilateral free trade area, proposed in 2002, will promote trade and hence economic growth in their respective countries.

Before the proliferation of sub-regional arrangements, almost all the thirteen East Asian countries had already formed part of multilateral trading arrangements, global and regional. However, involvement of these countries in these arrangements has been as individual countries. At the global level, except for a couple of the new ASEAN members, all the thirteen are members of the WTO.

A regional multilateral trading arrangement is APEC. China, Japan, South Korea and seven of the ASEAN countries (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam) are members of the Asia-Pacific Economic Cooperation (APEC). However, although the East Asian countries make up about half of the number of members of this Pacific Rim organization, there is no caucus among them. The establishment of APEC in 1989 was triggered by the end of the Cold War and the rise of East Asia at the turn of the decade. It was therefore based on the optimism of greater economic opportunities and political stability in the Asia-Pacific region. A proposal for an East Asian Economic Caucus within APEC was in fact made by Prime Minister Mahathir of Malaysia in 1990. However, most of the APEC countries, including those in East Asia, did not see the need for it.

It was in the ASEM (Asia-Europe Meeting) process that the East Asian countries found themselves in caucus. A process which began in 1996, ASEM consists of forums on a wide range of issues held every two years between Asia and Europe. ASEAN + 3 is the Asian counterpart to the European Union in these forums. In effect, in these meetings, ASEAN + 3 acts as a *de facto* East Asia community, although in this capacity the attention of the group is exclusively for the agenda of ASEM.

In recent years, initiatives of regional arrangements involving individual countries of East Asia and countries or regions outside of East Asia have increased. The more developed countries in ASEAN find it difficult to wait for the others to accelerate trade liberalization in their countries. Aside from having bilateral trading pact with Japan and Korea in the region, Singapore has signed proposal for bilateral free trade area with countries outside the East Asian region including Australia, Canada, Chile, Mexico, New Zealand, Taiwan, and the U.S. For its part, Thailand has proposed such bilateral agreement with Australia, Croatia, Czech Republic, and India. Liberalization is relatively slow in Indonesia, Malaysia, and the Philippines because of the presence of elite groups which tend to cling to protective policies. Malaysia in particular wants to protect its automotive industry.

### III. *The Rise of China and EA Regional Economic Interdependence*

Regional economic interdependence in East Asia, which began in the early nineties and accelerated later in the decade, continues to be dynamic. A significant increase in intra-regional economic linkages has been observed in both trade and investments.

Table 1 presents statistics on intra-regional trade based on ASEAN's trade. It shows the share of intra-ASEAN trade, share of China, Japan and Korea in the ASEAN's trade for various years. In the nineties, intra-ASEAN trade has increased as a result of the AFTA agreement to breakdown tariff barriers gradually. From 1993 to 2002, total ASEAN trade increased by 64.3 percent while intra-ASEAN trade grew by 93.6 percent (ASEAN Secretariat 2004). Since the late nineties, due to the rapid increase in trade with China, the ASEAN's trade with East Asia has grown very rapidly.

**Table 1. Intra-ASEAN Trade, ASEAN Trade with China, Japan and Korea**  
(In percent)

Country	1998	1999	2000	2001
Brunei	25.3	33.5	23.7	27.7
Cambodia	-	-	18.8	32.5
Indonesia	16.9	16.0	16.7	16.6
Malaysia	27.4	23.6	22.9	23.0
Myanmar	-	38.3	39.5	46.2
Philippines	14.0	14.9	16.2	16.2
Singapore	24.1	25.1	26.6	26.4
Thailand	14.7	17.1	19.6	19.7
<b>Intra-ASEAN</b>	<b>20.3</b>	<b>20.5</b>	<b>21.4</b>	<b>21.4</b>
ASEAN-China	3.4	7.1	7.8	7.8
ASEAN-Japan	13.7	13.7	15.2	14.3
ASEAN-Korea	2.9	3.6	3.8	4.0
<b>ASEAN-Northeast Asia</b>	<b>19.9</b>	<b>24.4</b>	<b>26.8</b>	<b>26.0</b>
<b>Total</b>	<b>40.2</b>	<b>44.8</b>	<b>48.2</b>	<b>47.4</b>

Source of basic data: IMF Direction of Trade Statistics

Japan, which has long been an important trading partner of ASEAN, trades industrial products for the ASEAN's primary goods. The share of China and Korea in the ASEAN's trade had been small. A slight increase in ASEAN's trade with Korea has been noted. From 2.9 percent in 1998, its share grew to 4.0 percent in 2001. Meanwhile the increase in its trade with China has been more significant (from 3.4 percent in 1998 to 7.8 percent in 2001).

The economic crisis of 1997 resulted in the devaluation of the currencies of the Southeast Asian countries and Korea, which stimulated their exports to China. Further stimulation of ASEAN's trade with China was due to China's WTO entry and the agreement to establish an ASEAN-China FTA. In the last few years (2001-2004) exports from the ASEAN countries to China grew at more than 40 percent annually.

Table 2 shows the statistics on the exports of East Asian countries to China, ASEAN as a whole, and Japan for 1985, 1995, and 2001. In this table of Ng and Yeats (2003), East Asia includes the ASEAN +3 countries excluding Japan and Myanmar, but with Hong Kong, Mongolia and Taiwan. From 1985 to 1995, the share of East Asia's exports to both China and ASEAN grew significantly, with China's share growing from 3.2 percent to 5.2 percent. Meanwhile the ASEAN's share grew from 10.2 percent to 13.7 percent. In the latter period from 1995 to 2001, the share of East Asian exports to China continued to grow, and reached 7.0 percent in 2001. The share going to the ASEAN countries, however, decreased to 11.5 percent. In contrast, Japan's share in East Asian's

exports declined by 6.9 percentage points from 1985 to 2001. Still, the reliance of East Asia on imports from Japan was still strong. For the same period Japan as an import market grew by 6.4 percent, thus making the total trade share of Japan in East Asia's trade virtually constant for the period 1995-2001.<sup>3</sup>

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<sup>3</sup> This is consistent with the figures in Table 1, which shows the share of Japan in ASEAN's trade to be fairly constant from 1998 to 2001.

Table 2.\* The Geographic Destinations of East Asian Exports: 1985, 1995, 2001

East Asian Country	Year	Global Exports (\$ Million)	Share of Total Exports Destined for (%)			
			East Asia~	Of which		Japan
				China	ASEAN	
Brunei	1985	2,864	32.2	0.0	20.7	66.6
	1995	2,573	37.0	0.0	20.4	52.2
	2001	3,632	32.8	4.1	16.3	46.7
Cambodia	1985	8	44.8	7.8	37.0	2.6
	1995	393	70.1	1.5	63.1	1.9
	2001	1,719	10.6	2.0	6.8	3.8
China	1985	31,356	34.7	0.0	10.5	20.8
	1995	232,623	39.0	0.0	4.5	15.4
	2001	415,879	30.7	0.0	5.0	13.9
Hong Kong	1985	24,071	27.6	19.8	4.6	3.2
	1995	55,742	35.9	15.4	15.7	4.9
	2001	59,682	35.2	15.8	14.2	2.4
Indonesia	1985	19,684	9.9	1.7	2.0	51.8
	1995	47,885	25.1	4.3	5.9	29.7
	2001	63,149	27.2	6.2	7.6	23.6
Korea	1985	25,207	10.2	0.0	5.2	16.4
	1995	117,907	34.2	8.7	13.8	14.7
	2001	163,645	34.1	14.3	10.0	10.5
Laos	1985	22	76.6	43.8	30.0	5.5
	1995	345	55.1	1.9	47.7	8.6
	2001	364	60.3	2.0	56.9	1.9
Malaysia	1985	17,947	38.1	1.1	26.5	24.2
	1995	86,288	43.6	2.4	30.6	12.2
	2001	111,429	42.0	5.6	24.4	11.5
Mongolia	1985	94	4.1	2.1	1.9	8.1
	1995	380	29.2	26.5	0.0	23.8
	2001	489	49.6	49.0	0.1	2.2
Philippines	1985	6,112	17.5	1.6	8.4	20.5
	1995	19,780	23.5	1.4	11.4	17.7
	2001	42,870	34.4	4.5	13.4	15.0
Singapore	1985	17,199	35.1	1.4	22.1	9.3
	1995	88,629	44.0	3.8	23.0	7.7
	2001	93,268	44.8	5.5	22.4	5.8
Taiwan, China	1985	33,610	14.9	0.0	5.9	10.2
	1995	122,940	39.9	12.0	12.2	11.7
	2001	151,981	41.1	18.0	11.1	9.3
Thailand	1985	7,787	25.4	3.4	14.4	13.3
	1995	54,837	32.0	2.9	19.7	18.5
	2001	72,746	33.5	6.5	17.0	14.2
Vietnam	1985	407	44.9	0.0	20.3	16.1
	1995	6,222	30.8	5.3	15.2	27.6
	2001	14,894	29.2	6.8	15.3	17.5
All Above Countries	1985	186,156	23.7	3.2	10.2	19.0
	1995	839,045	37.5	5.2	13.7	14.1
	2001	1,194,401	35.0	7.0	11.5	12.1
Memo Item						
East Asian Countries	1985-	--	11.3	3.8	1.3	-6.9
Export Share Change	2001					
Major Market Import		--	11.6	10.2	12.1	6.4
Growth Rate (%)						

~ Brunei, Cambodia, China, Republic of Korea, Hong Kong, Indonesia, Lao PDR, Malaysia, Mongolia, Philippines, Singapore, Taiwan (China), Thailand, Vietnam

Presently China is a main export destination for the ASEAN countries. After the Asian economic crisis, the trade balance of ASEAN-China trade has generally been in favor of the ASEAN countries because of China's continued economic growth and the relative strength of the RMB compared with the devalued Southeast Asian currencies. Hence from 1996 to 2001, China was the market with the largest share growth vis-à-vis ASEAN as a whole and almost all the individual countries (except for the Philippines

where the increase in China market share ranked second) (Ng and Yeats 2003). This trend has been intensified by the accession of China to WTO, which means greater access to its domestic market for both products and services.

The increased market liberalization resulting from the effort towards establishing an ASEAN-China FTA arrangement is expected to also contribute to more trade. The ASEAN-China FTA was initiated by China in 2001. Through such cooperation, China expects to “give the Southeast Asian neighbors a boost in their exports to the Chinese market” (Lo 2003). Under this agreement, China promised to offer even greater trade liberalization than its WTO accession agreement. The least developed ASEAN countries, namely, Cambodia, Laos, Myanmar, and Vietnam, are expected to benefit the most, as they will be granted by China “the most-favored nation status” which China grants to the WTO members. This trade arrangement is expected to push the ASEAN countries to increase their competitiveness and specialize in products where they have the best comparative advantage.

Much of economic interdependence in East Asian trade is due to the increase in foreign direct investments in the region. Some of these investments are intra-regional. Of the thirteen ASEAN + 3 countries, the three most industrialized countries, Japan, South Korea, and Singapore, invest significantly in the region. Together with the other NIEs-- Hong Kong and Taiwan, they contribute 60 percent of all the investment inflows that go to China and the ASEAN countries.

China has been a favorite FDI destination since it opened up its economy in 1979. Since 2003, it has become the world’s biggest recipient of foreign investments. There is always apprehension among the ASEAN countries that inflows to China might be at the expense of inflows to their countries. An empirical study however shows that FDI flows to the ASEAN countries are not being crowded out by the increase in China’s FDI inflows (Tan 2001). Since the nineties, FDI inflows to Asia have increased along with inflows to China, although the rate for China is higher. The share of China and ASEAN in global foreign investments both increased in the eighties and nineties. Of the FDI inflows that went to East Asia in the past decades, half were headed for China, while 40 percent went to the five original ASEAN member countries, namely; Indonesia, Malaysia, the Philippines, Singapore, and Thailand (Yusuf and Evenett 2002).

Foreign direct investments, whether from the region or outside, contribute to intra-regional networking and trade. The international segmentation production process of multinationals and other investing firms enhanced the production sharing operations in East Asia. Japan, for example, provides one-third of all regional exports of components for assembly (Ng and Yeats 2003). The workshop of such segmented production process is in labor-abundant China, where the assembly of the components and parts is being done.

It is clear that market-driven economic integration and cooperation have grown over the decades in East Asia. Intra-regional trade and foreign direct investment, driven by the globalization of production networks, have increased significantly. The integration of economies within the region is based on a network of production, sourcing, and distribution. Despite strong economic interdependence since the eighties, however, formal economic integration of the entire region has not happened because formal regionalism is the response of government policies to market-driven regionalization, making it a less spontaneous development. The establishment of APEC in 1989 evoked the proposal of an East Asian grouping a year later from Malaysia's former Prime Minister Dr. Mahathir Mohamad., With his Pan Asia vision and "looking East" policy, he wanted to establish an exclusively East Asian trading bloc within APEC that would exclude the U.S., Australia, New Zealand and all non-Asian countries. As expected, the idea was opposed by the U.S. and the other western countries in APEC. At that time, even the Asian countries did not embrace the concept.

Aside from the political inertia and lack of support from the West, the absence of formal regionalism in East Asia all these years is, to a great extent, due to the political history of relations between the countries in the region. While regionalism in Southeast Asia is present with the existence of ASEAN and AFTA, any multilateral or bilateral arrangement among the Northeast Asian countries is starkly absent. (In 2002, for economic expediency, a proposal for a trilateral economic arrangement has been made.) Suspicion and mistrust due to the history between China and Japan as well as Korea and Japan still exist. In fact, until recently, China was looked at as an enemy of the non-Communist world. In fact, to a great extent ASEAN was established in the sixties to fend off communism in the region.

#### IV. *Asian Economic Crisis*

The need for more structural institutions to systematize economic cooperation in the area became obvious and urgent only when a financial crisis beset East Asia in 1997 to 1998. The crisis came as a surprise to most, as the region, just a year ago, was fondly dubbed an "economic miracle" by the World Bank. However, due to structural economic and political problems, it found itself in financial trouble

Countries in the region were affected in varying degrees. Most seriously affected were Thailand, Indonesia, and South Korea. Malaysia, the Philippines, Singapore, Hong Kong and Taiwan suffered much contagion effect. Although China and Japan were not directly hit, they also feared the repercussions the crisis might have on their economies. The financial crisis, which turned into an economic crisis, became the impetus for serious discussion of cooperation among the countries in the region.

Today, monetary and financial policies, as well as macroeconomic coordination, are of particular concerns in the discussion of East Asian cooperation. The region wants

to make sure a financial crisis of the magnitude and contagion effect of the 1997 experience would never occur again.

The crisis therefore pressured the countries not only to institute domestic reforms but also to forge regional cooperation. It highlighted the need of the region to be self-reliant. APEC, which was built on the increasing economic dynamism of the East Asian region, was not prepared nor interested in solving the financial crisis of the region. The United States simply overlooked the crisis and did not provide the leadership needed to get the region out of it. Further, the U.S. supported the IMF policies which were deemed inappropriate by the affected countries. Not surprisingly, the countries in the region, even those not directly affected, were extremely concerned.

China and Japan provided more significant financial help except that there was little coordination between these two countries. For example, after Japan proposed to set up an Asian Monetary Fund and the proposal was turned down by the U.S. and IMF, Japan, in retrospect, felt that the proposal would have stood a better chance of being approved had it coordinated with China in this effort.<sup>4</sup>

The Asian economic crisis lent China an opportunity to demonstrate its economic power and strengthen its engagement with countries in Southeast Asia. It extended aid to Thailand and Indonesia, the countries most severely affected by the crisis, by contributing to the IMF bail-out package. It also extended direct bail-out, material and medical aid; and offered export credits and more investments to affected countries (Baviera 2001). On top of these the Chinese government maintained a responsible attitude during the crisis. It helped to control the crisis by deciding not to engage in competitive devaluation at the time, thereby earning the goodwill of Asia and the rest of the world.

The need for more regional cooperation among a wider group of countries gave birth to the ASEAN + 3 process with a summit held in Kuala Lumpur in 1998. While ASEAN had invited China and Japan to be “consultative partners” since 1991, it was only in 1998 that China, Japan and South Korea became “dialogue partners,” resulting in the informal group called “ASEAN + 3.” The summit discussions focused on the areas of financial cooperation and macroeconomic policy coordination. In the meantime, between 1995 and 1998, ASEAN was enlarged to include Vietnam, Myanmar, Laos, and Cambodia. Hence ASEAN + 3 grew to consist of ten ASEAN countries and the three economic giant countries in the northeast.

Since then the ASEAN + 3 process has regularly met to discuss wherein many regional issues. The process, in effect, is the East Asian Economic Grouping envisioned by Mahathir though the exclusivity is not as explicit as he had articulated. So far the ASEAN + 3 has been informal and somewhat *ad hoc* in nature. There is interest among

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<sup>4</sup> This view was expressed by Dr. Eisuke Sakakibara, Japan’s former Vice-Minister of Finance, at the East Asian Congress in Kuala Lumpur in August 2003.

the leaders of the thirteen member countries to make ASEAN + 3 into a more formal arrangement. Like most regional arrangements in this age of globalization, the ASEAN and the three Northeast countries would like cooperation embodied in the formal cooperation arrangement to be comprehensive, covering issues not only pertaining to trade and investments, but also those pertaining to financial and capital market, infrastructure, tourism, human resources, and technology.

To push this concept of regional cooperation one step further, Malaysia initiated a first East Asian Congress in Kuala Lumpur in August 2003 to more openly discuss the various issues of possible cooperation. This first congress, which was to be followed by a second one in 2004, was attended by experts, academicians, and government officials of the thirteen ASEAN + 3 countries to give the concept of a formal institution for East Asian regionalism more attention. Aspects of cooperation being discussed included trade, finance, education, health, migration, media, and institutions needed for the building of a framework for regionalism. Later that year, in the ASEAN +3 summit in Bali, the leaders agreed to implement a series of short-term measures to set the pace for an East Asian FTA, with the ultimate goal of creating an East Asian Economic Community that will provide formal institutions for comprehensive cooperation in the region.

#### V. *Advantages of Regionalism to ASEAN, China, Japan, and Korea*

The idea pertaining to the regionalism of East Asia has been a welcome principle for all ASEAN + 3 countries. As a whole, ASEAN is attracted by the large market and economic weight of the Northeast Asian countries. As a regional grouping, ASEAN's impact in terms of trade and investment has been limited. It is dependent on investments from outside of the region, but is too small to attract FDIs. On the other hand, ASEAN + 3 is thirteen times bigger in terms of GDP than ASEAN itself. ASEAN's trade with the northeast countries has been increasing more significantly than intra-ASEAN trade. Intra-ASEAN trade is 21.4 percent of ASEAN's total trade while ASEAN's trade with China, Japan, and South Korea constitutes 26.24 percent (Table 1). Hence, ASEAN feels that an expansion of regionalism beyond ASEAN would definitely be beneficial.

China for its part wants to see an integrated Asia where it hopes to provide a strong leadership.<sup>5</sup> It hopes to build a multi-polar region to provide a counterweight to the dominance of the U.S. in the whole of Asia. East Asia is a good place to start and build on before achieving an Asia-wide cooperation. At the same time, through greater economic cooperation with the ASEAN, China hopes to mitigate the conflicts it has with several of the ASEAN member countries over some island territories in the South China seas.

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<sup>5</sup> The Boao Forum begun in 2002 is an attempt for a cross-Asia forum, involving not just East Asia, but also South Asia and Central Asia. It is a nongovernment and nonprofit international organization that provides forums for Asian leaders from the government, business, and academia to express views on Asia and the world. The forum is held yearly in Boao, Hainan Island, China.

Japan has long been the economic leader in East Asia. However, in the last decade, its focus had been on its domestic economic problems due to the extended recession it was experiencing. With China's dynamic growth and increasing economic role in East Asia, Japan seems to be losing this leadership by default. To maintain its economic dominance in the region, Japan has thus signed a bilateral trade arrangement with Singapore and has proposed the same with Malaysia, the Philippines, and Thailand. Financial strength being its comparative edge, Japan wishes to push for more financial cooperation in the region. Japan also realizes that it needs the cooperation of the region, particularly China's, in order to realize the financial agenda it has for the region.

As one of the newly industrialized economies in the eighties, South Korea has extensive economic relations with China, Japan and some ASEAN countries. Having been one of the countries severely affected by the 1997-98 Asian financial crisis, Korea is very much in favor of an economic community in the region that would promote its trade and investments in the region and also to protect it from financial volatility.

The economic welfare effects of the various regional trade proposals on GDP growth involving ASEAN, China, Japan, and South Korea may be seen in a World Bank study (see Table 3). The figures show that for all the regional trade arrangements, benefits in terms of greater GDP accrue to the countries participating in the economic arrangement, while the excluded countries are affected negatively. An ASEAN + 3 FTA is calculated to increase ASEAN's GDP by 1.5 percent, China's by 0.1 percent, Japan's by 0.2 percent, and Korea's by 1.1 percent.

**Table 3.\* Effects on Economic Welfare of Various Regional Trade Proposals**

Proposal	% of GDP			
	ASEAN	China	Korea, Rep.of	Japan
China + Korea + Japan	-0.26	+0.1	+1.0	+0.1
ASEAN - China	+0.9	+0.0	-0.1	+0.0
ASEAN - Japan	+1.1	-0.1	-0.2	+0.0
ASEAN + 3	+1.5	+0.1	+1.1	+0.2
ASEAN + 3 + CER	+1.3	+0.0	+1.1	+0.2

Note: Calculations for ASEAN include only Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam. CER (Australia-New Zealand Closer Economics Relations Trade Agreement) includes Australia and New Zealand.

Sources: Scollay and Gilbert (2003) for free trade agreement proposals

\*Taken from Krumm and Khoras (2004), p.xxiv.

While it is clear that regionalism of ASEAN + 3 will bring about benefits to the ASEAN and China, Japan, and South Korea, the formation of such a regional trade arrangement is not developing very fast for various reasons, one of which is that dialogue among the three Northeast countries has not been easy. Their long history of animosity coupled with current disputes, has created a political fear of cooperation among the three countries. Another problem is ASEAN itself. Internally, the association is not strong enough to assume the hub position in a series of proposed preferential arrangements. Also, the member countries are very diverse in their level of development. On the one hand Singapore has been one of the four newly industrialized economies for more than a decade while Thailand and Malaysia will soon join the league. On the other hand, the four new members, Cambodia, Laos, Myanmar, and Vietnam (CLMV), are transitional developing countries whose income levels are still low and institutions are not yet well developed. Special and differential treatment is needed to accommodate them in the liberalization process of the trade arrangements involving the ASEAN. Moreover, even among the more mature economies, the pace of liberalization is not uniform. Some still want to adopt protectionist policy or to protect certain particular industries. Finally there is little support from the West. Both the U.S. and EU realize the importance of the rise of East Asia in global economic order, as can be seen from the linkage they tried to forge through APEC and ASEM respectively. However, the support the United States has for the formation of a formal regional cooperation is not strong, as can be seen in how the proposals for an East Asian Economic Group in 1993 and an Asian Monetary Fund in 1997 were received.

## **VI. *Regional Financial Cooperation***

The Asian financial crisis awakened the East Asian countries to a new reality in regional interdependence and cooperation. It revealed the need for institutionalized regional surveillance of monetary condition and coordination of macroeconomic and exchange rate policies. Without financial cooperation, the interdependence in trade and investments in the region can aggravate a financial crisis with a greater contagion effect. The Asian economic crisis also revealed the ineffectiveness of IMF and the disinterest of the U.S. in solving the region's economic problems. Thus the summits of ASEAN + 3, a process established after the crisis, have concentrated their cooperation effort on the financial aspect.

The fact that the financial crisis occurred in East Asia is rather ironical given the financial capability of the region. The foreign reserves of Japan and China add up to more than U.S.\$1trillion, an amount equal to about 50 percent of the world's reserves. Despite this capability, however, the minimal influence of the region on global financial system was evident when the Asian financial crisis broke out. Much as Japan and China wanted to help in terms of financial loans, no institutional structure was available to provide for such monetary cooperation. The U.S. and the IMF did not support Japan's informal proposal to set up an Asian Monetary Fund after the crisis because they were concerned

that such a regional fund would not be able to apply conditionalities the way IMF does (Soesastro 1999). The current surpluses of the region, which exceed U.S.\$200 billion annually, have built up large foreign reserves. Mostly invested in U.S. currency denominated assets, these surpluses help finance America's current account deficit. It is believed that with proper mechanisms in place, the region should be capable of protecting itself from another crisis, and will, in effect, promote global financial stability.

Since the 1997 crisis, ASEAN + 3 as a group has taken some initiatives toward financial and monetary cooperation, among them the Chiang Mai Initiative in 1999 which expanded the ASEAN swap arrangements and a series of bilateral swap arrangements between ASEAN member countries and each of the Northeast Asian countries. This regional financing facility can provide greater foreign exchange liquidity in times of need and thus help prevent a crisis from happening. In June of 2003, ASEAN + 3 also launched the Asian Bond Fund, which aims to develop long-term financial sources for development and reduce reliance on short-term borrowing.<sup>6</sup> ASEAN + 3 also puts in place a mutual surveillance process and greater coordination of macroeconomic policy and exchange rates for ASEAN countries.

Through the various financial cooperation initiatives, the region aims to achieve some long-term goals of financial self-reliance in the region. It also hopes to lessen dependence on the U.S. dollar and to be able to arrange for bilateral payments by developing a basket of currencies (U.S. dollars, euro, and yen) for the Asian currency unit. Japan has taken the lead role in this aspect as it continues to push for the greater use of the yen and the setting up of the Asian Monetary Fund (AMF). The latter, it argues, will lessen the region's reliance on the IMF, and will mobilize and provide liquidity during financial crises. The Asian Monetary Fund can also undertake surveillance of the financial systems of the individual countries and coordination of monetary policies in the region.

## VII. *Conclusions and Implications for the Philippines*

The ASEAN + 3 process, which was established in 1997 in response to the financial crisis that attacked the region that year, is a step towards East Asian regionalism. It is the start of an East Asian Economic Community process. The European Union had started with the Schumann Plan in 1950 and took more than half a century to reach maturity. In contrast to the closed regionalism of the European Union which thus requires the surrender of individual country sovereignty, East Asian regionalism will be an open one. Still it should also be expected that East Asia will take decades before its regionalism becomes functional the same way the EU's is today.

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<sup>6</sup> Annual saving of the region is approximately U.S.\$1 trillion. The Asian Bond Fund can make use of the saving for greater regional development and stability.

As the Chinese saying goes, “A thousand-mile journey starts with the first step.” Obstacles are sure to abound and consensus is not easy to arrive at. In general, though, all the countries have shown that they have the political will for this long-term goal, even though their economic and political motive and agenda may be quite different.

The Asian economic crisis was an impetus for governments in the region to organize formal cooperation. All thirteen countries have agreed that for the sake of economic stability of the region as well as that of the individual countries, their regionalism should focus on financial and monetary cooperation.

Just as regional integration and cooperation present benefits to individual countries, so do they present several challenges. Moreover, only individual countries that are ready can reap the benefits of regionalism. Through the integration with the Northeast Asian countries, the ASEAN as a whole wishes to attract more foreign direct investments. Such increased investments will only go to countries in the region where the economic as well as socio-political conditions are stable and investment climate conducive. As mentioned by former secretary-general of the ASEAN, Rodolfo Severino, in the paper in this volume, an East Asian community can end up “being a series of bilateral deals between China and individual ASEAN countries and Japan and individual ASEAN countries.”

The Philippines is one of the original member countries of the ASEAN. Its level of development is definitely higher than the new members, Cambodia, Laos, Myanmar, and Vietnam. But in the last few years, the Philippines has not been in the forefront of the organization as it lagged behind the other original ASEAN-6 and even some of the new members (ASEAN-4) in terms of economic performance, such as growth, employment, and poverty alleviation. Its governance reforms and structural adjustments have been slow compared to its neighboring countries. Although it was not as severely hit by the economic crisis as some of the neighboring countries, it has suffered political instability which has aborted economic progress. Its competitiveness has been overtaken by China and other ASEAN countries. Faced with a fiscal deficit problem, it has backslid in terms of its trade liberalization effort which it had advanced in the late eighties and early nineties. The Philippines declined to participate in the China-initiated Early Harvest program under the ASEAN-China FTA proposal which introduced tariff reduction for certain products over a three-year period starting January 2004.<sup>7</sup> Per the agreement for a Comprehensive Economic Cooperation which the ASEAN signed with India, the Philippines is scheduled to realize the free trade agreement at the same time as the new members (in 2016) while all other ASEAN countries will establish it by 2011.

The Philippines is presently engaged in a number of bilateral, regional, and global trading arrangements. As an ASEAN member it will stand to enjoy more benefits from

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<sup>7</sup> The commitment to participate came only during the state visit of President Gloria M. Arroyo in August 2004.

greater liberalization.<sup>8</sup> The Philippines can only meet the challenges of regional integration and cooperation with the introduction of some much-needed domestic reforms, for example, to respond to issues of corruption and bureaucratic red tape which are seen to impede free trade. Institutions and infrastructures should be developed to cope with the increasing competition for both trade and investments. Areas of comparative advantage should be identified and developed. Stability, in the political arena, in social order, as well as in the macroeconomic setting, should be worked at to attract investments. Only with these changes can the Philippines prepare itself for greater integration in the East Asia.

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<sup>8</sup> For example, the “two plus x” accord of ASEAN agrees that any two countries can go ahead with an idea of greater liberalization provided that other members can sign up on a reciprocal basis when they want to or become ready for it.

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