

Whither Economic Integration in East Asia?

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I. Research Questions

- Given that the East Asian region is becoming the motor of growth for the world economy, it is clear that the movement toward regionalization in East Asia will significantly influence the reshaping global economic and monetary order.
- This paper intends to shed a light on the possible future evolution of economic integration in East Asia.
- There are many studies addressing this issue from different national perspectives (Chia 2007 for ASEAN perspective, Munakata 2002 for Japanese view, Bergten 2007 and Martin 2007 for US view), but only a few of them deal with the Korean perspective.
- This paper tries to add to the Korean view, focusing on the following three questions

- First, this paper asks about how much market driven regionalization was achieved in East Asia and what the final goal of regionalization in East Asia will be.
- This paper argues that economic integration in Asia will encompass both regional and global integration and as a result, the intensifying regionalization in East Asia will contribute to globalization.

- Second, this paper looks at the policy-driven regionalization in East Asia.
- The ASEAN+3 framework is a main vehicle for building the regional community. This framework is important, in the sense that unlike APEC, it is a “Asia-only” regional arrangement including the most important +3 countries in East Asia (i.e., China, Japan and Korea).
- However, it is not enough because ASEAN was so far the center.
- A core network among the +3 is a precondition for the successful launch of a regional arrangement in East Asia.

- Third, this paper explores the most desirable strategy for Korea amid the recent regionalization efforts of East Asian countries.
- Korea should take maximum advantage of the two recently agreed FTAs with the US and the EU in the process of building the +3 core framework and develop itself as a gateway to East Asian markets for outside countries such as the US and EU and to global market for East Asian countries.

II. Market Driven Integration

(1) Regionally integrated yet globally connected Asia

- In most East Asian countries, regionalization was a natural response to cope with globalization
- The final destination of regionalization is, as Kuroda, President of ADB, said, to make Asia “regionally integrated yet globally connected ” (Kuroda 2010).
- East Asian countries will not accept a regionalization that will thwart economic globalization.
- This approach is in a sharp contrast with the European strategy of regionalization. In Europe, for example, regionalization once spread the fears on fortress of Europe

(2) Goods, Capital, Labor Markets and Business Cycle Movements

- Trade is inter-regional as well as intra-regional
- Furthermore, the US and the EU are the largest investors to East Asia, which means that the Asian trade structure reflects global as well as regional production sharing.
- Compared to commodity markets, financial markets in East Asia are far more globally integrated.
- Labor mobility measured by the movement of tourists is more global in East Asia than other regions.
- the business cycles of East Asian economies are closely connected with the global economies as well as Asian economies.
- This result suggests again that Asia is “regionally integrated yet globally connected” .

Figure 1: Intra-Regional Trade Share, 1990-2008 (%)

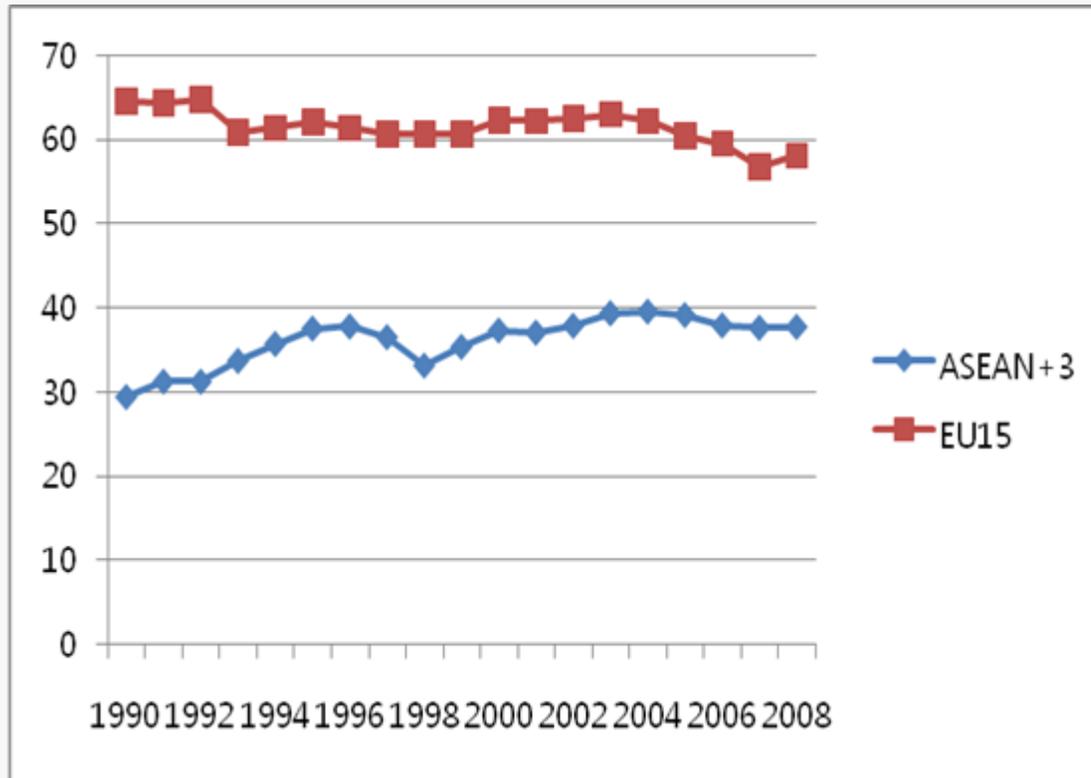


Table 1: Final Import Demand in China and US 2009

		China	US
World	Imports (billion \$)	955	2,171
	Share of final import demand (%)	68.1%	92.7%
	Final import demand (billion \$)	650	1,869
Korea	Imports from (billion \$)	82	46
	Share of final import demand (%)	68.2%	92.8%
	Final import demand (billion \$)	56	43

Figure 4: Intra-Regional Share of Tourism

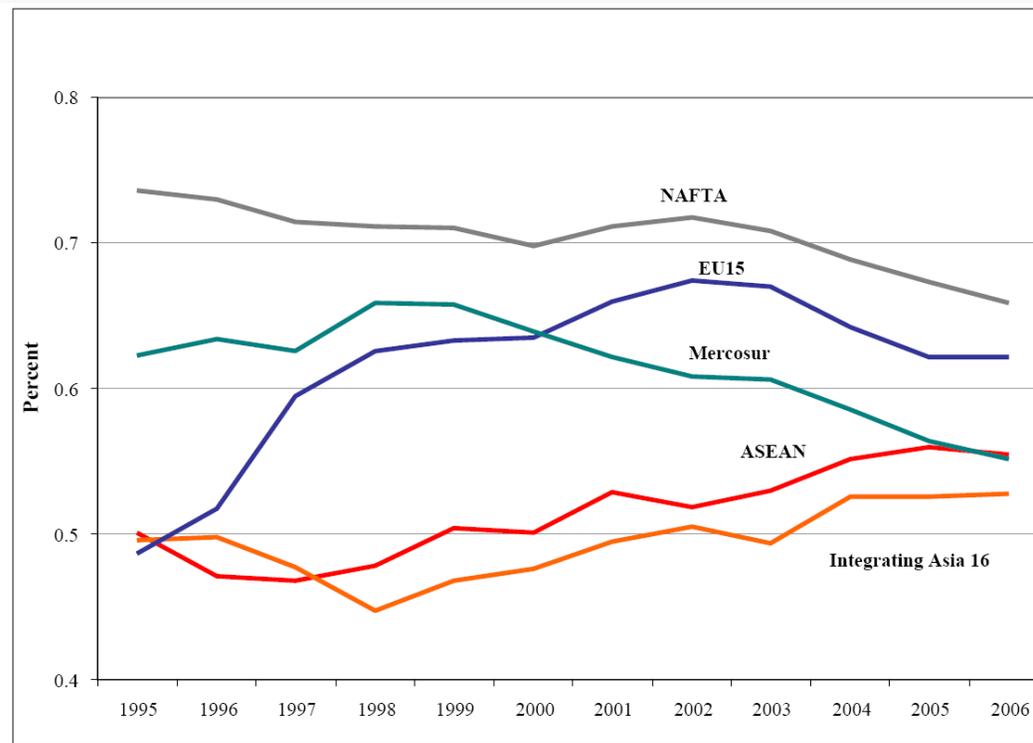


Figure 3 : Intra-Regional Share of Portfolio Inflows 2001-8 (%)

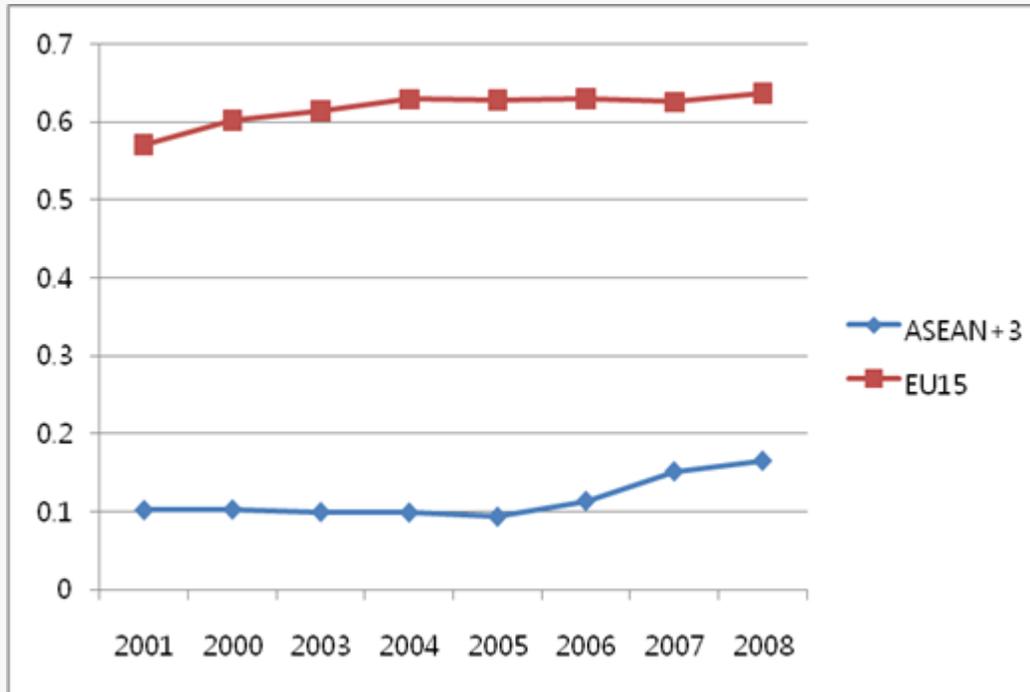


Table 2: Business Cycle Synchronization

	1990-1997			1998-2008		
	US	EU	EA	US	EU	EA
CHN	-0.02	-0.01	0.22	0.42	0.48	0.47
JAP	-0.26	0.5	0.53	0.82	0.84	0.72
KOR	-0.19	0.45	0.44	0.71	0.71	0.69
IDN	0.05	0.1	0.2	0.15	0.16	0.19
MAL	-0.02	0.24	0.45	0.66	0.57	0.79
PHIL	-0.34	0.21	0.29	0.22	0.25	0.29
SGP	-0.01	0.08	0.26	0.48	0.42	0.54
THAI	-0.2	-0.38	0.05	0.62	0.64	0.67
TWN	0.15	0.28	0.1	0.63	0.64	0.69
US	-	0.09	-0.23	-	0.71	0.83
EU	0.09	-	0.34	0.71	-	0.77

III. Policy Driven Integration

- The fact that East Asian countries pursued regionalization cum globalization might explain the relatively belated reaction in their official and policy-driven regional integration.
- Furthermore, there was an opposition from the US to Asia only regionalism.
- Following the Asian crisis, however, East Asian economies have embarked on various initiatives for establishing regional trade and monetary arrangements. There are two initiatives under way: EAFTA and AMF.

(1) East Asian Free Trade Area (EAFTA)

- There have been continuing calls for establishing FTA in East Asia, ever since the prime Minister of Malaysia Mahatir proposed the formation of East Asian Economic Caucus (EAEC) in 1990. This proposal could not be realized, however, because of the US opposition.
- The first official step toward forming an East Asian Free Trade Area started with the convening of ASEAN+3 Summit in 2000 and the development of the ASEAN+3 framework as a main vehicle for building an economic community in East Asia.
- The ASEAN+3 summit decided to create the East Asian Vision Group to explore “East Asian Community”. The East Asian Vision Group (EAVG) in 2001 recommended the formation of an East Asia Free Trade Area.

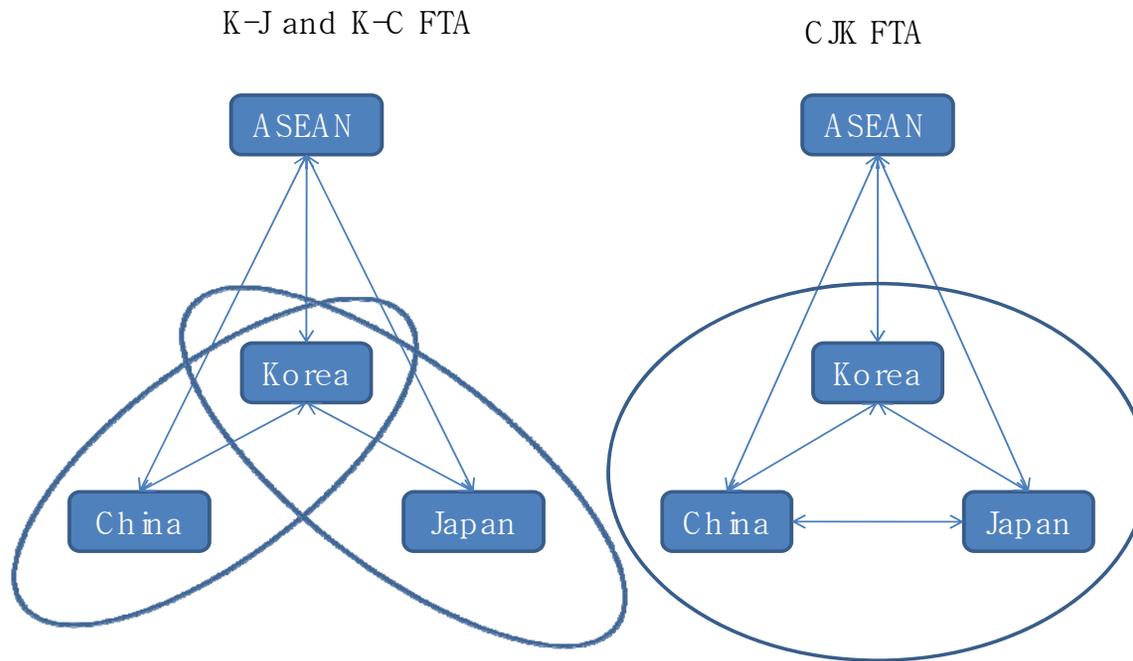
- Two facts are noteworthy.
- While the feasibility of East Asian FTA was still being studied, there was a proliferation of bilateral FTAs in East Asia and these FTAs are both for intra-regional and extra regional.
- Second, there is no region-wide multi-lateral FTA in Asia yet but the so called spaghetti bowl FTAs are leading to the creation of a de facto region-wide FTA through networking.
- The +3 countries had already an FTA with ASEAN, and thus if these +3 are linked with each other through the FTA, all countries in East Asia will be linked, which will be translated into an East Asian FTA.

Table 3: Status of FTAs of Korea, Japan and China (As of June, 2010)

		Within the region	Outside of Region
Korea	Concluded	Singapore ASEAN (for Goods, for Services and for investment)	Chile, EFTA, US, EU, India, Peru
	Under negotiation	Japan China	Canada, Mexico, GCC, Australia, New Zealand
Japan	Concluded	Malaysia, Singapore, Thailand , Indonesia, Brunei, ASEAN, Philippines, Vietnam	Mexico, Chile, Switzerland
	Under negotiation	Korea	GCC, India, Australia, Peru
China	Concluded	ASEAN(for Goods and Services) Hong Kong, Macau, Singapore	Chile, Pakistan, New Zealand
	Under negotiation	Korea	Australia, GCC, Iceland, Norway, South Africa

- There are currently two approaches in action.
- One is bilateral, linking Korea-Japan FTA with Korea-China FTA as a first step and to move to Japan-China FTA.
- The other is multilateral, leading to China-Japan-Korea FTA (CJK FTA).

Figure 5: Two Possible Scenarios for EAFTA



(2) Asian Monetary Fund (AMF)

- Compared to trade and investment arrangements, regional arrangements in the area of money and finance were more advanced.
- The first idea came out of the need to support Asian countries in crisis and to this end the Japanese Ministry of Finance proposed to create an AMF in September 1997. But this notion faced strong opposition from the US government on the grounds that the AMF was a duplication of IMF and would only exacerbate the moral hazard behavior of borrowing countries.
- In 2001, leaders of ASEAN+3 met together at Chiang Mai, Thailand and they agreed to create a set of bilateral swap arrangements (BSAs).

- The initiative called CMI was undeniably an important step in establishing a regional monetary cooperation.
- There were continuous efforts to expand the size of the CMI and multi-lateralize the CMI into the CMIM.
- Then in 2010, the total size of the CMIM was again extended to US\$120 billion and the existing multiple BSAs were replaced by a single contractual self-managed reserve pool agreement.
- Furthermore, ASEAN+3 agreed to establish an ASEAN+3 Macroeconomic Research Office (AMRO) in Singapore to conduct an effective surveillance and monitoring of member states' economies.
- In a sense, the CMIM is heading towards AMF, with further institutionalized structure combined with independent surveillance unit.

Table 2. CMIM Financial Contributions, Borrowing Agreements, and Voting Power

	Financial Contributions		Borrowing Agreements			Voting power			
	\$Billion	Share (%)	Multiplier	Maximum Swap Amount (\$Billion)	IMF De-linked Portion (\$Billion)	No. of Basic Votes	No. of Votes Based on Contributions	Total No. of Votes	Share (%)
Members									
Plus Three Countries	96.00	(80.00)	0.69*	57.6	13.20	4.8	96.0	100.8	(71.59)
PRC and HKG	38.40	(32.00)	0.72*	19.2	5.52	1.6	38.4	40.0	(28.41)
<i>PRC</i>	<i>34.20</i>	<i>(28.50)</i>	0.50	17.1	3.42	1.6	34.2	35.8	(25.43)
<i>Hong Kong, China</i>	<i>4.20</i>	<i>(3.50)</i>	2.50*	2.1	2.10	0.0	4.2	4.2	(2.98)
Japan	38.40	(32.00)	0.50	19.2	3.84	1.6	38.4	40.0	(28.41)
Republic of Korea	19.20	(16.00)	1.00	19.2	3.84	1.6	19.2	20.8	(14.77)
ASEAN	24.00	(20.00)	2.63	63.1	12.62	16.0	24.0	40.0	(28.41)
Brunei Darussalam	0.03	(0.03)	5.00	0.2	0.03	1.6	0.0	1.6	(1.16)
Cambodia	0.12	(0.10)	5.00	0.6	0.12	1.6	0.1	1.7	(1.22)
Indonesia	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Lao PDR	0.03	(0.03)	5.00	0.2	0.03	1.6	0.0	1.6	(1.16)
Malaysia	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Myanmar	0.06	(0.05)	5.00	0.3	0.06	1.6	0.1	1.7	(1.18)
Philippines	3.68	(3.07)	2.50	9.2	1.84	1.6	3.7	5.3	(3.75)
Singapore	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Thailand	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Viet Nam	1.00	(0.83)	5.00	5.0	1.00	1.6	1.0	2.6	(1.85)
ASEAN+3	120.00	(100.00)	1.16*	120.7	25.82	20.8	120.0	140.8	(100.00)

Note: *Hong Kong, China's borrowing is limited to the IMF de-linked portion because Hong Kong, China is not a member of the IMF.

Source: The Joint Media Statement of the 12th ASEAN+3 Finance Ministers' Meeting, 3 May 2009, Bali, Indonesia.

- Although the CMIM could be developed into an AMF, it is most likely that the CMIM would not be self-sufficient to protect Asian countries.
- The amount of swap is still insufficient and therefore should be supplemented further by both intra and extra-regional institutions.
- There are two possible ways to supplement the regional lender of last resort.
- The first one is to rely on global financial support. Indeed, in the case of global crisis, Korea and Singapore relied on US swap.
- The second option is to conclude a separate swap with Japan and China. For instance, Korea had a swap agreements with Japan and China for US 30 billion dollars.

(2) Challenges for economic integration: ASEAN+3 or 3+ASEAN?

- Despite the quasi-consensus on the ASEAN+3 as the basic framework for any regional institutional arrangements and community buildings in East Asia since the 1997 Asian currency crisis, there has been a continuing debate over the appropriate membership of the region-wide arrangement.
- One reason was the opposition of the US government.
- However, the most serious challenge is coming from the Asian side regarding the issue of leadership competition.

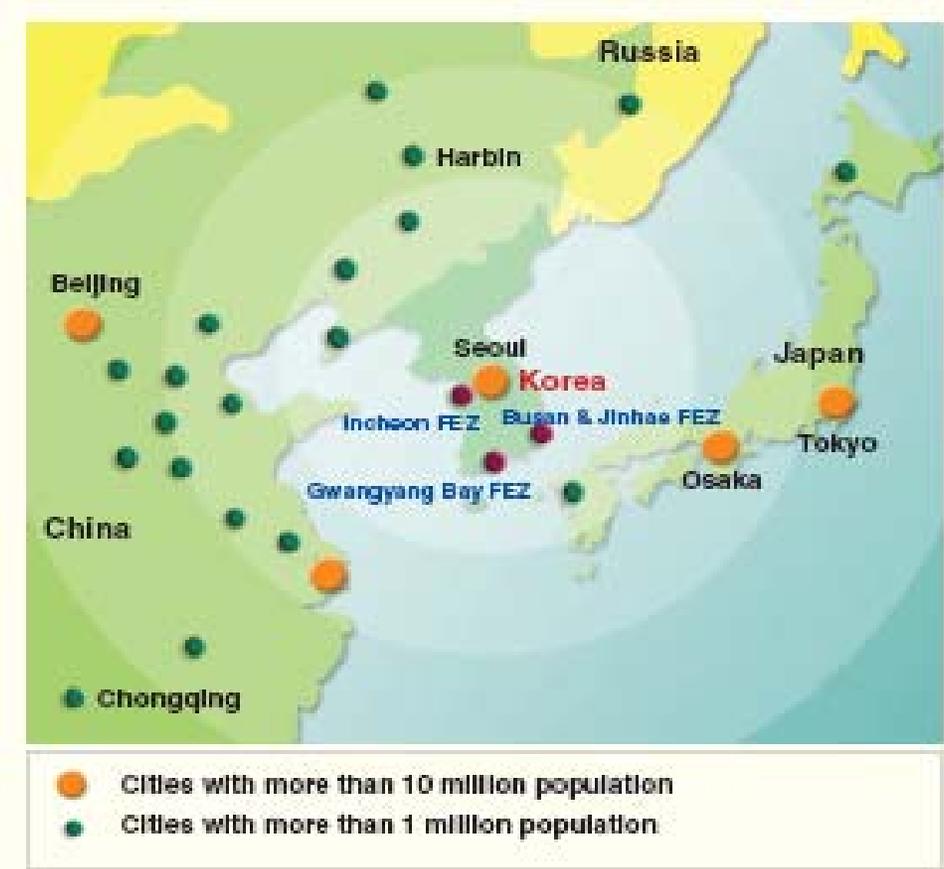
- Currently ASEAN has been and is still the central core of Asian regionalism.
- First of all, ASEAN does not have one voice or entity. The ASEAN is rather a forum for 10 different countries.
- Second and more importantly, ASEAN is an economic dwarf compared to the +3 countries in Northeast Asia. The ASEAN accounts for only 10% of the region's GDP and 20% of the quota for the CMIM, while the +3 represents 90% of the region's GDP and 80% of the CMIM quota. Most of the ASEAN members except for Singapore are also receiving official development assistances from the +3 countries.
- It is needless to say that successful regionalization in East Asia necessitates closer cooperation between the +3 countries, China, Japan and Korea.

- Fortunately, the leaders of the +3 agreed to establish a Secretariat for the efficient promotion and management of trilateral cooperative projects, separately from the ASEAN+3 process.
- This will be the first crucial step towards the institutionalization of the partnership among the +3, which few believed possible.
- And once this secretariat is in operation, the ASEAN secretariat and CJK Secretariat are likely to compete and cooperate to further regional integration in East Asia.

V. Strategy for Korea

- Given the limited role and importance of ASEAN for representing ASEAN+3, it is expected that the future process of regional integration in Asia will be shaped by two core sub-regional networks, ASEAN and +3, and two countries, Singapore for ASEAN and Korea for the +3.
- Korea is already playing a key role as a facilitator of regional integration as well as a sub-regional hub.
- Geographically Korea is in best position as a regional hub in Northeast Asia. Korea sits at the heart of Northeast Asia

Figure 6 Location of Korea



- Korean government tried to develop Korea as a FTA hub in the region and in the world.
- The most important landmark in the trade policy of Korea was the Korea-US FTA negotiations.
- The recent signing of Korea-EU FTA will create a huge opportunity for Korea to take a full advantage of the newly emerging multi-polar system and to develop its economy as a hub for world economy as well as for Asia.
- Korea is the only country in East Asia, capable of concluding FTAs with the US and the EU, given its size, not too big and not too small to fear them.
- For the EU and US, for example, Japanese industry will be too competitive and too large to open its market.
- China is also too big to allow it enter into the US and EU market.

- Korea will be a gateway for European and American companies to penetrate into Japanese and Chinese markets with no tariff. In the same way, Japanese and Chinese companies will have a strong interest to advance into European and American markets through Korea.
- To take advantage of this strategic position of the Korean economy as a gateway, both Asian and Western companies are expected to bring a huge FDI investment into Korea.
- Unlike Singapore, Korea has a good manufacturing base, which means that the rules of origin related to its FTA would strengthen Korea's merit as an FDI destination.

- Korea's strategic importance as a gateway is not fixed and is rather expanding because Korea is also concluding its FTA negotiation with India and ASEAN countries.
- To take a maximum advantage of this position, Korea will have to strengthen its bilateral cooperation with Japan and China and the CJK trilateral cooperation.

Thank you