

The Path to the East Asian Community--Transcending Diversity and Heterogeneity

Asian Community from an ASEAN Viewpoint

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On December 14, 2005, the first East Asia Summit (EAS) was held in Kuala Lumpur, Malaysia. This historic summit was attended by leaders from the 10 member states of ASEAN, China, Japan, South Korea, India, Australia and New Zealand. In their declaration, the leaders vowed to promote cooperation in political and security issues, development, financial stability, energy security, economic integration and growth, poverty eradication and narrowing the development gap in East Asia, as well as to promote deeper cultural understanding and mutual trust. This meeting was clearly a significant event and may be a small first step toward the future formation of a truly “Asian Community”.

Back in 1991, the then Prime Minister of Malaysia, Dr. Mahathir Mohamad, proposed the establishment of the so-called “East Asian Economic Caucus” (EAEC), which would be a consultative group consisting of the (original 6) ASEAN member countries, China, Hong Kong, Japan, South Korea, Taiwan, and Vietnam. The EAEC would be a forum for coordinating positions in trade relations and negotiations with countries outside the region. However, this idea was too radical back in the early 1990’s. ASEAN was still just embarking on its own Free Trade Agreement (AFTA). The United States was clearly opposed to the idea since it was not part of the grouping and successfully persuaded Japan, who relied heavily on the US involvement and military presence in the Asia Pacific region, not to participate. The EAEC could not get off the ground. Instead, an alternative grouping prominently involving the US and various Asia Pacific economies was forged and became more active, the Asia-Pacific Economic Cooperation (APEC)².

The holding of the first East Asian Summit last year shows that East Asia has come a long way from the situation in the early 1990’s. Some major events have provided the impetus for East Asia to embark on the path toward a concrete and more active regional grouping. The most important of these was the financial crisis that started in Thailand in 1997 and expanded to affect almost all countries in the region. The contagion resulting from the crisis showed that East Asian economies were inextricably linked to

¹ First, let me say that my view reflects that of one researcher from Thailand. Certainly I cannot claim to represent “the view” from ASEAN, or even “the view” from Thailand as there are obviously many alternative points of view about the development of an Asian Community and what it might imply for ASEAN and for Thailand. So the following is my own personal view on this topic.

² Dr. Mahathir was certainly unhappy with the outcome and refused to attend APEC’s first Leaders’ Summit in Seattle in 1993.

each other and could not afford to ignore what was happening elsewhere within the region. Countries in the region also had very limited influences on crisis resolution measures in the seriously affected countries; these measures were mostly dictated by the International Monetary Fund, with the US Treasury and the Federal Reserve having inputs behind the scenes. The economic grouping in which the East Asian economies were a part of, APEC, also hardly had any role in assisting the East Asian countries during the economic and financial turmoil. In addition, it was ironic that while the East Asian region as a whole was financially strong prior to the crisis, there was a lack of cooperation and self-help mechanisms that could have utilized the region's financial strengths to avoid the crisis or to give the region greater influence over crisis resolution mechanisms.

The East Asian region as a whole was a saving surplus region prior to the crisis³, yet the saving deficit countries in the region that became insolvent during the crisis and had to resort to IMF programs (Thailand, Indonesia and South Korea) had to rely mostly on short-term foreign borrowings to finance their saving deficits. The saving surplus of the region was invested mostly in US dollar denominated assets and the deficit countries had to rely on foreign bank borrowings. According to the provisioning requirements of the Basel Capital Accord, short-term bank lending to developing countries (with a maturity of less than one year) requires a provisioning equal to 20% of risky assets, while long-term lending (with a maturity of one year or more) requires 100% provisioning. This is because short-term lending is considered to be less risky to the lender than long-term lending. However, the consequence is that most lending to developing countries is short-term, and one can see a rapid increase in short-term lending to developing countries in the 1990's. The short-term foreign debts of the three East Asian countries that became insolvent increased very rapidly before the crisis, and the amount of short-term foreign debts became more than the amount of the official foreign reserves in all three countries. This meant that if the debts were not rolled over, each country would not have enough foreign currencies to repay the debts. This was a fundamental reason for the financial crisis in all the three countries.

Given the painful experiences of the crisis and the perception that if there were more financial cooperation mechanisms in the region, then the crisis could possibly have been avoided, countries in the region moved quickly to develop various post-crisis financial cooperation initiatives. Most significant was the formation of the ASEAN+3 group (ASEAN plus China, Japan and South Korea), which is similar to the EAEC earlier proposed by Dr. Mahathir Mohamad. Indeed, prior to the crisis it was hard to imagine the formation of a group such as the ASEAN+3 due to political frictions among some of the key countries. The fact that the ASEAN+3 group was formed, and a number of concrete financial cooperation initiatives have been carried out was a direct outcome of the financial crisis. Modes of financial cooperation that have been pursued ranged from surveillance and early warning mechanisms, the setting up of a regional financing facility through foreign reserves swap arrangements, the so-called Chiang Mai Initiative (CMI), and initiatives to develop the Asian Bond market. Apart from financial cooperation, East Asian economies have also pursued other areas of economic cooperation, particularly

³ The surplus saving of the East Asian region before the crisis was more than US\$ 100 billion annually. This became even larger after the crisis.

in the area of trade. This is in line with the increasing importance of intra-regional trade within East Asia, currently accounting for about half of total East Asian international trade.

Another development which has provided impetus for East Asian economic cooperation was the emergence of China as a powerful economic force, both in the region and globally. To further enhance its leadership role in the region, China initiated the ASEAN-China FTA which was very quickly agreed to by the leaders of ASEAN, and the “Framework Agreement on Comprehensive Economic Cooperation between the Association of Southeast Asian Nations and the People’s Republic of China” was signed on November 4, 2002 in Phnom Penh.

From ASEAN’s perspective, the sustained rapid growth of the Chinese economy provided an important new source of demand for ASEAN products, particularly as Japan had been in economic stagnation for more than a decade. The introduction of the so-called “Early Harvest Programme” in the framework agreement, which involved fast-track tariff reductions on many agricultural commodities was also regarded favorably by many ASEAN countries who have some comparative advantages in agriculture. Of course, the huge size of the Chinese economy and the high competitiveness of the Chinese manufacturing sector is an important issue of concern to ASEAN, whose manufacturing base may become more and more threatened over time. However the ASEAN-China FTA also brought other indirect benefits to ASEAN in the form of the need for other economic powerhouses to respond to the Chinese initiative, in particular Japan had to move quickly to pursue its own FTA with ASEAN and even the US paid more attention to ASEAN as a result.

The “Joint Declaration of the Leaders of ASEAN and Japan on the Comprehensive Economic Partnership” was announced on November 5, 2002, in Phnom Penh just one day after the signing of the China-ASEAN economic cooperation framework agreement. Subsequently, the “Framework For Comprehensive Economic Partnership Between The Association Of Southeast Asian Nations And Japan” was agreed on 8 October 2003 in Bali on the sideline of the 9th ASEAN Summit. It seems clear that if the China-ASEAN FTA was not on the table, then it is unlikely that Japan would have moved as quickly to develop a framework for economic partnerships with ASEAN. The United States also appeared to take notice of China’s initiative, and also introduced an Enterprise for ASEAN Initiative (EAI) that opened the window for possible bilateral FTA’s between the United States and members of ASEAN along the lines of the Singapore-US FTA.

As more FTA’s are agreed or are being considered within the region, there seems to be a momentum leading to ever more FTA’s. This is partly because countries do not want to be excluded from the proliferation of FTA’s, as being left out could mean being discriminated against down the road. Thus, there are many FTA’s with ASEAN being prepared or in the process of negotiation at present, including with India (framework agreement signed in October 2003), South Korea (framework agreement signed in December 2005), and Australia/New Zealand (intention to negotiate announced in November 2004). Apart from FTA’s at the level of ASEAN, many ASEAN countries including Thailand have been pursuing numerous bilateral FTA’s with countries both within the region and from outside the region.

In addition, there are numerous FTA agreements/negotiations between the countries that are pursuing FTA's with ASEAN and other partners, both within and outside the region. All these FTA's result in the so-called "spaghetti bowl effect". While these may end up with many inconsistencies among themselves, if each remains WTO consistent and pushes out the envelop of trade liberalization, then they could form part of the process leading to an eventual comprehensive economic cooperation framework for Asia as a whole (or "Extended Asia" including Australia and New Zealand).

Apart from the crisis and the emergence of China, another factor which also provides an impetus for greater regional economic cooperation in East Asia is the development of region economic cooperation agreements elsewhere. The European Union (EU) of course has been expanding eastward with the addition of ten new members in May 2004 with plans to add other members in the future. In the American continent, a process of North-South integration is on-going. The Free Trade Area of the Americas (FTAA) has been under negotiations for some time and even though there appears to be some recent stumbling blocks, it is likely to lead to a significant regional trade agreement in the future. It is clear that these regional agreements within Europe and America could make these continents focus more attention on economic activities within each continent and pay less attention to outside economic relations. Asia could have a lower economic priority for these continents in the future. Given this it makes a lot of sense for Asia to embark of a path of greater intra-regional economic cooperation.

The trend of greater economic integration in Asia offers many opportunities as well as poses many challenges for countries in ASEAN. It is expected that the larger market resulting from greater regional trade integration will create greater demand for ASEAN products, whether goods or services, including tourism. It will also offer greater investment opportunities for ASEAN businesses (particularly the larger business groups). However, there is also real concern that the manufacturing production bases that have been built up in ASEAN over the past several decades could be adversely affected, particularly by competition from lower cost manufacturing production bases in China (and may be India in the future). ASEAN has already lost market share to China in third markets for many products. While this has been compensated to some extent by greater export from ASEAN to China, the prospects for ASEAN manufacturing are still very uncertain. How this may develop in the future is not well understood at present. The reason is that a significant part of the manufacturing bases in ASEAN belongs to multinational enterprises and how these enterprises will strategically position their production bases in the region in the future under the environment of freer trade within the region is still not clear. There is of course a fear that the production bases of multinationals in ASEAN will not expand much in the future, with most of the expansion happening in China. That this is already occurring to some extent can be witnessed by the much greater size of foreign direct investment (FDI) in China compared to that in ASEAN in recent years. On the other hand, multinationals cannot afford to put all their eggs in China, given uncertainties about how the gap between economic and political developments in China will eventually be resolved. So ASEAN should still be able to attract FDI at a certain level. However, there is no guarantee that this will happen automatically and will depend on ASEAN's own ability to make the region attractive enough to remain a significant manufacturing production base for multinational companies.

ASEAN was highly regarded as a competitive region a few years prior to the crisis. The crisis and the rapid emergence of China changed this picture significantly. In order for ASEAN countries to meet the future challenges and exploit opportunities arising from greater economic integration in the region⁴, it is very important for ASEAN to revitalize its competitiveness. To become more competitive ASEAN countries will need to carry out domestic “upgrading” policies in many areas, particularly in technological capacity and skills formation. However, ASEAN needs to learn from the example of China that “size does matter”. To better exploit the benefits of size, ASEAN will need to integrate a lot more and a lot more quickly in order to reduce the costs of doing business in ASEAN, to make the region more competitive and more attractive for foreign investment. Unless ASEAN pushes ahead quickly with much deeper economic integration, there is a danger that each of the ASEAN economies will become marginalized within a large Asian region dominated in size by China and India, and dominated technologically by Japan and South Korea.

The issue of deeper integration of ASEAN into some form of an ASEAN Economic Community (AEC) has been under discussion within ASEAN for a number of years. ASEAN leaders have set 2020 as the target date for reaching the ASEAN Economic Community. Because 2020 is very far away, and ASEAN may have already lost out a lot to regional competitors by that time, some countries such as Singapore and Thailand have been trying to push for an earlier target date. However, many ASEAN countries still feel that they are not ready for deeper integration at this stage and the effort has not been successful so far. Instead, as a sort of compromise, ASEAN has opted for a sectoral integration approach where eleven priority sectors have been targeted for ASEAN integration. These are agro-based products, fisheries, wood-based products, rubber-based products, textiles and apparels, electronics, automotives, air travel, tourism, healthcare and e-ASEAN. This has led to the endorsement by ASEAN Leaders of the ASEAN Framework Agreement for the Integration of Priority Sectors during the 10th ASEAN Summit held in Vientiane in November 2004, and roadmaps for the integration of these various sectors have been drawn up covering a broad range of issues; such as, tariff elimination, non-tariff measures (NTMs), rules of origin, customs procedures, standards and conformance, logistics services, investments, trade and investment promotion, intellectual property rights, movement of business persons, skilled labor and professionals, human resource development and research and development.

At this point it is difficult to judge whether these sectoral integration roadmaps will be effective in significantly improving ASEAN competitiveness in these sectors. In many areas, detailed implementation plans remain to be worked out. More worrying is that countries still put many products into sensitive lists excluding them from the Framework Agreement, so it is not clear how serious are the intentions for real integration among ASEAN countries.

Japan has an important role to play in the revitalization of ASEAN competitiveness. Japan has for a

⁴ And also globally through the WTO process.

long time been the most important economic partner for ASEAN in the region. Apart from being an important trading partner of ASEAN, Japanese FDI played a very important role in bringing about rapid industrialization and growth of many ASEAN countries after the appreciation of the Yen as a result of the Plaza Accord in 1985. Although Japanese FDI inflows into ASEAN declined after the economic crisis, the stock of Japanese investment operating in ASEAN countries is still fairly large, and is still more than twice as large as the stock of Japanese investment in China. There is therefore a common interest between ASEAN and Japan for ASEAN to be able to revitalize its competitiveness. Without a vibrant ASEAN, Japanese investments and business networks in ASEAN that have been built up over the last couple of decades would decline substantially in value. Even though a number of ASEAN countries are still reluctant to move more quickly to form an ASEAN Economic Community, large Japanese multinationals do have influences on ASEAN governments and they should try to persuade ASEAN countries on the need for quicker ASEAN integration. To maintain competitiveness of their production bases in ASEAN vis-à-vis production bases in China, multinational companies need to develop their production strategies in ASEAN as a “Regional Strategy” rather than as a series of “Country Strategies” as in the past. This requires an integrated ASEAN market.

It is ironic that while many ASEAN countries are reluctant to move more quickly toward an ASEAN Economic Community, they have actually pursued many FTA’s with various partners that will bring about a great deal of competition for their economies. The thinking seems to be that a more integrated ASEAN will lead to greater competition for FDI among ASEAN countries and the currently weaker countries are likely to lose out and are therefore reluctant to move quickly to establish the ASEAN Economic Community. Yet in the pursuit of FTA’s with highly competitive trading partners, such as China, the worry that FDI will be diverted to China does not appear to be of such a great concern. This is a puzzle, but possibly the attraction of easier access to the huge Chinese market may have diverted attention from the risks of shifts in production bases to China. However, given that many ASEAN countries are concerned with greater competition arising from deeper economic integration within ASEAN, it is inevitably that if the prospect of an “Asian Economic Community” being actually realized came closer, many ASEAN countries will also be wary of such integration.

Many ASEAN countries would like to see appropriate sequencing along the path toward an Asian Economic Community. Some unease about the name “East Asia Summit” from within ASEAN have been expressed. It is felt that calling the meeting an East Asia Summit will downgrade the importance of ASEAN, and ASEAN countries will simply become a marginalized part of the Asia region. It would be better for ASEAN if ASEAN can integrate to become an ASEAN Economic Community first and revitalize its competitiveness, so that it can participate in an eventual “Asian Economic Community” or even an “Asian Community” similar to the “European Community” on equal terms with other large or technologically advanced members in Asia. The “Kuala Lumpur Declaration on the East Asia Summit” on December 14, 2005, clearly tried to take account of this unease by some ASEAN countries. It declared that “participation in the East Asia Summit will be based on the criteria for participation established by ASEAN” and that “the East Asia Summit will be hosted and chaired by an ASEAN Member Country that assumes the ASEAN Chairmanship and held back-to-back with the annual

ASEAN Summit.” Thus, the declaration assured that ASEAN will remain at the center of this grouping, at least for the time being.

While the various FTA's being pursued within the region could build up toward an eventual FTA for most of East Asia and South Asia as well as Australia and New Zealand, the notion of an Asian Community (or extended Asian Community) goes far beyond a regional FTA. The end point that many people envisage would presumably be something like the European Community, with cooperation in diverse areas including in the security and social spheres as well as monetary integration and the free movement of labor. For Asia, this eventual goal will likely need a very long time to come to fruition.

As was mentioned earlier, because the financial crisis was a key event that kicked off the path toward regional economic cooperation in East Asia, the first concrete cooperation initiative of the ASEAN+3 group was actually in the area of finance, this was the Chiang Mai Initiative. Since then, there have been cooperation to develop the Asian Bond Market and many discussions have taken place within the region about possible moves toward the eventual monetary integration along the lines of the EU. In particular, as intra-regional trade and investment within East Asia increase more and more, the volatilities of exchange rates of East Asian countries with respect to each other result in added costs of doing business within East Asia. Therefore, there have been various suggestions for an exchange rate arrangement for East Asia, such as a common basket peg, a yen block, an East Asian Currency Index and a monetary union for East Asia.

While Asia can learn about the requirements and appropriate sequencing for an eventual monetary integration from Europe, Asia does not have a comparable history as Europe or the necessary push factors that can convince countries that reducing their sovereignty will be a good thing. In the case of Europe, conflicts between sovereign nations that led to the destructions of the World Wars provided important push factors that led to the Shuman Plan and the establishment of the European Coal and Steel Community that took away member states' sovereign roles in these sectors. In Asia, every nation still jealously guards its own sovereignty, and the historical conflicts within the region also reinforce this in Asia rather than reduce it as in Europe. Therefore, it is unlikely that any move toward monetary integration can take place in the foreseeable future. Nevertheless there are many areas where Asian countries (particularly East Asian countries) can fruitfully cooperate in a win-win manner on financial matters. East Asia is probably the most power region financially, but it has not been active enough in leveraging on this financial strengths. Together East Asian countries own well over half of the world's foreign reserves. So far there have been very little coordination on how these reserves are managed. This is an area for further exploration in the future. How East Asia invests its huge foreign reserves holding can affect relative exchange rates among the major international currencies and it can also affect global yield curves on debt instruments, particularly the yield curve of US Treasury Bills. Both of these, relative exchange rates and yield curves, have important repercussions on global financial markets. A more proactive East Asia in this area will therefore fundamentally change the way global financial markets are managed. It is easy to envisage a situation in the future where decisions being made by the

group of countries (or central banks) in East Asia will have more weight on the direction of global financial markets than decisions being made by the US Federal Reserve.

There are also many other areas of regional cooperation inherent in the notion of an Asian Community that would require probably as long a time frame as monetary cooperation to come into fruition. Cooperation on national security is one area, another is cooperation to bring about free movement of labor within the region. On the latter, it can be observed that even within China itself there are still stringent controls on labor movements in order to prevent unmanageable urbanization. And among the nations of Asia, there are huge differences in living standards, differences that will require many decades before one can envisage a significant reduction. So the tasks over the next few decades are to promote the rapid development of those parts of Asia that continue to fall behind. As within ASEAN, which has regional schemes to try to assist the newer and less developed member countries, similar initiatives will be necessary in Asia as a whole. Finally, for a truly Asian Community (or an extended Asian Community), the development of greater mutual trusts and respect among the various peoples making up the region needs to be continually promoted. Most of all, Asia needs to leave its tensioned past behind and look resolutely toward its future.

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