

## U.S. PERSPECTIVES ON EAST ASIAN ECONOMIC INTEGRATION

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USA is the only major trade power with equal economic stakes in all regions, and will oppose Asian economic integration if it excludes USA. Charts show relatively declining US role, rising China role as key trade partner for Japan, Korea, ASEAN. Responding to China's lead, as in its ASEAN trade deals, and shaped by former USTR Zoellick, there is growing US support for bilateral trade agreements, including Korea-US FTA, though most economists oppose bilateral/regional approach as inconsistent with the WTO-multilateral trade format. From US perspective, the prognosis for East Asian economic integration is not good.

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### 1

This paper on American attitudes and policies toward East Asian economic integration is a slightly revised and updated version of the original, which was presented in Seoul in October 2005. At that time the issue was already emerging as an important one in American discourse, and since then a number of related steps have taken place that impact on the issue. Among the most notable are the now-ongoing talks between the United States and Korea that aim to formalize a bilateral US-Korea "Free Trade Agreement." But even in the Autumn of 2005 three developments had recently taken place that bore on the issue of East Asian economic integration, and those developments set the context for this discussion.

The first was a long essay published in the *Wall Street Journal* on September 15, 2005. It was co-authored by Charlene Barshefsky, the United States Trade Representative in the second Clinton Administration. Its title was "Revolutionary China, Complacent America," and it began with a warning that China "is rapidly creating an informal 'Asian Union' - a deeply integrated Asian economy." The essay made a number of suggestions for a US policy response to this development, and among them was this:

*"Regardless of the outcome of the WTO's Doha Round, ambitious*

*agreements should be negotiated with the major Asean countries, South Korea, and Japan.”<sup>1</sup>*

The second development came the same week. It was a report suggesting that one of the Barshefsky recommendations was already being acted on. According to a front-page report in the 14 September *Financial Times*:

*US and South Korean officials are holding preparatory talks on a bilateral trade agreement, potentially paving the way for President...Bush to launch formal negotiations when he visits [Seoul] in November.<sup>2</sup>*

In the same vein and on the same day, Australia’s Foreign Minister reportedly made these comments while in London:

*“an embryonic Asian regional bloc could develop by 2020 into a ‘free trade area’ stretching from India to New Zealand.”<sup>3</sup>*

Not surprisingly, these recommendations for new bilateral or regional trade agreements brought quick reactions. Some expressed outright opposition to the concept, others reflected doubts and cautions, and some sought simply to explain what appeared to be the sudden eruption of these trade-related steps. For example, Marcus Noland, a well-known Korea-watcher at the Institute of International Economics in Washington, looked at why Washington and Seoul were then holding preliminary talks aiming at a bilateral trade pact. In his view, they indicated that the US was now worried it might be left out of the developing agreements:

*The [Bush] administration must be concerned that East Asia in general, and north-east Asia in particular, will develop in a way that excludes the US.<sup>4</sup>*

The third development in this string of events was a particularly strong condemnation of all such bilateral and regional trade agreements, especially those aiming at an East Asian “economic union.” It came in the form of a top-of-the-page editorial in the *Financial Times*, presumably prepared by Martin Wolf, its senior economics writer and a widely-respected trade authority. Aptly titled “Undermining the Doha Round,” the editorial roundly criticized the growing Asian propensity to negotiate

<sup>1</sup> *Wall Street Journal*, 15 September, 2005. Emphasis added.

<sup>2</sup> “Washington and Seoul hold preliminary bilateral trade talks ahead of Bush visit,” *Financial Times*, 14 September, 2005. Emphasis added.

<sup>3</sup> “New Asia grouping aims for free trade by 2020,” *Financial Times*, 14 September, 2005.

<sup>4</sup> *Ibid.*

bilateral deals that “do little to open markets” (Japan’s in particular were singled out), and it then took aim at the entire regional concept. In a clear reference to the classic debate about whether such arrangements are “building blocks or stumbling blocks,” the editorial concluded that “*claims that they lower barriers faster than trade rounds are fanciful.*”<sup>5</sup>

Based on that analysis, the editorial then identified three warnings about the current proliferation of bilateral and regional trade deals:

- today’s “stampede to conclude bilateral deals,” with their “burdensome rules of origin for exports, raise new barriers to trade”;
- the *timing* of the Washington-Seoul talks “could hardly be worse” since they would immediately precede December’s WTO “make or break meeting”;
- regional/bilateral arrangements are an “ominous” threat to the WTO because they erode each nation’s “incentive to support global liberalisation [and] “*risk balkanizing the global economy.*”

## 2

Those generally critical judgements have much support among economists and other specialists. For example, in 2003 *The World Economy* published a major study of East Asian trade arrangements, and its two main findings are worth repeating here:

*The overriding conclusion ...is that multilateral trade liberalisation has positive and often sizeable impacts on economic welfare in all of the industrialised and developing countries/regions... A second conclusion is that while regional and bilateral FTAs may be welfare enhancing for the member countries directly involved, these welfare gains are considerably smaller than those resulting from multilateral trade liberalisation...It is also the case that the regional and bilateral FTAs involve elements of trade diversion and are therefore detrimental to some non-member countries.*<sup>6</sup>

Most economists would concur, but there are exceptions, and some have reached favorable conclusions about regional and bilateral FTAs. Indeed a recent article by two Korean specialists, also in *The World Economy*, argued that “an East Asian FTA will likely be a building block for a global FTA.”<sup>7</sup> Yet even that favorable judgement was

<sup>5</sup>“Undermining the Doha Round,” *Financial Times* (editorial), 16 September, 2005. My emphasis.

<sup>6</sup> D. Brown, A. Deardoff, and R. Stern, “Multilateral, Regional and Bilateral Trade Policy Options for the United States and Japan,” *The World Economy*, Vol.26, No.6, June, 2003, p. 803-828. My emphasis.

<sup>7</sup>Jong-Wha Lee and Innwon Park in “Free Trade Areas in East Asia: Discriminatory or Non-Discriminatory,” *The World Economy*, Vol.28, No.1, January 2005, p. 21-48.

immediately followed by a qualification that put the FTA concept into a much broader context. An East Asian FTA, the authors wrote, would be a building bloc “*if it takes the form of deeper integration...with ...APEC and the WTO.*” That qualification of course begs the question of what “greater integration” with the WTO might actually mean in practice. Moreover, the authors’ acknowledged uncertainty about whether “integration” would take place is a good reminder that the word “*if*” is the most powerful word in the English language.

Perhaps even more troubling was the same study’s conclusion that “if the major three East Asian countries successfully expand it into an...arrangement leading to the East Asian FTA...we *anticipate a tripolar system...consisting of the American FTA, the European FTA and the East Asian FTA.*” That statement has powerful strategic implications that would affect not only the United States, but the other main economic and political actors in East Asia and beyond. Those implications are beyond the scope of this paper, but should not be ignored. Suffice to say here that the idea of a “tripolar system” – in other words a *three-bloc world* – is one of the major economic and strategic outcomes most steadfastly warned against by regionalism’s’ critics.

These comments reflect several major themes in today’s US debate on issues both of regional/bilateral trade agreements, and the broader topic of East Asian economic integration. On one side of the debate are the great majority of economists, as well as foreign policy specialists, all of whom oppose most or all regional and bilateral trade arrangements. Among economists, an early and leading voice has been the highly-regarded Professor Jagdish Bhagwati of Columbia University. His work has repeatedly found that so-called “Free Trade Areas” are a decidedly negative development, and among his reasons are these:

- they are trade-diverting;
- they are bad for business because in practice they require impossibly complex “rules of origin”;
- they subtract scarce resources and energies from the broader and more important goal of multilateral trade negotiations;
- they should in reality be called PTA’s, i.e., “preferential trade areas.”<sup>8</sup>

Yet despite that background, during the past decade American trade policy has nevertheless emphasized bilateral and regional arrangements, and a sizeable number already have been negotiated and approved. In July 2005, for example, the US Senate approved and the President signed “CAFTA,” the Central American Free Trade

<sup>8</sup> An early example of his views is Jagdish Bhagwati, “The Threats to the World Trading System,” *World Economy*, July, 1992, vol. 15, No.4. Indeed the “spaghetti bowl effect” - the label now widely used to warn against all such trade deals - originated with Bhagwati. He joined with another prominent economist, Anne O. Krueger, in *The Dangerous Drift to Preferential Trade Agreements*, AEI Press, 1995.

Agreement.<sup>9</sup> That agreement followed trade deals the US had signed with Chile, Singapore, Australia, steps that were soon followed with new FTA talks with small economies in the Middle East, most recently with Bahrain.

In the same period, the United States began preliminary FTA talks both with Thailand and Korea. The Thai discussions initially were expected to produce an agreement by early 2006, but were interrupted by a political upheaval in Bangkok in mid-2006. The result is that Washington's discussions with Bangkok were on hold at the end of 2006. The FTA talks with Korea have continued throughout the second half of 2006, and have been accompanied by numerous reports of difficulties emanating from both sides.

Each believes the other is making unreasonable demands, and at the time of this writing, at the end of 2006, the prognosis for success is not good. This paper is not the place to explore the Korea-US FTA issue in detail, but it is worth noting that each side is insisting on provisions the other regards as "deal breakers." On the Korean side there is a concern to protect not only agricultural goods, but to insulate aspects of Korea's economy from America's advanced service industries. And on the US side, there is something approaching disbelief that Korea seeks to include products of the Kaesong Industrial Park (located in North Korea) within the framework of the bilateral US-South Korea Free Trade Area. Likewise, the American negotiators have aimed to "open up" Korea's internal automotive market, so far with little evident success.

Each of those bilateral FTA talks have come, moreover, against the background of two potentially much larger developments. The first was a Latin American-US effort known as "FTAA," the "Free Trade Area of the Americas." The second and even broader concept was revived by President Bush at the APEC meetings in Vietnam, in November 2006. This current initiative is known as the "Free Trade Area of Asia and the Pacific," or FTAAP. It would seek to link the economies of all 21 APEC states, on both sides of the Pacific Ocean.<sup>10</sup>

The FTAA concept has a relatively long history in US policy, although its progress is now stalled (some would say it is comatose) as a result of Brazil's strong opposition. Even so, the idea of a continent-wide free trade area - one that would reach from Alaska to Chile - continues to appeal to many Americans and has had strong bipartisan support. The FTAA idea was formally begun in the administration of President Clinton in the 1990s, and was adopted enthusiastically in the administration of President George W. Bush. It was given particular emphasis by the President's first-term Trade Representative, Robert Zoellick. He later became America's Deputy Secretary of State, and after a short tenure in that office left government, but his role in recent US trade policy deserves special mention.

<sup>9</sup>For a critical view, see Bernard K Gordon, "CAFTA's False Advertising," *Wall Street Journal*, 1 August 2005.

<sup>10</sup>See Bernard K. Gordon, "Asia's Trade Blocks," *Asian Wall Street Journal*, 17 November, 2006

Robert Zoellick was widely respected for his high intelligence and energy level, as well as his appreciation of Congress' Constitutional prerogatives and sensitivities on trade issues. His earlier US government experience was in the State Department, where he was a close associate of then Secretary of State James Baker III - a fact worth mentioning because in the context of the earlier GATT - Uruguay Round, Zoellick learned from Baker a method to accelerate those trade talks.

The method, in sum, was to hold out the prospect - some would say the threat - that the United States might negotiate separate bilateral trade arrangements if the slow-moving GATT talks did not move more quickly. The method's aim was to induce the world's major trade actors, especially Europe and Japan, to complete the broader and multilateral agenda of the World Trade Organization. There is no secret about the purpose of this strategy, which in the GATT period was successful and has often been publicly discussed. In a letter to me in late 2001, Mr. Zoellick pencilled in these points:

*I believe a strategy of trade liberalization on multiple fronts - globally, regionally and bilaterally - enhances our leverage and best promotes open markets. As Europeans have pointed out to me, it took the completion of NAFTA and the first APEC Summit in 1993-94 to persuade the EU to close out the Uruguay Round. I favor a "competition in liberalization" with the U.S. at the center of the network.<sup>11</sup>*

Mr. Zoellick was exactly correct in his description of events in the early 1990s, when GATT was notoriously in trouble, and when Lester Thurow of MIT coined the phrase "GATT is dead."

But Zoellick over-learned the lesson, and some results have been troubling. Primary among them is that America's turn toward regionalism encouraged many other nations to negotiate their own FTAs, and in the context of this discussion, that consequence has been most evident in East Asia. At the same time, America's effort to kick-start the global process by promoting various bilateral arrangements appears not to have worked.

For several reasons, American threats to build bilateral and regional "free trade areas" carry less weight than in the GATT years. Among them is the far larger size of the WTO as compared with GATT, as well as a widespread post-cold war willingness to resist American-led demands, both in the trade sphere and others. In any case, Zoellick's approach - he once wrote that "The Bush administration has completed FTAs with 12 countries, is negotiating with 10 others, and is *preparing for more*" - recalls the German folk-tale *The Sorcerer's Apprentice*.

In that tale, the apprentice learned enough magic to do his job automatically, but *not* enough to end the spell - and was unable to stop producing multiple brooms. And like those magical brooms, FTAs are now madly multiplying and do more harm than good.

<sup>11</sup> Letter to the author, 26 October, 2001. Emphasis added.

Zoellick himself gave the reason when he wrote that “integrating trade and foreign policy must be part of America’s strategy,” but in fact America’s proliferating FTA policy has simultaneously undermined American strategic interests, and sometimes those of friendly states.

Australia’s former Ambassador to China, for example, calls them “an abomination,” and in the past two years, as I will show now, the growing problems for the United States arising from bilateralism and regionalism have begun to gain high-level concern and attention among Americans. A good example was the important essay by James W. Hoge, Jr, the Editor of *Foreign Affairs*, which appeared in the Summer, 2004 issue. Accurately-titled “A Global Power Shift in the Making,” it warned that in the light of tightening economic ties in East Asia, Americans “risk being left out of future trade arrangements”:

“Southeast Asian states are steadily integrating their economies into a large web through trade and investment treaties. *Unlike in the past, however, China - not Japan or the United States - is at the hub.*”<sup>12</sup>

In the same month Kurt Campbell, a former Deputy Assistant Secretary of Defense, issued a similar wake-up call: “Multilateral regional formations are proliferating with China rather than the US as the hub, *sometimes without America even in attendance.*”<sup>13</sup>

Another warning came in May 2005, from Richard Armitage, who had recently retired as America’s Deputy Secretary of State. He spoke in Tokyo about recent proposals for an “East Asian Community,” and he characterized them as “a thinly veiled way to make the point that the United States is not totally welcomed in Asia. I think that’s a real mistake.” Armitage added that while the proposed Asian “community” would not undermine America’s bilateral security structures, “it’s the direction...the beginning of an erosion...China is quite willing to be involved in *fora* that don’t include the United States.”<sup>14</sup>

All these signs point to a rising American apprehension that the United States is in danger of being “left out” of important Asian developments - developments that impinge directly on permanent and vital concerns and interests of the United States. After all, in geographic terms alone the United States is as much a Pacific-region nation as Korea, Japan and China. America’s Pacific coastline, even without Alaska, is nearly the length of China’s, and two of its Pacific-coast states - Washington and especially California - are world-class economic powerhouses. As Californians often remind other Americans,

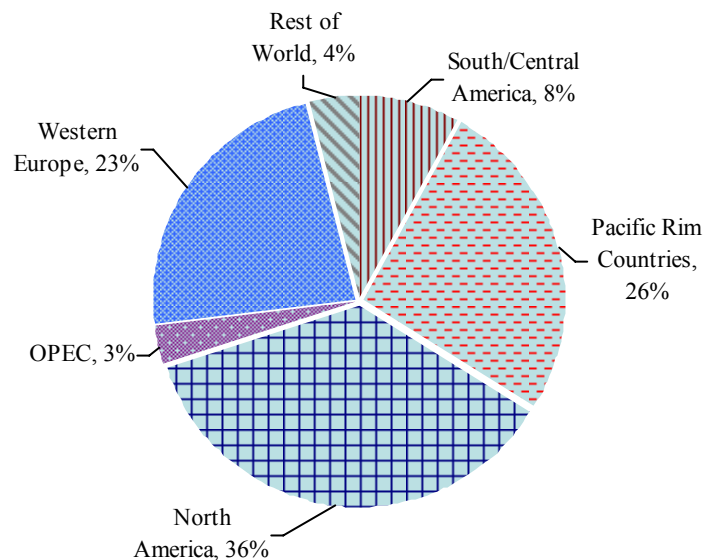
<sup>12</sup> James F. Hoge, Jr. “A Global Power Shift in the Making,” *Foreign Affairs*, July-August 2004. My emphasis.

<sup>13</sup> Kurt Campbell, “The US Turns its Gaze from Asia at its Peril,” *Financial Times*, 22 June, 2004. My emphasis.

<sup>14</sup> Quoted in *Asahi Shimbun*, 2 May 2005.

if their state were one of the world's independent nations, its economy in 2004 would rank it in *sixth* place - ahead of both Italy and China!

Another way to recognize the full economic importance to the United States of the Asia-Pacific region is to recall the global distribution of America's exports. Figure 1 illustrates that distribution in 2004; it shows that the Pacific region accounts for *more than a quarter of US total merchandise exports*. The illustration also shows that a slightly higher proportion - roughly one-third-goes to America's immediate neighbors on the North American continent, i.e., Canada and Mexico. The Western European share - at 23 percent - is consistently *smaller* than the 26 percent of US exports directed to the Pacific Region. Overall, the shares of US exports sent to the world's *three main economic regions remains remarkably even*, and that global distribution is absolutely unique to the United States. It is the crucial underpinning for America's also - unique *tripolar* strategic investment, and underscores the enduring importance to all Americans of their nation's vital political and strategic involvement in the Asia-Pacific region.



Source: US Commerce Department, Census Bureau, Exhibit #13, FTD Final Revisions 2004

**Figure 1.** Global Shares of US Merchandise Exports in 2004; Total=\$807.5 Billion

Those roughly equal export shares, especially in the context of East Asia's tightening economic ties, underline another reason why America's policy of promoting FTAs has been questioned. Indeed after Mr. Zoellick left government service, there was evidence



suggesting that his immediate successor, Robert Portman, had begun to alter the policy. One press account wrote that Portman had “dropped Mr. Zoellick’s formula of ‘competitive liberalisation’ - in which *bilateral and regional trade deals* were seen as pressing countries to make concessions in the Doha talks....<sup>15</sup>

At least two tactical factors, in addition to broad political and strategic considerations that have long argued against a bilateral/regional approach, would support such a policy shift. The first is a recognition that for American business the actual gains from the FTA agreements have been quite small. The second, according to a close Washington observer of US trade policy-making, is that the sheer number of bilateral negotiations “has exhausted the USTR staff.”<sup>16</sup>

Yet even the hint of FTA fatigue brought quick rejoinders, which illustrate once again the vitality of the debate between those favoring the bilateral/regional approach and those who believe it is not in America’s interest. No less than Fred Bergsten, one of the best-known American voices on international trade, quickly and flatly rejected the Financial Times view that bilateral or regional deals “will undermine Doha and the WTO”:

*to the contrary; such deals generate ‘competitive liberalisation’ that persuades excluded countries to overcome their reluctance to reduce barriers on a broader scale in order to minimise the new discrimination against them...Such dynamics are particularly likely when the preferential pacts are between leading countries, such as the proposed new agreement between the US and Korea...*<sup>17</sup>

Clearly, Mr. Bergsten had adopted the “competitive liberalization” mantra from the Zoellick policy manual, and despite his departure supporters of Zoellick’s regional and bilateral posture are not prepared to go quietly. A prime format in which it might be maintained is APEC, and several factors - despite APEC’s very low profile in recent years - seemed to commend it for heightened US attention. One factor was that President Bush planned and in fact did attend the November 2005 APEC summit in Busan, Korea. Another is that just before coming to Korea for that APEC event Mr. Bush also met in Japan with then-Prime Minister Koizumi.

This convergence of events began to put APEC at center stage among the region’s principal leaders, a development that, in 2005, seemed to present a potential opportunity

<sup>15</sup>“Portman opts for the power of persuasion,” *Financial Times*, 16 September 2005. My emphasis.

<sup>16</sup> Personal communication to this author, 22 September, 2005. This observer added that negotiations toward the proposed Andean agreement will likely continue, partly because its proposed members are tied to the drug war, while the agreement with Thailand, as already suggested, may be too far along to bring it to a halt.

<sup>17</sup> Bergsten letter to the *Financial Times*, 23 September, 2005. His letter also stressed one of his long-standing arguments: that “growing current account imbalances,” specifically dollar overvaluation, are the root cause of what he regards as rising American protectionism.

for a Korean-US initiative to re-energize APEC. After all, Korea was involved in APEC's early stages and has long been a particularly strong APEC supporter.<sup>18</sup> Beyond that of course a major APEC asset is that it incorporates all the Asia-Pacific economies, as well as some (Chile, Mexico, and Peru), not normally thought of in that context. The result was that the next phase in US trade policy seemed to portend a "choice" between APEC and the WTO. That possibility was furthered when, at APEC's 2006 meetings, the US requested that the FTAAP proposal be put on its agenda.

Conversely, of course, from a global and long-term US trade perspective, these events also represented a perhaps final opportunity to give the troubled WTO Doha Round a massive push forward. At the time of this writing in late 2006, when Susan Schwab became the new US Trade Representative, successful completion of the Doha Round appeared still to be the main US objective. Yet it must be said that the clarity of that objective was clouded by America's continued stress on bilateral FTA's, with signings in the Middle East, and with the talks with both Thailand and Korea that have already been mentioned.

## 4

In whatever way these developments proceed, they come against the background of the developing new effort to establish an Asian "economic community." That new arrangement, known informally as "ASEAN+6," was designed to include all the relevant players *except* the United States (and Canada). It also meant expanding to something much broader the existing "ASEAN+3," which brought ASEAN together with Japan, Korea, and China. The proposed new and broader arrangement was scheduled to be formalized in Kuala Lumpur in December, 2005. Its advocates proposed broadening the format by adding two nations - Australia and New Zealand - that had long been deliberately excluded from these ASEAN-related steps, and by the further and much more recent addition of India as well.

Those with long memories will recall the similarities between ASEAN+3 and an effort dating from the early 1990s, when former Malaysian Prime Minister Mahathir proposed an "EAEC" - an East Asian Economic Caucus. Because it excluded Australia, New Zealand, and the United States critics quickly labeled it a "Caucus without Caucasians." More importantly, it was strongly resisted by former US Secretary of State James Baker III, who warned it would "draw a line down the Pacific." Yet that is precisely what seemed to be taking shape in late 2005: a major new effort to achieve "East Asian Economic Integration" in a format that notably excludes the United States.

<sup>18</sup> For both Korean and US policies toward APEC in its relatively early stages see Il Sakong and Taeho Bark, "Korean-U.S. Economic Relations under the New Global Order," Chapter 5 in Claude Barfield (ed.), *Expanding U.S.-Asian Trade and Investment* (The AEI Press, 1997).

If successful, it would set apart two of the region's economies - Japan and Korea - from the nation that has been not only their principal security guarantor for 50 years but also for many years their largest market.

The United States remains both a key market and supplier for East Asia's economies, but as the following illustrations demonstrate, for several of the region's economies the US is no longer the prime factor. In the case of Korea, America's role has been supplanted by trade with China, and as both Figure 2 and Figure 3 show, the shift is very recent and also quite dramatic.

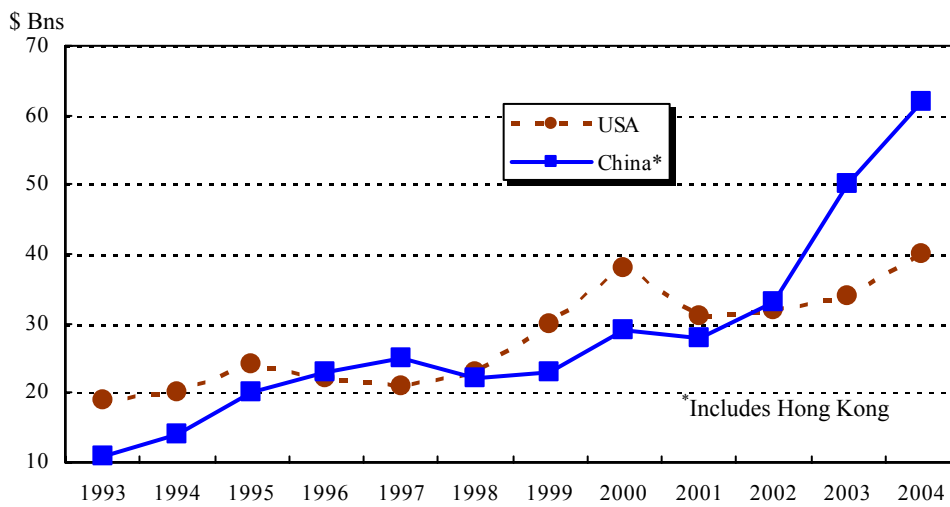


Figure 2. Korea's Exports to USA & China\*, 1993-2004 (\$Bns)

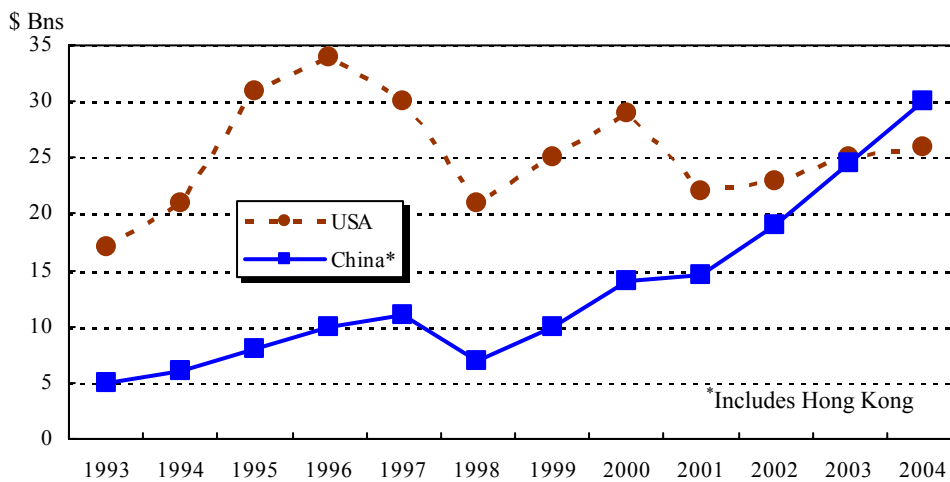
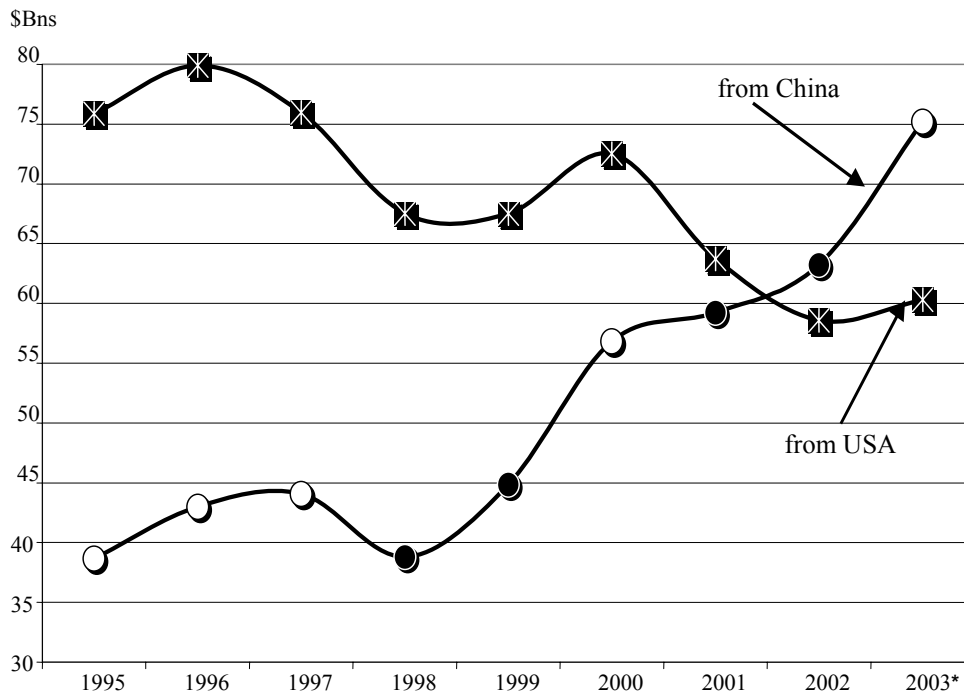


Figure 3. Korea's Imports from USA & China\*, 1993-2004 (\$Bns)

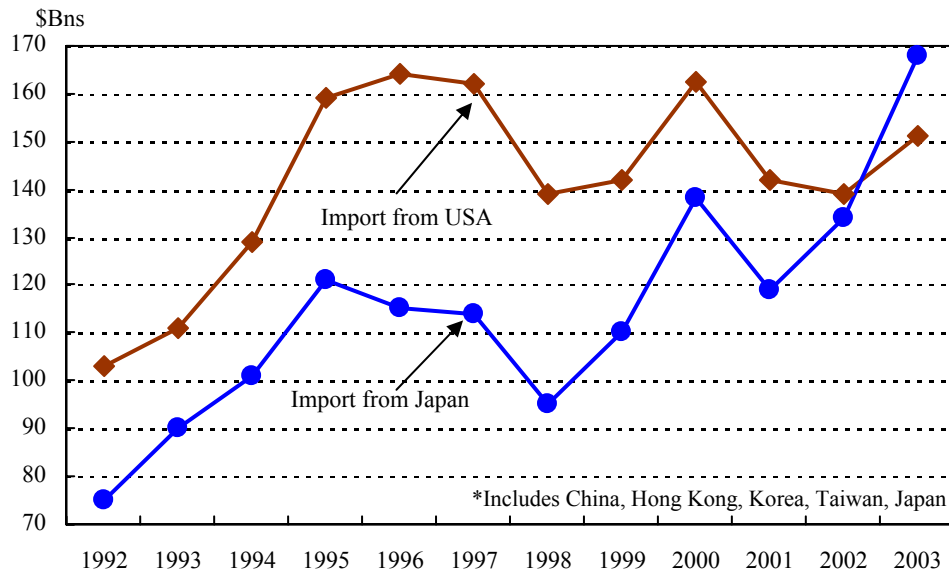
Japan's trade shows a quite similar pattern, and a truly striking reversal of fortune is illustrated in the next chart (Figure 4). As recently as 1995 Japan's imports from the US were almost \$40 billion *larger* than from China, but in 2003 roughly \$15 billion *more* came from *China*.



Source: Data in IMF, Direction of Trade Statistics, Annual issue; 2003 data from Statistical Handbook of Japan

**Figure 4.** Japan's Imports from USA & China, 1995-2003 (\$Bns)

Much the same change is evident when we construct a region we'll call "Northeast Asia" (China, Hong Kong, Taiwan, Korea, and Japan). It is Asia's most vibrant economic sub-region, and a comparison of its imports from the US and Japan shows that as recently as 1995 they were \$30 billion *larger from the US* than from Japan. By 2002, however, imports of "Northeast Asia" from the US and Japan were almost identical, and as Figure 5 shows, by 2003 Japan had become Northeast Asia's principal supplier.



Source: IMF, Direction of Trade Statistics, Annual Issues

**Figure 5.** Imports of “Northeast Asia”\* from USA & Japan, 1992-2003 \$Bns

US and Chinese trade with ASEAN shows similar trends. From 1993-2002 US exports to ASEAN rose from \$28 billion to \$45 billion - a 46% increase - but China’s grew from \$12 billion to more than \$31 billion: a 150% increase. Recent US and Chinese imports from ASEAN’s largest economies adds more evidence that is troubling from a US perspective. In 2001-03, Malaysia, Thailand and Singapore each doubled their China exports (to \$14 billion, \$9 billion, and \$10 billion), but to the US they either declined or were at best stagnant.

These new trade patterns are the background for today’s revival of earlier calls and proposals for an Asian economic “Community.” But in past years the concept had little rationale in the region’s economy. It lacked a heavyweight - other than Japan - which was not much interested, and the region’s interactions were mainly with the US. None of that now applies, and an “East Asian Economic Community” is now pressed not only by relatively small states, but more importantly by China, Korea, and in different ways by Japan too.

The current revival of the concept dates from 2002, when China and ASEAN began talks on a “free trade” accord, a step that was followed by China’s call for a “China-ASEAN” FTA within ten years. Beijing has continued to move that process along, as with its “early harvest” tariff-reduction steps, and in 2004 there were further reductions, including large exceptions for ASEAN’s “sensitive sectors.” In sum, a China-led process of economic integration with ASEAN began to accelerate, and in

2004 Beijing proposed a further step that a generation ago would have alarmed Asia's other capitals. Beijing exhorted representatives of Asia's 20 million "overseas Chinese"-the "Nanyang" community long held at arms length and in some cases feared - to now "play a positive role in enhancing the good neighborly friendship and political trust between China and...ASEAN."

Other previously unthinkable steps soon followed, including talks among all 13 Asian Foreign and Finance Ministers to create an Asian Bond Market. These and other developments led to the calls to turn the "ASEAN plus Three" framework "into a regular summit of the East Asian Economic Community." A critical step came in July 2004, when ASEAN's leaders met with "the three," i.e., China, Japan, and Korea, and agreed to formally discuss the proposal. That step culminated in December 2005 in Kuala Lumpur, when Australia, New Zealand, and India were also included. And most revealingly, Singapore-with the region's best antennae and closest US ties -endorsed the step. It called for an "historic reconciliation" between China and Japan, because "*The vision is to create an East Asian Community.*"

## 5

All these developments have come in an environment that both reflects and promotes a world of several trade regions. Such a world, which must necessarily have political and strategic overtones, strongly contrasts with the global trade system long championed by the US. That system is the world of GATT and the WTO, whose Article 24 specifically-but also toothlessly-calls for such regional trade arrangements to include "substantially all trade" among the participants. That proviso clearly has not been adhered to, but the reasons are less clear. One explanation (as was also the case with GATT in its final years) is widespread dissatisfaction with the pace of change in the WTO. But no less important is that at crucial decision-times the United States, by errors of omission and commission, helped bring upon itself this troubling state of affairs.

Not that there were no warnings, from voices normally worth listening to. In a recent book I pointed out that in the mid-1990s Ryutaro Hashimoto, then Japan's Finance Minister, had warned Henry Kissinger against precisely the East Asian developments we are witnessing today. Hashimoto told the former Secretary of State that Japan was being pressed to support a Malaysian proposal for a "caucus" of Asian nations, and that it would exclude the United States. When Kissinger asked whether Tokyo would be influenced by American plans to extend NAFTA to South and Central America (the effort that would become the FTAA) Hashimoto answered "Yes, that is what will happen":

*As a member of the cabinet I do not highly regard the Mahathir Plan. But if the United States strengthens its posture towards forming a protectionist bloc by extending NAFTA and closing off South America and North America, then*

*Japan will have to emphasize its position as an Asia-Pacific country. This will inevitably alter the Japan-U.S. relationship...so please do not force us into such a corner.*<sup>19</sup>

A year later Japan's Vice-Minister for Foreign Affairs repeated the warning. As he told a San Francisco business group:

*questions have begun to be asked whether the United States...has shifted its emphasis from a global to a regional approach...Utmost care is necessary in order to prevent regional integration from leading to...trade blocs.*

And In the same period, Kiichi Miyazawa, then Japan's Prime Minister, along with Japan's MITI minister, both underlined the same point. In a meeting with Canadian leaders, Miyazawa urged NAFTA to be careful, because, as he said, Asian nations feared the creation of a "fortress North America." The MITI Minister used "even stronger terms" when he told Carla Hills, the US Trade Representative, of Japan's worries about the direction of US trade policy.<sup>20</sup>

Those worries, along with a growing East Asian sense that the United States had lost touch with important regional developments, soon came to a head. The catalyst was the 1997-98 financial crisis, which had disastrous consequences for the peoples of several East Asian nations. As the crisis was developing, Japan responded with a revival of its long-standing (but never-forgotten) proposal to create an "Asian Monetary Fund" (AMF). That idea was immediately (some would say brutally) torpedoed by the US Treasury Secretary. Washington's view was that the International Monetary Fund, in which the US is the leading stakeholder, should remain the central clearing house for such issues. The full story of the rise and fall of the AMF is well beyond the scope of this paper, but it is important in recent East Asian history because it left behind a sour aftertaste. In Japan it produced considerable bureaucratic resentment against the US, and in several Southeast Asian capitals it left the view that Washington either ignored or was inexcusably slow to respond to the seriousness of the Asian crisis.<sup>21</sup>

Some particularly dark and unsubstantiated reasons were attributed to US behavior; some even charged that the United States had initiated the crisis to benefit American investors. In fact, Washington's behavior was rooted in arcane aspects of its bureaucracy

<sup>19</sup> Hashimoto was Prime Minister from 1996-98; his remarks are in his book *Vision of Japan* (Bestsellers, Tokyo (1994) p. 71). I reported them in *America's Trade Follies: Turning Economic Leadership into Strategic Weakness* (Routledge (2001)).

<sup>20</sup> Remarks of Koji Watanabe, MITI Minister; Koji Kakizawa, Parliamentary Vice Minister for Foreign Affairs; and Prime Minister Kiichi Miyazawa, in Japan Economic Institute, JEI Report No.41B, 30 October, 1992. There is no evidence any of these warnings were heeded.

<sup>21</sup> For some of this story's history and details, see Gordon, *ibid.*, p. 114-126.

and related inter-agency rivalries. Even so, the crisis led to the rise of an Asian view that East and especially Southeast Asia were considered less important to the US than other global regions. The results were still evident two and three years later, as the following plaintive comment from Thailand's Foreign Ministry will show. The background is that in 2000 Bangkok was organizing an international conference to develop methods to avoid a repetition of the 1997-98 events, and a senior official said this about America's response:

*The leaders of eight ASEAN countries have confirmed participation. The Japanese prime minister will attend...EU leaders will...attend [but] I am a bit disappointed with the US participation...The US domestic economy is large and sound, which is probably why it does not attach much importance to participation in international forums.*<sup>22</sup>

Similar comments were repeated in the following years, and came regularly in the context of continuing insistence from Malaysia-but no longer restricted to Kuala Lumpur-that East Asia badly needs its own economic organization. Those voices have spread to other capitals, and while some continued to argue that the US should not be excluded from any new all-Asia format, their voices had only limited effect. Japan, Australia, and Singapore were most active in resisting America's exclusion, but in the run-up to the December 2005 Kuala Lumpur meeting there were reports that both Tokyo and Canberra had not prevailed. Some suggested that Tokyo made an overtly political deal: in exchange for ASEAN's assurance to support Japan's bid for a UN Security Council seat, Tokyo dropped its insistence that the US be allowed to participate in the ASEAN summit. As one commentator put it, "This was a breakthrough that meant the beginning of the end to the deadlock surrounding the summit."<sup>23</sup>

The reasons for the Australian and New Zealand shift are no less cynical, and grow directly from a 30 year-old relic of the cold war: the 1976 ASEAN "Treaty of Amity and Cooperation." The Treaty's roots are even longer: they stem from the non-aligned movement of the 1950s, and from the anti-nuclear movement of the early 1970s. In Indonesia "non-alignment" was a particular point of pride because its formal establishment dates from the 1954 Bandung (Indonesia) Conference. The anti-nuclear cause, which had much global currency at the time, was reflected in a 1971 Malaysian initiative known as "ZOPFAN" (Zone of Peace, Freedom and Neutrality). Further details are altogether beyond the scope of this paper, but the 1976 ASEAN Treaty issue came to a head in 2004-05. The reason was ASEAN's insistence that any state seeking to

<sup>22</sup> Director-General of the Foreign Ministry's Economics Department (Kopsak Chutikul), speaking to the Thai reporters association, in *Siam Rat*, 6 February, 2000, in FBIS, 6 February. My emphasis.

<sup>23</sup> Chen Heng-yu (Professor at Taiwan's National Chengchi University), "Let's Plug Into the Regional Economy," *Taipei Times*, 19 September, 2005.



participate in ASEAN's expanded summit meetings-of the sort projected for December in Kuala Lumpur- must meet three conditions.

The first two are simple and straightforward: the candidate-state must be an ASEAN "dialogue partner," and have substantial relations with the group. Those two requirements were clearly met by the US and several others, but the Treaty's nuclear free-zone provision represented a different sort of hurdle to the US and several of its security partners. That point was made in April 2005, when Australia's Prime Minister, at a joint press conference with his Malaysian counterpart, explained why Australia could not sign on:

*...not out of any disrespect or disagreement with the spirit of that agreement [but] that given its antecedents and given that it was delivered to the world or to the region by a mindset that we've really all moved on from, I didn't think I was appropriate that Australia should sign it.*<sup>24</sup>

Just months later, in July 2005, Prime Minister Howard reportedly again "expressed his disdain for the Treaty as a relic of the Non-Aligned Movement, which was no longer relevant." At the same time however, his Foreign Minister was under evident domestic and foreign pressure to reverse the policy, and sign the Treaty.

*We see the East Asia summit as the birth of a growing East Asia Community, so it makes good sense for...Australia to be involved. And if the price is signing the Treaty of Amity and Cooperation, we'll do that...*<sup>25</sup>

Thus the deed was quickly done. Australia agreed to sign by December 2005, though with the "reservation" that its signature will neither impact on its ANZUS Treaty alliance with the United States, nor impede other Australian concerns and interests. New Zealand had already signed, and the result-since Japan and South Korea have long since acceded to the ASEAN Treaty-is that the United States remained outside the charmed circle of the Kuala Lumpur summit. The fact that Washington did not pay ASEAN's price of admission also meant success for former Malaysian leader Mahathir's long-sought goal of an East Asian community separate from the United States. And in all likelihood, that will mean Washington's exclusion from the developing plans for "East Asian Economic Integration."

That Malaysian-ASEAN insistence is worth special mention, because from the time of ASEAN's creation in 1967, Washington has been highly supportive of the group. Indeed the US was long (and wrongly) thought by some to have privately worked to create ASEAN. In economic terms, moreover, the US is ASEAN's (and Malaysia's)

<sup>24</sup> From the Australian Broadcasting Corporation program "The World Today," 22 July, 2005.

<sup>25</sup> *Ibid.*

largest source of Foreign Direct investment and has long been its first or second largest trading partner. Yet since Mahathir came to power in 1981, Malaysian policy has frequently reflected resentment of the United States (and sometimes Britain, Australia and “the Jews”). The result has been a pattern of often-tense Malaysian political relations with several Western nations, marked by walkouts, boycotts and other threats, and frequently heated rhetoric. A further manifestation of a troubled Malaysia-US connection came in a patronizing and often-critical speech Malaysia’s current Prime Minister gave in late 2005 to the Council on Foreign Relations in New York.<sup>26</sup>

Whatever the reasons and origins of Malaysia’s policy, the 1976 ASEAN Treaty will not be acceded to by the United States. That step assured America’s exclusion from the December 2005 summit and the “East Asian Community” it was expected to establish. That exclusion, though long resisted by some in ASEAN and elsewhere, has for an equally-long time been sought by Malaysia, and necessarily recalls once again former Secretary of State Baker’s caution against “drawing a line down the Pacific.” America’s exclusion in this era, especially against the background of the global distribution of US exports shown in Figure 1, necessarily will raise well-founded American hackles, and has much potential to become a politically-explosive issue both in East Asia and beyond.

Indeed that may already have happened; at precisely the time this paper was presented in its original form, in October 2005, the Wall Street Journal published a first-page article headlined “China Irks U.S. as It Uses Trade to Embellish Newfound Clout.” That report, which has been followed by several since then in a similar vein, focused on China’s role in East Asia’s intensifying economic interactions. It reported for example that

*China has sealed or is seeking free-trade pacts with 25 countries-up from zero two years ago [and] all this is raising alarms within the Bush administration ...concern that the U.S. may be losing influence in Southeast Asia is now widespread within the U.S. government.”<sup>27</sup>*

<sup>26</sup> The speech is remarkable for its many ill-informed criticisms of American relations with ASEAN, which the Premier wrongly insisted were concerned mainly with political and strategic issues. That would greatly surprise the “US-ASEAN Business Council” and other groups. Also remarkable was his gratuitous lecturing to US officials on how to do better: “the United States has to listen more to ASEAN’s concerns [and] must make efforts to appreciate the ‘ASEAN way.’” He also complained that in contrast with “the ASEAN relationship with China...the United States gives a higher priority to ASEAN as a strategic partner for political and regional security purposes” (Creating a Better Understanding of ASEAN-United States Relations,” Speech by Prime Minister of Malaysia Abdullah Ahmad Badawi, New York, 15 September, 2005.

<sup>27</sup> *Wall Street Journal*, 3 October 2005. My emphasis.

And not to put too fine a point on it, the report added that Singapore's authoritative Ambassador Tommy Koh had warned that "The U.S. is losing the competition for influence in Southeast Asia [and] the winner...is China,"

Yet in a striking illustration of self-deception, the article concluded that although the "13 country East Asia Summit wouldn't include the U.S....*officials now maintain that the forum isn't a big deal.*" The reality, of course, is that the December 2005 meeting in Kuala Lumpur that was expected to establish an "East Asian Community" was indeed a big deal. That outcome was avoided owing largely to strong actions taken principally by Japan, which for its own reasons has begun to strongly resist the "Asian Community" concept under Beijing's leadership. Yet the concept is far from dead, and its advocates-led most enthusiastically by China- have not given up.

An equal reality is that in practice the U.S. cannot be excluded from the implications of the Asian community idea, including in particular its stress on East Asian economic integration. That concept moves in the direction of what in earlier years was called a "bloc," and a world of blocs is incompatible not only with American interests but with global stability. Such a world will and should be strongly opposed by the United States, for reasons that by now should be clear not only to economists, but just as importantly to those who concentrate on international politics.

After all, as economic historians tell us, the final years of the 19<sup>th</sup> century witnessed the first efforts at what we are now calling "globalization." With the outbreak of World War I, however, that effort was suddenly halted, and its opposite-the world of blocs that formed in the 1930s-was one of the factors associated with the outbreak of World War II. Only after its end did efforts at globalization, in new, more intensive, and with added aspects resume, and we are all the better off for it. Because of that improved global stability and increased prosperity, the United States must and will resist the historically-retrograde effort to advance, in this era, proposals for "East Asian Economic Integration."

There are at least three main reasons to expect that American resistance to continue and gain strength. One is the certainty that any movement toward Asian economic integration will also be characterized by a pattern of growing competition between Japan and China. That competition implies a world of Asian conflict and rivalry, centered on Japan and China, that is absolutely contrary to basic US political and strategic interests in Asia.

A second reason is the growing evidence, gleaned for example from the patterns already evident in the US-Korean FTA talks, that that United States will not sacrifice basic political concerns on the altar of potential economic advantage. The deal-breaking nature of Korea's insistence on including Kaesong within the proposed bilateral FTA is but one illustration of that point.

A third reason, made more evident as a result of the American elections in November, 2006, is that domestic US resistance to any added bilateral FTA deals, is growing. It will become more evident as the Democratic Party assumes leadership of the

House of Representatives in early 2007, and the added likelihood of its leadership in the US Senate as well.

For all of these reasons, rooted as well in the simple fact that the United States is and will remain a Pacific power, the prospects for the concept of “Asian Economic Integration,” do not- from a US perspective-look at all promising.

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