

Principles and Practicalities

- Cooperation truly not a zero-sum game; thus pooling of sovereignty for common good is common benefit
- Avoid not-invented here; learn best practices;
- Need for patience, tolerance, long term approach;
- Involve the People: create sense of ownership;
- Joint development in disputed areas;
- Good neighbor approach..some practical suggestions
- Adopt roadmaps & criteria to measure progress
- Disseminate info & stimulate discussions amongst the people; better understanding creates more support;
- Create implementation & monitoring mechanisms;
- Promote sense of belonging & bonding to Asean: set up Asean passport; Asean Day celebrations/Asean news.

Why did EU succeed?

- Members are mature nations prepared to pool sovereignty for common good;
- Similar cultures & histories & approx. levels of developments; sizes not too disproportionate;
- All are developed states with capacity to engage in community building;
- Germany was prepared to bear financial burdens;
- US was supportive in crucial early phase;
- Visionary leaders: J. Monnet; de Gaulle; Adenauer;
- Compare Asean by these factors; compare East Asia; what lessons can we draw?

East Asian Regionalism

- Issue of defining East Asia: where are borders?
- Geography or Interests? US, in or out?
- Identity: East Asians/Asians? Aseans? Chinese...
- US attitude: Benign attitude to APT; depends on Japan to protect US interests;
- Huge obstacles: many differences; history; WW2;
- Integrative processes: MNCs operations; RTAs; roles of Japan, China, NIEs;
- Market driven integration. China as locomotive.

Asean Position on E.A Regionalism

- Asean needed to respond to EU/Nafta expansion;
- Malaysia in 1990 proposed EAEC-US blocked it;
- Thai initiatives: ACD/Bimstec/ Asian Bond fund
- Asean Regional forum launched in 1990;
- Asean Plus Three (APT) launched in 1997;
- Asean accepted Japanese PM proposal of EAC, Dec 03;
- Chaingmai Initiative on currency swaps May 2000;
- Institutionalisation of APT began at Manila summit: 8 area identified for cooperation;
- Asean accepted East Asian Summit at Jakarta AMIM, july July 04; Malaysia to host first in 2005, China hosts second 07; Asean wants to be driver of Asian regionalism-APT.

Key Developments

- Dec 1998: S. Korean Prez Kim proposed EAVG
- EAVG suggested 57 ideas: AMF; Asian currency and EA FTA; East Asian summit; 2001: EASG set up; its report presented at PP Summit in Nov 2002; 26 recommendations; EA Summit & EAFTA supported; Jakarta AMM agrees to EA summit;

Japan's Role

- Japan was active whilst others were absorbed in domestic issues: Japan was active in 1980s on Apec
- Feeling isolated, Japan turned south to Asean;
- Driven by rivalry with China;
- Countered Chinese offers to Asean by JACEP/signed Asean TAC;
- Japanese identity problem: Asian or OECD;
- Constrained by US interests; irritated by US pressures on trade surpluses;

China's role

- China's rapid economic rise helps drive market forces to integrate region;
- Various options: EA could be its power base to challenge US; co-opt neighbors to prevent anti-China feelings; exclude US from Asians-only club;
- Various reactions: neutral, not to get involve in clash between US & China;
- Pro-China: nearer to China, more exposed to its influence;
- Pro-US, bound by treaties;
- China counters by theory of peaceful rise, woos Asean;
- China has choice between APT/ACD/Apec/EA Summits, although geographic footprints varies; functional goals differ; China also has choice of trilateral FTA in N.E.Asia

The China Factor

- China's population of 1.4 bn equals 75% of EA pop.
- It will be world's largest economy around 2040;
- E. Asia is main beneficiary of Chinese boom;
- If US & EU will not provide trade, investments & security to Asean, it will look to China;
- Contrast neg. signals sent by US troop withdrawal from SK to China's soothing messages to Asean;
- China plays its cards shrewdly;
- What rules can others negotiate whilst it is still rising;
- Only counter-balance is US; hottest issue is Taiwan;
- Key triangle is China/US/ Japan

What kind of EA community?

- Simic-based or multi-cultural etc?
- How to build Trust, Friendship, responsiveness?
- How to go about socialisation, identity building and norms-creation?
- How to get the People involved?
- What routes: APT/ACCD/EA Summit?

Conclusions

- Asean's 3 Communities: a bold vision, but a long & difficult road..
- Asean's experience could be relevant/useful to EA community building;
- Many tough demands coincide to increase burdens on already weakened Asean;
- Key roles: US supportive or blocking;
- Key steps: reconciliation between China, S. Korea and Japan



**Japan's Growing Relations with Southeast Asia:
Underpinning an East Asian Community?**

LAM Peng Er
East Asian Institute
National University of Singapore
Singapore

organized by

Institute of East Asian Studies
Thammasat University

Saranrom Institute of Foreign Affairs
Ministry of Foreign of Thailand

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LAM Peng Er

Unlike the European Union (EU), East Asia lacks two great powers working hand in hand like France and Germany to underpin a nascent regional community. The two great Asian powers of China and Japan have yet to resolve their historical burdens and jointly lead the endeavor of constructing a region with a sense of common interests and a distinct identity. Indeed, the Lilliputians of ASEAN have been at the heart of East Asian multilateralism such as the ASEAN Regional Forum (ARF) and ASEAN Plus Three (APT). A counter-factual analogy of this remarkable feature of East Asian regionalism would be the small and middle European powers such as Italy, Spain, Holland, Portugal, Denmark, Ireland, Belgium and Luxemburg driving European regionalism.

While the ASEAN states are presently the hub of an emerging East Asian regionalism,¹ this grand enterprise will take off and eventually come into fruition only with the indispensable participation and cooperation of China, Japan and Korea. These three nations in Northeast Asia will add considerable clout and weight to East Asia's regionalism. Increasingly, there is a perception in this region that China, buoyed by its phenomenal economic growth, is a rising power. Cognizant of the perceptions of smaller East Asian countries that an ascendant power might emerge as a "threat", Beijing has shrewdly proposed a Free Trade Agreement (FTA) to the ASEAN countries, offered them a stake in its economic growth and portrayed itself as an opportunity rather than a menace to its neighbors. Pursuing regional cooperation will strengthen Chinese claims that they are committed to an approach of "peaceful ascendancy" (*heping jueji*) in international affairs.

There is also the perception in the region that China has stolen a march on Japan by boldly proposing a FTA to the ASEAN states. Beijing's wooing of the ASEAN states forced Tokyo to belatedly offer an economic partnership to the Southeast Asian countries. Moreover, China's willingness to sign a treaty of amity and cooperation (TAC) with Southeast Asia has also compelled Japan to follow suit. It appears that China and Japan, unlike France and Germany in European regionalism, are competing to forge closer ties with Southeast Asia. But this "competitive regionalism" is not necessarily bad for the ASEAN states. On the contrary, it is good for Southeast Asia to be wooed by both big powers from Northeast Asia. China's regional initiatives are a catalyst to Japan moving faster towards East Asian regionalism. Despite Tokyo's initial reluctance (in part due to the political clout of its domestic agricultural lobby), it gingerly moved ahead to avoid being left behind by its Chinese rival in East Asia's quest for regionalism.

While China has become a rising power which is broadening and deepening its economic and political relations with the ASEAN states, one should not forget that Japan had already weaved an extensive web of economic and political ties over the past few decades with Southeast Asia. Since mid 2002, the Japanese economy had been recovering after more than a decade of economic stagnation. Japan's GDP still is around four times larger than

¹ I view "East Asian regionalism" as an imagined community based on a sense of geographical proximity, rising economic interdependency, common norms and a shared destiny. It is a quest and a process which may become increasingly institutionalized. Mid-wives and nannies of East Asian regionalism were essentially political and bureaucratic elites but citizens and civil society must embrace it before it can further develop and come into fruition. Thus far, baby steps have been taken towards this regional project.



China's. Despite the rise of China, Japan's role was, is and will be vital to East Asian regionalism. Indeed, Japan's bilateral and multilateral relations with the Southeast Asian countries will continue to grow and will, directly or indirectly, facilitate the process of regionalism in the decades ahead. Moreover, Japan's presence in East Asian regionalism will help to balance China's influence on this process and allay the fears of smaller Asian countries of being dominated by the once and future Middle Kingdom.

This paper first examines Japanese ideas of an East Asian Regionalism. It then traces Tokyo's growing diplomatic activism in Southeast Asia. Following that, is an analysis of Japan's future role and challenges in constructing an East Asia Community (EAC). My central argument is that Japan has established multifaceted and durable ties with Southeast Asia and will continue doing so especially in the face of strategic competition from China. Japan's longstanding ties with Southeast Asia coupled with "competitive regionalism" between the two great Asian powers will help to underpin a nascent East Asian Community. If this competitive regionalism does not become dysfunctional, then East Asia's long road to regionalism might well turn out to be quite different from the European model: that East Asian regionalism can still proceed even if China and Japan do not behave like France and Germany in partnership.

Japanese scholars have argued that Japan's web of economic, political and strategic ties with Southeast Asia underpins East Asia's open regionalism.² My caveat is that, while this thesis is correct it is incomplete: They tend to downplay if not ignore the China factor in Japan's growing relations with Southeast Asia. For analytical purposes, this paper focuses on Japan's intertwining ties with Southeast Asia but we must be mindful that these are taking place in the context of a US global hegemonic system and the phenomenal economic rise of China. In this regard, Japan's approach to regionalism with the Southeast Asian countries has been profoundly influenced by its US superpower ally and more recently, an ascendant China.

Japanese Ideas on Regionalism

Arguably, the first Japanese conception of an East Asian regionalism in the 20th century was the Greater East Asia Co-Prosperity Sphere. Despite the rhetoric of Japan liberating Asia from Western colonialism and sharing a common identity and destiny with East Asia, the Co-Prosperity Sphere was merely a fig leaf for Japan's conquest and colonization of East Asia. The Co-Prosperity Sphere was really the Empire of the Sun with its god-Emperor at its apex. The colonials were, of course, second class citizens of the Empire.

After Japan's defeat in World War II, the US occupied and democratized Japan's political system including the hoisting of a new constitution which bans Tokyo from adopting military means to settle international disputes. To end the US Occupation in 1952, Tokyo had no choice but to accept a security treaty with Washington. The price of Alliance for Tokyo in the context of the Cold War was to offer bases in Japan (including Okinawa) to the US military and not to forge diplomatic relations with Communist China. Following the loss of the China market, Southeast Asia was a good source of raw materials and market for

² See Suetō Sudo, *The International Relations of Japan and South East Asia: Forging a new regionalism* (London and New York: Routledge, 2002). See also Japan Center for International Exchange, *ASEAN-Japan Cooperation: A Foundation for East Asian Community* (Tokyo: Japan Center for International Exchange, 2003).



Japanese goods. Reparations and ODA (Official Development Assistance) paved the way for substantial Japanese business and investments in Southeast Asia and by the end of the 1960s, Japan could well consider Southeast Asia to be its economic sphere of influence.

In the 1970s, then Prime Ministers Miki Takeo and Ohira Masayoshi floated ideas of an Asia-Pacific Community which included Japan and Southeast Asia.³ In 1977, Prime Minister Fukuda Takeo articulated and codified post-war Japan's first foreign policy doctrine: Japan will maintain a "heart-to-heart" relationship with Southeast Asia, abhor militarism, and play a political role by acting as a bridge between non-communist ASEAN and Communist Indochina to promote regional peace and stability.⁴ Two decades later, Prime Minister Hashimoto proposed that regular political summits and bilateral security talks between the top leaders of Japan and the Southeast Asia countries. Responding to Chinese regional initiatives, Prime Minister Koizumi proposed an economic partnership with the ASEAN states in January 2002.

There are common assumptions in various Japanese schemes for East Asian regionalism. First, Tokyo affirms that the US-Japan Alliance is the cornerstone in Tokyo's international relations. Therefore, Japan's participation in East Asian regionalism is not to be at the expense of the Alliance. When the push comes to the shove, the Alliance will take precedence over regionalism. Since Tokyo operates within a US hegemonic global system, it has latitude in bilateral and multilateral diplomacy insofar as it does not clash with the perceived core interests of Washington. In this regard, Japan's role in East Asian regionalism has to be consonant to maintaining the US-Japan Alliance.

Two examples illustrate this point. When former Prime Minister Mahathir of Malaysia first articulated the idea of an EAEG (East Asian Economic Grouping) to counterbalance the emergence of other regional blocs especially the EU and NAFTA, it aroused much interest among many Japanese. After the US opposed even to a watered down EAEC (East Asian Economic Caucus), Japan towed the line and failed to throw its weight behind the EAEC concept. During the Asian Financial Crisis (1997-98), Tokyo proposed an Asian Monetary Fund to assist the crisis-stricken Asian countries. However, Tokyo dropped the idea after running into opposition from Washington which viewed the scheme as a challenge to the International Monetary Fund (IMF) in which the US is dominant. However, Japan mounted a package of US\$63 billion to rescue the countries suffering from the financial meltdown and also proposed a currency swap arrangement known as the Chiangmai Initiative. In the Asian financial crisis, Japan played a much more positive role to assist the Southeast Asian countries than the US and China.⁵

³ Among Prime Minister Ohira's advisory bodies, the Study Group on Pacific Basin Cooperation submitted an Interim Report in November 1979. See Seizaburo Sato, Kenichi Koyama and Shunpei Kumon, *Post War Politician: The Life of Former Prime Minister Masayoshi Ohira* (Tokyo: Kodansha, 1990) p.523.

⁴ Suetō Sudo, *The Fukuda Doctrine and ASEAN: New Dimensions in Japan's Foreign Policy* (Singapore: Institute of Southeast Asian Studies, 1992).

⁵ Ironically, China won praises for doing nothing: by not devaluing the yuan, East Asia was spared a vicious cycle of competitive currency devaluation. Many in the region viewed the US as cynically taking advantage of the crisis by demanding market openings as a precondition for IMF assistance and opportunities for American big businesses buying Asian corporations and industries in distress on the cheap.



Second, Tokyo's preferred geographical scope for East Asian regionalism includes Australia and New Zealand. It is probable that Japan's advocacy of these two countries from the Southern hemisphere is due to the fact that they are both allies of the US, affluent liberal democracies similar to Japan, has considerable economic ties with them, conceivably help to balance China and dilute the flavor of ten Southeast Asian countries in an EAC. Japan's image of East Asia's geographical, cultural and historical boundaries is actually out of sync with most East Asian countries which do not regard Australia and New Zealand to be Asian but culturally European. Simply put, most Asian countries view an East Asia Community as comprising Pacific Asia while Japan interprets it as Asia Pacific.

Third, Japan played an economic leadership role in East Asian regionalism based on the models of state-led economic development and the flying geese model of development. With the emergence of Japan as an economic superpower, Southeast Asian countries especially Malaysia and Singapore were keen to learn from Japan. Kuala Lumpur had a "Look East" Policy and Singapore studied various Japanese practices ranging from industrial cooperation between management and labor in house unions, QC (quality control) circles, WITS (Work improvement teams) to introducing the *koban* (police box) system. In 1993, the World Bank published the *East Asian Miracle*, which examined the Japanese state-led model of development as a viable alternative to the laissez faire Anglo Saxon capitalist model of development.⁶

Very popular among Japanese academics, journalists, bureaucrats and politicians is the notion that Japan is the leading goose in a flying geese pattern of economic development in East Asia based on the economic principle of comparative advantage and the division of labor. According to this model, as Japan moves up the technological ladder and facing more expensive labor costs, it sheds the more labor intensive and less technologically advanced industries to the NIES (Newly Industrializing Economies) of Singapore, Hong Kong, South Korea and Taiwan. This next echelon as it develops, in turn, sheds their more backward industries to the succeeding tier of developing countries such as Thailand, the Philippines, Malaysia and Indonesia. The subsequent wave would be China followed by the Indochina countries. In this flying geese conception, Japan, as the lynchpin of an East Asian production networks, helps to integrate the region economically through its investments, management know-how and trade.⁷ However, the Japanese Ministry of Economy, Trade and Industry 2001 White Paper noted that this model of East Asian production network centered on Japan has become obsolete with the economic rise of China.⁸

Fourth is the Japanese dream of an East Asian region which adopts the yen instead of the US dollar as the preferred currency for trade. A variant is a basket of currencies in which the yen would be the key or anchor. However, East Asian countries (especially China) are not enthusiastic about being incorporated into a yen bloc. Even the US is unlikely to support an economic regionalism centered on the yen which displaces the American dollar as the *de facto* international currency. At a 2004 seminar by the Asian Development Bank, Kuroda Haruhiko (Cabinet Secretariat's special adviser on financial affairs and formerly vice finance

⁶ World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (Oxford: Oxford University Press, 1993).

⁷ For such a view, see Walter Hatch and Kozo Yamamura, *Asia in Japan's Embrace: Building a Regional Production Alliance* (Cambridge: Cambridge University Press, 1996).

⁸ METI, *White Paper on International Trade 2001*, p.17.



minister for international affairs) proposed a road map for Asia to adopt a single currency. Kuroda said: "Strong regional political determination will be an absolute prerequisite to create such a currency. It's commonly recognized by people concerned that the scheme will not merely be a dream, but one looking more like reality within 30 years."⁹ Interestingly, the Japanese media also reported that the People's Bank of China were now willing to create such a currency.¹⁰

Japan's Political and Strategic Networks with Southeast Asia

Japan's trade, investments and ODA are considerably larger than China's in Southeast Asia (See Appendixes One and Two). In the 1990s, Tokyo's relations with Southeast Asia have also expanded especially in political and strategic dimensions. A catalyst to Japan's activism in international relations was its fiasco over the First Gulf War. Tokyo was severely criticized both internationally and domestically for doing nothing other than disbursing US\$13 billion to the US-led multinational forces against Iraq's invasion of Kuwait. Stung by such criticisms, Japan became more forthcoming in diplomatic initiatives especially in Southeast Asia. From the early 1990s onwards, influential politicians such as Ozawa Ichiro have argued that Japan should become a "normal" state which is capable of playing a political and even security role to enhance regional peace and stability.¹¹ Conducting active diplomacy including the forging of multilateralism and regionalism would be evidence of Japan's quest to be a normal state.

Giving notice of Japan's intent to play a strategic role in East Asia, then Foreign Minister Nakayama Taro suggested that a multilateral forum should be established in East Asia to discuss security issues and enhance confidence building and regional stability.¹² Nakayama's proposal caught many Southeast Asian countries by surprise not because the idea was novel but the very fact that it came from Japan, long reputed for its post-war passivity in strategic issues. The Nakayama Initiative resonated with the thinking of the ASEAN states and subsequently the ASEAN Regional Forum (ARF) was established, the very first multilateral process and institution to deal with strategic issues in the post-Cold War era.

Besides the ARF initiative, Japan was also actively involved in addressing various intra-state and inter-state disputes in Southeast Asia. Indeed, it sought a mediatory role in that region which was not pursued (either unable or unwilling) by other great powers. These include:

- acting as a bridge between the Myanmar's military junta and Nobel Peace Laureate Aung San Suu Kyi. As an incentive to the junta to liberalize politically, Tokyo offered substantial

⁹ Naoki Okabe, "Unity could unleash huge potential for growth in East Asian region" in *Nikkei Weekly*, May 31, 2004.

¹⁰ Ibid. If China were to support a common Asian currency, it is most likely to ask for its yuan to be an important component to a basket of Asian currencies. Its support is a reflection in China's confidence as a rising economic power and probably the desire to create a multi-polar world which is not dependent on the US dollar of international trade and investments.

¹¹ See Ichiro Ozawa, *Blueprint for a New Japan: The Rethinking of a Nation* (Tokyo: Kodansha, 1994).

¹² See Kikuchi Tsutomu, APEC: *Ajia taihōyo shin jitsujō no mosaku* [APEC: Searching for a new order in the Asia Pacific] (Tokyo: Nihon kokusai mondai kenkyūjo: 1995) pp. 264-271. In actuality, the ASEAN-ISIS think tanks also had floated similar proposals.



ODA to Myanmar. That Japan can adopt a diplomatic posture different from the US hard line policy of international sanctions against Myanmar is because the issue of Myanmar's lack of democratization and human rights is not a core issue for the US. In this regard, Japan's diplomacy in Myanmar does not clash with the imperative to maintain the US-Japan Alliance.

- Besides dispatching Japanese troops for United Nations Peace Keeping Operations in Cambodia and East Timor, Tokyo also successfully brokered a cessation of hostilities between the rival forces of co-Prime Ministers Hun Sen and Prince Ranariddh. The Japanese peace proposals paved the way for national elections in Cambodia and consolidating peace in that war-torn country.

- Japan sought to act as a diplomatic bridge when the Philippines had a territorial squabble with China over the Mischief Reef, part of the disputed Spratlys in the South China Sea.¹³

Although Beijing rebuffed Tokyo's desire to play a diplomatic role in the dispute, the latter made it known that, though it is not a claimant state, it has significant strategic and economic interest in the avoidance of conflict in the South China Sea.

- The Koizumi Administration has also taken a keen interest in the ethnic conflict and civil war between the separatist movement in Aceh, northern Sumatra and the central government of Indonesia.¹⁴ Working closely with the Swiss-based Henry Dunant Center, Japan held an international conference in Tokyo (December 2002) to reconstruct Aceh following the cessation of hostilities. When relations deteriorated between the rebels and the Jakarta, Japan made a last ditch effort to save the peace again in Tokyo (June 2003). Though hostilities have resumed, the Japan continues to work behind the scenes to encourage both sides to cease hostilities and offer substantial ODA as an incentive to consolidate peace.

- Concerned about maritime security in Southeast Asia especially in the Straits of Malacca, Japan organized conferences in April 2000 and October 2001 to deal with the threat of rampant piracy to shipping.¹⁵ The Japan Coast Guard had also sent patrol vessels and conducted exercises with countries including India, Malaysia, the Philippines and Singapore.¹⁶ Its Coast Guard Academy also accepted students from Thailand, Indonesia, the Philippines, Malaysia and Vietnam from April 2001. Tokyo even proposed the joint patrolling of the Straits by its coast guard. While the US is apparently supportive of a Japanese security role in protecting the sea lanes of communications in the Straits, it is unlikely that China and the littoral states of Malaysia and Indonesia are keen on this proposal.

- To mark and celebrate three decades of close relations between Japan and the Southeast Asian countries, their top leaders convened in Tokyo in December 2003.¹⁷ This was the very first summit to be held outside Southeast Asia between the top leaders of Japan and the ASEAN states. In the Tokyo Declaration, Japan pledged to play a security role along with the

¹³ Lam Peng Er, "Japan and the Spratlys Dispute", *Asian Survey*, Vol.36, No.10, 1996.

¹⁴ Lam Peng Er, "Japan's peace building diplomacy in Aceh", *East Asia: An International Journal* (forthcoming).

¹⁵ Ministry of Foreign Affairs Japan, "Japan's efforts to combat piracy and armed robbery against ships", November 2001. For details on Japan's role in maritime security in Southeast Asia, see The Ministry of Foreign Affairs of Japan, "The Issue of Piracy in Asia", September 2001.

¹⁶ The Japan Coast Guard said: "Since 2000 (till December 2003), Japan Coast Guard has dispatched 10 patrol vessels to Southeast Asia ...". See "Singapore and Japanese coast guards conduct largest counter terrorism and piracy exercise", *Channel NewsAsia*, December 4 2003.

¹⁷ See "Tokyo's role grows as summit ends", *Asahi.com*, December 13, 2003, "Japan, ASEAN look to future: Summit signs off with 'special relationship declaration'", *Japan Times*, December 13, 2003 and "Japan, ASEAN celebrate 30-year friendship", *Asia Times Online*, December 13, 2003.

For a detailed report on the Japan-ASEAN Commemorative Summit Meeting, see The Ministry of Foreign Affairs of Japan, Press Conference, 12 December 2003.



Southeast Asian states to deal with the scourge of piracy and terrorism. Tokyo also promised to assist in sub-regionalism in the Mekong area. In that summit, Japan also promised to accede to ASEAN's Treaty of Amity and Cooperation. This includes the norms of non-interference in the domestic politics and respect for the sovereignty of the ASEAN states and rejecting the use of force in regional disputes.

● At the APT Foreign Ministers Meeting in Jakarta in June-July 2004, Foreign Minister Kawaguchi Yoriko urged the ARF to play a greater role in conflict prevention. Japan also prepared a discussion paper to realize an East Asian Community. These ideas include: strengthening the mechanism of an EAC which can implement policies such as anti terrorism and crime, and promoting an FTA; including also Australia and India as members of an EAC; and embracing the values of "democracy" which underpins an EAC.¹⁸

Contrary to the persistent image that Japan is a reactive state in international affairs, the country has actively played a political role even in the domestic disputes of Cambodia, Myanmar and Indonesia. Japan's dense network of economic, political and strategic ties cultivated over the past few decades with Southeast Asia has placed it in good standing with the region. Tokyo has no territorial disputes with any Southeast Asian countries and adopts a consultative and non-abrasive style of diplomacy towards them.

Despite the residual legacy of its invasion of Southeast Asia during the Second World War, the younger generation of Southeast Asians, unlike the Chinese and the Koreans, tend not to harbor anger and suspicions toward Japan over historical issues. Indeed, Japan has become a country with "soft" power in Southeast Asia as a result of its "cool" fashion and style, movies, television dramas, *karaoke* and *manga* (comics) in Southeast Asia. The considerable and enduring intermeshing of Japan's cultural, political, strategic and economic ties with the states and societies of Southeast Asia suggests that there is potentially a solid base for the construction of an EAC in which both Japan and Southeast Asia will be at its very heart.

A recent episode demonstrates the substantial goodwill which Southeast Asia harbors towards Japan. When Japan needed a venue to reunite a Japanese woman (who had been earlier abducted by North Korea) with her American husband (accused of military desertion by the US) and two daughters, Cambodia, Malaysia and Indonesia quickly offered their assistance. In July 2004, the family was reunited in Bali in the face of extensive Japanese media coverage. The episode suggests that "a friend in need is a friend indeed". In a small way to assist in an issue which is very emotional and headlines news to the Japanese people, three Southeast Asian countries offered to return the favor to Japan without any hesitation.

Challenges Ahead: Japan & East Asian Community

The two greatest challenges facing Japan's role in an EAC are the attitudes of the US superpower and China as an ascendant power. In the years ahead, Tokyo will have to cautiously tread the path of regionalism by assuring the US that East Asia's regionalism will be an "open" one (which will not discriminate against other regions in the areas of trade and investments) and not at its ally's expense. Japan will have to maintain its fidelity to the

¹⁸ "Higashi Ajia kyodotai jitsugen he: Nihon ga [ronten pepa] teishutsu" (Towards the actualization of an EAC: Japan proposed a concept paper) in *Asahi.com*, 27 June 2004. See also "Japan wants ASEAN regional forum to have conflict prevention role", *Kyodo News*, June 27, 2004.



Alliance. Washington is probably assured of Tokyo's reliability as an ally when the Koizumi Administration made the domestically controversial and politically costly decision of sending Japanese troops to assist the US-led multilateral forces in Iraq.¹⁹ Given the US preoccupation with the war on terrorism, it will tolerate an East Asian regionalism (and Japan's participation) which is explicit on combating terrorism, piracy and weapons of mass destruction in the same region.

Simultaneous collaboration and competition are the likely leitmotif of Japan's multifaceted relations with China in the decades ahead. Not surprisingly, this dialectical relationship will also extend to Sino-Japanese relations in East Asian regionalism. The phenomenon of "China rising, Japan declining" has led to the perception among many Japanese opinion shapers of an amorphous China threat. Seen from such a prism, the Japanese media regards China's closer ties with Southeast Asia as a source of competition and anxiety.

For example, when China and ASEAN announced a "strategic partnership" at their foreign ministers meeting in June 2004, the Japanese media perceived that China is seeking regional leadership at the expense of the US and Japan.²⁰ However, it is now apparent that the Japanese economy is on a rebound. The new phenomenon of "China rising, Japan recovering" is best for East Asian regionalism. A Japan which recovers its confidence is one which will be less paranoid about a China threat and in better shape to balance China. But the challenge still remains for China and Japan to resolve their burden of history. Unless and until these two nations can reconcile over the past and commit themselves to a future-oriented relationship, it will be difficult for them to jointly play a constructive role like Germany and France in spearheading regionalism. But if China and Japan can learn to work together for the common good within a multilateral framework, a new habit and mentality of cooperation forged in the EAC might help to mitigate their periodic bilateral problems.

The joker in the pack that might derail a nascent EAC is the Taiwan issue. Increasingly, the Japanese are becoming more sympathetic to a democratizing Taiwan. Tokyo is also obliged by the 1997 New Defense Guidelines to provide logistical support to its US ally if Washington chooses to intervene in "areas surrounding Japan". In a scenario where the US decides to militarily intervene in a cross-strait conflict, Japan is likely to be sucked into it as an American ally. Such an outcome is likely to rupture Sino-Japanese relations. In the meanwhile, there is little Tokyo can do besides urging Taipei not to provoke Beijing by moving toward *de jure* independence (such as revising their constitution and conducting a referendum on independence) and Beijing not to use force to address the Taiwan issue.

Another uncertainty is the domestic politics of Japan. In the July 2004 Upper House Elections, the opposition Democratic Party (DP) made strong inroads into rural Japan, the bedrock of the ruling Liberal Democratic Party (LDP). During the campaign, the DP promised the farmers direct financial subsidies, much to the chagrin of the LDP. Given its rising vulnerability even in its traditional bastion of rural Japan, the LDP hesitates to forge and implement FTAs with Southeast Asia. There is much hope that FTAs within East Asia

¹⁹ The LDP's poor performance in the 2004 July Upper House Elections were due to voter dissatisfaction with two main issues: pension reforms and Japanese troops participating in a US-led multinational force in Iraq.

²⁰ *Sankei Shimbun*, June 22, 2004.



will underpin an EAC but given the politically sensitive issue of opening Japan's agricultural market, the Koizumi Administration is likely to drag its feet. Japan is caught between its agricultural lobby and the fear of losing out to China in forging FTAs with Southeast Asia. However, within a decade, the electoral clout of Japanese farmers will gradually diminish due to an aging and shrinking labor force in the agrarian sector.

Notwithstanding a myriad of challenges, East Asia should seek progress in areas such as environmental protection, economic cooperation, anti-crime measures on human and narcotics trafficking and security measures against piracy and terrorism. With patience, political creativity, flexibility, goodwill and luck, East Asia can and should construct its own process and institutional framework of regionalism. The tasks ahead are daunting:

- Can East Asian regionalism move beyond an elite-driven process and resonate with ordinary East Asians and civil society? Presently, most East Asians are apparently unaware of, let alone share any emotional affinity to, an East Asian Community.
- How will Japan and East Asian regionalism deal with the political imponderables? These questions include: will US hegemony wane in East Asia? Will North Korea implode? Will Japan become a "normal" state? Will China become more politically pluralistic with greater respect for laws and human rights? Can a pariah state like Myanmar fit into an EAC which is deserving of respect by international society? Can ASEAN, as a sub-regional grouping, continue to draw closer together and act as an important building block to East Asian regionalism?
- In the long term, can an EAC go beyond self-centeredness to work for a fairer trading and distribution system in which the poorer regions of Africa and Latin America can benefit too? Can an EAC be more than just a periphery in a US-dominated world order? Will an EAC be underpinned by its own distinct set of values such as communitarianism, tolerance for cultural and political diversity and respect for the individual?

Conclusion

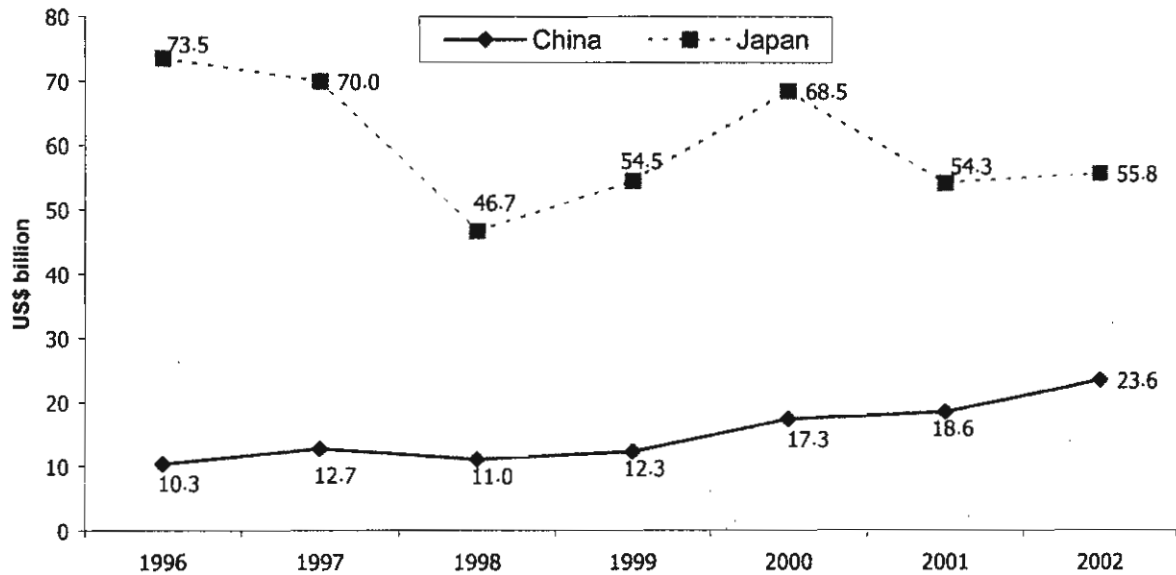
The adage goes: The journey of a thousand miles begins with a single step. In the case of East Asia, a few steps forward have already been made. The ASEAN states in their sub-regional experiment have evolved a cooperative set of norms that include rejecting the clash of arms to settle territorial disputes; China has boldly offered an FTA to the ASEAN states; Japan has already established an extensive and dense web of strategic, economic and political ties with Southeast Asia. Cumulatively, these processes along with the rising economic interdependency within East Asia will be the building blocks of an East Asian Community. It remains to be seen whether East Asians are truly wise enough to pursue a positive-sum game in building a community of their own based on the principles of equality, fairness, humility and mutual respect.

Acknowledgement

Thanks to Liang Ruobing for his kind assistance in preparing the tables on Japan and China's trade with the ASEAN 10.

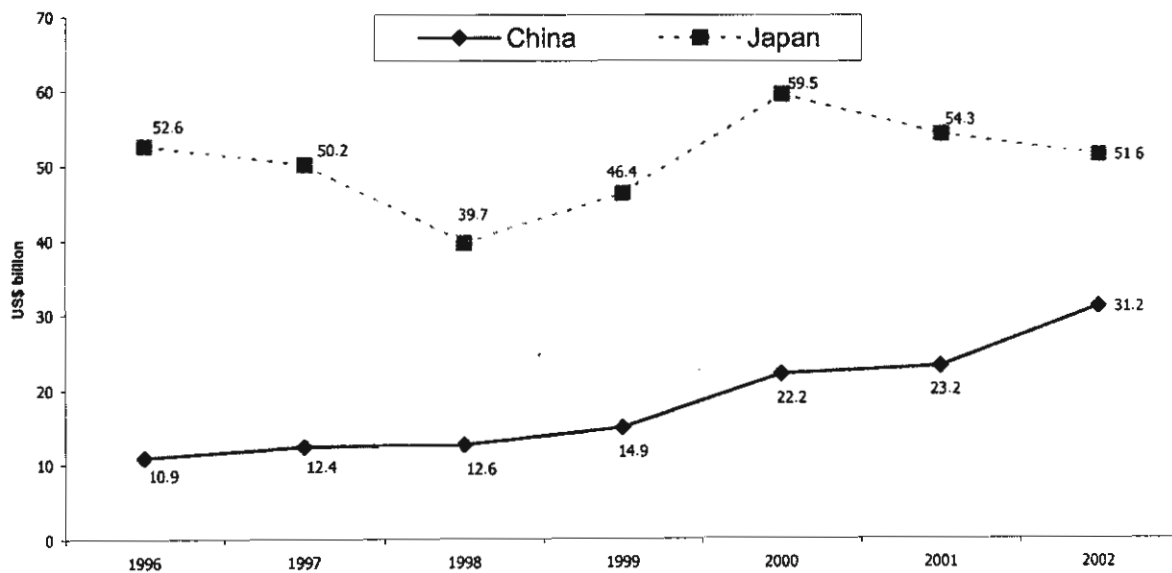


Appendix 1: China and Japan's Exports to ASEAN-10, 1996-2002



Sources: *Direction of Trade Statistics Yearbook*, International Monetary Fund, 2003.

Appendix 2: China and Japan's Imports from ASEAN-10, 1996-2002



Sources: *Direction of Trade Statistics Yearbook*, International Monetary Fund, 2003.



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CURRICULUM VITAE

Associate Professor Dr. Prapat Thepchatree

1. Date of Birth 19 September 1955

2. Education

- Ph.D. in Political Science (International Relations)
University of Georgia, U.S.A.
- M.A. in Political Science (International Relations)
Ohio University, U.S.A.
- B.A. in Political Science (International Affairs)
Thammasat University

3. Past Working Experience

- Third Secretary, Economic Department, Ministry of Foreign affairs (MFA), Thailand
- Second Secretary, ASEAN Department, MFA
- Consul, Royal Thai Consulate-General, Osaka, Japan
- Counsellor, Division 4, East Asian Department, MFA
- Director, Center for International Policy Studies (CIPS), Faculty of Political Science, Thammasat University, Thailand
- Association Dean for Research and Development, Faculty of Political Science, Thammasat University

4. Present Positions

- Associate Professor, Faculty of Political Science, Thammasat University
- Chair, Asean Studies Programme, Institute of East Asian Studies, Thammasat University

5. Teaching Experience

Adjunct Lecturer

- Institute of Advanced Military Studies, Royal Thai Army
- Institute of Advanced Naval Studies, Royal Thai Navy
- Rangsit University
- University of Thai Chamber of Commerce
- Webster University, Cha-am, Thailand

6. Other Experience

- Vice President, Association of American Studies in Thailand
- Chairman, Sub-Committee on International Journal, Social Science Association of Thailand
- Member, Political Science Association, Thammasat University
- Member, International Studies Association

7. Areas of Specialization

- ASEAN
- Thai Foreign Policy
- Thai-US Relations



CURRICULUM VITAE

- Foreign Policy Analysis
- International Security
- International Political Economy

8. Publications (in Thai)

- 2004 • United States' Security Policy Towards Asia. Thammasat University.
- 2003 • Thailand's Foreign Policy in The New Millennium. Faculty of Political Science, Thammasat University.
- East Asian Economic Grouping. Institute of East Asian Studies, Thammasat University.
- 2002 • Global Situations in 2002: Impacts on Thailand. Thammasat University Press (Editor).
- Asean in The 21st Century. Institute of East Asian Studies, Thammasat University.
- 2001 • The Role of the United Nations in the New Millennium. Thammasat University Press (Editor).
- 2000 • Thailand's Foreign Policy: from the Era of Economic Crisis to the New Millennium. Chulalongkorn University Press.

9. Publications (in English)

- 1999 • "Thai's Foreign Policy in the Era of Economic Crisis" MIR Newsletter 1. (3): p.3-4.
 - 1988 • Intra-ASEAN Trade Cooperation: A "Policy Analysis" Approach RAPS, Japan Institute of International Relations.
 - 1986 • "Political Economy of Global Trade Problems: the Regime Perspective" Saranrom 1986: 52-60.
-



CURRICULUM VITAE

HIRONO, Ryokichi

Professor Emeritus, born in 1931 and a University of Chicago graduate, taught at Seikei University, Tokyo from 1961 through 1998, and now is teaching International Development as Visiting Professor, Graduate Institute for Policy Studies (GRIPS) in Tokyo. Currently, he is holding various public positions at home and overseas, including Vice President, International Development Evaluation Association (London), Vice Chairman, Japan Evaluation Society (Tokyo), and Vice Chairman, International Management Association of Japan (Tokyo). Professor Hirono has been active in Japanese government advisory councils on Foreign Economic Policy, ODA Policy and Evaluation, Education for Sustainable Development, Forestry Policy and Environmental Policy. Professor Hirono, president of the Japan Society for International Development from 1993 to 1998, also sits on the board of various foundations and research institutes in Japan and overseas, including the Aeon Environment Foundation (Makuhari), the Japan Fund for Global Environment (Tokyo), Institute of Global Environmental Strategies (Hayama), the Philippine Institute of Development Studies (Manila), African Institute of Strategic and Development Studies (Lagos), and Modern African Institute (Quagadougou). Overseas, he has taught at a number of universities overseas including the University of Singapore (now National University of Singapore) and other universities in ASEAN countries, Delhi School of Economics in India, Australian National University and Monash University in Australia, University of Sussex in United Kingdom, University of California, Berkeley and Columbia University in the United States and INSEAD in Fontainebleau, France. In addition to the position of Chairperson, Committee on Development Policy, U.N. Economic and Social Council (New York), he also held various management positions in international organizations including ESCAP (Bangkok), UNCTAD (Geneva), OECD (Paris), ADB (Manila) and UNDP (New York) as well as Asia and Pacific Development Centre (Kuala Lumpur), and has chaired many international conferences on international development during the last 40 some years. Over 500 books, reports and journal articles have been published at home and overseas.



CURRICULUM VITAE

- Name: SORN SAMNANG Sex: Male
- Date of Birth: 15 January 1949
- Place of Birth: Kampot Province, Cambodia
- Marital Status: Married, four children
- Present Position: President of Royal Academy of Cambodia
- Participation in Regional Visions:
- Member of the ASEAN Eminent Persons' Group on Vision 2020
 - Member of East Asia Vision Group
- Academic Qualification: Ph.D. in History (Modern History of Cambodia)
Université Paris 7, Paris, France
- Professional Experience:
- Head of History Department, 1987-98.
 - Under Secretary of State, Ministry of Rural Development, December 1998 - June 1999.
- Organizer of the following conferences:
- 1- *First International Conference on Khmer Studies*, Phnom Penh, August 1996.
 - 2- *National Conference on Research, Standardization and Promotion of Khmer Language*, 7-9 September 2000.
 3. *National Conference on the Preservation and Promotion of Khmer Culture*, 4-7 April 2001, etc
- Speaker in the following conferences:
- 1- *13th Conference of the International Association of Historians of Asia*, Sophia University, Tokyo, September 5-9, 1994.
 - 2- *International Conference on Cambodia: Power, Myth and Memory*, Monash University, Australia, December 11-13, 1996.
 - 3- *Euro-Japanese International Seminar, "The Second International Seminar on Trade and Navigation in Southeast Asia"*, Sophia University, Tokyo, Oct. 1997.
 - 4- *Conference on Southeast Asia in the 20th Century*, University of the Philippines, Diliman, Quezon City, January 28-30, 1998, etc
- Publications: Proceedings of First International Conference on Khmer Studies (1996):
Volume I, 1998, 592 p. and Volume II, 1999, 588 pages
- Address:
- P. O. Box: 2070, Phnom Penh 3, Cambodia
 - E-mail: hacademy@camnet.com.kh



CURRICULUM VITAE

Woo-Jun Kim, Professor Dr.

Institute of East and West Studies, Yonsei University
134 Shinchon-Dong, Seodaemoon-Gu, Seoul, KOREA
Tel: (office) 02-2123-3457, (Mobile) 017-288-3457, (home) 02-454-8785
e-mail: wjkim@yonsei.ac.kr

Education

- | | |
|--|-----------|
| Ph.D. Department of Political Science,
University of Frankfurt, Germany | Jan. 1999 |
| B.A. & M.A. Department of Political Science,
University of Frankfurt, Germany | Sep. 1992 |
| B.A. Department of Chinese Language and
Literature, Yonsei University, Korea | Feb. 1981 |

Experience

Professor Institute of East and West Studies, Mar. 2001 – Present
Yonsei University

Research Interests

- Sino-Russian Economic & Security Relationship
- Regional Integration(East Asia)
- Area Studies

Major Publications

- 2003. “ Korea 's Role in Northeast Asian Economic Integration: The case of Tuman river project as a model of Regional Governance” (Joint paper with Kap-Young Jeong, Mongolia)
- 2001. “ Agricultural Reform in North Korea : Decollectivization? ” (Journal of Asia-Pacific Affairs Vol. 3. No.1)
- 2001. “ The Relationship between China and Siberia/Russian Far East : Economic Cooperation and Security Conflicts ” (IEWS, Global Economic Review, Vol.30, No.4)



CURRICULUM VITAE

MARK HONG

Born in Singapore on 18 March 1947, Mr. Hong was awarded the President of the Republic of Singapore's Scholarship in 1965, after completing his secondary school education at Raffles Institution in Singapore. He obtained a Bachelor of Arts degree in Economics from Cambridge University, United Kingdom in 1969 and a Master of Science degree in International Relations from Georgetown University in Washington DC in 1982 on a Fulbright Scholarship. He is married to Maria Remedios Bello, and they have a son, Alexander.

Mr. Hong joined the Ministry of Foreign Affairs in 1969. He served at the Singapore Embassy in Phnom Penh as Charge d'Affaires from 1974 to 1975, at the Singapore Commission in Hong Kong as First Secretary from 1975 to 1976, at the Singapore Embassy in Paris as Counsellor from 1982 to 1986 and at the Singapore Permanent Mission to United Nations in New York as Deputy Permanent Representative from 1988 to 1994. In the Ministry of Foreign Affairs Headquarters, he has served in various capacities. He was Deputy Director of Policy, Planning and Analysis Directorate III (East Asia) and Director of the Policy, Planning and Analysis Directorate IV (Developing Countries and International organizations)) and the Information, Management and Research Directorate. His last posting was as Singapore Ambassador to Russia and Ukraine from November 1995 to March 2002. From May 2002 to January 04, he was on attachment to the Institute of Defence and Strategic Studies, Nanyang Technological University, Singapore, as visiting senior fellow. He is currently a Vice-Chairman of the International Committee of the Singapore Business Federation and an International Advisor to the Port of Singapore Authority, and a Visiting Research Fellow at Institute of Southeast Asian Studies from February 2004.

Mr. Hong was awarded four scholarships, including the prestigious President Scholarship, Humanities Scholarship and Fulbright Scholarship. He has delivered over 100 conference papers and lectures to various international seminars and conferences, and attended many UN General Assemblies, ASEAN and other regional meetings. He has delivered many lectures on various subjects such as terrorism; the rise of China; political Islam; security challenges facing Singapore; Singapore foreign policy; Asean matters, Russia.

May 2004



CURRICULUM VITAE

Dr. LAM Peng Er

East Asian Institute, National University of Singapore
AS5 Level 4, 7 Arts Link, Singapore, 117571
eailampe@nus.edu.sg

PLACE OF BIRTH & NATIONALITY

Singapore

EDUCATION

- Columbia University (1987-94: PhD)
- Inter-University Center at Yokohama (1990-91: Certificate in Japanese Proficiency)
- Australian National University (1985-86: MA in International Relations)
- National University of Singapore (1980-84: BA Honours First Class)
- Anglo-Chinese School (1966-1977)

LANGUAGES

English, Mandarin, Cantonese, Japanese

WORK

- Senior Research Fellow, East Asian Institute, National University of Singapore (2001-)
- Lecturer, Department of Political Science, NUS (1994-2000)
- Senior Tutor, Department of Political Science, National University of Singapore (1986-1994)
- Bank officer, Development Bank of Singapore (1984-85)
- Singapore Armed Forces (1977-80)

SCHOLARSHIPS

- Ford Foundation Scholarship (US): Full tuition and stipend for my masters at the Australian National University
- National University of Singapore Scholarship: Full tuition and stipend for PhD at Columbia University and Inter-University Center of Japanese Studies at Yokohama
- Columbia University Dissertation Write-up Scholarship

VISITING FELLOWSHIPS

- Visiting Professor, Institute of Social Sciences, University of Tokyo (1 August-30 November 2003)
- Shibusawa Fellow, Shibusawa Foundation (2003-2004)
- Rikkyo University (1999)
- Japan Institute of International Affairs (1995)
- Keio University (1991-93)

RESEARCH INTERESTS

- Japan's political and strategic role in Asia
- Japan's local democracy: referenda, non-party partisan governors and women in politics
- Advent of East Asian Community: China, Japan & ASEAN

PUBLICATIONS

Books

- (Single-authored) *Green Politics in Japan* (London: Routledge, 1999).
- (Edited with Kevin Tan), *Lee's Lieutenants: Singapore's Old Guard* (Sydney: Allen & Unwin, 1999).



CURRICULUM VITAE

Dr. LAM Peng Er

East Asian Institute, National University of Singapore
AS5 Level 4, 7 Arts Link, Singapore, 117571
eailampe@nus.edu.sg

PLACE OF BIRTH & NATIONALITY

Singapore

EDUCATION

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CURRICULUM VITAE

Selected Book chapters

- "Local referenda and independent governors" in Glenn Hook (ed.), *Contested Governance in Japan* (London: Routledge, forthcoming).
- "Liberal state and illiberal society: Ethnic minorities in Japan" in Will Kymlicka and He Baogang (eds.), *Multicultural Citizenship and Democracy in Asia* (Oxford: Oxford University Press, forthcoming).
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 - "Japan and the Spratlys Dispute: Aspirations and Limitations", *Asian Survey* (US), Vol.36, No.10, October 1996.
- [My article on Japan and the Spratlys has subsequently been published in two anthologies: Edward R. Beauchamp (ed.), *Dimensions of Contemporary Japan: Japan's Role in International Politics since World War II* (New York: Garland Publishing, 1998) and Wolf Mendl (ed.), *Japan and Southeast Asia: International Relations* (London: Routledge, 2001).]
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 - "The Liberal Democratic Party's Quest for Local Policy-making Party Organization", *Japan Forum* (UK), Vol.7, No.2, 1995.
 - "Urban Political Machines in Japan", *Asian Journal of Political Science* (Singapore), Vol.2, No.2, December 1994.



A Perspective for East Asian Economic Integration

DoHoon KIM

**Director of Industrial Cooperation and Globalization Division
Korea Institute for Industrial Economics and Trade**

organized by

**Institute of East Asian Studies
Thammasat University**

**Saranrom Institute of Foreign Affairs
Ministry of Foreign of Thailand**

Thailand Research Fund

A Perspective for East Asian Economic Integration

DoHoon KIM

Contents

- I . Introduction
- II . Importance of East Asia
- III . New Changes in East Asia in favor of Regional Economic Integration
- IV . Prospering Industrial Cooperation in East Asia
- V . Towards a Better Economic Integration

I . Introduction

There are several elements inside and outside of East Asia which necessitate a more serious discussion about the issue of economic integration in the region than ever.

First, the worldwide comprehensive negotiation underway for further trade liberalization under the name of the Doha Development Agenda is producing a rather disappointing outcome.

Second, there has been no serious institutional framework for regional economic integration in East Asia whereas economic integration in the NAFTA area and in the EU is increasingly deepening and widening. As a result, each country in East Asia has been somewhat alone in the international trade arena, such as the WTO, whereas other countries have easily formed sympathetic groups.

Third, bilateral and plurilateral FTAs are becoming fully a la mode both inside and outside of the region. AFTA and JSEPA are already effective, negotiations for the Korea-Japan FTA and Korea-Singapore FTA are ongoing, commitments for starting negotiations between ASEAN-China and ASEAN-Japan are already made, and talks for future FTA between ASEAN-Korea are on process.

Above all, economic cooperation and especially industrial cooperation in the region has been fully prospering despite the fact that the region does not have any form of institutional framework.

II . Importance of East Asia

1. Absolute size

In terms of GNP, East Asia (AFTA + 3) is the third largest economic power in the world next to the NAFTA and EU.

However, when it comes to GNP by purchasing power parity, East Asia becomes the second economic power, surpassing the EU and approaching the level of NAFTA.

Of course, the region is the first power population-wise.



Economic Power of Major Economic Integrations

	GNP (US\$ bil)	population (million)	per capita GNP(US\$)	GNP share in the world (%)	PPP GNP (US\$ bil)	PPP share in the world (%)
APEC	16,213	2,495	6,498	56.17	19,862	54.33
AFTA	575	507	1,133	1.99	1,588	4.34
China-Korea-Japan	5,547	1,418	3,912	19.22	7,628	20.87
AFTA-China-Korea-Japan	6,122	1,925	3,180	21.21	9,216	25.21
NAFTA	8,914	397	22,454	30.89	9,444	25.83
Mercosur	1,112	210	5,293	3.85	1,440	3.94
FTAA	10,463	789	13,262	36.25	11,866	32.46
EU-15	8,280	375	21,420	28.69	7,564	20.69
World Total	28,862	5,897	4,894	100.0	36,557	100.0

Source: Robert Scollay and John P. Gilbert, *New Regional Trading Arrangements in the Asia Pacific*, IIE, May 2001.

2. The most dynamic region in the world

The region is becoming the most dynamic engine of world growth. During the last three decades, the growth pace of this region has been the fastest in the world.

Despite the financial crisis that hit the region harshly in the late 90s, East Asia seems to be rapidly recovering its traditional dynamism. For example, China is naturally regarded as a leading growth source, even for the whole world economy, and Japan is gradually regaining its once-lost growth pace.

3. The most attractive destination for FDI

China has become the second largest FDI destination in the world next to the US. Korea, even though being sluggish these days, attracted a huge amount of FDI right after the financial crisis.

ASEAN countries are also regarded as attractive FDI destinations, at least for the manufacturing and service sectors.

III. New Changes in East Asia in favor of Regional Economic Integration

1. China's accession to the WTO

China managed to enter into the world trading system, overcoming industrial countries' stringent requests. This may be regarded as another favorable element for regional economic integration. Without any further suffering, China may be able to play the role of a good partner for any kind of talks and negotiations regarding further trade liberalization.

2. Market opening measures undertaken during the financial crisis

Countries in the region, after having been harshly hit by the financial crisis, have applied very drastic economic reforms including many market opening measures such as methods of attracting foreign direct investment. One example is the elimination of the notorious import diversification system that discriminated against Japanese products in the Korean market.



IV. Prospering Industrial Cooperation in East Asia

1. A global manufacturing powerhouse

According to a research report by KIET (2002), three countries in the region (China-Korea-Japan) are playing the major role in terms of manufacturing production in seven leading manufacturing sectors: computers, electronic appliances, semiconductors, steel, petrochemicals, automobile, and shipbuilding. If ASEAN countries are included in this analysis, the representation of East Asia for those sectors will become even greater.

Among the 7 sectors considered, the production share of the three countries for petrochemicals is the lowest, standing at 19%, whereas that of shipbuilding is the highest, taking 70% of the world production.

World Production Share of China-Korea-Japan for 7 major manufacturing sectors

	unit	world production	market structure (%)				
			production for three	share in the world	production	domestic demand	exports
computers	US\$ bil	324.4	103.5	31.9	100	82	12
electronic appliances	US\$ bil	67.7	42.3	62.5	100	58	42
semiconductors	US\$ bil	215.2	73.0	33.9	100	70	30
steel	mil T	74,145	30,627	41.3	100	82	18
petrochemicals	mil T	156	29	18.6	100	117	24
automobile	mil unit	55.9	15.1	26.9	100	65	38
shipbuilding	mil GT	20.0	13.9	69.8	100	17	83

source: KIET, *For a Better Industrial Cooperation System between China, Korea and Japan*, Aug. 2002

2. Active industrial cooperation in the region

Complementary industrial structures between countries in East Asia make active industrial cooperation in the region easier. This is because the region is endowed with all the elements for many manufacturing sectors to obtain world level competitiveness, namely high technology, core intermediate products and basic equipment in Japan, average intermediate goods & production technology from Korea, and assembly & processing in China & ASEAN countries.

The region can be regarded as a model case for vertical specialization, intermediate goods trade, and international decomposition of production processes.

3. Dependent on overseas markets

Even though industrial cooperation at the level of production is highly well organized in the region, there is a serious loophole in terms of market structure because not a single country in the region plays an effective consumer's role. The fact that East Asia is highly dependent on overseas markets such as the US and EU for their manufacturing products can be considered a defect to be fixed collectively.



V. Towards a Better Economic Integration

1. An assessment for economic cooperation

Many aspects have been playing the role of obstacles in pushing forward economic integration in the region: a rather regretful historical background, development gaps between countries in the region, and differences in the political systems.

Moreover, the long lasting stance that two leading economies, Japan and Korea, have been taking (that is, prioritizing the multilateral trading system over regionalism), has hampered any kind of potential economic cooperation in the region.

Loosened forms of economic integration, so-called open regionalism, which cover a wide range of countries outside of the region, such as APEC and ASEM, have played a rather disturbing role against the intensive economic integration among countries within the region.

2. For a better economic cooperation

The fact that there has been intensive economic integration at the level of private manufacturing companies, without any serious institutional framework for economic integration in the region, is conducive to the argument that governments should start institutionalization at the level of industrial cooperation, such as further liberalization of trade and investment.

At first, a talk to form a FTA involving all the member countries should be started in the near future.

Apart from FTA issues, an initiative to form any kind of arena which can be helpful for promoting business dialogues to talk about many issues for further industrial cooperation, such as collective restructuring efforts in traditional sectors and collective R&D efforts like EUREKA in the EU, might be a promising avenue.

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AN INTEGRATED ROADMAP FOR EAST ASIAN ECONOMIC INTEGRATION

Dr. Hank LIM Giok-Hay
Director for Research
The Singapore Institute of International Affairs (SIIA)
Singapore

organized by

Institute of East Asian Studies
Thammasat University

Saranrom Institute of Foreign Affairs
Ministry of Foreign of Thailand

Thailand Research Fund

AN INTEGRATED ROADMAP FOR EAST ASIAN ECONOMIC INTEGRATION

Hank LIM

1.1 Introduction

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

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

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

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

1.2 Non-Economic Regionalism

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

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



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

East Asia faces a lack of leadership, although China and Japan are seen as natural candidates for regional leadership. However, their relationship is troubled by suspicion and differences notwithstanding the high levels of investment that Japan has in China and the reasons are of course historical dating back to World War II. Japan's relationship with China is also complicated by Japan's dependency on the US alliance for its security, its own decade long recession and present attempt at reform.

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

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

Non-state actors also play an important in regional economic integration. The cost-benefit calculations at the corporation level, cross-border state business dynamics has been a determinant to regional economic stability. The underlying market-driven forces of economic regionalisation suggest that to achieve economic stability, the interests of the private sector should be incorporated. Access to technologies in the region is now the key factor to identify new sources of economic growth. Foreign direct investment (FDI) inflows and technology transfers are increasingly concentrated in a handful of economies.

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



non-state actors in regional affairs have added new variables and elements to regional cooperation.

1.3 Economic Regionalism

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

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

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

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

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



2. Trade and investment linkages

2.1 Trade

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

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

2.1.1 Sensitive goods

The range of market access barriers employed by countries consists mainly of three types – (a) tariffs, (b) domestic support (c) export subsidies. In terms of benefit, the lowering of tariffs has the greatest welfare effect but the benefits of the other two cannot be underestimated either. Reducing barriers in this area is particularly beneficial if pursued by an EAFTA as opposed to smaller initiatives. An EAFTA would raise the net agricultural exports of ASEAN and China.

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

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

2.1.2 Services

Unlike liberalisation of goods, countries in East Asia are particularly resistant to the liberalising of service sectors. Initiative for service liberalisation in ASEAN came about after the 1995 ASEAN Bangkok Summit where ASEAN countries agreed to launch negotiations in



seven service sectors namely banking, tourism, air and maritime transportation, telecommunications, construction and professional services. This was termed the ASEAN Framework Agreement of Services (AFAS). A positive list approach was used and members are required to place requests and offers on liberalising their respective service sectors.

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

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

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

It is more beneficial for countries to expose the services sector to a wider region-wide group such as ASEAN+3 as opposed to bilateral groups to leverage on and maximise on the high costs related to and characteristic of the services industries. A wider regional arrangement can allow for greater policy space as it takes into consideration the diversity in the region as well as the socio-political and geopolitical issues that abound whilst still allowing for gains from liberalisation. It allows smaller states to have greater bargaining power and a greater sense of security as well. It is also necessary to countries to institute reforms with broad development objectives in mind such as effective regulation in the event of market failure and pro-competitive regulation.

2.2 Investment/Trade facilitation

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



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

3. Regional Institutions

3.1 Asia Pacific Economic Cooperation

Since its inception in the 1960s, APEC has become the major forum for broad regional dialogue. Each member government can choose to adopt or not, proposals made. Over the years, APEC has morphed into a bureaucratic machine and many doubt its relevancy and purpose in the wake of the 1997 Asian financial crisis. The general consensus is that APEC is still relevant and its vision remains one of the ways towards liberalised and open trade regime in the region. In 1994 in Bogor, Indonesia, the eminent persons group (EPG) of the members of APEC adopted the proposal for free trade which called for developed economies to achieve free trade status by 2010 and developing members by 2020. However, the Bogor Declaration aims to achieve “open regionalism” and “free trade. The 1995 Osaka Action Agenda laid out the blue print for achieving the broad goals of the Bogor Declaration and eliminating trade barriers. The 1995 Osaka agreement established a liberalisation process in the APEC Individual Action Plan (IAP).

In the 1996 Manila meeting, initial reports from all member countries on their individual action plans (IAP) to advance APEC goals were presented. Greater formality and clarity in the review of the IAPs in meeting in Shanghai in 2001 was a great step forward but APEC remains stuck with a trade liberalisation process in which unilateral action is the only aspect of EPG’s four-part recommendation that has been put in place. More importantly, the annual ministerial meeting prior to the APEC summit meeting in Shanghai established a goal of reducing transaction costs associated with trade by 5 per cent in 2006.

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

The limitations cited above are one of the reason members have turned to bilateral and sub-regional free trade negotiations. But there are four main achievements that continue to make



APEC a relevant regional institution. First, APEC encourages government officials across the region in regular dialogue and promotes a specific action agenda. Specific accomplishments on APEC policy, especially reduction in tariffs, have been quite successful; the engagement of these officials in regular dialogue has a cumulative effect on their thinking about liberalisation.

Second, APEC appears to be making progress on the trade facilitation agenda, albeit the progress is no ambitious. The goal of voluntary 5 per cent reduction in transaction costs does represent a specific goal driving APEC discussions toward specific proposals and easing access to markets. Third, the Ecotech agenda is worthwhile. APEC includes developed and developing nations and the opportunity to address development issues for the mutual benefit of all works to the advantage of all members. Fourth, the leaders' meetings are not always focused on the economic agenda as it also provides an opportunity for holding a number of bilateral meetings in addition to the formal group meeting.

3.2 ASEAN

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

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

Despite the proliferation of FTAs, the level of intraregional trade is low. ASEAN began with 12 per cent intra-regional trade when ASEAN was formed. In the 1980s, only 13 per cent of imports of the original five members of ASEAN came from within the group and only 17 per cent of exports were sent to group members despite their geographic proximity. This low level of intra-ASEAN trade explains why preferential trade agreements were not originally high on the ASEAN agenda.

The other reason that held back intra-ASEAN trade cooperation for so long was the group's belief that its members' economic structures and trade patterns were more competitive than complementary. ASEAN eventually realised the benefits of preferential trade arrangements might help raise its trade shares and work to the mutual benefit of members. ASEAN