



expanded its membership to include four new members - Cambodia, Laos, Myanmar, and Vietnam (CLMV).

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

3.3 ASEAN+3

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

A rough framework was also established to define the characteristics of EAFTA. It was proposed that CMLV countries would be given preferential treatment and GSP status. An East Asian Investment Information Network (EAIIN) was also proposed to facilitate intra-regional investment flows by providing comprehensive and up to date information on investment opportunities in the individual East Asian economies. The EAIIN would complement current information providing initiatives such as in ASEAN Investment Area (AIA) and the ASEAN-Japan Center activities. It was also proposed that AIA be expanded and possibly evolve to become an East Asian Investment Area (EAIA).

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

3.4 Challenges facing East Asian regionalism

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



The first major factor is the importance of the US to the region as a whole and to certain countries in particular. The US is a very important source of foreign direct investment and export market to practically all East Asian economies and will continue to be for a long time to come, although at a decreasing rate. On security, the US presence has been the foundation pillar of security in the region. Japan and South Korea in Northeast Asian, Thailand and the Philippines and Singapore have close defence arrangements with the US. As the region becomes more developed economically and as China gradually becomes a major economic and military power in East Asia, how the perception and relationship between the US and major regional countries would evolve is a vital issue to be addressed. Therefore, a mature and robust foreign policy is required by major individual governments in the region. Otherwise, the region would be involved with increased uncertainty and insecurity.

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

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

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

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

From an economic point of view, several studies have shown that such initiatives will bring greater benefits to its members if it involves a larger grouping. However, in practice, it might



be difficult to achieve this, given the diverse economic interests. Even ASEAN+1 formats, although appearing to be more feasible than an overall arrangement amongst all ASEAN+3 members, yet a series of ASEAN+1 arrangements may be more difficult to manage and it may create an overlapping and duplicating trade and investment rules and regulations and thus increase the transaction costs of doing business in the region. The ASEAN-China FTA process is proceeding well and it is expected to be concluded on the goods sector sometime this year. While the ASEAN-Japan FTA process is still in early stage of negotiations.

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

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

4. Summary and Conclusions

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

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

Because of the existence of many regional and bilateral FTAs arrangements in East Asia, it is vitally important that these arrangements adhere to a common framework and principles with a view to standardised and harmonized overlapping FTAs agreement. At the same time, more developed economies in the region would provide development assistance and regional "public goods" in order to redistribute regional welfare and to reduce the gap between more and less developed economies in East Asia.

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



It is Time to Project East Asian Community Building

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It is Time to Project East Asian Community Building

Zhang Yunling

The concept of East Asian Community has been accepted as an institutional architecture of East Asian cooperation, which represents a significant progress of emerging East Asian regionalism. However, East Asian regionalism is still in a framework of "10 + 3" and a multi-layered liberalization process. Comparing with Europe and North America, East Asia is moving slow in moving toward an integrated approach of regional institutional building. East Asia should feel pressure to speed up its process of regional cooperation and community building.

Learning from European and American Experiences

EU's most valuable contribution is that peace and prosperity have been secured through its process of cooperation and integration. The following three major experiences are the most valuable for us to learn from:

Political reconciliation. Two world wars made Europe highly divided. The European cooperation process provided a single and genuine framework to make the used enemies together and to work for the shared and increasingly common interests.

Institutional building. A gradual and steady institutional designing and building made Europe really integrated. From European Coal and Steel Union, to European Common market, European Economic Community, and European Community and finally European Union, this progressed for half century.

Balanced interests. During liberalization and integration process, the interests of less competitive sectors and less developed economies were specially considered and protected through well-designed arrangements.

The significance of European regionalism is that all European countries have been gradually absorbed into a united and highly integrated Grand Europe, by a single market, a single currency, as well as a single supper political system. This is a big challenge to the other parts of the world since European countries can act as a single powerful group to gain and also defend their best interests.

North American countries have realized their integration mainly through NAFTA. The nature of NAFTA is to integrate the market through comprehensive coverage of sectors and regulation arrangements. NAFTA provides a unique case how to integrate the most developed economy (the US) and the developing economy (Mexico). The experience of NAFTA shows that less developed economy can also gain from participating the regional liberalization arrangements. NAFTA will expand itself into FTAA in the short coming years, which will make the North America, Central America and Latin American into a single liberalized market. This will significantly reshape the structure of the world market.

In East Asia, the regional cooperation and integration effort pioneered by ASEAN. Almost at the same time, EU launched its single market, North America started NAFTA and ASEAN launched its AFTA. The ASEAN plays an important role in bridging the Southeast and Northeast Asian regions together. What we need urgently now is to project an integrated approach of East Asian Community building

Determination, pragmatism and wisdom are probably three key words we should keep in mind in studying the experiences of EU and NAFTA. East Asia will lose if it moves to slow to integrate itself and to play role as a united one region in the international arenas.



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How should we define ourselves?

EAVG in its report to the leaders recommended that the long-term goal for East Asian cooperation and integration is an East Asian Community. It seems that the concept of "East Asian Community" has been commonly accepted. However, the real challenges for us are how to define ourselves.

What is the foundation for an East Asian community? The simple answer is that we have shared and common interests together, not just economically, but also politically. East Asian regionalism mostly started from economic cooperation. Nevertheless, the process is well beyond economic areas. For the long-term peace and prosperity of the region, we need regional institutions.

The great value of East Asian regionalism is its process of participation, conciliation and cooperation for the members of the region. East Asia may not go to a European style union, but gradual institutionalization is absolutely necessary. EU and FTAA provides two different models for regional integration, East Asia has to find its own way.

ASEAN is a pathfinder in developing regional convergence in East Asia. ASEAN experience illustrates that differences are not the decisive obstacles to the regional integration. "10 + 3" now provides a general framework for East Asia to be together. It gives birth to a consciousness and structure of East Asian regionalism.

The aim of East Asian regionalism is to bind all members of the region together based on agreements and institutions. It is to secure peace and development through cooperation. East Asian regionalism does not intend to be exclusive. It needs cooperation with other parties based on its own institutional identity, but this does not mean that we should not have our own regional identity. East Asians should be confident enough to define themselves as a real identity. By an East Asian open regionalism, it means that the region will make all efforts to develop the cooperative relations with other partners along with its community building.

What should be done now and in the near future?

Firstly, we should strengthen regional institutional building from high level. It is very important to move the current "10+3" process into an East Asian identity. There are two options:

Option one: To have a Leaders Declaration on East Asian Community in 2005, or at least in 2007 (a 10th anniversary of East Asian cooperation, 10+3), indicating the aim, goal and principle of the community building, by which the current "10+3 framework" is to be upgraded to an "East Asian cooperation framework" with top level cooperation of an "East Asian Summit". East Asian institutional building will follow the functional approach, not for a super-national power organization. This is different from European model.

Option two: As a first step of East Asian community building, to set up a regional organization, e.g. Organization of East Asian Cooperation (OEAC) by 2007. However, considering great difference of East Asia, at the beginning, OEAC will not be a regional organization with super-national authority, but a regional "Association" for coordinating and promoting of cooperation developments.

Secondly, While encouraging all of existing multi-layered FTA (CEP) efforts, to have an early project on the East Asian FTA (CEP). Leaders should consider setting up an official expert group to start the feasibility study in 2005 and present a recommendation report in 2007. East Asian FTA (CEP) should be completed earlier than 2020.

Thirdly, further step should be made in strengthening financial cooperation through doubling the size of SWAP arrangements under the Chang Mai Initiative and advancing it



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into a common regional financial architecture. It should be encouraged that an expert group to be set up to start feasibility study for a regional monetary fund.

Aside from the above three, there are the other areas to move, e.g. as the efforts of community building, it is also important to setup functional mechanism for non-traditional security cooperation; to launch an East Asian education program during 2004 "10 +3" leaders meeting for the aim of setting up student exchange programs and East Asia teaching programs on among East Asian universities; to launch an East Asian business travel card program and an electronic East Asian tourism network etc.

The value of East Asian Community building is its process, i.e. the comprehensive participation and cooperation of nations in the region. There is no ready model for East Asia to copy. It must find its own model and approach in the principle of gradualism and pragmatism.



East-Asian Economic Cooperation Challenges and Prospects

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East-Asian Economic Cooperation Challenges and Prospects

U Thein Aung

Introduction

East Asia is defined here to encompass the 10 nations of South East Asia that form the Association of South East Asian Nations (ASEAN) – 10 (Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam) and the North East Asian economies of China, Korea and Japan.

As we are all aware, the tide of regionalism is running high in the world today. Most industrial and developing countries in the world are members of a regional integration agreement and many belong to more than one. Although East Asia joined the bandwagon only recently, regionalism is on the rise in East Asia. Until the 1990s, East Asia had no formal regional trading arrangements except for ASEAN. East Asia used to shy away from too much institutionalization of regional integration. There was hardly any cooperation among the North-East economies until recently.

The past decade, however, saw a change in the mind-set of East Asian nations. East Asia became engrossed with regionalization. There has been a proliferation of bilateral trading initiatives across the region. Japan, a very strong supporter of the multilateral framework of the WTO shifted its policy of multilateralism to initiate negotiations on free trade areas (FTAs) with a number of economies outside the region. What is more, even ASEAN which has always been unanimous in matters concerning regional cooperation is having one of its members: Singapore aggressively pursuing free trade areas outside the region.

What explains this new interest in finding new arrangements for cooperation? And where will this lead East Asia? This paper will attempt to address these questions. In particular the paper will analyze the developments in East Asian Economic regionalism to identify the challenges and prospects that will be faced by East Asia in the years ahead.

Regionalism in East Asia

While the world is becoming increasingly integrated because of the intensive trade liberalization in different parts of the globe, regionalism or establishment of regional trading arrangements (RTAs) are also on the rise. (WTO 2000, WTO 2001). RTAs are not actually new since they have been a part of the post war global trading system. Article XXIV of the General Agreement on Trade and Tariffs (GATT) permits the formation of RTAs where parties to the agreement grant each other preferential tariff treatment on the reciprocal basis provided some conditions are met.

1. The conditions for the formation of an RTA under Article XXIV include (i) the establishment of a free trade area among members within a reasonable period of time; (ii) the reduction of tariffs to zero and the elimination of other restrictive regulations on substantially all trade between the participants; (iii) duties and other regulations to third countries are not raised.

These arrangements are, by nature, discriminating against non-members. RTAs are thus, exceptions to the most favored nations (MFN) principle of the WTO.



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2. The most favored nation (MFN) principle means that member countries of the WTO cannot discriminate between their trading partners. A lower tariff rate for a particular product that is granted to one member has to be granted to all the other members.

The proliferation of RTAs has raised concern over their effects on the trade environment as well as on the trading system. Whether an RTA brings about a gain in welfare or not depends on the balance between trade diversion and trade creation. Trade diversion occurs when an inefficient firm inside the RTA is able to gain market access due to the preferential agreement at the expense of an efficient firm from a non-member of the RTA. Trade is created when efficient firms inside the RTA are able to expand their market shares at the expense of inefficient firms from non-members. The overall impact depends on the net effect of trade creation and trade diversion. The more pressing issue at this stage is the impact of the proliferation of the RTAs on the policy options of developing countries.

At present, East Asia is the only region in the world that has no region-wide trade bloc, even though it includes Japan the second world economic power. Two reasons are cited for this apparent absence of regional integration of the kind that exists in Europe.

First, Asia in general has no enduring history of unity and accepted commonality. East Asia is a region of diversity with differences in terms of population, land mass, GDP per capita, government systems, culture, religion, languages and politics just to name a few. This diversity presents an enormous obstacle to the development of a regional entity.

Second, the trading partners of the East Asian economies have been traditionally outside the region, basically Europe and North America. These two regions are not only the primary export markets but also the source of foreign direct investment for most of the East Asian economies.

However, there has been increasing interdependence among the East Asian economies since 1997. Such interdependence and integration are primarily market driven and without any formal economic and institutional arrangements. The developing countries in the region have adopted significant measures in trade and investment liberalization either unilaterally or multilaterally through the WTO. To a large extent, the kind of integration that emerged in East Asia is the product of intra regional trade and investment linkages between the North East Asia and South East Asia and it has expanded to North America.

This process of increased economic integration in the region has emerged mainly through the "flying geese model" led by Japan and followed by the four "tigers", Korea, Singapore, Hong Kong and Taiwan, Newly Industrialized Countries (NICs). The "flying geese" can best be explained as the process of transnational companies (TNCs) of industrialized economies such as Japan and the US operating their international production through their affiliates in developing countries in East Asia. Due to circumstances such as rising wages, shortage of labor and appreciation of the Yen following the Plaza Accord in 1985, Japan was forced to go global. The capital intensive components of its technologically complex production were separated from the labor intensive segment and relocated the latter in different developing countries: [the Newly Industrialized Countries (NICs) at first and later ASEAN] linked through sub-contracting and outsourcing arrangements. The outcome of this process was the significant improvement of economic performance in East Asia. This process was made



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possible by the rapid reduction of barriers to trade and investment and the rapid development of transportation and information, communication technology.

The significant improvement of economic performance in East Asia, together with the intensification of economic linkages among the economies, has led to the growing appreciation of the commonality of interests and concerns among the economies in the region.

Contributing Factors

While market forces are still very much prevalent in East Asia, there was also a simultaneous growth in regionalism. There is a shift from multilateralism to the preferential route to liberalization. A number of contributing factors are given to this change in the mind set regarding the modalities of trade liberalization. First, many APEC member economies including some East Asian economies started to consider using RTAs as an alternative to multilateral liberalization under APEC and WTO. Second, the slow pace of liberalization at the WTO and the dissatisfaction with the implementation of rules by some WTO members may have pushed some economies to look for alternative modes of liberalization.

Third, the aftermath of the 1997 Asian financial crisis, although the crisis; did not kill East Asia, it undoubtedly dealt a severe blow to its credibility. East Asia need to reinvigorate itself. Among others, the crisis has highlighted the interdependency of the countries in the region. The crisis spread quickly around the region despite the differences in the economic fundamentals. The kind of integration that already exists in the region was of little help for the economies. In fact, lack of coordination in the response of affected economies themselves attributed to the contagion. This realization, together with their frustration with the perceived lack of understanding in the region by the International Monetary Fund (IMF) and the World Bank (WB), increased the awareness of the economies that something should be done by themselves as a region.

Finally, the recent competitive regional initiative has been intensified by the geopolitical motivation on the part of China and Japan. Japan was the leading edge of East Asian industrialization in the postwar period and the growth and transformation of Japan into a modern industrial economy has had a profound effect on the East Asian and world economies. The long time leading economic power of the region, Japan, has largely influenced the industrial development in the region following the flying geese pattern of development, that, ultimately lead to the high economic growth and emergence of NICs in the mid 1980s and then the ASEAN-Four in the 1990s at least prior to the financial crisis. However, Japan's the "lost decade" in the 1990s questioned its leadership position in the region. In addition, Japan wants to maintain its influence on the global economic agenda. Japan's position as the second largest economic power in the world is being threatened by the US and EU's expanding role in America and Europe. Japanese corporations are losing their competitiveness to their US and EU counterparts as they are excluded by the US and EU free trade areas. If Japan were to maintain its multilateral approach to liberalization, its negotiating power could be significantly weakened as it loses its markets in the two regional markets.



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Another important consideration is the possible impact that the euro may have on the yen. The development of the euro may eventually divide the world into two currency blocs, crowding out the yen from global currency markets.

The last two decades saw the emergence of China and "the third wave of East Asia trade and industrial transformation", after the first led by Japan and the second led by the newly industrializing economies of Northeast and Southeast Asia. China has become a burgeoning economic power not only in East Asia but also around the world. Measured in terms of purchasing power parity (PPP), China is already the largest economy in East Asia larger than Japan and on the way to being larger than United States in the next couple of decades. In recent years China has experienced phenomenal economic growth especially in exports. By itself, China is a huge market but labor-intensive relatively low priced Chinese products have also flooded the world market. China's relatively low wages competed away foreign direct investment from the NICs and ASEAN. Hence, China's new approach of preferential trading with the rest of the region could open the door for the country to seize the opportunity to compete with Japan as the engine for economic growth and integration in East Asia.

Recent Developments in East Asian Economics Cooperation

Recent developments in East Asian Economics Cooperation in response to rising regionalism and the Asian financial crisis and the institutionalization towards formal economic integration began first in East Asia as ASEAN+3 framework. This process is picking up momentum and proceeding rapidly and receiving increasing attention not just in East Asia but also in other parts of the world. ASEAN+3 include the first ASEAN-6 and later ASEAN-4 (CLMV) and its three recent dialogue partners China, Korea and Japan.

The formal process started only from 1997, and notable achievements have been made: an institutional framework for regional cooperation has been set up through annual leaders meetings, ministers meetings and senior officials meetings; real progress has been made in financial cooperation through the Chiang Mai Initiative and there has been the growth of preferential trade arrangements (PTA) like AFTA, the China – ASEAN FTA initiative, and the Japan – Singapore closer economic partnership (CEP) as well as sub-regional development projects.

The first ASEAN+3 Summit Meeting was held in Kuala Lumpur on December 16, 1997, where the leaders discussed ways to cope with the Asian financial crisis and to promote economic integration through regional cooperation. ASEAN+3 has now become the major mechanism for the East Asian cooperating process. Thus, an integrated framework for East Asian cooperation is emerging.

Framework for East Asian Cooperation

The framework for East Asian Cooperation can be summarized as follows.

1. Annual leaders' meetings for official dialogue and consultation on regional immediate and long term issues ranging from economic situation to political stability as well as security. There are four tracks of leaders meetings, i.e. ASEAN 10, ASEAN to 1 (China, South Korea and Japan separately), the 3 (China, South Korea and Japan) and ASEAN+3. Each group identifies its own priority for discussion.



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2. Ministers' meetings including foreign ministers, trade ministers and finance ministers. These meetings have two major functions; one is to prepare the agenda for the leaders meetings; the other is to discuss relevant regional affairs. Macro-economic policy is one of the most important areas for minister's meetings.

3. Senior officials' meetings, task forces and functional forums such as "East Asian Vision Group" (EAVG); the "East Asian Study Group" (EASG) etc.

At the Second Summit Meeting held in Hanoi on December 16, 1998, the Miyazawa Plan was discussed and the East Asian Vision Group was established. The Third Summit Meeting held in Manila on November 28, 1999 adopted a Joint Statement on East Asia Cooperation and the leaders agreed to hold ASEAN+3 Ministerial meetings. At the Fourth Summit Meeting in Singapore on November 24, 2000 Singaporean Prime Minister Goh Chok Tong mentioned the possibility of evolving the ASEAN+3 into an "East Asia Summit" whereby member countries participate as individual members in order to promote cooperation in East Asia. Prime Minister Goh also suggested to the East Asian Study Group to consider the potentials of an "East Asia Summit" together with a free trade and investment area in East Asia. At the Fifth Summit Meeting in Brunei Darussalam in November 5, 2001, President Kim Dae-jung reiterated the idea of the East Asia Summit. He also proposed that following the recommendations of the East Asian Vision Group (EAVG) to form the East Asia Free Trade Area as vision and the establishment of an East Asian Forum to discuss ways to achieve the vision. Furthermore, ASEAN+3 Ministerial Meetings – the ASEAN+3 Foreign Ministers Meeting, ASEAN+3 Economic Ministers Meeting (AEM) and ASEAN+3 Finance Ministers Meeting – were held for the first time in 2000. Part of the agenda of these ministerial meetings is to deal with the follow-up measures from previous ASEAN+3 Summit Meeting and to prepare for the Summit Meeting.

The first ASEAN+3 Finance Ministers Meeting held in Chiang Mai on May 8, 2000 deserves special mention as it produced the Chiang Mai Initiative (CMI) with some concrete results in the sphere of financial cooperation in East Asia. At this meeting it was agreed to strengthen policy dialogues and regional cooperation activities in the areas of capital flow monitoring and self-help and support mechanisms. To facilitate self-help and support mechanisms through the ASEAN+3 framework, the ministers recognized the need to establish a regional financing agreement to supplement the existing international facilities. To begin with, they agreed to bolster the existing cooperative frameworks among the monetary authorities through CMI. The CMI involves an expanded ASEAN Swap Arrangement that would include all ASEAN countries, and a network of bilateral swaps and repurchase agreement facilities among the ASEAN countries and China, Korea and Japan. Most importantly, Japan announced that it had signed a USD3 billion swap arrangement with Thailand, USD2 billion and USD1 billion deals with Korea and Malaysia respectively.

There are other Senior Officials Meetings (SOM+3), Senior Officials Meetings (SEOM+3) and the ASEAN Finance and Central Bank Deputies Meetings (AFDM+3).



East Asian Economic Cooperation - Prospects

Northeast Asia

Even if the Northeast major economies, China, Korea and Japan are not ready to consider formal regional economic integration they are not averse to the idea of forming free trade agreements (FTAs). Both Korea and Japan started formal negotiations with China and Singapore respectively. Japan and Singapore concluded the Economic Partnership Agreement on January 13, 2002. Thus Japan has become the first North Asian country to conclude an FTA. Apart from this agreement, there are many proposed FTAs at different stages of development involving China, Korea and Japan. Among them the following three FTA proposals seem to be the most important as far as East Asian Economic integration is concerned.

First, the Korea Institute of International Economic Policy (KIEP) and the Institute of Developing Economies (IDE) in Japan made a joint study in 1999-2000 to identify the implications of an FTA between Japan and Korea. This joint study, commissioned by the respective governments is quite important as it was the first time two Northeast Asian countries showed an interest in formal economic integration.

Second, following the Korea-Japan Summit meeting of September 2000, the first Korea-Japan Business Forum was held in Seoul in September 2001.

Third, the Second Korea-Japan FTA Business Forum took place in January 2002 where businessmen from two countries jointly requested the respective governments to consider Korea-Japan FTA. Furthermore, at the fourth Summit Meeting in Singapore, it was reported that Chinese Prime Minister Zhu Rongji proposed to set up a group of specialists to come up with concrete ideas on how to cooperate with ASEAN. The group submitted a report in October 2001 recommending the formation of China-ASEAN FTA within ten years. Then at the Brunei ASEAN+3 Summit, Chinese and ASEAN leaders agreed to form a China-ASEAN FTA within ten years.

Furthermore, the idea of an FTA among China, Japan and Korea has been explored by economists and researchers. However, these proposals are still at an early and academic stage but it is remarkable that they are proposed by Chinese scholars which seemed unthinkable until recently.

In addition, the leaders of China, Japan and Korea had their first historic meeting at the Manila Summit which augurs well for regional integration and economic cooperation within the region.

At these Summit Meetings, the leaders of the three countries agreed upon some proposals that could become the foundations for trilateral cooperation. Based on an agreement reached at the Manila Summit Meeting, the research institution of the respective countries embarked on a joint research project in November 2000. Their joint report presented policy recommendations on "Strengthening Trade Relations between China, Japan and Korea" and was submitted to the respective leaders prior to the Brunei Summit Meeting, where the leaders agreed to hold regular meetings of Economic Ministers, Finance Ministers and Foreign Ministers. These Ministerial Meetings will serve as fora where major trilateral



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economic cooperation issues will be discussed and could help prepare for formal economic integration in Northeast Asia.

ASEAN+3

In the wake of regionalism in the Americas and enlargement of Europe it becomes imperative that East Asia which is still in search of its own institutional identity, adopt "East Asia Free Trade Area" as its long term vision. Thus, it is quite likely that an East Asia trade bloc may emerge. The East Asia Vision Group (EAVG) in the report which was submitted to the leaders at the Hanoi Summit describes its vision of an "East Asian Community" and recommends the formation of an East Asian Free Trade Area. Based on this EAVG recommendation, President Kim Dae-jung proposed at the Brunei Summit that there should be efforts towards an East Asia Free Trade Area.

The question now is what are the potentials for the establishment of East Asia Free Trade Area? ASEAN is at various stages of implementing the FTA Agreements with its three dialogue partners.

ASEAN-China

China's growth and size suggest that it will become a major economic power whose actions and reactions will have a profound impact on the East Asia region as well as globally. In the last decade, China experienced an average real annual rate of growth of 10 percent. Its exports increased about 4 times from US\$62 billion to about US\$250 billion. At the same time investment flows have increased dramatically from about US\$3 billion to US\$40 billion. Consequently, for the past several years, the neighboring East Asian economies are facing the challenges and opportunities of China's growth and continuously contending with the issue of how best to respond to China economically. In addition, China's accession to the WTO is widely expected to result in further changes in the trade and investment pattern within the region as well as globally. Thus any discussion of East Asian cooperation will need to give serious considerations to the impact of China's accession to WTO on the trade and investment patterns and what should be ASEAN's responses. The idea of deepening cooperation in trade between ASEAN and China, as well as a wider cooperation with East Asia has been gaining a lot of momentum since the financial crisis.

Should ASEAN economies respond to the China challenge by competing in the open and free market under unilateral framework, and undertaking unilateral liberalization of trade and investment regime or adopt the regional economic approach? Or can both tracks be pursued as long as they are complementary tracks?

The East Asian identity reemerged as an aftermath of the 1997 financial crisis. The impetus of crisis led to the first ASEAN+3 dialogue amongst the leaders. An East Asian Vision Group was set up at the Singapore Summit to work out the vision of the should be. By 2000 the group proposed that there should be an East Asia wide free trade arrangement or closer economic partnership. The proposal was a comprehensive one and included liberalization of trade in all goods, services, investment, technology and mutual recognition arrangements. The proposal also mentioned separate agreements and cooperation on anti-dumping, competition policy, investment principles, dispute settlement and capacity building.



Ambassador U Thein Aung, Myanmar

However, apart from the agreement to review the possibility of an East Asian Economic Zone nothing much was done to pursue these recommendations.

At the fourth Summit Meeting in Singapore in November 2000, the leaders agreed to create a task force to study these various proposals for regional cooperation and committees were set up to evaluate these possibilities including the ASEAN-China experts group. This group produced a vision report led to the announcement of the agreement reached between ASEAN leaders and Chinese Premier Zhu Rongji to establish a free trade area between ASEAN and China within ten years.

IN addition to the economic cooperation with ASEAN, China is also considering other options. The other proposal include cooperation among the three dialogue partners China - Korea - Japan and ASEAN + 3, although they are mostly in the study and discussion stage.

On the other hand, separate ASEAN economies such as Singapore and Thailand have approached China to have separate bilateral free trade areas. However, China has indicated that it prefers to deal with ASEAN as a region rather than bilaterally.

In response to the increasing regionalism in the Americas and enlargement in Europe, China is also considering the pros and cons of regional versus multilateral framework to undertake its liberalization and reform process.

While the Chinese leadership appeared to have succeeded to persuading the ASEAN economies to begin negotiations on an ASEAN-China FTA, there is not yet general acceptance of the idea as the ASEAN economies still express "fears & doubts" of their ability to compete with China and whether the FTA would be mutually beneficial; Thailand and Singapore are most supportive of the idea while Indonesia and the Philippines have taken a moderate stance, Malaysia is adopting a careful position while the CLMV economies are the most concerned about the pace of creating an ASEAN-China FTA.

The realization of an ASEAN-China FTA would entail a total market size of around 1.7 billion people and total GDP of US\$2 trillion which will be half that of Japan.

The positive impacts of free trade proposals together with the size and the growth of Chinese economy implies that responses will be needed to manage economic relationships between ASEAN and China. However, concerns remain from ASEAN side with regard to competition from China especially in the agricultural sector. There is the concept of the early harvest to ensure that ASEAN economies can enjoy early entry into China market before other WTO members and some ----- have already been laid out. A Framework Agreement on Comprehensive Economic Cooperation was signed on November 4, 2002. The ASEAN-China FTA covering trade in goods will be established by 2010 for ASEAN-6 and China; and by 2015 for ASEAN-4. There is the Early Harvest component so that the stakeholders may reap the benefits of the FTA at an early stage. China also offered one-sided immediate tariff eliminations on requested items for ASEAN-4.



ASEAN-Japan

Economic partnerships between ASEAN and Japan were first proposed by Japanese Prime Minister Koizumi in Singapore during his Southeast Asia tour in January 2002 as a first step toward the establishment of an East Asia economic co-operation. From the 1980s through the mid 1990s, Japan, through its direct investments, was a driving force behind regional economic development in East Asia. As a consequence, Japan, Korea, China and ASEAN economies have achieved significant degree of economic integration. Japan considers economic partnerships with Southeast Asia countries a crucial component of its initiative to promote for the integration of the region.

However since 1997 Japan has been adjusting its trade policy stance, allowing a wider choice to include various forms of RTAs. As stated earlier, Japan had been a very staunch supporter of the multilateral approach to trade relations. However, with rising trend of regionalism and increased pressure of "competitive liberalization", Japan has to leave its options open. Competitive liberalization refers to the phenomenon where in liberalization occurring between two nations or among several in a region spark participation in the process by other nations anxious not to be left out. Without a flexible approach to regionalism, Japan could well end up tying its hands in international economic relations.

In 1997-2000, Japan explored the feasibility of two FTAs Japan- Mexico and Japan- Korea. The first was in response to the concern of Japanese firms about being discriminated in Mexico against American and European firms from NAFTA economies. The IDE-KIEP joint study reports mentioned earlier highlighted the dynamic effects of Japan-Korea FTA to be achieved through the integration of the two economies.

Following a joint study between Singapore and Japan on an FTA between the two countries continued with inter governmental negotiations between 2000 and 2001, the Japan-Singapore Economic Partnership Agreement (JSEPA) was concluded by the two Prime Ministers in January 2002. This agreement is in keeping with Premier Goh Chock Tong's New age FTA and incorporated facilitation and Ecotech elements as well as elimination of tariffs and non-tariff barriers. Agreement on investment, mutual recognition agreement, movements of professionals, and intellectual property rights were also included. The scope for the economic partnerships was extended to cover IT technology, human resource development, trade and investment promotion, small and medium enterprises, tourism, electronic trade and documents exchange. Japan has also expressed its willingness to conclude similar economic partnerships with ASEAN members. Consequently, negotiation in similar agreements with Thailand, Malaysia and the Philippines are expected to be completed by 2004.

Japanese Prime Minister Koizumi proposed formal economic cooperation with ASEAN in January 2002, soon after ASEAN accepted China's proposal for an ASEAN-China FTA and immediately after the signing of Japan-Singapore Economic Partnership Agreement. This proposal sets in motion negotiations for an ASEAN-Japan Comprehensive Economic Partnership. However, given the sensitivity of agriculture in Japanese politics and economics and the fact that several ASEAN economies are highly competitive and major exporters of agricultural products, ASEAN-10 plus Japan FTA could be difficult to negotiate. Hence, Japan favors bilateral agreements with individual ASEAN countries under a comprehensive economic partnership framework.



Ambassador U Thein Aung, Myanmar

Japan's motive for the ASEAN-Japan economic partnership is the growing Japanese concern over the economic ascendancy of China and its involvement in Southeast Asia which Japan considers to be its sphere of influence. A reinvigorated ASEAN will help it avoid putting all its investments in China. On the other hand ASEAN appreciates Japan's role as the region's driver of economic growth in the last two decades. ASEAN seeks to balance the power within the region by having a strong Japanese presence balancing the rapidly growing China. However, ASEAN is also concerned that bilateral agreements would enable Japan to "cherry pick" and undermine ASEAN negotiating leverage and unity.

A framework for Comprehensive Economic Partnership was signed on October 2003. It is merely a framework and not an agreement. Negotiations on the CEP between Japan and ASEAN as a whole will commence from the beginning of 2005.

ASEAN-Korea

Korea's participation in ASEAN+3 is through bilateral FTA initiatives. Korea's first experience of FTA was an FTA with Chile. Following preparatory meetings in 1998, the leaders of Korea and Chile declared the official launch of Korea-Chile FTA negotiations at the APEC Summit Meeting on September 11, 1999. Another FTA proposal that is relevant to ASEAN+3 is the FTA between Korea and Japan. The IDE-KIEP joint study commissioned by the respective governments was the first attempt made by two Northeast Asian countries towards formal economic integration.

The study started formal negotiations between Korea and Japan for Korea-Japan FTA. Then following the Korea-Japan Summit Meeting in September 2000, two Korean-Japan Business Forum took place in Seoul and Tokyo. During the Japanese Premier's visit to Seoul in March 2002, he and the President of Korea agreed to set up a joint study panel comprising made of relevant ministries, industries and academic to make recommendations to their respective governments in 2003.

ASEAN+3, Korea showed interest in the idea of a East Asia Summit. At the fifth Summit Meeting in Brunei Darussalam President Kim Dae-jung reiterated the idea of an East Asia Summit and following the recommendations of EAVG, the Korean President proposed the formation of an East Asia FTA as a vision and establishment of an East Asian Forum.

Only at the 2003 ASEAN-Korea Summit did Korea indicate interest in establishing an ASEAN-Korea FTA. Currently, a joint experts group is studying on the ways to bring about this initiative.

Having iterated the East Asia cooperation initiatives, what now are the prospects and challenges?

Deeper economic integration will enable the economies to reap the benefits of specializations and division of labor. East Asia economies currently are creating optional cross border processes indicating substantial progress towards regional division of labor. In East Asia, the division of labor today reaches from the vertical to horizontal. It also extends across all fields including not only production process but also software and R&D activities. Another benefit of regional economic cooperation lies in the achievement of locational economies. Production



Ambassador U Thein Aung, Myanmar

sites have today been extended across all of East Asia. Business crosses borders in such of the most advantageous locations for their activities.

On the other hand, concern over the possible hollowing out of industry have also been rampant. However, by accelerating the free flow of exchanges and receiving the benefits of free trade could be the foundation for further prosperity.

Furthermore, greater economic integration of East Asian economies will enable the region to meet the challenges and respond more effectively against the formation of large economic blocs like EU and NAFTA.

On the other hand, most ASEAN economies are concerned over the flow of foreign direct investment (FDI). Due to the favorable circumstances like relatively low cost labor China has been competing away FDI from ASEAN countries.

Another component of the regional cooperation to be considered is the trade in services, especially tourism, financial and telecommunications services. For example, China's growing prosperity means more Chinese tourists will visit ASEAN countries. Increased interdependence between East Asian economies through steady expansion of trade and investment has been accompanied by rapid financial integration in terms of increased flow of foreign capital across money and capital markets in the region.

Conclusion

East Asia has not be left out in the growing tide of regionalism around the world. Long known staunch supporters of multilateralism, the leading economies of the region Japan, Korea, China and Singapore have been pursuing bilateral arrangements with other economies outside the region. A host of factors have influenced the phenomenon, including economics as well as political. Thus, the East Asian economies are using both regional and multilateral routes as strategy for regional and global liberalization.

The elements and form of recently concluded bilateral trading arrangements in the region is indication of their convergence towards the goal of free and open trade and investment. Regional integration and economic cooperation within East Asia is more market oriented than institutional arrangements.

East Asia is a region of diversity which is often cited as a factor for lack of common ideology necessary for regional integration and cooperation. Likewise, consensus decision making is central to the process of regional cooperation..

On the other hand, there is no certainty that all the initiatives will materialize as most negotiations are still on going which means they can end up nothing, while some are still at the proposal or study stage. Moreover, with more complex issues in the agenda of the new initiatives weak consensus within the region could be a serious limiting factor.

Furthermore, where these bilateral / regional initiatives will lead East Asia is uncertain. The realities existing in the region, political, institutional and economic could make East Asia Economic Cooperation difficult.

Remarks
By H.E. Dr. Sorajak Kasemsuvan,
Vice Minister for Foreign Affairs of Thailand
At the 2nd Meeting of the Network of East Asian
Think-Tanks (NEAT)
16 August 2004, Bangkok, Thailand

Excellencies,
Distinguished Participants,
Ladies and Gentlemen

As Vice Minister for Foreign Affairs and Director of Saranrom Institute of Foreign Affairs or SIFA, it is a pleasure and privilege for me to be invited to address this distinguished gathering of academics from renowned institutes and think-tanks across East Asia. Allow me to extend on behalf of the Ministry of Foreign Affairs and the organizers of the 2nd Meeting of the Network of East Asian Think-Tanks (NEAT) a very warm welcome to all of you. I do hope that you will be able to find some time from your scheduled meetings to enjoy the sights and sounds of Bangkok, while also strengthening your personal contacts and networking.

As an academic arm of ASEAN+3 Cooperation, NEAT has a crucial role to play in helping policy and decision makers to deepen and shape the future of East Asia. Indeed, with the emerging consensus that East Asian Community is a desirable long-term goal of East Asia Cooperation, we eagerly anticipate the contribution of NEAT in this exercise. And I am most certain that you will be able to build upon the numerous ideas as well as the momentum generated by the successful first meeting in China last year.

Before going on, allow me to briefly mention a few words about SIFA, the institute to which I have the privilege to serve as director. SIFA is a semi-autonomous academic institute

established in February 2003 with the support of the Ministry of Foreign Affairs of Thailand. The institute aims to create opportunities for policy and issue-related discussion for the benefit of formulating and conducting foreign policy and to promote public awareness and understanding of major foreign policy issues. Since its inception last year, SIFA has organized a number of activities such as academic meetings and seminars on various aspects of international affairs. I do hope that now that you are aware of this institute, we will be able to collaborate in many more joint activities in the future.

Distinguished Participants,
Ladies and Gentlemen

We are fortunate to live in this part of Asia that has been the world's economic powerhouse for the past two decades. But during those two decades, no doubt, our powerhouse was also seriously interrupted by some major financial hiccups. Now that our eyes are on the building of an East Asian Community, we must ensure that the future should look more stable and more promising for people in this region. We must ensure that the process of building this Community rests on firm foundation and can be sustained. Amid tremendous resources and potential, poverty remains widespread and large development gap exists among countries in the region. Much more remains to be done to reduce and eventually eliminate this gap in parallel to fostering greater partnership, cooperation, and interaction both within this region and with our other brothers in Asia.

What the present Thai Government has been implementing is an attempt to make whatever contribution we could to build such firm foundation for Southeast Asia, East Asia and the Asia continent as a whole. Guided by the principle of 'prosper thy neighbours', we pay priority attention to economic and social development of our immediate neighbours. In April 2003, Prime Minister Dr. Thaksin Shinawatra floated an idea known

as Economic Cooperation Strategy (ECS) to assist our three adjacent neighbours in their economic development. This cooperation strategy which is now called ACMECS after the first summit meeting in Bagan Myanmar last November now encompasses Cambodia, Laos, Myanmar, Thailand and Vietnam and involves 5 areas of functional cooperation, namely agriculture, trade and industry, transport linkages, tourism and human resource development.

Thailand is also an active player in the Greater Mekong Sub-region (GMS). The Mekong Institute was set up in Northeastern Thailand as a truly regional training centre for the GMS. The Institute recently developed a five-year Strategic Management Plan to facilitate regional cooperation and integration in the GMS.

On ASEAN, Thailand has been an active member of the ASEAN+3 Process and has proposed a roadmap for the evolution of ASEAN+3 into East Asia Cooperation.

At the inter-regional level, Thailand is a founding member of the 'Bay of Bengal Initiative for Multi-Sectoral, Technical and Economic Cooperation' or BIMSTEC (a trans-regional economic grouping that links 5 South Asian countries, namely Bangladesh, Bhutan, India, Nepal, Sri Lanka, with 2 South East Asian countries, Myanmar and Thailand). On 30 July 2004, Thailand is honoured to host the 1st BIMST-EC Summit. At this historic Summit, the BIMSTEC Leaders agreed to strengthen cooperation in various fields, such as, poverty reduction, anti-terrorism, biotechnology, energy, and tourism. The Leaders also agreed to hold a regular summit every two years. The 2nd BIMSTEC Summit will be held in India in 2006.

Above all, what Thailand is trying to do is to help spin the Asian cobweb or networks of multi-tiered cooperation at the bilateral, sub-regional, and regional levels. As it stands, the separate cogwheels of cooperation in Asia are varied in size and

nature and turning at varied speeds. However, every single wheel, no matter how small it is, is crucial in turning the larger cogwheels, each encompassing a larger number of countries in each region and sub-region. Compare this with Asia, there already exist numerous stand-alone regional cooperation frameworks but what is missing is the arrangement that could bring together these regional groupings.

Distinguished Participants,
Ladies and Gentlemen

.. Asia is the world's largest and most diverse continent, covering nearly a third of the world's land mass. Asia is home to over 3 billion people, roughly half of the world's population, making it the largest market in the world. Asia is the fastest growing economy and accounts for a quarter of the world's exports and global GDP. Asian countries' combined foreign exchange reserves amounts to more than one trillion U.S dollars, well over half of the world's international reserves. Moreover, Asia is also abundant with natural resources.

Given the size of the population, the wealth of foreign reserves, and the rich endowment of natural resources, Asia should be a continent of prosperous nations. But in reality this is unfortunately not the case. The majority of people in Asia are living in poverty. Many are struggling to survive with a meager income of less than a dollar per day. Poverty makes it harder for Asian countries to trade among themselves and to be strong trading partners with the rest of the world. Poverty weakens Asia despite its enormous potentials.

The prosperity of Asian nations depends very much on their ability to cooperate with each other. Without an Asia-wide cooperation, Asian nations would be unable to utilise their resources, their manpowers, their markets and skills to create mutual benefit from their combined potentials. To realise the

vast potentials of Asia, there is a need to embrace all the regions of the continent.

In 2002, Prime Minister Dr. Thaksin Shinawatra launched the ambitious initiative of the Asia Cooperation Dialogue or ACD. The ACD is both a cooperation **and** a dialogue. It is meant to be a capacity-building process relying upon the flexibility and comfort level of all participants. Driven by positive thinking, the ACD is an evolving, informal, non-institutionalized, non-exclusive and open process. As an Asian-wide forum, the ACD will fill in the gap left by the Continent's 'missing link' between existing inter-regional groupings, such as APEC and ASEM and regional grouping, such as ASEAN, ASEAN+3, SAARC, BIMSTEC, and GCC.

After just over two years and three ministerial meetings, the ACD has been enlarged from 18 Asian members at its inception to 25 Asian countries at present ranging from east to west and north to south of our continent. The ACD's primary goal is to tap into the inherent strengths of Asian countries for mutual prosperity and sustainable development. Cooperation takes the forms of annual ministerial dialogues and joint projects in 18 functional areas, ranging from key issues of poverty alleviation to SMEs, e-commerce to energy security, and tourism to financial cooperation. To encourage cooperation among the diverse members, a project does not require the members' full participation. Cooperation projects can be launched by a few member countries, while others may choose to join later when they feel ready.

Within three years of its existence, the ACD has proven itself as a promising forum in fostering partnership for Asia-wide cooperation. It is the only forum where countries across Asia can exchange views with one another in a frank manner on international and regional issues that have a direct bearing on Asia, and to which Asia should make meaningful contribution. By consulting and working together to pool each Asian

country's individual strength to make Asia stronger and a better place to live, it helps to promote Asian consciousness and with it Asian confidence and creativity. With its expanding membership, the ACD has disproved the archaic presumption that Asia is too diverse to achieve anything together.

Distinguished Participants,
Ladies and Gentlemen

Against that backdrop and the ever readiness of all of us to cooperate and forge meaningful partnership, East Asian Community is a timely endeavour. East Asia will certainly continue to enjoy impressive economic growth which would propel our region to be the largest economy by year 2020. The 21st Century truly belongs to East Asia. I believe that the emerging East Asian Community (EAC) should be an outward-looking community that brings peace, prosperity and progress not only to East Asia but also to the rest of Asia. The EAC will be a locomotive that will pull the rest of Asia forward to prosperity. Its realization does not depend on any government or any sub-regional cooperation. Nor does it depend on efforts of any particular sector of our region. Its success must be an outcome of aggregate cooperation and partnership of all sectors and every one in the region. Your meeting and the academic contribution will be so important and valuable for making the East Asian Community truly beneficial to our region and our people.

Thank you very much for your attention.



Future Prospect for Financial Cooperation in East Asia

Masaru YOSHITOMI
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organized by

**Institute of East Asian Studies
Thammasat University**

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

Thailand Research Fund

Future Prospect for Financial Cooperation in East Asia

Masaru YOSHITOMI

The Asian financial crisis of 1997-98 has given a strong impetus and recognition to "institutionalize" regional cooperation to prevent or resolve similar crises.

The Asian crisis can be characterized as a capital account crisis, which is 180 degrees different in nature from a conventional current account crisis. A capital account crisis starts with currency appreciation due to massive capital inflows, which are, however, followed by sudden, massive, capital reversals, causing both currency collapse and domestic banking crisis, (i.e., twin crisis). In sharp contrast, a current account crisis is caused by such poor macroeconomic fundamentals as large fiscal deficits, high inflation rates, and low domestic saving rates. These features were not at all shared by the crisis-hit Asian economies.

The very nature of the capital account crisis has inspired a staged, two-track approach towards greater regional financial integration: one track for establishing a regional lender of last resort function and the other for coordinating a suitable exchange rate mechanism in the region.

The two tracks will mutually enforce each other in a closely integrated manner because a regional lender of last resort function is aimed at preventing a currency collapse by defending the particular exchange rates agreed upon by regional members.

The Chiang Mai Initiative of May 2000 by ASEAN plus Three has expanded currency swap arrangements among central banks up to about US\$ 40 billion. However, the current CMI has some limitations as a regional lender of last resort : (1) the networks are essentially bilateral, not multilateral, (2) the amount is still small in light of the nature of the capital account crisis, and (3) monitoring, surveillance, and peer-pressure mechanisms required for the regional lender of last resort function is not firmly established.

A full-fledged regional lender of last resort facility can be established by pooling some portions of massive foreign exchange reserves held by ASEAN plus Three. Such a facility will supplement IMF for both surveillance/conditionality and international liquidity provision, since the globally engaged IMF can neither effectively analyze region-specific financial and corporate-governance problems. Nor can the IMF provide "massive" liquidity in a "timely" manner, because IMF can only better manage conventional current account crisis, not capital account crisis which will require far larger international liquidity than the quota of each member of the IMF.

Trade-FDI centered development in Asia prefer stable exchange rates to volatile free float, but at the same time, volatile international capital movements should be accommodated by flexible exchange rates. For attaining these two objectives, flexible but stable exchange rate arrangements such as a crawling-band system will be more appropriate and compatible with long-term development in Asia.

For individual countries, a central reference rate for a crawling-band should be real effective exchange rate consistent with economic fundamentals. An effective exchange rate implies a multiple currency basket rather than a single currency basket. The reference rate should

“Future Prospect for Financial Cooperation in East Asia”

Masaru YOSHITOMI

Research Institute of Economy, Trade and Industry (RIETI)

Presentation for The Second Annual Conference of NEAT, 16-17 August, 2004

Inter Continental Hotel, Bangkok Thailand

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✍ For individual countries, a central reference rate for a crawling-band should be real effective exchange rate consistent with economic fundamentals. An effective exchange rate implies a multiple currency basket rather than a single currency basket. The reference rate should crawl up and down so as to be adjusted to international inflation differentials compared with trading partners.

✍ Greater intra-regional integration of both global networks of trade-FDI and finance will require closer cooperation and coordination in the exchange rate alignments of individual countries.

✍ Therefore, a more closely coordinated regional exchange rate mechanism will be called for, requiring a common basket for individual exchange rates in the region so as to prevent exchange rate competition. Thus, much closer macroeconomic policy coordination should be developed on the monetary and fiscal policy fronts.

- In view of the large diversity among the ASEAN plus Three countries, particularly in terms of the broadness and depth of domestic financial markets, the exchange rate regime should be compatible with the development of domestic financial markets of individual countries. The shallower the domestic financial market, the narrower the band of a crawling exchange rate in order to avoid too volatile and harmful fluctuations of the exchange market rate.

✂ In order to develop sounder and stronger domestic financial markets, a regional cooperation should be called for to nurture domestic bond markets. The developed bond markets and freely determined interest rates are essential for better risk management by banks. The development of long-term corporate bond markets will also contribute to mitigating the maturity and currency mismatches, a source of a capital account crisis.

✗ In this context, a regional bond market which has to be internationally competitive in efficiency should be established in Asia, through better accommodating the demand of Asian investors for long-term bonds issued by Asian corporations with the denomination of Asian currencies.

✍ When regional cooperation proves successful in establishing (1) the regional lender of last resort facility, (2) the regional exchange rate arrangement, and (3) stronger domestic banking and deeper bond markets, then the possibility of East Asia evolving into common currency area and hence into the regional monetary integration should become feasible and desirable.

✍ Sooner or later, the large U.S. twin deficit (her fiscal as well as current account deficit) will become a serious global issue, promoting the U.S. demand for currency appreciations in East Asian countries which have been accumulating huge foreign exchange reserves thanks to their current account surpluses in the post-crisis era together with incoming FDI. This time, confrontation will arise between East Asian Community and the U.S. unlike the case of the Plaza Accord in 1985. Strong regional cooperation will be urgently required to cope with this new global issue.



The Economic Impacts of East Asian FTA on East Asian Countries

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The Economic Impacts of East Asian FTA on East Asian Countries

Shujiro Urata

I. Introduction

East Asia was not active in the formation of regional trade agreements (RTAs), which include free trade agreements (FTAs) and customs union, until recently (Table 1)¹. Indeed, ASEAN Free Trade Area (AFTA) was the only major FTA until Japan and Singapore enacted JSEPA in 2002. AFTA was established in 1992 with six ASEAN member countries, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Brunei. New ASEAN members, Cambodia, Laos, Myanmar, and Vietnam joined AFTA in the latter half of the 1990s, and currently AFTA has 10 member countries. Besides AFTA, ASEAN as a group as well as its members individually have become active in FTA discussions with other countries in recent years. One of the FTAs involving ASEAN that has received most attention recently is that with China. ASEAN and China started FTA negotiations in January 2003 with the target of concluding the negotiations by June 2004. ASEAN is also discussing the possibility of FTAs with Japan and Korea. Some ASEAN members have become active in establishing bilateral FTAs. Singapore enacted or signed several FTAs with countries such as New Zealand, Japan (JSEPA), Australia, the USA, the EFTA, and began negotiations with countries including India. Thailand has also become active in establishing FTAs, as it is currently under negotiations with the USA and Japan. The Philippines and Malaysia began negotiations with Japan in 2004.

Compared to ASEAN countries in Southeast Asia, the economies in Northeast Asia including China, Japan, Korea, and Taiwan had not been active in FTAs until recently. Despite increasingly strong interest in FTAs by Northeast Asian countries, there is only one FTA (JSEPA) that has been enacted so far. Japan is currently negotiating an FTA with Mexico, Korea, Thailand, Malaysia, and the Philippines. Furthermore, it has been studying possible FTAs with ASEAN, Indonesia, and Vietnam. Korea started having an interest in FTAs before Japan. In 1998 Korea disclosed a plan to start FTA negotiations with Chile, and it also set up a joint-study group at private level on FTA with Japan. Korea started negotiations with Chile in 1999, and Korea and Chile signed the agreement in October 2002 after difficult negotiations on liberalization of agricultural imports. After reaching an agreement, it took the Korean National Assembly more than a year to ratify it, because of strong opposition from the farmers. Korea started studying the possible FTA with Singapore, New Zealand and ASEAN.

China's active FTA strategy has received a lot of attention. China joined the WTO in 2001 and established an access to the world market, and it started to pursue regional strategies by using FTAs. China signed a framework agreement on comprehensive economic cooperation with ASEAN in November 2002. The agreement, which was proposed strongly by China, has not only trade liberalization but also cooperation in the areas of FDI and economic development. As noted above, China and ASEAN started negotiations on FTA in

¹ In the GATT/WTO, regional trade agreements (RTAs), which violate one of its basic principles of non-discrimination, are permitted under GATT Article XXIV with several conditions, which include liberalization of substantially all the trade of the members, not increasing trade barriers on non-members, and completing the RTA process within ten years. For developing countries, more lenient conditions are applied under the enabling clause. An FTA is considered to be a shallow form of regional integration, because it only removes tariff and non-tariff barriers among the members, while a customs union is a deeper integration, as it adopts common external tariffs on non-members, in addition to the removal of tariff and non-tariff barriers on trade among the members.



2003. China has offered various schemes attractive to ASEAN and particularly to its new members such as economic cooperation for the new ASEAN members and advanced trade liberalization (early harvest) in agricultural products. In addition to ASEAN, China has proposed Japan and Korea to establish a trilateral FTA including these three countries. China enacted an FTA (CEPA) with Hong Kong

An idea of FTA covering East Asian countries has emerged. At the Leaders' summit meeting of ASEAN+3 (China, Japan, and Korea) in 1998 the leaders decided to set up East Asia Vision Group to study long term vision for economic cooperation. The group has presented the leaders with recommendations including the establishment of East Asia FTA. Despite the recommendation from the Vision Group, East Asia FTA has not yet become a concrete agenda at the leaders meeting.

In light of sudden surge in the interests in FTAs in East Asia, this paper examines the factors behind such surge and the possible impacts of East Asia FTA on East Asian countries.

II. The Factors behind the Increasing Interest in FTAs in East Asia

Various factors can be identified behind emergence of strong interest in FTAs in East Asia. First, rapid expansion of FTAs in other parts of the world has prompted East Asian economies to have an interest in establishing FTAs, in order to maintain and expand market access for their exports (Figure 1). Many East Asian economies have become to realize the benefits of trade liberalization for the promotion of economic growth, as it has brought expected outcome of rapid economic growth. Despite the desire of many policy makers for promoting trade liberalization, it has become apparent that trade liberalization under the GATT/WTO has become increasingly difficult. As the number of GATT/WTO members increased, their views on the pace and the extent of trade liberalization have become diverged. Indeed, the fact that it took the GATT members eight years, twice as long a period as initially planned, to conclude the Uruguay Round (UR) negotiations, indicates the increasing difficulty in reaching a consensus on trade liberalization. The increasing difficulty in reaching a consensus was a factor that led to a failure by the WTO members to initiate a new round of trade negotiations in Seattle in 1999. Although an agreement was reached in Doha to launch a new round, the new round has faced difficulty in starting substantive negotiation, as even the modality of the negotiations has not been agreed yet. Faced with the difficulty in carrying out trade liberalization on the global scale, many countries in other parts of the world have opted to form FTAs among the like-minded countries to pursue trade liberalization. As a result of increasing FTAs in other parts of the world, East Asian countries started to feel that they are discriminated against in many markets in the world. To overcome such disadvantage and to secure markets for their exports, East Asian countries have become active in forming FTAs.

It should also be noted that many countries in the world including those in East Asia began to realize that the GATT/WTO rules cannot adequately deal with newly emerging international economic activities such as FDI, services trade, mobility of labor, and others. To put it differently, the rules concerning border measures such as tariffs, which are main focus of the GATT/WTO, cannot provide foreign as well as domestic companies with the level-playing field. It is necessary go deeper beyond the border measures and to set up the rules covering domestic systems such as competition policy. Many countries share a view that GATT/WTO cannot provide such rules and thus have opted for using FTAs to deal with the problem.

It is important to note that East Asian countries recognize that the EU and the NAFTA are very successful in promoting economic growth, and thus East Asian countries have become



interested in forming FTAs. East Asia's interest in FTAs has intensified as the EU and the North and South Americas are expanding their FTA networks.

Second, somewhat related to the point just made, East Asian economies have become interested in using FTAs as a way to promote deregulation and structural reforms in the domestic market. Many East Asian economies pursued deregulation and structural reforms in the 1990s, which contributed to the realization of rapid economic growth. Although the need for accelerating deregulation and structural reforms to further promote economic growth is recognized by many East Asian economies, it may not be easy for them as many economies are still recovering from the crisis, and as the room for further deregulation became limited as a result of earlier deregulation. Under these circumstances, external pressures such as FTAs are considered very effective in pursuing deregulation.

Third, many East Asian economies have become interested in using FTAs to promote economic and other types of cooperation in East Asia. The financial crisis in the late 1990s in East Asia increased the awareness of the need for regional cooperation such as FTAs to avoid another crisis and to promote regional economic growth, because East Asian economies could not get as much assistance as they hoped from the countries outside the region. Indeed, as we have repeatedly pointed out earlier, FTAs and future FTAs in East Asia include not only trade liberalization under traditional FTAs, but also trade and FDI liberalization and facilitation under the name of EPAs. It should be noted that regional cooperation in the area of finance has moved forward significantly, as many East Asian economies realized the need for such cooperation to avoid another financial crisis. Specifically, the Chaing-Mai Initiative, which consists of bilateral currency swap arrangements, was instituted by selected East Asian countries.

Fourthly, it has to be emphasized that the political factors have contributed to the increased interest in FTAs in East Asia. A rivalry between China and Japan for becoming a "leader" in East Asia has made them interested in using FTAs to strengthen their relationships with ASEAN and the NIEs. Indeed, in November 2002 Japan proposed an economic partnership framework to ASEAN one day after China agreed to start FTA negotiations with ASEAN. It should also be noted that ASEAN and the NIEs consider FTAs as a means to maintain and increase their influential position in East Asia. This is particularly notable for ASEAN, as it has been seeking to establish FTAs with China, Japan, and Korea separately, or three "ASEAN+1" FTAs, to maintain and increase its influence before the establishment of an East Asia wide FTA, which will be dominated by China and Japan. ASEAN has been successful in attracting India, the US, the EU and other countries outside East Asia to form FTAs, mainly to maintain its influential position in East Asia. It should be noted that India, the US, the EU and other countries outside the region regard the relationship with ASEAN countries important to maintain their presence in East Asia, in light of emergence of regionalization in East Asia.

Korea, one of the NIEs, which is sandwiched between China and Japan not only geographically but also economically and politically, is keen on maintaining its position as a balancer between the two countries. Indeed, Korea has been an active advocate of an FTA involving China, Japan, and Korea. It should also be noted that Korea is interested in establishing a cooperation mechanism in Northeast Asia with China and Japan, which would contribute to facilitate the unification of South and North Korea.

Taiwan stepped up its efforts to establish FTAs with various countries after becoming a WTO member in 2002. Taiwan is interested in using FTAs not only to expand economic relationships but also establishing political and diplomatic relationships. Despite its desire to form FTAs with many countries, its diplomatic status in the international community has made it difficult to achieve its objectives so far.



Finally, we should point out the reasons for emergence of EPAs rather than traditional FTAs in East Asia. One notable characteristic of East Asia is diversity in the level of economic development for the countries in the region, ranging from high-income countries such as Japan and Singapore to low-income countries such as new ASEAN members. In order for FTAs involving such diverse countries to become a success, traditional trade liberalization under FTA should be supplemented by cooperation programs such as trade and FDI facilitation and economic assistance under EPAs, as such programs reduce the adjustment costs of trade liberalization.

III. Impacts of FTAs in East Asia

The countries interested in FTAs expect various benefits from the formation of FTAs, ranging from economic to non-economic benefits. This section first discusses benefits of FTAs in terms of trade liberalization and then turns to additional benefits from deeper integration through implementing additional features such as FDI liberalization and economic cooperation under new types of FTAs.

Let us first examine the possible impacts of an FTA on member countries through foreign trade. The trade impacts of an FTA can be classified into two types. One is the static effect and the other is the dynamic effect. As to the static effect, trade creation, trade diversion, and terms of trade effects are important. Removal of trade barriers among the members would promote trade among them (trade creation effect) sometimes at the expense of imports from non-members (trade diversion effect). If an FTA leads to a reduction in imports from non-members, FTA members are likely to experience an improvement in their terms of trade vis-à-vis non members (terms of trade effect). Trade creation effect and terms of trade effect lead to an increase in economic welfare of the members, while trade diversion effect is likely to reduce economic welfare of the members because imports from most efficient suppliers in non-members are replaced by imports from less-efficient producers from the members. It is important to note that for non-members trade diversion effect and terms of trade effect lead to harmful impacts on their economic welfare.

The preceding discussions on the impact of FTA on foreign trade are given from the point of view of an economy as whole. From the point of the view of the business sector, which has strong influence on policy-making process, two different types of effects are expected. For competitive business, FTA will bring benefits as it enables them to increase their access to members' markets. However, for non-competitive business sector, FTA will have a harmful effect as it introduces competitive pressure.

In addition to these static effects, dynamic effects can be expected. They include mainly scale effect and competition enhancing effect, both of which would increase economic welfare for both members and non-members. The scale effect may arise from the formation of larger market as a result of an FTA. Faced with larger market, companies may be able to exploit the benefits of economies of scale, giving beneficial impacts on consumers in not only member but also non-member countries. Pro-competition effect may be expected as competition in member countries' market is likely to intensify as a result of trade liberalization. Pro-competition effect may give rise to the development of new products and new technology, which in turn would benefit consumers in both member and non-member countries. One may consider pro-competition effect as the effect, which would promote domestic policy reform. Many countries can use external pressure to promote domestic reform. In the past GATT commitments as well as threats from the US and other countries



were effective external pressure. However, at present, these pressures are weak. Under such circumstances, FTAs could be effective external pressure.

In addition to the impacts on foreign trade, FTA is likely to have impacts on FDI. As to the possible impacts of FTA on FDI, one would expect both FDI creation effect and FDI diversion effect. FDI creation effect indicates an increased FDI among member countries, while FDI diversion effect refers to a shift of FDI from non-member to member countries. Both effects have positive impacts on member countries in that FDI would be flown into member countries, as trade liberalization via FTA would increase attractiveness of members' market. While FDI creation effect does not have any immediate negative impacts on non-member countries, FDI diversion effect has negative impacts as FDI is diverted from non-member to member countries. So far the impacts of FTA, or free trade agreement, on FDI were discussed. If an agreement has FDI liberalization under new type of FTAs, then naturally it would yield directly the kinds of impacts on FDI discussed above.

The preceding discussions indicate possible benefits for member countries and possible negative impacts on non-member countries. Having noted this, we would like to emphasize the point that the above statement is correct if only static effects of FTA are considered, and if both static and dynamic effects are taken into account FTA is likely to bring benefits not only to members but also to non-members.

Let us examine the possible impacts of an East Asia FTA on East Asian economies. Urata and Kiyota (2003) conducted a simulation exercise by using a general computable equilibrium (CGE) model. Table 1 presents their results for GDP and welfare, measured by equivalent variation (EV), for East Asian economies with a few selected countries. The results indicate that all FTA member economies gain benefits from an East Asia FTA in terms of GDP and EV. The positive impacts are very large for the ASEAN countries. Among the ASEAN countries Thailand gains substantially. Indeed, Thai GDP is estimated to increase as much as 16 percent from the East Asian FTA. A large gain for Thailand is attributable mainly to high protection imposed on the Thai economy before the formation of East Asia FTA. Vietnam and Indonesia also would gain substantially from the East Asia FTA.

By contrast to the gains accrued to the FTA members, non-member countries experience negative impacts in the forms of declines in GDP and EV. These negative impacts are mainly attributable to the trade diversion effect from the East Asia FTA, through which non-member countries' exports to East Asia are substituted by member countries' exports as a result of preferential treatment given to trade involving the members. It should be noted that the negative impacts on the United States and the EU are quite small while they are somewhat substantial for Australia/New Zealand and other Asia. Relatively large negative impacts for Australia/New Zealand and other Asia are attributable to the fact that East Asia is a very important region for their export destination.

Having presented the estimates based on CGE model exercise, it is important to note that these estimates are likely to be smaller than actual impacts, because they do not include dynamic effects fully. In addition, the impacts would be greater if deeper integration including trade and FDI facilitation, and economic cooperation is adopted.

Before ending the discussions on the benefits of FTAs and EPAs on member countries, we should emphasize the non-economic benefits from these arrangements. Through EPAs the member countries expect to deepen mutual understanding, which would reduce political and social frictions to achieve social and political stability. Social and political stability in turn would contribute to economic growth.



IV. Obstacles to FTAs in East Asia

One may classify the obstacles on the formation of FTAs in East Asia into several categories including economic, historic, and political factors. Let me begin with economic factors. The formation of FTA involving the countries in different levels of economic development as the case for East Asia is likely to result in sizeable economic benefits as the removal of trade barriers through FTA enables the members to use resources efficiently by making them specialize in the production of goods with a comparative advantage. Theoretically, this point may be used as a rationale for establishing FTAs in East Asia, particularly a East Asia-wide FTA, but in reality the formation of such FTA would encounter strong opposition from non-competitive sectors, which are pressured to go through painful structural adjustment. Indeed, it may be argued that the formation of FTA involving the countries with similar level of development is easier because they are engaged in intra-industry trade of horizontal type more actively, and under such circumstances weaker opposition may be expected.

This point may be supported by the results of simulation exercises by Urata and Kiyota (2003). According to their estimates shown in Table 3, the level of production of the non-competitive and "sensitive" sectors is projected to decline as a result of FTA. For example, an East Asia FTA would result in the reduction in output of agriculture in Japan and Korea, transportation machinery in China, Taiwan, Malaysia, Indonesia and several other countries. Although agriculture is a declining industry for Japan and Korea, and therefore it may be better to reduce the size of agricultural production from the point of view of resource allocation for them, a strong opposing coalition of farmers, politicians, and bureaucrats makes it difficult for these governments to pursue East Asia FTA. Many developing East Asian countries, which are interested in developing the automobile sector, presently non-competitive sector, would not like to see the decline of the sector.

In addition to these economic factors, several political factors are hindrance to FTAs in East Asia. One is a security issue. East Asia has countries with different political systems. Most countries have democratic political system, but China and Myanmar have authoritarian regime. While many countries have security alliances with the US, China is still considered as a possible threat to these alliances. These issues may be dissolved as economic development is achieved and as international exchange among these countries is enhanced to result in sharing common views toward political system and regional security.

Another political problem in this region toward the establishment of East Asia FTA is the absence of strong political leadership toward its formation. The experiences in Europe remind us of the crucial role that strong political leadership played in the formation of the EEC (European Economic Community) in 1957 and subsequent deepening experiences. It is reasonable to assume that China and Japan should jointly take leadership in East Asia, but so far the differences in their views in various issues such as political system and regional security, as noted above have been obstacles.

Finally, different views on history involving the Northeast Asian countries, namely, China, Japan and Korea are obstacles to East Asia FTA. Closer economic and social relations will contribute to reducing the gaps in their views on historic and other issues.

V. Conclusions: Suggestions to Overcome the Obstacles toward the Establishment of an East Asian FTA

East Asian countries have been active in forming FTAs with other East Asian countries. Many East Asian countries consider the formation of an East Asia FTA as a