

ERIA RIN STATEMENT No. 1

WHAT KIND OF ECONOMIC INTEGRATION?

ERIA RESEARCH INSTITUTE NETWORK



A Statement by the ERIA Regional Institutes Network Meeting at Phuket, January 2012

FOREWORD

I would like to express my appreciation and thanks to Professor Gary Hawke of New Zealand Institute of Economic Research (NZIER) for drafting the Regional Institute Network (RIN) Statement and for writing a comprehensive coverage of the background paper on “What Kind of Economic Integration?”.

I would like also to register my appreciation and thanks to various members of RIN in submitting their comments, views and perspectives that are certainly useful for writing the final text of the “RIN Statement”.

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Hank LIM
Chairperson, Regional Institute Network Meeting

RESEARCH INSTITUTE NETWORK (RIN)

The Research Institutes Network consists of research institutes from 16 East Asia Summit countries. Economic Research Institute for ASEAN and East Asia (ERIA) requests Research Institutes Network for continued cooperation in the following:

- To support ERIA's research activity through providing ERIA with country information and research findings from individual countries and giving advice to ERIA's research theme and policy recommendations;
- To encourage the dissemination of ERIA's research outcome to policymakers and political leaders who implement policy as well as opinion leaders in the countries;
- To support ERIA's capacity building programs;
- While ERIA will seek the best available talent for its research activities, it will look especially for participation from within members of Network.

Australia	: Australian National University (ANU)
Brunei	: Brunei Darussalam Institute of Policy & Strategic Studies (BDIPSS)
Cambodia	: Cambodian Institute for Cooperation and Peace (CICP)
China	: Chinese Academy of Social Sciences (CASS)
India	: Research and Information System for Developing Countries (RIS)
Indonesia	: Centre for Strategic and International Studies (CSIS)
Japan	: Institute of Developing Economies (IDE-JETRO)
Korea	: Korea Institute for International Economic Policy (KIEP)
Laos	: National Economic Research Institute (NERI)
Malaysia	: Malaysian Institute of Economic Research (MIER)
Myanmar	: Yangon Institute of Economics (YIE)
New Zealand	: New Zealand Institute of Economic Research (NZIER)
Philippine	: Philippine Institute for Development Studies (PIDS)
Singapore	: Singapore Institute of International Affairs (SIIA)
Thailand	: Thailand Development Research Institute (TDRI)
Vietnam	: Central Institute for Economic Management (CIEM)

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RIN Statement

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Research Institute Network

The economic research of ERIA and its network of research institutes seek to provide policy-relevant knowledge in a world which is marked by complex interaction of continuity and change. Against a constant background of seeking higher living standards in inclusive societies and of managing maintenance of national identities while benefiting from international economic integration, international supply chains have changed the nature of economic interdependence so that trade in goods and services has become trade in tasks, and interaction of real and financial economic transactions invalidates much conventional thinking.

We recognise three specific challenges to economic researchers:

1. Have we understood the challenges inherent in a change of emphasis from “trade” to “economic integration”?
2. Have we understood the transition which is occurring in which “negotiations” are giving way to “consensus building”? and
3. What is happening to the relationship between economic interdependence and strategic security?

Tariffs remain significant but many of the major issues for economic integration now relate to “behind the border” barriers. They require changes in mindsets as regulators of various kinds are required to discard their domestic focus and make decisions with due regard for the international context. Top priority is capacity building, and that will be accomplished much more readily in a process of learning together than by any one economy demanding that the regulators of other economies conform to the practices of its own regulators.

Important “behind the border” issues relate to achieving the benefits of economic integration through the operations of international supply chains. They give a new importance to economic diplomacy in providing for interoperability and innovation.

Facilitating extension throughout East Asia and to South Asia can be achieved by infrastructural development, both in ICT and in traditional road and maritime logistics. All of regulatory reform, financial integration, and narrowing development gaps come together in this aspect of economic integration.

The “Asian” economic integration processes centred on ASEAN address behind the borders issues such as infrastructural development and narrowing development gaps more directly than do the Asia-Pacific processes based on APEC. But Asian financial integration continues to provide scope for increased welfare and looking closely at potential welfare gains through risk sharing is likely to prove a fruitful line of analysis for deciding on which integration moves should proceed first.

International economic integration depends on genuine commitment to agreed objectives and processes of reporting progress and peer review. Merely completing agreements on paper even with provisions for supranational surveillance of compliance is not a substitute for genuine commitment. The ERIA-devised “scorecard” for monitoring implementation of the ASEAN Economic Community from the viewpoint of economic impact, in association with the compliance monitoring of the ASEAN secretariat, rejuvenates the concept of “concerted unilateralism”.

Economic integration overlaps with international security but is distinct. Economic integration is facilitated when leaders and societies have mutual trust, and that is most likely when strategic tensions are minimal. However, the biggest strategic issue in economic diplomacy is not possible interference from human security issues, let alone traditional security conflicts, but the demands of reconciling national interests in the processes of forming and maintaining international rules and norms and ensuring appropriate scope for all economies, especially major ones, to play a full part in this process.

ERIA research is right to emphasise supply chains, connectivity and fragmentation of production. Rigid compartmentalization in research should be avoided, and links should be sought among the three pillars of deepening economic integration, narrowing development gaps and sustainable economic growth. While there is more plentiful international research on trade in goods to draw on, investment and services are prime (important?). Food security and energy security are components of economic integration, not an exception to it. Social resilience is desirable but should be promoted by facilitating inclusion in the modern world, rather than by protecting existing activities in a search for a (mythical) golden age of the past. Capacity building workshops are not an optional extra but are crucial for the process of economic integration, and should maintain their emphasis on learning together.

Background Paper:

What Kind of Economic Integration?

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Abstract

World trade has changed. International economic understanding and the diplomacy based on it have not kept pace. The agenda is now economic integration, not trade; to think otherwise, whether in promotion of trade liberalization or in opposition to globalization simply reveals outdated thinking. The agenda of diplomacy has widened; more important, international supply chains have changed the nature of economic interdependence, and so has a little understood interaction of real and financial economic influences. Asian and Asia-Pacific approaches to economic integration overlap but differ in important respects. More important than issues of China v Japan or even China v USA are understandings of infrastructural investment and development gaps, two important components of community-building. Consensus building is not a weak substitute for negotiation; rather it recognizes the nature of the integration now taking place. Recent meetings of the G20, APEC and EAS illustrate the challenges which are barely understood. The most important requirements are up-to-date learning about collective choice and economic interdependence.

Introduction

I intend in this presentation to raise some deep questions about economic integration in Asia and the Asia-Pacific region. I want essentially to ask three questions:

1. Have we understood the challenges inherent in a change of emphasis from “trade” to “economic integration”?
2. Do we understand the transition which is occurring in which “negotiations” are giving way to “consensus building”? and
3. What is happening to the relationship between economic interdependence and strategic security?

Underlying all this I want argue that we have difficulty in getting change and continuity into appropriate focus. Historians of all kinds are predisposed towards recognizing continuity – it is simply an enduring feature of much human activity. I think of the British public servant of the first half of the twentieth century who throughout his career of 40 years began each year with the judgment, “there is a zero probability of a major war beginning this year”. He was wrong only twice. That tells us that the difficult task is to recognize when a significant change has occurred.

I think we are experiencing significant changes, some of which are signaled in the three questions I ask in this presentation. They are not the changes which feature doing much journalistic commentary. I do not think we are seeing “new economic models” anywhere, any more than we saw one in the New International Economic Order of the 1970s, which was not new, was domestic rather than international in outlook, was anti-economic rather than economic, and which promised anything but order. In the current circumstances, I expect to see a great deal of continuity. In particular, I expect gains from trade to continue to be exploited, including trade between Asia and other major regions of the world.

We should remind ourselves frequently that the argument for international trade is essentially a mathematical truism. Any set of resources will generate its maximum contribution to living standards when there is a minimum requirement of constraints – and international boundaries or domestic constraints on cross-border activity are essentially a constraint. We know the qualifications that need to be genuinely understood alongside that simple truism: it can be upset by learning which changes the pool of resources as in the infant industry argument or any positive feedback from engagement in production; it does not guarantee increased living standards for all parts of the international economy, whether regionally or nationally; and it does not guarantee

increased living standards for all members of participating economies.¹ Those qualifications need to be taken seriously; they are at the heart of the debate about economic interdependence. But they are qualifications, not the principal argument.

Current public debate is always littered with the relics of past ideas. What was once useful terminology lingers long after it has been superseded. I am inclined to think that the idea of “graduation” from developing to developed status is such a relic, but perhaps the whole notion of development is where confusion lies.² The notion of progression from free trade area to customs union to economic union and eventual political union certainly belongs in the litter. Until recent events in Europe revived ideas of progression to fiscal union and political union, only customs unions were mentioned often and even that nostalgia should not have survived the lowering of tariffs which has occurred and the growth in relative importance of behind-the-border barriers – only its enshrinement in the founding lexicon of GATT kept it alive. Treating European experience as universal adds to the litter. So we have inappropriate connotations often attached to “community”, continued misunderstanding of the relationship between security and economic issues, and even perhaps inappropriate fixation of the particular way in which Europe reconciled – or fudged – the line between national autonomy and supranational management.

All of these thoughts play a part in this presentation. But my first point is the apparently simple one that we do not have to choose between continuity and change. We always observe change against a backdrop of continuity and our task is to identify their distinct roles.

My stance is that of an economist, but an economist seeking policy relevance. The clearest self-disqualification of a policy analyst is the excuse, “that is not my field”.

¹ G.R. Hawke “Introduction” *Free Trade in the New Millennium* (Wellington: Ministry of Foreign Affairs and Trade for NZ Institute of International Affairs, 1999), pp. 9-29

² We might recall earlier debates about Japanese insistence that development aid in the form of interest-bearing loans induced stronger local responses than soft loans. Deborah Brautigam “Chinese development aid in Africa” *East Asia Forum* (December 2011) observes that Chinese aid is not ODA as much as assistance to businesses which reminds us that “business led” is often used to describe Asian integration but seldom analysed”. Christopher Findlay “WTO ministerial conference: time for a new world trade strategy” *East Asia Forum* (19 December 2011) identifies the mixture of “development” with “trade” as one of the reasons for the failure of Doha – which implicitly treats “development” as it was understood in the 1960s, government-promoted and aid-financed economic change as distinct from the “economic growth” experienced in advanced economies.

Policy analysts have to define problems, and identify the analytical tools which permit formulation of the best possible collective response. The great intellectual attraction of policy analysis is that it generates continual demands for additional learning. But equally, identifying feasible responses within constrained resources guarantees that economic analysis is always part of the required policy analysis. It is, however, the process of analysis, not the conclusions of past analysis, which is most likely to be required. I share the view of Keynes, in his introduction to Cambridge Economic Handbooks in the 1920s,

The theory of economics does not furnish a body of settled conclusions immediately applicable to policy. It is a method rather than a doctrine, an apparatus of the mind, a technique for thinking, which helps the possessor to draw correct conclusions.

which is far more enduring than the specific models and analytical devices which Keynes used to analyse the issues of the first half of the twentieth century. Economics has contributed its share of ideas that have become outdated, although ideas such as the cobweb theory and kinked demand curves are still useful devices for teaching analytical thought – it is when they are confused for description of reality that they become rubbish.³

I suspect that we have lost by not finding vehicles for training students to distinguish between abstract reasoning and description. We have gained enormously from the way that economics textbooks now routinely include lessons in the use of empirical databases; an unfortunate side-effect has been loss of recognition of the need to distinguish analysis from description. They occur together, but it pays to know with which one is engaged.

The immediate issue, however, is simple lack of facility with economic analysis where it matters. The biggest threat to international security today is the economic illiteracy of the US Congress. It is not that Congressmen know less economics than parliamentarians elsewhere, but they are more influential. Economics and security are related, but the connections are not those which are most asserted.

1. Asia and Asia Pacific

Both Asia and Asia-Pacific are a mixture of organically-evolved and invented

³ Cf the review by Robert Whaples in EH.Net (December 2011) of Mark Blaug and Peter Lloyd, editors, *Famous Figures and Diagrams in Economics* (Cheltenham, UK: Edward Elgar, 2010).

categorizations. Like “America”, the notion of “Asia” is often seen as a European invention meaning little more than “over there”, while the modern concept is often traced to Indian, Japanese and Chinese intellectuals becoming more assertive about European domination in the early twentieth century. But the region which loosely constitutes modern Asia “also displays a common set of social values and similarities in cultures”⁴ which draw on Buddhism, a long history of trade and economic interaction, and intellectual exchanges. The precise boundaries seldom matter and for practical purposes what matters is the membership of Asian institutions rather than the meaning of “Asia”. One of the most important such institutions is the Asian Development Bank which may point to the future in including Central Asia while it also reflects pragmatism in including the Pacific.

“Asia-Pacific” is more technocratic in origin while drawing on some long traditions. As European integration generated thinking about appropriate responses in other parts of the world, the early institutions were the *Pacific Trade & Development Conference*, *Pacific Basin Economic Council*, and *Pacific Economic Cooperation Council*, and it was only with APEC that *Asia Pacific* came to prominence. But the essential idea was always Asia Pacific, a linking of the West Pacific, Asia, with East Pacific, the Americas, close to the geographic concept of the Pacific Rim.⁵

Several distinct lines of development contributed to the concept of Asia Pacific. The one that loomed largest in most PECC discussions was Japanese in origin, so that the noun is Asia while Pacific is an adjective. Asia Pacific could be rendered in English as Pacific Asia, and was essentially the Pacific rim of Asia which from a Japanese point of view extended southwards and included Australia and New Zealand. Furthermore, in Japanese thinking “Asia Pacific” was to be the region most important to it and it was therefore extended to include the US was included. Canada was not really distinguished from the US. Hence Asia Pacific comprised, Japan, Korea, China, ASEAN, Australia, New Zealand, Canada and the US, with some potential or associate members such as the south east Asian states which were not yet members of ASEAN, Papua New Guinea and Pacific Islands.

⁴ Ram Upendra Das, C.M. Vasudev and Madhukar Gupta “Regional Integration and Cooperation in Asia – An Indian Perspective” *Global Journal of Emerging Market Economies* 3(3) (2011), p. 376

⁵ There is a good summary history in *Institutions for Regional Integration: Towards an Asian Economic Community* (ADB, 2010), pp. 57-60. This section draws on G.R. Hawke “Track 2 Diplomacy” in James Veitch (ed) *Strategic Manoeuvres: Security in the Asia-Pacific* (Wellington; CSS, 2009), pp. 5-18.

In the US however, Asia Pacific was redolent of a history that went back to the voyages which linked the Spanish empire in central and south America, and California, to the Asian mainland, especially China, with the Philippines as a major staging post. This was followed by a significant relationship between the US and Asia, essentially a trading relationship with a religious and cultural element in the case of China, and a political element in the case of the Philippines. The US saw it as natural to bring Mexico into APEC once the North American Free Trade Area, NAFTA, provided for economic integration between Canada, Mexico and the US. When Edgardo Boeninger was president of PECC in 1995-97, Chile took advantage of growing ASEAN confidence to gain renewed traction for the vision of an open economic region across the Pacific.

The Japanese and US understandings of Asia Pacific were not uncontested. To anyone with a British heritage, “Asia” immediately suggests India, the jewel of the British imperial crown and the touchstone for maintenance of the British Empire after World War II. Furthermore, the very concept of Asia owed a good deal to Indian scholarship in the early twentieth century. An Asia Pacific without India therefore looked like an incomplete agenda. India’s lack of interest in participating in a particular process of economic integration was ignored as a conventional scholarly agenda was pursued. India’s “Look east” policy of recent years has greatly changed that and given its membership of the East Asian Summit a firm economic basis.

New Zealand ears naturally hear Asia Pacific not only as suggesting the inclusion of India but also as “Asia and the Pacific” where the Pacific means the Pacific Islands, especially members of the Pacific Forum. But for the most part the Pacific islands are too economically insignificant to rate highly on the agenda of PECC or APEC.

The various different meanings of Asia Pacific do not pose major difficulties. Some commentators mistake precision of terminology for precision of analysis, and some use tedious questions of definition as a device for not engaging in the substantive track 2 dialogues. For the most part a general notion of economies around the Pacific Rim is entirely adequate.

A complexity is added when we turn from the economic sphere to that of security. Its principal discussion vehicles, ARF and CSCAP, do not extend to Latin America and they do include India. Latin America has an intense interest in Asian economic integration, a negative one of using Asian markets as a means of reducing dependence on the US, and a positive one of participating in the economic dynamism provided by Asian economic growth (exactly like New Zealand in the latter case). But the defence linkages of Latin America do not extend to Asia. On the other hand, the importance of

sea-lanes between the Indian Ocean and the Pacific and the impossibility of drawing a line between the Pacific and Indian Oceans in the defence assessments of many South-east Asian states means that India is a natural member of ARF and CSCAP.

The difference in the Asia Pacific “footprint” depending on the topic under consideration is a major concern only to those who want to circumscribe international diplomacy into neat boxes. What is really important is that there should be enough recognition of common interest for members to monitor the discussions, participate when a contribution serves their own interests or because they are required to facilitate the deliberations of other members, and to be confident that their interests will be listened to sympathetically when they are advanced. It is not necessary that at all times all members acquiesce positively in a consensus, let alone that all agree. That the selection of directly engaged members is made from a different pool according to whether the topic is economic or security is not crucial. Within CSCAP or ARF, the members directly concerned with management of sealanes within the Indonesian archipelago will differ from those concerned with the Korean peninsular, while within PECC and APEC different subgroupings may be especially interested in migratory fish or management of telecommunications.

Within all this complexity, the pressing issue of “Asia” versus “Asia Pacific” is really the role of USA in the Asian region. In particular the challenge is whether Asian processes of economic integration can co-exist with Asia Pacific processes and whether they can create positive synergies or will necessarily be competitive.

The most prominent Asia Pacific process is currently TPP, but APEC is wider. The relationship between APEC and TPP necessarily has some tension, since APEC itself is not a negotiating forum and TPP is self-consciously a negotiation. But economists would almost unanimously agree that TPP makes sense only as a path towards a Free Trade Area of the Pacific which includes all APEC member economies, and perhaps others as well (especially India). Consequently, the progress of TPP has been shared with all APEC members, perhaps to the consternation of those who see its objectives as extending beyond economics.

The APEC agenda has, in any case, continued the economic integration elements which have always been at the heart of APEC. Its mission was quickly formulated as having three pillars: trade and investment liberalization, trade and investment facilitation and economic and technical cooperation. The “ease of doing business” agenda of ABAC ensures that trade facilitation is actively promoted. The Economic Committee continues the Leaders’ Agenda for Implementing Structural Reform although that particular title has rather diminished in salience. Facilitation and

cooperation ensures that the APEC agenda encompasses economic integration as a whole.

Asian processes of economic integration are centred on ASEAN. The central process is the formation of the ASEAN Community with its three components of Economic Community, Political and Security Community, and Social and Cultural Community. The three components are interrelated, and they share some common features. So the way the Economic Community is conceived as existing within a wider regional network of interactions is paralleled by the way the Political and Security Community is conceived as relating to the ASEAN Defence Ministers' Meeting+, a vehicle for dialogue with defence ministers from ASEAN dialogue partners. Some cross-linkages are deeper; the Social and Cultural Community relates to a vision in which middle-income consumers in the ten members of ASEAN will have more in common with one another than they have with the poor within the same national economy. But it is the ASEAN Economic Community which is most relevant here.

AEC is scheduled for completion (of the current aspirations) in 2015 and ERIA appraisal is that about 75% of the commitments of the ten members will be completed on time. The most significant part of that statement is that ASEAN has evolved a mechanism for monitoring progress and identifying where shortfalls will occur. ERIA has been able to go beyond awarding ticks and crosses to bland apparent or asserted assessments of effective implementation and develop measures which have economic significance. ERIA remains a research organization. There is no trans-national authority; ASEAN has rejuvenated the concerted unilateralism which characterised the early years of APEC and which relies on agreed objectives, peer review, and mutual support.

Many ASEAN officials and participants are understandably anxious not to be deflected from the tasks of its internal community-building, but AEC has to be built with an eye on regional and global interdependence. The core mechanism is known as ASEAN++. ASEAN has economic integration agreements of some kind with each of its dialogue partners – ASEAN + China, ASEAN Australia New Zealand Free Trade Agreement, etc. – although all of these define paths for further change rather a final equilibrium, and ASEAN++ essentially expresses an intention to develop these in regional contexts.

We still hear a good deal about ASEAN Plus Three versus a wider grouping of ASEAN+ Six or EAS with EAS now including also USA and Russia. ASEAN Plus Three versus ASEAN plus Six owed a lot to non-economic thinking and especially the relative roles of China and Japan in Asian leadership. The crude idea was that by including India, Australia and New Zealand, Japan reduced the overwhelming weight of

China in a regional grouping.

Economically, the debate ended some time ago. Plus three versus Plus six or eight is essentially one of those outdated ideas that litter the landscape although we hear it a lot more now from the thinktank community than from officials, and more in international relations than in economic diplomacy. The economic debate generated a proposed East Asia Free Trade Agreement and a suggested Closer Economic Partnership for East Asia. The outcome was agreement at an EAS Summit that the ideas of both EAFTA and CEPEA should be referred to ASEAN with a request that it form working groups inviting participation as it thought appropriate from among ASEAN dialogue partners – i.e. they could be confined to ASEAN plus 3 or draw more widely on ASEAN plus 6. Four working groups were formed and all extended invitations to all members of ASEAN plus 6. ASEAN++ will surely follow this precedent and extend to the wider East Asian region.

There is, however, an important qualification to this conclusion. Asian economic integration integrates real and financial interactions much more so than APEC where the Finance Ministers' Process Financial has been crippled by APEC's origins as a gathering of trade and foreign ministers, while TPP is conceived as a trade negotiation and trade negotiations like the WTO are distinct from international financial institutions. It is now over 25 years since the world was mostly characterised by official determination of exchange rates. In a regime of floating exchange rates and with little effective restriction on investment flows, trade and finance cannot be kept separate. It is foolish to assess the impact of changes of exchange rates on trade flows – the classic “elasticities” and “absorption” analytical approaches – without considering also the impact on investment flows and the further feedbacks to exports and imports. This equally applies to explicit and implicit changes in exchange rates and so to all barriers to the flow of exports and imports.

TPP is often presented as a twenty-first century agreement, but it is the Asian integration processes which have got furthest in the financial sphere. Even they have kept distinct but that is at least partly because it is the ASEAN+3 grouping which has led the way. After the 1997-98 financial crisis, the Chiang Mai initiative began a gradual growth of cooperation among the ASEAN+3 parties. Progress was by slow steps, initially a set of limited bilateral swap agreements, but there has been gradual multilateralization of the agreement. A recent addition is an ASEAN Macroeconomic Research Office based in Singapore, AMRO, which will become a monitoring and consultation mechanism. That the Chiang Mai International Initiative still has no independent mechanism for monitoring lending and makes significant borrowing

dependent on IMF participation is often seen as a weakness, but it might be interpreted as a clever use of an international mechanism to solve reluctance to lose “face” by subjecting an economy to plurilateral supervision. It is also interesting to reflect on the possibility of the IMF becoming a contracted monitoring agent, monitoring agreements made elsewhere, rather than being the international leader in defining and implementing packages. The Asian source of much of the aggregate international reserves makes such a scenario more plausible.

There is another significant mechanism for Asian financial integration, the development of Asian bond funds. This process is taking place within what is essentially a subset of ASEAN+3, based in the Executives Meeting of Central Banks of Asia and the Pacific, EMEAP, but without participation by EMEAP members, Japan, Australia and New Zealand.⁶ There is still work to be done to bring the financial and real aspects of Asian integration into line with contemporary economic thinking and out of the prison created by mid-twentieth century institutional design, but it has moved further than have Asia-Pacific integration processes.⁷

This is one of the differences between the two sets of processes. There are others. They share many common features; the concern with economic liberalization and recognition that this necessarily goes beyond tariffs and border restrictions. Key differences in addition to integration of real and financial processes include explicit treatment of infrastructure and the approach to development gaps.

ERIA has played a significant role in energising Asian processes with its development of the concept of connectivity to include not only information and communication technology but also traditional transport communications, road, rail and maritime (with particular attention to efficient port operations). Furthermore, that has been developed not in a traditional mode of national projects but in the light of modern economic organization – supply chains linking producers in different locations and regions crossing national boundaries. In particular, important corridors link ASEAN with India and with China. The “Comprehensive Asian Development Plan” has a name

⁶ www.emeap.org and *Institutions for Regional Integration: Towards an Asian Economic Community* (ADB, 2010), pp. 68, 143, 219.

⁷ Cf Shinji Takagi “Asian financial integration: an unfinished agenda” *East Asia Forum* (18 November 2011). See also Yung Chul Park and Chi-Young Song “Prospects for Monetary Cooperation in East Asia” *ADB Working Paper* 314 (October 2011) although the Korean authors might well underestimate the significance of Chiang Mai and think too readily only conventional approaches to financial regulation can work.

which sounds somewhat antiquated, but it has thoroughly contemporary content. Furthermore, priority projects are making progress faster than non-priority projects, and links between financial integration and facilitation of trade flows, including removal of regulatory barriers, are being addressed in an integrated manner.

Another important distinction is that Asian processes take “narrowing development gaps” much more seriously. APEC has capacity-building initiatives but they are dominated by training which facilitates implementation of what suits the richer members, and indeed sometimes has the character of “do it our way”. Asian capacity building has much more the character of learning together.

The bigger distinction, however, is in the conception of development. It is not seen as a matter of official development assistance but of facilitating participation in the contemporary regional and global economy. In economies like those of Cambodia, Laos and Myanmar, it is a matter of promoting access to participation in supply chains. In middle-income economies, the task is to promote the spread of supply chains from industries where they are already well established, such as electronics, vehicles and textiles, to sectors which are important to individual economies, such as food processing. And in higher-income economies, it is promoting the innovation capacity of supply chains in general. There are many worries to be overcome, more or less modern manifestations of the fundamental qualifications to the economic welcome to global interdependence. It is worth noticing that ERIA research, while still tentative, suggests that firms which participate in supply chains are more likely to be innovative; worries about being reduced to minor mechanistic cogs in bigger machines are not supported.⁸

The recent season of summit meetings for Asia-Pacific and Asian processes supported these observations. The *Jakarta Framework on Moving the ASEAN Community Forward into 2015 and Beyond* provided a general framework for continued progress. ASEAN approved some ERIA suggestions on SME development including facilitating their role in regional production networks. The Declaration of the 6th East Asia Summit on ASEAN Connectivity “includes connectivity as one of the key area of cooperation of the East Asia Summit besides the existing five priorities, namely finance, energy, education, communicable diseases and disaster management”. There was also on infrastructural developments, underlining the importance of integrating financial and real processes.

⁸ The international discussion is extensive. See Tim Sturgeon MIT “Innovation and Technological Learning under Compressed Development: Global Value Chains and the Prospects for Local Industry and Enterprise”, paper presented at VUW (December 2011).

When the US and Russia were invited to participate in EAS, it was explicit that the intention was to maintain the existing agenda. During 2011, the US APEC Senior Official several times suggested a natural ordering in which trade issues were assigned to APEC while EAS should be considered a “strategic forum”. But that ignored both the existing agenda and also the priorities declared by the 2011 chair of EAS, Indonesia. Which were disaster management, connectivity and maritime security. The US took a low-key approach to what was a new forum for it, and the existing agenda was indeed maintained. Asian economic integration has not been subsumed by the Asia Pacific processes.⁹

The report of the APEC Finance Ministers on the other hand looks distinctly dated, the underlying economic logic suggesting the 1960s rather than now. Infrastructure investment is related to “boosting recovery” rather than facilitating business. The Leaders’ Declaration has the same character but the annexes do move towards sensible consensus. The material on innovation is not remarkable and the treatment of SMEs makes only token recognition of supply chains but establishing *de minimis* rules for customs is probably a significant facilitation effort and the same is true of an effort to expand the ITA and establish cross-border privacy rules. Abolishing fossil fuel subsidies is a worthy objective and so is establishing a goal of reducing energy intensity by 45% by 2035 which has the incidental effect of using a Chinese approach rather than pursuing Kyoto. The Ministerial Statement simply provides a bit more detail while having a similar character – but it declares on regulatory cooperation that “no ‘one size fits all’” and it proposes a principles approach with content such as supporting the WTO, and aiming at “tangible and practical outcomes that matter” which seems to be as much as the Americans got on their priority goal of “getting stuff done”. There was progress in disaster preparedness but the emphasis remains on facilitating the movement of goods and services during disasters when Innovation relates to the whole process of production research suggests that facilitating movement of people is what matters and APEC is still limited in treating movement of people as part of economic integration because of sensitivities in the US Congress about migration.

It is clear that TPP, APEC processes generally and ASEAN-based processes can co-exist, the only significant cost being the number of calls on small cadres of officials. The most significant question arising out of the various ASEAN-based meetings is the

⁹ Cf. Leonard C. Sebastian “Indonesia and EAS: Search for a ‘dynamic equilibrium’” *RSIS Commentaries* No. 168/2011 (16 November 2011); David Capie and Amitav Acharya “The United States and the East Asia Summit: A New Beginning?” *PacNet* #64 (14 November 2011).

nature of the ASEAN++ process. It is formally described as developing a template which can be the basis for discussion with ASEAN partners. The two major questions this raises are the nature of the negotiations and the speed of movement. The former is a question shared with TPP and indeed with FTAAP. In all cases, ideas that a template can be a matter of take-it-or-leave-it is a dead end; the original TPSEP provided a reasonably open accessions clause but the complexity of the current TPP negotiations shows that any hope of simplicity is a dead end. Secondly, ASEAN is very firmly a consensus-based organization but it cannot afford to move only at the pace of its slowest member. It was an Asian participant, not from one of the usual more adventurous economies, who observed recently that the main point of TPP might prove to be to energize ASEAN processes.

2. Trade and Economic Integration

Supply chains have changed international business and the context of economic diplomacy. We are probably all familiar now with calculations of the number of national economies involved in producing a “world car”. But even economic commentary, let alone political and journalistic discussion, allows too little for the impact of supply chains.

In the middle of the twentieth century, it was still possible to think of world trade as being characterized by the exchange of food and raw materials for manufactured products. Folke Hilgerdt and J.B. Condliffe provided empirical evidence to that effect,¹⁰ and the picture looked very much like Ricardo’s analysis of comparative advantage using cotton from the UK and wine from Portugal. We then became aware of the growth of intraindustry trade, two-way exchange of manufactured products at quite disaggregated levels of industrial classification. Now we are experiencing the rapid growth of trade in components as production processes are spread among economies, in a process of fragmentation. All is within a continuing search for the best possible use of the world’s resources, but there is a great challenge to conventional ideas. Exporting was seen as a matter of generating a product which satisfied a consumer demand in another country; now it is often a matter of cooperating with a producer in another economy for joint satisfaction of consumers elsewhere.

The likelihood of outdated ideas is apparent at a much more aggregate level. IDE

¹⁰ J.B. Condliffe *The Commerce of Nations* (London: Allen & Unwin, 1951).

in Tokyo and the WTO have compiled¹¹ a database of trade patterns taking account of trade in intermediate goods. The effect is dramatic. The US deficit with China becomes little more than 10% of that with Japan, and about a quarter of those with Korea and Germany. Simple statement of conventional bilateral accounts can be very misleading. We have been familiar for a long time with the folly of focusing on bilateral balances of payments although that has had little impact on a lot of journalism; we must expect an equally strong resistance to surrendering familiar listing of bilateral market trends.¹²

The impact of supply chains is complex. They are related to “just-in-time” manufacturing – essentially a process of managing logistics to demanding standards in order to economize on the cost of holding stocks, but also a way of ensuring that process manufacturing does not become presiding over routine but is attuned to solving problems since every interruption of production is a crisis. Following the Tohoku earthquake and tsunami there has been a lot of discussion of the insecurity of supply chains. In fact, most supply chains found alternative supplies reasonably quickly, and more important, the effect was from just-in-time manufacturing rather than from cross-border supply chains. Had more Japanese products relied only on Japanese suppliers the impact they experienced would have been *greater*, not less; producers elsewhere who relied on Japanese suppliers would clearly have experienced less impact if their suppliers had been located elsewhere but where will the next earthquake occur?

Supply chains require assured interoperability. Standards and the closely connected topic of Intellectual Property have moved to centre stage. What were formerly technical issues relegated to the arcane topic of “technical barriers to trade” and a subsidiary discussion forum for those with specialized knowledge are now fundamental to economic integration.

Some standards may be public goods, but many are private property. Fundamentally, there is a tension between standards and innovation. Standards can freeze technology. On the other hand, standards define “fitness for purpose” and facilitate compatibility and interoperability. Furthermore, “the challenge for

¹¹ *Trade patterns and global value chains in East Asia: From trade in goods to trade in tasks* (IDE-JETRO and WTO, 2011)

¹² Mercantilism is often used a term of abuse even as it is practised. Ironically, serious study of the history of economic thought would include a concern with “power and plenty”, a better integration of economic and security interdependence than many modern treatments, and also a concern with employment promotion far in advance on modern political rhetoric about “jobs”. Cf Eli Heckscher *Mercantilism* (London: Allen & Unwin, New York: Macmillan, rev.ed. 1955).

standardization now is no longer technology alone. Equally important is the challenge to standardize the interactions of people who create and use the technology within these networks, In other words, standards need to be developed for the work practices and business routines that enable these networks to grow and adjust to changing requirements of technology and markets.”¹³ That was always true of innovation, but it is now more obvious.

The demands for adjustment are enormous. One of the three competing 3-G standards is protected by than 2000 patent families comprising more than 6000 patents from 50 companies and consortia. A smart phone involves hundreds of standards coming from dozens of standards-setting organizations – camera, video, web browser, PDA, Wifi etc. Smart phones are the field for 8000 patents held by 41 companies.¹⁴

Many in China must have been startled when after succeeding in entering the WTO, they found that their participation in the international economy was governed by lawyers and litigation. “Chinese firms typically pay foreign patent holders 20-40 percent of the price of each cell phone made in China; 30 percent for each PC; and 20-40 percent for each CNC machine tool.” (CNC is computer numerical control.) The Chinese value added share is usually estimated at 10-15% - Asian subcontractors of multinationals do better than domestic firms.¹⁵ We should not be surprised that there are many disputes about intellectual property rights. We may be more surprised that there is less reporting of the place of standards in economic diplomacy.

Some pressure results from complaints by external owners of IP, most commonly American firms investing or trading in China. However, the biggest engine of change in China is the challenge to legitimate Chinese business from illegal producers.¹⁶ Exactly the same has happened earlier elsewhere. The balance of interests between tolerance of imitation and protection of intellectual property moves over time in favour of the latter. This has been discussed in the case of Hong Kong,¹⁷ but it is familiar to economic

¹³ Dieter Ernst *Indigenous Innovation and Globalization: The Challenge for China's Standardization Strategy* (UC Institute on Global Conflict and Cooperation and East-West Center, June 2011), p. 45

¹⁴ Ernst, p. 44

¹⁵ Ernst, p. 51

¹⁶ Ernst, p.82.

¹⁷ David Clayton “Trade-offs and rip-offs: Imitation-led industrialization and the evolution of trademark law in Hong Kong” *Australian Economic History Review* 51(2) (July 2011), pp. 178-98; a paper available on the author’s website, Sherry M. Stephenson “Standards, Conformity Assessment

historians over a long period – Charles Dickens made exhausting reading tours of the USA because they could not be copied whereas his books could in the absence of US adherence to European copyright laws, while the UK had earlier tried to restrict emigration of skilled mechanics in a forlorn effort to maintain monopolies of knowledge.

The challenge to economic diplomacy is to design international norms which properly balance competing interests. It is easy to write commitments by firms and the governments of advanced economies to ensuring “Fair, Reasonable and Non Discriminatory” access to standards and patents; it is much less easy to interpret them and apply them to particular cases.

Existing American, European and Japanese provisions do not necessarily constitute the international system. There are many national systems, and there can be no international norms or systems which do not involve some Chinese participation. In Chinese thinking, “international standards” are those developed by an international organization recognized by China, mostly the UN. “Global standards” are de facto recognized standards. They can be copied without formal adoption. “National” standards are those which exist in China, as they are in other countries, but the distinction between “international” and “global” is not universal. Furthermore, Chinese rhetoric about the primacy of economic development is not merely “aspirational” – it is the starting point of national strategy. It leads into an intention to use “indigenous innovation” as a means for economic development. There are many tensions to be managed. It is not easy to manage information security while participating in global networks and focusing only on claims that controls on the internet are intended only to preserve the political elite is simplistic. Managing the tension between promotion of innovation as a protective device versus participation in global innovation processes is equally problematic.

For most economies, economic development is a matter of catching up with the frontier. That creates problems for any idea of a uniform international intellectual property regime. For poor countries, a weak IPR regime is optimal – to encourage dissemination; utilization of knowledge invented abroad should be preferred to incentives for innovation. Advanced economies will naturally prefer stronger IPR regimes.

Innovation occurs across the whole process of production and marketing, not only

and Developing Countries” (9 May 1997) is interesting for revealing how few developing then participated in discussions of standards

in the use of machinery. Mechanization is easily seen and appreciated, more than aspects of innovation which may be more important. Furthermore, it is a source of productivity growth that has been relatively readily available. That kind of technology which has been most susceptible to productive change is technology which is “a humanly devised means for meeting a particular end, whose workings and effectiveness are relatively uniform when employed by those skilled in the art.”¹⁸ Replicability and uniformity are the key to innovation through mechanization. If we were seeking to maximise the pace of technical change, there is a strong case for looking to concentrate innovation in areas where mechanization is readily possible. But if we are looking to understand where innovation has had most impact on growth we will probably find that mechanization was only part of the innovations which were most important and we might be willing to conjecture that the same will be true in the future.

Innovation is a business activity. For many years, no historian of technology or innovation has taken seriously the idea of a linear sequence from research to development to technology to final product. Nate Rosenberg has stated the consensus:¹⁹

we still very much exaggerate the extent to which new technology is based upon scientific research. We certainly wildly exaggerate it when we suggest, as is often suggested by the spokesmen for science in Washington, that technological change depends upon recent developments in science.

In this respect Wellington and many other capitals resemble Washington. The notion that research has primacy and a strong claim on public expenditure can be regarded as the biggest success of a PR campaign in the twentieth century as it was how Vannevar Bush sold continuation of Manhattan Project support for scientists to the US Congress in the 1940s; fortunately few PR consultants have an atomic bomb in their armoury.²⁰

The challenges of innovation for economic diplomacy are something other than

¹⁸ Richard R. Nelson “The Moon and the Ghetto Revisited”, paper presented at “Nickfest”, a conference at the University of Sussex in honour of G.N. von Tunzelmann, March 2010, p. 8

¹⁹ in John S. Lyons, Louis P. Cain and Samuel H. Williamson *Reflections on the Cliometric Revolution: Conversations with economic historians* (London and New York: Routledge Explorations in Economic History, 2008), p. 251.

²⁰ The idea of a linear progression of pure science, applied science, and economic growth was much older, going back at least to Francis Bacon *The Advancement of Learning* (1605) but Vannevar Bush made it dominate policy advocacy. Note the passage in the 2010 speech of President Obama to a White House gathering of scientists, “As Vannevar Bush, who served as scientific advisor to President Franklin Roosevelt, famously said: ‘Basic scientific research is scientific capital’.”

devising acceptable subsidies for scientists. But then so are the challenges for managers of industry. Firms within supply chains have to maintain interoperability, but their growth will depend on successful innovation. Should they attempt to develop new ideas and simply sell them, or should they attempt to grow their firms? Would their firm then remain a national identity with international connections or would it start to become an offshore entity? The boundary of economic diplomacy and domestic industry policy becomes variable, but how many officials dealing with industry policy see themselves as participating in international economic diplomacy?

Mattoo and Subramanian recently observed that while the WTO (and formerly GATT) adapted to major changes such as European integration, Japan's rise to importance, the inclusion in decisionmaking of developing economies, and the emergence of China, it has not recognized the overwhelming importance of adapting to the dominance of China as a world trader.²¹ Their essential argument is that the agenda of a post-Doha WTO has to include what is of central interest to China. They think mostly in conventional terms such as security of access to resources and food, and climate change, but managing IP and standards is likely to be much more central. Mattoo and Subramanian want restraints on regionalism to ensure China's focus remains the WTO, but what look like preferential agreements may be the best available instrument for addressing behind the border issues which are now appropriately the centre of attention.²²

We have seen evolution as well as the manipulation of GATT which accommodated European integration despite the mfn principle, the "voluntary" export restraints, and the "special and discriminatory" treatment which addressed specific issues as they arose. In the middle of the twentieth century, rules about cross-border investment were dominated by debates about exchange controls and guarantees for repatriation of profits and investment. That boundary between financial and trade rules was breached and gradually eliminated as subsidy codes were added to GATT. Now microeconomic consideration of cross-border investment flows is centred on manage

²¹ Aaditya Mattoo and Arvind Subramanian "China and the World Trading System" *World Bank Policy Research Working Paper* WPS5897 (December 2011).

²² Andrew Elek "Immunising Future Trade Against Protectionists- Preventing the Emergence of More Sensitive Sectors" *Asia Pacific Economic Papers* 372 (2008) qualified his distaste for regional agreements by suggesting that goods subject to patent or copyright protection should be excluded from protective devices. The idea is intriguing but it would divert focus on devising an appropriate framework for IP and create many debates about what constitutes a protective mechanism.

services trade – since cross-border trade in services is closely related to commercial presence – and on the newer issues of managing standards and patents. At the same time, macroeconomic debate has shifted to managing reserves and increasingly to disputes between investors and states which is essentially establishing international norms about the interaction of assurance to international investors and domestic autonomy in internal regulation.²³ There is a lot more evolution to be experienced and the big challenge is for national governments and their agencies to keep abreast of contemporary requirements.

TPP seeks to be a “leading edge” agreement. But its debates about IP show little common understanding of what is at stake, while nothing has emerged of anything beyond identification of investor-state disputes as a matter to be discussed. ASEAN-based approaches are informed by discussions which include awareness of contemporary issues, but it may be wondered about how widely understanding extends among the relevant officials, politicians and leaders.²⁴

3. Behind the Border

The importance of behind the border issues has become well-known although its implications are not well understood. Again there is a large element of continuity. It was in 1998 that the *Economist* drew attention to the widening agenda of trade negotiations with the following table:

Gatt Rounds		
Rounds		
1947	Geneva	tariffs
1949	Annecy	tariffs
1951	Torquay	tariffs
1956	Geneva	tariffs
1960-61	Geneva (Dillon Round)	tariffs
1964-67	Geneva (Kennedy Round)	tariffs and anti-dumping measures
1973-79	Geneva (Tokyo Round)	tariffs, non-tariff measures, framework agreements
1986-94	Geneva (Uruguay Round)	tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc

²³ See the recent discussion of the Australian Productivity Commission.

²⁴ Cf G.R. Hawke “The TPP: What are Asia’s Alternatives” *East Asia Forum* (19 November 2011).

Source: Economist 3 October 1998, "World Trade Survey"

In the last thirteen years, the agenda has continued to widen in the Doha Development Round with the Singapore issues – trade facilitation, government procurement, trade and competition, and trade and investment – along with further additions such as trade and environment, trade and labour standards and other interpretations of “development”. But there has been significant change as well.

The most important is that cross-border economic interactions have come to encounter constraints that are not administered at borders. In seeking to establish commercial presence in another economy, firms have encountered requirements such as limitations on foreign investment or requirements for national subjects on board of directors. Any domestic regulation may become a barrier to international commerce.

The first implication of this is an enormous expansion in the number of authorities relevant to considering issues of economic integration. Trade negotiators in trade and foreign ministries have over time learned to consult not only with customs officials but also with administrators of sanitary and phytosanitary regulations and tax authorities, but they now have to consider the views of many more – competition authorities, custodians of commercial requirements, and so on. In one sense, this is merely an aspect of the change in international communication. In the early GATT rounds, a small team of delegates from each of a small number of economies – little more than the present membership of APEC in the earliest rounds – who had plenipotentiary powers and could be sequestered in a hotel and required to produce an agreement (albeit knowing that it would require ratification from their governments at home). Now large teams of negotiators from nearly 200 economies are in constant communication with their home governments, and the vast array of affected agencies in their official bureaucracy, and the larger range of domestic lobbyists. The increasing duration of rounds is not surprising, and perhaps Doha shows that the process has reached a limit.

But the point goes deeper. Domestic regulators do not necessarily have a predisposition to think of international connectivity in the same way as trade and foreign ministries or even sanitary and phytosanitary inspectors and customs officials. Competition authorities start with a preoccupation with management of domestic markets even if they begin with a broader perspective than simply anti-trust legislation. Education authorities conceive of managing a domestic education system although they might think it appropriate to have a small office which can manage offering educational facilities to some favoured foreigners. They do not readily think of managing a small

component of an international network. It is not too much to say that there is now no aspect of policy development and public management that does not have a significant international component. The standard mindset of regulators in all economies lags somewhat. Even the concept of mutual benefit is not prominent; regulators are more likely to think in terms of control and of reciprocity which is not what is most likely to promote international cooperation.

Making and implementing regulations is core government business. We have had many years of understanding the use of government powers at the border within international norms, 60 years of the GATT/WTO process alone. There has been no similar learning path for regulations in general.

Even in the case of border controls, the intellectual battle is not over. Conventional notions of protecting domestic activity still compete with the gains from international specialization. The qualifications to the core argument for economic integration can be turned into conferring privilege on domestic groups. But there is experience to draw on – the experience of Japan in its period of super-growth of the benefits of facilitating adjustment towards a moving comparative advantage rather than seeking to protect existing activity – from toys and textiles to shipbuilding to motor vehicles to electronics, and the similar skills of Korea in providing for facilitated adjustment to liberalization for even its agricultural sector. An interesting argument in some Asian circles is whether facilitation finance should be provided for in the course of international agreements or whether it is better to force national political assemblies to be conscious of the actions they authorize. From the point of view of educating regulators, let alone guardians of constitutional procedures or even managers seeking long term durability, the latter approach is preferable but the pragmatic answer is not so obvious.

TPP and APEC processes are aware of these issues. The principal challenge for those who favour an Asia Pacific approach is that the US has a complex structure of Federal Government in which it is very hard to change patterns of behavior. Trade negotiators are specialized; they have established means of communication with Congress and known routines for communication with other branches of the Executive, and they are surrounded by a network of professional lobbyists to ensure they know what the US private sector wants and what will lead it to encourage Congressmen to ratify Executive agreements. (Negotiators often look forward to future employment within the private sector too.) Such a machine is easier to drive to a familiar target – hence the simplistic doubling of US exports which is not easy to reconcile with creating the kind of regional context which most serves economic integration. (It is always odd

to hear US negotiators treat US domestic law as a binding constraint on international dialogue whether it relates to a need for reciprocity, continuation of arms sales to Taiwan, or entire separation of migration issues from trade negotiations; it is not that US diplomats do not know that in the US as elsewhere public policy objectives may best be sought by changes to the existing law, but that they regard themselves as working within a Congressional mandate and their life is easier if they satisfy existing demands rather than seek to have them changed.)

Asian processes have an advantage, albeit a limited one. East Asia is often said to lack regional architecture, but that is not true. On the contrary, it has a “dense web of overlapping regional and subregional institutions that are largely intergovernmental and focus on specific functional goals”.²⁵ What is correct is that these institutions have few delegated powers but there are many models for economic cooperation around the world and no reason for Asia to copy any one of them.²⁶ The ASEAN example has the useful characteristic that it involves many meetings. The result is that “ASEAN is influential because of how it has succeeded in developing a sense of shared values and accepted procedures”.²⁷ This can be utilized to facilitate the transition from trade diplomacy about border issues to economic integration and behind the border issues simply by extending the meetings to various kinds of regulators.

Asian processes have a long way to go. ASEAN has moved slowly as newer members struggle to catch up with what older members have achieved in the way of multilateralization,²⁸ ASEAN+1 FTAs have magnified the administrative problems, and wider regional integration extends them further. But there is a vehicle for learning together which is what is most required.

4. Negotiate versus Consensus

Changing focus from the borders to structural changes is difficult. It may even require reconsideration of the basis of international economic cooperation in diplomacy.

Diplomacy has attracted numerous clever quips, not all of which translate readily

²⁵ *Institutions for Regional Integration: Towards an Asian Economic Community* (ADB, 2010), p. xii

²⁶ *Ibid*, pp. 114, 162.

²⁷ *Ibid*, p. 17.

²⁸ Jayant Menon “ASEAN’s newer members coming to grips with multilateralism” *EABER/SABER Newsletter* (November 2011).

among languages, and most of which are attributed to many people in numerous variants. “A diplomat is a man sent to lie abroad for his country” was not true even before the profession shared the common experience of changed gender balance. “A diplomat is a person who can tell you to go to Hell in such a way that you actually look forward to the trip” has some weight, but mostly reminds us that diplomats are often congenial hosts. “To say nothing, especially when speaking, is half the art of diplomacy”²⁹ also suggests nothing other than social interaction. “Diplomacy is the art of letting someone have your way” takes us toward negotiating skills³⁰ while “Diplomacy is the art of saying ‘Nice doggie’ until you can find a rock” is a humorous approach to many thoughts about diplomacy and war.³¹ For economic diplomacy, the key point is that the most valued skill is often taken to be negotiation, and the most prized product is a completed agreement. That requires a text signed by all parties, setting out what is agreed, along with an equally agreed procedure for monitoring its implementation and processes for resolving any disputes which arise.

However, we can already observe some rebalancing away from such western-oriented negotiations towards Asian consensus building. While the origin of APEC is contested, the strongest argument is that the key driver was a desire to link West Pacific and East Pacific – North-East Asia, South-East Asia and America, not just geographically but reconciling Asian processes of consensus building and western notions of reciprocity supported by binding commitment and monitoring. Managing the tension between consensus and commitment has been an enduring theme throughout the history of APEC.³² Events in the last year have surely pointed towards questioning the western emphasis on concepts such as binding, agreements, monitoring and verification, and sanctions. While many observers continue to express scepticism of “voluntary cooperation” and consensual objectives and peer review,³³ nobody could have even the slightest acquaintance with recent events in Europe and continue to hold an unqualified preference for black-letter negotiated agreements.

²⁹ Will Durant http://www.brainyquote.com/quotes/keywords/diplomacy_2.html#ixzz1hyeSPPBD

³⁰ Daniele Vare Quotes, <http://www.worldofquotes.com/topic/Diplomacy/index.html>

³¹ Will Rogers, <http://www.brainyquote.com/quotes/keywords/diplomacy.html#ixzz1hydUun>

³² G.R. Hawke “Business Opportunities in a World of Variable Economic Integration” presentation to the symposium, The Assessment on the WTO's Doha Round for Economic Growth, Chung-Hua Institution for Economic Research in Taipei, Taipei, November 25th~26th, 2010.

³³ e.g. Jacob Funk Kirkegaard “Europe’s role in global economic governance” *East Asia Forum* (26 July 2011)

APEC resembles Alcoholics Anonymous³⁴, an organization of people who know exactly what it is in their interests to do, and who know that the power to do what is best for them lies in their own hands, but who find it helpful to come together from time to time to provide mutual assurance and to compare their progress. Nothing could be further removed from the archetypal formal agreement, with a distinct supranational authority able to compel compliance, but that does not necessarily imply that it is ineffective. Most evaluations of Alcoholics Anonymous are positive. An explanation of that result is likely to have several components but perhaps the most important is that we seek is commitment to a common endeavour rather than completion of a published agreement.

Barry Eichengreen has recently argued:

that successful cooperation is most likely in four sets of circumstances. First, when it centers on technical issues. Second, when cooperation is institutionalized – when procedures and precedents create presumptions about the appropriate conduct of policy and reduce the transactions costs of reaching an agreement. Third, when it is concerned with preserving an existing set of policies and behaviors (when it is concerned with preserving a policy regime). Fourth, when it occurs in the context of broad comity among nations.³⁵

At one level, the conclusions are obvious: technicians agree more readily than strategists, let alone politicians; change is difficult; and agreement is easier among friends. But it has interesting implications. Cooperation is hard to combine with antagonism, an issue which is the topic of the next section, and cooperation is promoted by frequent interaction among people with similar interests – which sounds like advocacy of the “ASEAN way” with a broad range of regulators.

Discussion can be a tool for securing agreed progress, or it can be an excuse for prevarication. Furthermore, like a formal negotiation, it requires a decision on who should be invited to participate.

ASEAN benefits from having a membership decided most by history and geography. Membership is not entirely uncontroversial, as shown by the debate before it was extended to Cambodia, Vietnam, Laos and Myanmar. Myanmar still causes some discussion although more among outside observers than within ASEAN and there is a current debate about the inclusion of Timor Leste. There is more about debate about how best to manage the positioning of ASEAN in regional affairs, in creating dialogue

³⁴ A thought which originated with Bobby Romulo of the Philippines.

³⁵ Barry Eichengreen "International Policy Coordination: The Long View" *NBER Working Paper* w17663 (2011).

partners and extending the ASEAN++ process.

Something of the same could be said about APEC, with earlier decisions about Latin America and Russia, a moratorium on expansion, and a case-by-case process that has not resulted in any change of membership. APEC has struggled to give practical meaning to “open regionalism”; the basic notion of establishing common ground with members while not raising barriers to non-members is inherently problematic although not oxymoronic and eminently attractive. New thinking always challenges prevailing routine.

The issues are much more obvious when they relate to formal negotiations and to participation in negotiated agreements. The idea of “open regionalism” is readily translated – via the International Relations concept of “regionalism”, an institution with states parties from a defined geographical region as members – into the idea of an agreement which is negotiated among specific parties but to which adherence is possible by other parties who are willing to meet the conditions prescribed and announced in advance for membership by the existing members. Currently, TPP is presented as a negotiation towards a leading-edge agreement which will be open to membership by any economy willing to subscribe to its membership criteria. At the most recent APEC Economic Leaders’ Meeting in Honolulu, there was some progress towards specification of those criteria.

However, an ambition to specify criteria sufficiently for the admission of new members to be a simple process of declared adherence and ready confirmation is chimerical. It flies in the face of experience with attempts to anticipate all future contingencies; even limited knowledge of the economics literature developed over the last thirty years in incomplete and relational contracting is sufficient to be persuasive. Alternatively, we have already observed that the P4 agreement among New Zealand, Singapore, Brunei and Chile has an exemplary open access clause, but we are already past a year of negotiations for accession by the USA. We should certainly welcome curtailment of access negotiations such as occurred before China’s admission to the WTO, or those which have not yet finally concluded for Russia’s admission to the WTO,³⁶ but adherence by any major economy (and most non-major economies) to an existing formal agreement will generate questions about how the terms of the agreement will be interpreted in new specific conditions. Negotiation will be required. (An advantage of setting TPP negotiations within the context of APEC, which is not a

³⁶ Agreement was announced at the most recent WTO Ministerial Council but still requires ratification.

negotiating forum, is that several major economies whose future adherence to TPP will be sought, can be kept informed of emerging agreements and permitted to participate in evading some future issues. Decisions by the Japanese, Canadian and Mexican governments to join the negotiations – of varying certainty – no doubt reflect this information flow. So do the moves by the Chinese government to commission major policy development initiatives around China’s relationship with TPP.³⁷⁾

TPP might be “leading edge” but it does not come close to dealing with the range of issues in contemporary economic integration. However, that does not mean that what will inevitably be called in the media for a long time “free trade agreements” do not have continuing utility. First, while tariff levels have been reduced, they have not been eliminated, especially in some sectors like agriculture. What appear to some observers to be a few remnant products with high political sensitivity are of significance to some producers and even to some economies. Secondly, the widening agenda included in what are conventionally labelled “trade” talks, through the GATT years as well as more recently, means that their agenda remains an important part of economic integration. That behind-the-border issues have become more salient does not mean that border issues have become irrelevant. Thirdly, in many contexts, the value of meetings is that they provide an incentive for progress to be made on matters handled intersessionally rather than for what they produce directly. The main functions of the APEC Economic Leaders’ Meeting, for example, have little to do with the communiqués which are issued and a great deal to do with whatever leaders want to talk about and the deadline which is imposed on work programmes for other groups. Fourthly, while commitment is far more important than precision of dated agreements, records of progress are desirable. Individual memories are fallible; changing membership makes records of past decisions essential.

The WTO is an institution with membership rules, and there is no reason why that should change. Interpretation of the rules will be contested, as has always been the case. The mfn principle was bent to facilitate European integration, to accommodate the politics of US agricultural protectionism, and to be paternalistic to developing countries. The rules of the WTO on free trade areas have been reinterpreted beyond recognition. But the institution survives because it expresses the deep-seated logic of economic

³⁷ As was apparent to participants in two meetings convened by the Chinese committee of PECC, Seminar on TPP and its Implications on Regional Economic Cooperation, Beijing 8-9 December 2011 and Symposium on Promoting People-to-People Exchange, Consolidating Basis of China-East Asia Friendship, Nanning, 10 December 2011.

integration and because it has credibility in managing dispute resolution. Its future rests on preservation of that credibility.

Economic diplomacy need not be concentrated in a single institution even if one is selected as the principal venue for dispute resolution. We live in a world of networks with many communication systems, not in one characterized by bureaucratic institutions organized around formal paper agreements. So we should be relaxed about a world characterized by numerous networks with differing coverage and variable membership. Given the range of the economic integration agenda, such an outcome looks very likely.

This is disconcerting to many traditional trade negotiators and commentators. They worry about multilateralism and non-discrimination, and about the formality of agreements. The “most favoured nation” principle, that a concession to one member of GATT should be extended to all members, was always qualified but more important, it really applied only in the exercising of tariffs. It remains important, but efforts in its defence should be directed against entrenched preferences in tariff regimes created by preferential trade agreements, not against the creation of clubs for facilitating cross-border business.

A world of variable networks loses the “single undertaking”, the arrangement that nothing is agreed until all is agreed, which was central to the institution of “rounds” by which trade liberalization was managed after they had been discovered more or less by accident. The single undertaking was formalized in the Uruguay Round in response to unhappiness about the decision of many members of GATT to remain aloof from various codes which had been negotiated in previous rounds, to prevent opting out from agreements on new agenda items, and to dignify the transition from GATT to WTO. However, its essentials go back to the origins of GATT and the idea that a comprehensive package allowed tradeoffs among components and facilitated consensus. The idea remains attractive, not least to participants who give high importance to a component which other participants find especially difficult, notably agriculture. However, the agenda is now too wide and significant participants too numerous for nostalgia to be accommodated. Negotiators have to find new ways to ensure that their particular concerns do not slip off the international agenda.

In the absence of a single undertaking, we must expect a messy arrangement of overlapping agreements with variable membership and variable coverage. Theoretical arguments in favour of multilateralism are as valid as ever, but they will not prevail in the world we live in. So the issue is to preserve as much of the advantage of multilateralism as possible while using the tools which are available to minimize barriers to cross-border business. That is, we should seek to achieve “open regionalism” through accession

clauses which facilitate extension to different circumstances and which minimize obstacles to new members.

This has implications not only for the balance of regional trade agreements and multilateral rules, but for the nature of regional trade agreements. A Free Trade Area of Asia Pacific would be a little less difficult to secure than a WTO round – the Europeans would not be at the table – but only utopians would believe that a single complete agreement akin to NAFTA or even ANZCERTA is attainable. Nor can we expect an orderly succession of agreements. The idea of a sequence of ASEAN+1, ASEAN+3 (EAFTA), ASEAN+6 (CEPEA), extensions to America (FTAAP) and to Europe, while attractive to orderly diplomatic minds, is a pipedream. Barriers to business will be disassembled where political will and economic pressure prevails, and a pattern will be discerned only in retrospect. Commentators often take pride in deciding Asian integration as “business-led” but less often recognise that business worries little about tidiness relative to effectiveness. Diplomats and analysts are right to resist the tendency of business to identify its interests with the public interest but wrong to see the public interest as promoted by what they find familiar and comfortable.

We must anticipate a more complex world. But it has some positive attractions. What was developed in the middle of the nineteenth century to manage negotiations over tariffs on trade in goods is not necessarily a good way to manage negotiations relating to the movement of services across national boundaries. There is a lot to be said for using different modalities in services negotiations.³⁸

ASEAN meetings can more easily accommodate different modalities than can conventions managed by trade negotiators. This increases the likelihood that the “ASEAN way” will form the basis for regional discussions of economic integration. The main worry then is that the speed of change may be determined by the most reluctant member. However, ASEAN has devised mechanisms for allowing different speeds of adaptation by individual members. Furthermore, long transitional phases are not uncommon in regional trade agreements and even WTO accession agreements. And European experience gives case studies in a multi-track community. It is useful to distinguish “club” and “convoy” models, the former having strict membership for admission and securing leverage for existing members over the policies of applicants, and “convoys” more welcoming to new members but required to travel at the speed of

³⁸ PECC-ADBI *Services Trade: Approaches to the 21st Century* (2011); Sherry Stephenson and Maryse Robert “Evaluating the Contributions of Regional Trade Agreements to Governance of Services Trade” *ADBI Working Paper* No 307 (August 2011).

the slowest member,³⁹ but the dichotomy does not exhaust the range of possibilities. Clubs vary in their tolerance for misbehavior by members; convoys may give way to multitrack and variable speed conveyor belts. Furthermore, there can be differences of view about what constitutes “depth” of agreement. One respected US observer, for example, has remarked⁴⁰

The U.S.-led model is deep and requires massive political commitments by governments to legally bind themselves and reform current regulations and practices. The China-led model is relatively shallow and easier for governments to join. It is high-profile, with nonbinding agreements expressing general intent and some specifics around tariffs, but it includes little on other commercially important rules and regulations.

But that is to mistake the distinction between shallow and deep for that between negotiations and consensus-building. Similarly, thinking in terms of “The so-called platinum standards the US is pushing for in the TPP — stronger intellectual property rights, stronger labour and environmental standards and regulatory discipline of state-owned enterprises” is to accept that US interests should take priority over those of other economies. Others might well think that IP regimes and standards protection are much more important issues. However it is correct that insistence on the priorities of any single participant “will make it hard for developing countries and transitional economies to join.”⁴¹

It is always possible to question the effectiveness of institutions. International agreements usually have to be enforced by national authorities and it is seldom entirely self-evident how much is due to international decisions and how much to local wishes. This is especially so when it is remembered that collective decisions do not require participants to agree on precisely why they are doing what they do, and when we allow for feedbacks such as promoting an international decision in order to foreclose local debate. So doubts about the effectiveness of APEC could be paralleled by doubts in the 1950s over whether any government could really bind its successors, and even later, the gap between bound and applied tariffs could be used to show the preeminent importance

³⁹ *Institutions for Regional Integration: Towards an Asian Economic Community* (ADB, 2010), pp. 108, 187-90.

⁴⁰ Ernie Bower “Two Models for Integrating Asia: A Must Win for President Obama” *CogitASIA* (a CSIS blog) (11 November 2011).

⁴¹ Shiro Armstrong “The TPP, APEC and East Asian trade strategies” *East Asia Forum* (14 November 2011).

of domestic liberalization over international.

In the most recent extension of such arguments, Philippa Dee and Anne McNaughton have questioned the conventional wisdom that regionalism promotes domestic reform.⁴² For historians of New Zealand economic development, that would require a major reconsideration of CER! But the argument is not convincing because it does not allow for feedbacks. Most government action is unilateral – it is hard to see how it can be otherwise – but it may well be promoted by the process of engaging in agreements, and the timing of domestic activity and international agreements is not decisive.

Dee and McNaughton nevertheless draw attention to a major issue facing economic integration, the tension between facilitating cross-border economic activity and maintaining national regulatory discretion. At present, this is most readily apparent in the need to consider investor-state dispute provisions in international agreements which has been signalled in TPP negotiations, but the underlying issue exists whether we think of conventional agreements or looser processes of consensus-building. It is not a new issue. It was raised in the form of the rights of investors to repatriate profits and the rights of governments to implement exchange controls as early as the 1940s, and we still depend on a number of general principles, the most important being national treatment. All that we are seeing is the process of evolution of such principles to deal with issues which have become more prominent such as public health schemes and environmental regulation. We can expect evolution to continue. The European Union has devised some useful mechanisms for allowing individuals to challenge national regulations on the basis of EU agreements which has enabled it to overcome “the problem of loss of sovereignty by internalizing the political battle to domestic interests, and yet still provided a nonpolitical frame of reference for the debate.”⁴³ Courts and legal processes will not be appropriate in all cultures, and in any case it is not the form of decision making which is crucial but finding an appropriate and acceptable balance of competing interests. We can expect a process of evolution to continue, with the prime policy implication that learning together is to be welcomed.

5. Economics and Security

⁴² Philippa Dee and Anne McNaughton “Promoting Domestic Reforms through Regionalism” *ADB Working Paper* 312 (October 2011)

⁴³ *Ibid*, p. 24.

If we contemplate a world of networks, we might wonder about the future of ASEAN. But just as we can see a basis for the continued existence of the WTO, so we can for ASEAN. Networks and institutions can coexist.

The history of ASEAN is well-known. Founded with an economic rationale, it was for a number of years a security organization. It is now centred on the ASEAN Community, with its three components, economic, political and security, and social and cultural. It is unique, and efforts to evaluate it according to the extent to which it resembles the European Union are simply silly. So are efforts to determine the extent to which its members are identical, or even to compare the extent to which it is self-contained relative to trading with the outside world or drawing investment from non-members. Communities are not homogenous and they are not isolated blocs. ASEAN is certainly engaged in community-building, the central element of which is a mutual assistance club in which each member considers the interests of other members as it makes decision.

The cohesion of ASEAN therefore depends fundamentally on each member expecting to benefit from taking account of the interests of other members. What is the nature of those benefits? They are undoubtedly varied but we might conjecture that they include promotion of common interests against potential threats from outside – whether the classic security argument or the challenges of managing externalities or spillovers where problems of various kinds have implications that pay no attention to national boundaries such as natural disasters, pollution, animal and human health epidemics, the human security and nontraditional security agenda and the economic issues of public goods - and of taking advantage of specialization with the resources of a wider region than is available in each member economy. The latter is essentially the regional aspect of the wider argument for economic integration, with the additional consideration that the problem of the “theory of the second best” has to be taken into account. (In general, where there is more than one impediment to reaching a global optimum, eliminating any one impediment cannot be guaranteed to result in a movement towards the optimum. Removing all impediments is so guaranteed but sequential change needs examination of the adjustment path.)

As the three pillars of the ASEAN Community make clear, ASEAN goes well beyond economic integration. It is essentially, however, a network of meetings and relationships, mostly organized on a sectoral basis. Leaders meeting in summits (and the ASEAN Director-General) are expected to be knowledgeable about all aspects of the ASEAN relationship – or at least about all current issues across the whole range of the ASEAN agenda – but otherwise some specialization is apparent. The officials who meet

on economic affairs are not necessarily the same as those who meet in the other pillars of the ASEAN Community although some cross the obvious boundaries. Because practical affairs do not come in ready-packaged groups, there needs to be communication among specialists. The business world does not care that some issues belong to both regulators of commercial affairs and trade negotiators, or that the managers of ports have obligations to guardians of security as well as facilitators of trade. Communication will always be challenging and costly, but there is some reassurance to be taken from the realization that this is just as true of ASEAN and any other large institution as it is a set of networks.

ASEAN cohesion does not depend on the convergence of issues with the Leaders but on commitment to community-building. It requires communication across topics of integration, economic and other, and it therefore benefits from an atmosphere of goodwill that goes beyond the affinity that often exists among individuals in different economies who have similar responsibilities.

When we relate these reflections not to ASEAN but to regional issues, we recognise immediately that the difference between Asia-Pacific and Asian processes is almost entirely the presence of the USA. China, Japan and Korea fit into the preceding analysis with little adaptation needed; Australia, New Zealand with barely any more. The history of interactions differs but the same basic considerations apply. Even extending to APEC does not add much to the adjustment needed for the US.

The reason is simply the pre-eminence of the US in world affairs for the 60 years after 1945.

This distinctiveness is much more significant in security affairs than it is in economic. The US is certainly the world's largest economy and there can be fascination in watching it being overtaken by China. But its economic significance depends on a security context, not an economic one. Ability to exert military power depends on aggregate economic resources and so the absolute size of China relative to the USA is significant in that context. But when aggregate GDP in China equals that of the USA, per capita income will be approximately a quarter as much and for most economic purposes, per capital income is much more significant than aggregate.

In terms of per capita income, the US is a rich country but not uniquely so. It is a significant market for many other economies, and for many more exporters, but again not uniquely so. Europe is also a major market, but nobody thinks that Europe is indispensable *within* Asian institutions although it is a significant participant in international deliberations which influence the global context for Asian or Asia-Pacific economic integration, most notably in the international financial institutions and in the

G20.⁴⁴

The US is important for Asia Pacific security considerations because of the unique military position of the US, and because China's absolute size dominates any Asian grouping other than one which includes India which has yet to establish continuing commitment to Asian networks. China's position is not replicated in Europe although Germany is achieving preeminence, and there is no single dominant party in other regional organizations such as those of Latin America (although nobody thinks China or India should be called in to counter US dominance in Inter-American institutions).

So much is more or less uncontroversial, but there is no such agreement on whether a US presence, and therefore an Asia-Pacific rather than Asia design, is equally needed in economic institutions. Assertion that the US economy is too important to be left out does not stand comparison with other regional organizations. That economic and security affairs overlap is an argument for communication, not for institutional amalgamation. There are some arguments of convenience such as that if one is gathering a lot of leaders together, it is economical to add a few more and include their interests – which seems to have been a principal argument for expansion of the membership of the East Asia Summit – but that gives undue weight to leaders' summits within complex and wide-ranging networks.

In the same way, arguments that it is convenient for foreign ministries to have their work packaged into a smaller number of institutions are not weighty (even though they loom large in the minds of many public sector managers). An even less weighty set of reasons can be summarised as a desire for tidiness by many commentators and even participants in international affairs.

It is hard to resist the conclusion that the belief that security and economic interdependence reflects a desire for convenience by participants and commentators on international affairs. Many are more comfortable with political analysis than with economic analysis. One can even detect some resentment that mere economics has deflected attention from important issues of high strategy. The academic study of Strategic Studies tends not be closely related to the field of International Relations. Even

⁴⁴ Not always constructively, as in the case of its curious fixation on European style regulation as a solution for international financial issues. But then scepticism is always needed about public commentary and clever quips. The comment that China will be the first country to get old before its rich has force, but few recognise the parallel with Oscar Wilde's quip that the US was the first country to pass from barbarism to decadence without an intervening period of civilization (which is cleverer but less true).

leading practitioners within the field acknowledge that it is dominated by North Atlantic thinking – it grew with the world in which US preoccupations dominated international issues.⁴⁵ Furthermore, Strategic Studies is populated by many scholars with experience and expertise as defence planners. That is an occupation which requires potential dangers to be recognized; pessimism is almost a professional requirement rather than a personal characteristic. The British diplomat with whom I started was not a defence planner!⁴⁶

Many commentators on international affairs are infected with pessimism; they identify a problem and turn immediately to the crucial importance of rectifying it. The next step should rather be to assess the probability of its occurrence. The sky might fall in; the world might come to an end; China might implode – but the probability of any of these is infinitesimal. Continuity will persist, albeit with some adaptation.

We see the consequences of this in discussion of Asia Pacific integration. More prominent than any of the important issues is the question of whether TPP is not a plot to divide ASEAN and/or a device to facilitate containment of China. In any important initiative, there are always many agendas in play, and while there is no clear indication of any wish to destroy the cohesion of ASEAN there are certainly many voices in Washington which see the world in terms of a US-China contest, sufficiently to be disconcerting to both the Australian and New Zealand ministers of trade who made it very clear at a symposium in Washington that they would not be part of any TPP

⁴⁵ Shaun Breslin “(Not) Reconciling International Security (IS) with Non-traditional Security (NTS) Studies: Westphalia, the ‘West’ and the Long Shadow of 1944” *Asia Security Initiative Policy Series Working Paper No 17* (August 2011). On p. 3 Breslin quotes Joseph Nye and S.M. Lynn-Jones “International Security Studies: a Report of a Conference on the State of the Field” *International security* 12 (4) (1988) p. 13 on how defining security in relation to nuclear weapons and the cold war “led to a preoccupation with contemporary issues and a neglect of pre-nuclear problems of war and peace and of the broader economic and social context of security.” The world of security has a litter of inherited words and ideas just as much as economic diplomacy. The founding mission of ARF, confidence building, conflict resolution and preventive diplomacy, is rehearsed ritualistically and contrasted with experience since the early 1990s. There is seldom any questioning of whether it was always understood everywhere as it is in North American academic circles, let alone whether it has any relevance to the current security agenda.

⁴⁶ On the nature of defence planning, I owe a large debt to the instruction of Hugh White whose analysis may be pessimistic but is always incisive and extremely well-informed historically.

conceived as an anti-China instrument.⁴⁷ In any case, it makes no economic sense. TPP has economic content only as a vehicle to FTAAP with China (and Japan and Korea) as members. We should not take seriously the alternative of a hi-jacking of an economic initiative for strategic games.⁴⁸

Strategic analysis makes many positive contributions, elucidating the various ways in which integration processes may work out.⁴⁹ Linking TPP directly to a geopolitical contest is not one of them. The strategic element to TPP is not a new application of “containment”.⁵⁰ Rather it relates to the forming of international rules and norms.

There can be no doubt that the US moment of being the unilateral superpower is coming to an end. No sensible observer doubts that the US will remain influential in all global affairs, but will be less able to determine international norms and rules than it has for the last 20 years. Not only the US, but the Atlantic powers which have been dominant in international affairs and even the “Quad” in which Japan joined Atlantic powers (including Canada) in economic affairs will experience reduced influence in determining international norms and rules. Those commentators who think it sufficient to advocate a “rules-based approach” to international affairs will have to think more carefully about whose rules they are advocating. Put very simply, it is no longer possible to define or interpret international rules and norms without providing for Chinese participation.

The effort to complete TPP among current negotiators (with or without Japan) and then make a 21st century agreement open to anybody who is prepared to satisfy the membership conditions defined within it will fail. It amounts to trying to define the next

⁴⁷ The official report of the Asia-Pacific Council makes this clear. Personal ministerial testimony was even more forthright.

⁴⁸ More generally, we should be sceptical of seeing Asia Pacific debate entirely in terms of US – China relations, important though they are. v. Robert Ayson “Loosening the US-China Straitjacket” *PacNet* #67A (6 December 2011).

⁴⁹ E.g. Hugh White “Obama and Australia’s vision of Asia’s future” *East Asia Forum* (16 November 2011); Tan See Seng “Visions at War?: □EAS in the Regional Architecture Debate” *RSIS Commentaries* No. 164/2011 (10 November 2011), and for discussion of the specific case of Japan, Jeffrey W. Hornung “Japan Needs the TPP” *PacNet* #63 (9 November 2011).

⁵⁰ Cf Bernard K. Gordon “The Trans-Pacific Partnership and the Rise of China: What Japan Joining the TPP Means for the Region” *Foreign Affairs* (7 November 2011), <http://www.foreignaffairs.com/articles/136647/bernard-k-gordon/the-trans-pacific-partnership-and-the-rise-of-china?page=show>

stage of international norms and rules without Chinese participation. It is inconceivable that the regimes for government procurement, IP and standards will develop in this way.⁵¹

However, we should notice that anybody who conceives ASEAN++ as ASEAN designing a template which can be offered to any other party as a basis for participation in Asian integration is equally misguided. The difference is only that Asian integration is in practice more attuned to consensus-building and negotiations based on carrying ASEAN think outwards is less confrontational (even with the USA and EU) than would be the process of opening up a formal black-letter TPP for dialogue with major economies not included in the initial agreement.

6. Conclusion

It will be apparent that I expect more to be achieved in Asian economic integration than in Asia-Pacific. The latter may well prove to be a useful stimulant to the pace of the former. The fundamental reason for my judgment is that the contemporary agenda offers most challenge to the US, while the US political and governmental system has least capacity to change.

We will know that we have achieved understanding of the shift from trade diplomacy to economic integration when issues like food security and energy security are not discussed as separate issues but are treated in the context of qualifications to the desirability of economic integration. We will know that we have achieved understanding of the changed nature of international relations when it is not regarded as quixotic to

⁵¹ Cf. Ernie Bower “Two Models for Integrating Asia: A Must Win for President Obama” *CogitASIA* (a CSIS blog) (11 November 2011). Bower recognizes the importance of including China but implies that the desirable rules are already well-known and defined. The same message might be deduced from statements of President Obama during his visit to Australia at the time of the EAS and APEC summits. He responded to a question about China, “The main message that I’ve said not only publicly but also privately to the Chinese is that with their rise comes increased responsibilities. It’s important for them to play by the rules of the road and, in fact, help underwrite the rules that have allowed so much remarkable economic progress to be made over the last several decades. And that’s going to be true on a whole host of issues.” The implicit assumption seems to be that existing and American rules are all that is required. The *Australian* (17 November 2011) also reported that “Mr Obama said he wanted China to be involved in the TPP but that, like all TPP members, it would have to “rethink some of its approaches to trade” if it wanted to join” which has similar implications.

give more emphasis to mutual learning than to completion of a negotiated agreement. We can look especially for evidence of acceptance that this is how international norms and rules are evolved, not by demands that any specific current understanding has been sanctified. And we will know that the relationship between economic interdependence and international security has been understood when we see evidence of concern with communication rather than tidy institutional definition.

The future of economic integration depends on dissemination of contemporary knowledge about collective choices and economic interdependence. In more concrete terms, economic analysis has to prevail over the kind of strategic analysis favoured in most public discussion. Implicit in this discussion, however, has been the assumption that economic analysis has to be *used* for policy purposes; good policy will not follow from merely drawing implications from standard economic analysis. It will, however, result in good delineation of what is new within what maintains continuity.

Comments on Background Paper

Jenny CORBETT

Executive Director, Australia National University, Australia

The paper is a really excellent and wide-ranging summary of several interrelated issues that go well beyond just the question of (East) Asian regionalism but the key messages I take away for our work in ERIA are that: We need to understand the benefits of economic integration in any region better and this involves considering the full range of fields of integration (what is often called deep integration). This requires analysis of the nature and scale of the benefits and the issue of what groups make "natural" or optimal partners for different activities.; We still need to discover the barriers to closer integration in different fields.; Then we need to consider what negotiating, or consensus building mechanisms work best in those fields (e.g., whether ASEAN consensus or WTO rules).; and we need consider whether institutions or architecture are required and if so what.

Prof Hawke discusses at length the nature of Asian (or Asia-Pacific) regionalism. Several of his points have been addressed by other commentators so I will focus on his discussion of the expansion of integration beyond the conventional trade integration of the second half of the 20th century to include financial and other forms. A consideration of the nature and economic purpose of this broader form of integration leads to a consideration of which countries are the "natural" members. Clearly the production network pattern has changed the nature of trade integration in the region. Less clear is the pattern of financial integration. Hawke comments that "Asian economic integration integrates real and financial interactions much more so than APEC ..." and that "it is the Asian integration processes which have got furthest in the financial sphere". Hawke's main point is about the institutions that have a financial focus (CMI, AMRO and the Asian Bond Fund) but importantly the empirical evidence shows that Asia (whichever set of countries are included) as a region is still relatively less financial integrated than other "regions" (including the countries in APEC) when we look at both transactions and pricing data. This is important for several reasons. First it suggests that there may be impediments to the "natural" development of financial integration that would follow trade integration. Second there may be unrealised economic benefits from greater integration (though there are some costs) and third, the region will need a completely

different set of institutions to manage closer financial integration when it comes.

The recent ERIA research project on Financial Integration and Global Imbalances gives some clues on these issues (though there is more that could be done). Trade and financial integration do go hand-in-hand but it is not clear which is the leading factor. While the region has relatively few explicit border barriers to financial transactions most of the flows are with countries outside the region not inside it. Price integration within the region is increasing but is still very far from being a single financial market in any set of assets. Since the benefit of financial openness and internationalisation comes from the ability to diversify risk and smooth consumption there are potential welfare gains from greater opening of financial markets in all countries in the region. But that leaves the question of which countries should integrate with which. As Hawke notes, there are many strategic and historical reasons for the groupings that are emerging and for the proposed regional agreements – including TPP. Some of these are helpful and some are becoming a liability. He also notes Eichengreen’s pragmatic list of factors that make cooperation easier. We can actually say more than this and economic research could contribute more than it has to date. The notion of optimal currency areas is an old one though it has not always been applied in the creation of the few existing, formally-integrated currency unions. The recent ERIA project used a new technique, based on the idea of welfare-improving risk sharing, to begin to identify the “best” financial partners for countries in the region. It is unrealistic to think that economic optimality will determine who becomes a member of a club but awareness of it could improve the discussions about what the entry terms should be and what will be the effects of opening initial clubs to new members. One earlier observation is that ASEAN as a group is not an obvious, financially-optimal group for most of its members so carefully choosing new partners could have significant welfare effects. This also gives one empirically-based method for assessing the impact of including the US in regional groups (though it doesn’t address Hawke’s well-argued points about who should set the rules of the game and the risk of having the US dominate that process).

The same project also assessed the risks of closer financial integration by identifying some of the mechanisms by which financial shocks are spread and measuring some aspects of the scale. This becomes an important element of understanding one source of global imbalances. Countries which are faced with unknown risks from international financial markets have greater incentives to run economic policies that build up reserves of foreign exchange as a form of insurance – a war chest to fight off crises. To the extent that these risks can be managed in other ways – such as by risk-sharing through appropriately diversified financial engagement – there

is less need to build the war chests and rebalancing may be less resisted.

The messages that I take away from Hawke's paper – beyond the ones that he draws out clearly himself – are that we still have not clearly demonstrated and communicated the source and scale of benefits from closer integration. This leaves it open to politicians and governments to pick and choose who and what to integrate on the basis of non-economic and sometimes ill-defined “strategic” and security grounds leading to confused, wasteful and potentially dangerous argument about who should join and who should be excluded. If we can do a better job of elucidating the benefits (by measurement and illustration) of forms of integration we can better advise policy-makers or at least provide grounds for reasoned criticism of proposed policy. We can also identify the barriers to the most desirable forms of integration and focus policy attention on removing those (for example addressing the question of whether regionalism promotes structural reform or not).

If this kind of analysis can be used to improve the economic literacy of policy makers, it should be easier to address the really difficult questions of what sort of architecture and institutions would best facilitate closer integration. One area where the ERIA project already suggests there is a glaring gap is in the field of financial regulation. CMI, AMRO and the Asian Bond Fund notwithstanding, the region has a truly frightening absence of forums in which the right regulators (i.e. those that would have to work together in the event of a European-style financial crisis that engulfed banking sectors across borders) meet and where they have opportunities to understand how their regulatory structures and cultures differ and how or whether to harmonise them.

This suggests that certain research topics should remain amongst ERIA's most important tasks – alongside the deeper understanding of production networks and connectivity. They should include further work on the links between financial structures and the real economies, the mechanisms by which financial shocks are transmitted between countries, the role of behind the border regulations in promoting or impeding “healthy” (i.e. risk-reducing) financial integration and the link between fear of financial openness and the building of defensive, financial war chests that contribute to global imbalances.

Chheang VANNARITH

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The paper examines the shortcoming of the economic discipline especially the international trade since it does not timely reflect the changing reality of the international economic relations. It also challenges us about the economic identity in Asia Pacific through the lenses of evolving economic regionalism and globalism, and diplomacy.

Asianization of the international political economic norms is emerging and challenging the existing regional and global economic order. However, the remaining question is whether the deepening economic interdependence and integration can really reduce the strategic threat perception.

What matters most here is perception. Domestic political changes driven by domestic political, economic and strategic perception can change the trend of the evolving regional economic dynamism.

Its probably too early to say that East Asian regionalism is driven by market. States remain the key actor in driving regional integration based on their calculation of national interests which most of the time motivated by political and strategic interests.

Domestic political and economic reforms need to go in tandem with the current regional context. Otherwise, the effort of promoting regional integration is just on the surface.

It is therefore necessary to facilitate and encourage regional countries to deepen their domestic reform in all sectors that can support regional integration process. Good governance is the core while leadership is the driving force.

Tetsusaburo HAYASHI

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First of all, I really appreciate Prof. Gary Hawke's efforts to present us wide range of discussion topics regarding economic integration in Asia and the Asia Pacific.

I would like to focus my comments on three issues; economic interdependence and strategy security, negotiations vs. consensus-building (Asia vs. the Asia-pacific or TPP), and trade vs. economic integration.

Regional Issues of Economic Interdependence and Strategy Security

With regard to this issue I would like to share IDE President Dr. T. Shiraishi's view and stress the importance of adding analysis from the political science point of view to understand this issue. The following (in *italic letter*) are abstracts from newspaper article of ASAHI SHIMBUN of Jan.5, 2012 (original text is in Japanese).

East Asia has structurally unavoidable tension in security arena. Comparison with Europe might ease our understanding. In Europe, security system of NATO has expanded to eastward in post cold war era. And under the umbrella of NATO, EU as architecture for politico-economic cooperation and integration has expanded to eastward. Since security framework is bigger enough, serious tension or conflict will not arise in Europe. Whereas, in East Asia, security framework is much smaller than trade framework. Asian countries are divided into three groups; countries in the security system under the umbrella of USA, countries having security policy linked to such premises and countries having different political system without any umbrella of USA such as China and Vietnam. As a result of progress in economic integration in East Asia, all these groups are in the same economic and trade framework. Therefore, as China strengthen its economic and military power, tension arises in security arena, In order to manage such security tension under control, not only USA but also every East Asian state should engage with such management process. In last November, US President Barak Obama confirmed US' firm commitment to Asia-Pacific region in his remarks to the Australian Parliament "As President, I have, therefore, made a deliberate and strategic decision -- as a Pacific nation, the United States will play a larger and long-term role in shaping this region and its future, by upholding core principles and in close partnership with our allies and friends."

So far security system in East Asia has been constructed around USA as hub and states like Japan and Korea as spokes. Obama administration will further strengthen its

commitment to Asia and seems to try to reconstruct its security system with allied nations, while keeping dialogue with China.

Without doubt the role of USA in East Asia is important. US- led TPP could be conceived as an anti-China instrument. But the reality is that USA itself is not a monolithic nation.

USTR, State Department, Defense Department and Congress tend to take different approaches to FTA based upon their own interest.

USTR seems to have less political intention but strong economic interest, whereas, State Department and Pentagon seem to have strong geopolitical interest.

Regional Issues of Negotiations vs. Consensus-building (the Asia-pacific vs. Asia or TPP vs. ASEAN++)

I would like to see rather positive effects than negative effects in co-existence of two different approaches. The both approaches are competitive with each other but could create positive synergies. At first TPP started from P4 (Brunei, Chili, NZ and Singapore) and later Australia, Malaysia, Peru and Vietnam joined in negotiation process to capture opportunity to expand their export to US market after US announced her intention to join. Last year when Japan disclosed its intention to participate in negotiation process of TPP, Canada and Mexico showed their strong interest in participation in TPP. Such development in TPP will surely stimulate the process of ASEAN ++ countries and is expected to accelerate its negotiation process. TPP aims at higher level of FTA and harmonization of rules and regulations, thus will influence levels of other regional FTA architectures.

Regional Issues of Trade vs. Economic Integration

The recent development of distribution system and new communication technology has brought in a rapid expansion of production network across borders, and the vertical division of labor between countries became increasingly complex and intertwined. Production processes are fragmented into several stages and countries specialize in each production stage according to their own comparative advantages, for producing just a single final good to consumers.

This change has many implications for the way we understand the international trade. The traditional concept of the "country of origin" became practically irrelevant and outmoded. What we see today are no longer the products "made in Japan" or "made in the USA": rather they are truly "made in the world ".

In this sense, a de-facto economic integration is in progress in East Asia based upon

ever growing supply chain networks.

The joint report of IDE-JETRO and WTO is a product of the first-ever joint experiment to measure and analyze "trade in value-added" , by integrated IDE's experience in international input-output analyzes and the WTO's expertise on international trade.

I would like to emphasize the importance of realization of smooth connectivity both in physical infrastructure (transportation, communication, etc) and institutional infrastructure (harmonization of rules, regulations, standards, and trade & facilitation measures, IPR, etc) as well as tariff reduction to raise efficiency of supply chain networks.

Chang Jae LEE

Senior Research Fellow, Korea Institute for International Economic Policy, Korea

First of all, I really enjoyed reading Prof. Gary Hawke's paper, which covers many key issues regarding economic integration in Asia and the Asia Pacific. I admire his profound knowledge on the subject coming from his experiences as well as his sharp intellect. I have learned a great deal from his paper.

Since I am in general agreement with him on most points he made in the paper, let me focus my comments on the issue of "Asia and the Asia Pacific".

First, I am in full agreement with Prof. Hawke when he said "the pressing issue of 'Asia' versus 'Asia Pacific' is really the role of USA in the Asian region. In particular the challenge is whether Asian processes of economic integration can co-exist with Asia Pacific processes and whether they can create positive synergies or will necessarily be competitive."

As he said, the most prominent Asia Pacific process is currently TPP, but APEC is wider, while the Asian processes of economic integration are centered on ASEAN, i.e., the ASEAN Economic Community, and ASEAN++.

In this regard, the most sensitive question is whether TPP is not a plot to divide ASEAN and/or a device to facilitate containment of China. Although TPP might result in some division within ASEAN countries, in my view, it could not be regarded as a plot to divide ASEAN. However, I shared Prof. Hawke's concern that "TPP could be conceived as an anti-China instrument."

I fully agree with Prof. Hawke on that "the effort to complete TPP among current negotiators (with or without Japan) and then make a 21st century agreement open to anybody who is prepared to satisfy the membership conditions defined within it is likely to fail."

I also agree with Prof. Hawke when he argues that "anybody who conceives ASEAN++ as ASEAN designing a template which can be offered to any other party as a basis for participation in Asian integration is equally misguided."

In my view, the United States may still be able to dictate its own template when it negotiates a bilateral FTA with a partner, but not for a plurilateral FTA in the Asia Pacific. It seems to me that the same argument can also be applied to ASEAN regarding ASEAN++.

With regard to East Asian economic integration, the lack of consensus regarding the starting membership, i.e., ASEAN+3 vs. ASEAN+6 has been regarded as an

obstacle to the process to form a region-wide FTA in East Asia. However, I think, it is the lack of any FTA among the three Northeast Asian countries that is the fundamental impediment to progress and efforts toward a region-wide FTA in East Asia.

Fortunately, in this regard, it is quite likely that we will see new developments within this year. The Joint Study Committee for a CJK FTA concluded its work in December 2011, and its outcome will be submitted to the leaders at the Trilateral Summit Meeting which will be held in May 2010. Therefore, the CJK FTA negotiations may begin within this year.

As for the effects of TPP on East Asian economic integration and a CJK FTA, many people seem to consider it a risk factor for both of them. It could be a risk factor for them. However, I think, it could also accelerate East Asian economic integration by providing competition. Additionally, it could also help the launch of a CJK FTA, because if Japan is ready to liberalize its agricultural sector to join the TPP, it will be much easier for Japan to participate in a CJK FTA.

Finally, I think that this new idea of having a mini seminar at the RINM is a great one. Thus I would like to propose to continue more seminars like it in the coming RINMs. The problem is that due to the seriousness and the high quality of Prof. Hawke's paper, it will not be easy to find a volunteer who is willing to make a paper presentation next time.

Leeber LEEBOUAPAO

Director General, National Economic Research Institute, Lao PDR

I would like to congratulate Professor Gary Hawk's draft paper on the topic "What Kind of Economic Integration? I think it is excellent.

Main issues of the paper

In his paper, Professor Gary Hawk has started with three philosophical questions, which he wants to build content of his paper:

1. Have we understood the challenges inherent in a change of emphasis from "trade" to "economic integration"?
2. Do we understand the transition which is occurring in which "negotiation" are giving way to "consensus building", and
3. What is happening to the relationship between economic interdependence and strategic security?

In the paper, he has highlighted 5 main points and 1 conclusion: 1) Asia and Asia Pacific, 2) Trade and Economic Integration, 3) Behind the border, 4) 5) Negotiate versus consensus Economic and Security, and 6) conclusion.

Comments

May be we can also take some of the following issues and question into account?

1) Why economic integration in general and for each country? What sectors to be integrated and when in the sense of more advanced and less developed countries? Why AEC by 2015, why not now and why not by 2020 or later? All member countries or what kind of country can benefit from the economic integration by a particular time? It is s a win-win kind of integration? Or somehow, are there still some winners and losers? How can less developed countries narrow their development gaps, such as Laos, Cambodia, and Myanmar? What integration can be linked with economic integration or as consequences of economic integration? How can member countries maximize the benefit from economic integration? East Asia or Asia maximize? What past failures and achievements of economic integration as lessons we can learn so far? Finally, what are the most appropriate models or kinds of economic integration should East Asia take into account and apply?

2) Problems and challenges

Some problems we might to take into account would be:

- The differences of development's level of each country combining with the differences of political willing.
- The physical connectivity problems
- The social-cultural and political system differences
- Economic integration means economic cooperation and also free and very hard competition
- Political agreement/commitments vs. Action, openness vs. Protectionism

Recommendation

- 1) East Asian regionalism should be driven by both political willing and market forces. States should be the key actors for facilitating regional integration, and market forces would be the key actors for achievement.
- 2) Domestic political willing, together with economic policy reform in consistency with the regional integration policy framework, and certain promising economic benefits would be keys to the success of integration process.
- 3) Narrowing development gaps by strengthening Government and private sector cooperation among East Asian countries, capacity building, strengthening integration mechanism by strengthening regional institutional framework such as ERIA would be keys for accelerating integration process in East Asia.

Zakariah RASHID

Director, Malaysian Institute of Economic Research, Malaysia

Prof Hawke's paper "What kind of Economic Integration" illuminates me a great deal of insights into the important and wide-ranging issues of economic of integration facing us today. The paper reflects his wide but deep understanding on the subject, culminating from his long experience and thoughtful on the subject. I must admit that this is not my area of expertise, the paper (and comments from others during RIN meeting) has taught me a great deal on the subject.

Prof Hawke inquiry on the subject "what kind of Economic Integration" deserves special attention as today's multilateral trade and economic relations among nations observe some degrees of technological and cultural divides, therein changes occur. Prof Hawke's paper calls for us to define the depth of integration, once set, for example ASEAN blueprint, AEC, to be achieved in 2015, the process of consensus building must always be adhered to at every stage of the integration. East Asia and ASEAN approach the issue of economic integration by setting the depth, implement it through consensus building and continuous monitoring on those related to behind the borders issues and perseverance with the.

In order to achieve economic integration, we have to manage these differences and changes by undertaking structural adjustments and reforms. We observe many instances where nations are resistant to change due to some non-economic reasons, and/or perhaps we are rather impulsive negotiators. In achieving economic integration, though the speed of change may to some extent be determined by the decision taken by the most reluctant members, the comity of nations principle should be always upheld.

I would think that managing rather than enforcing differences and change is more appropriate and pragmatic, say existing standards and conformances, TPP for instance seems to drive changes by employing economic rationale and strategic security consideration! A better approach would be courteous in negotiations in the spirits of comity of nations, observing considerate behavior towards others in the process of gaining mutual benefits. Economic integration at the global scale, therefore, would focus not on maximizing benefits of individual nations but rather on the regional or global level as the current problems of global imbalance teaches us invaluable lesson on how maximizing individual benefits may finally become undesirable.

The paper has made us to see that the current issue on economics of integration in Asia and the Asia Pacific is multi-faceted, embracing the inter-play of both economic and non-economic factors, wherefrom the old discipline of economics alone not only is

insufficient but also “littered with the relic of past ideas”. Are we pointing our finger to the negotiators for ill-equipped with economic tools or the “old” economic theory has failed to see the dynamics of the present problems or to interface with the current issues on economic integration. I would subscribe to the later view, therein the recent phenomenon of supply-chain constraints and disruptions and EZ debt crisis let us see how inadequate we are in facing the issues of economic integration.

In summary, I am in full agreement with Prof Hawke that in pursuing economic of integration, consensus-building is paramount importance, especially in Asia and the Asia Pacific; goes beyond the traditional argument for trade integration that we normally read in our text books, demands beyond economics considerations such as strategic interdependence and security. Finally, Prof Hawke makes very pertinent remarks that anybody who still think along the traditional view think that ASEAN++ as a mere designing template, which can simply be offered to any party is grossly misguided.

Khin San YEE

Acting Rector, Yangon Institute of Economics, Myanmar

Prof. Gary Hawke's paper is a remarkable work and I really appreciate it. His paper highlighted the differentiation between economic integration and trade, consensus building and negotiations and the consequences of relationship between interdependence and strategic security. The work defines an outlook on new economic ideas and how it can be applied for economic integration. I am in full agreement with his paper. I believe that "the future of economic integration depends on dissemination of contemporary knowledge about collective choices and economic interdependence".

Josef YAP

President, Philippine Institute for Development Studies, Philippines

Professor Hawke makes an important point about the process of economic integration in Asia and the Pacific: “...we do not have to choose between continuity and change. We always observe change against a backdrop of continuity and our task is to identify their distinct roles.”

This observation can be interpreted to mean that any change can be managed by the appropriate policy in order to maximize the benefits from this change—or in some instances minimize the cost. This will assure continuity in progress. Another possibility is that policy itself will instigate the change.

The *progress* in East Asia is captured by the evolution from trade to economic integration; by the advancement towards an ASEAN Economic Community and perhaps an Asian Economic Community; and by the emergence of institutions that support the economic integration.

At the heart of economic integration in East Asia are regional production and distribution networks, or more generally global value chains. What is relevant in this context are policies that allow lower income countries to participate in these networks. Meanwhile, as Professor Hawke argues, “in the case of middle-income economies the task is to promote the spread of supply chains from industries where they are already well established, such as electronics, vehicles, and textiles, to sectors which are important to individual economies, such as food processing.” This is where policy to initiate change becomes relevant.

Undoubtedly, behind the border issues are important and rank relatively high in terms of priority. Professor Hawke devotes an entire section to this topic. He couches the argument in terms of the tension between trade and investment facilitation and domestic regulation. He also cites the debate on whether regionalism can promote domestic reform.

However, in my view supply-side constraints are equally important. This is where policy can bring about meaningful change and progress. There are several areas where domestic resistance to reform is weak or non-existent. It is a matter of providing opportunities and enabling economic agents to take advantage of these opportunities.

There are several supply-side constraints that are important for the ability of domestic firms—whether foreign or local—to participate in supply chains. One of them is technological capability. The other is “capacity” which is defined as the capabilities to exploit technological opportunities. One example is human capital in terms of level and

quality of education. Both technological capability and capacity have been determined to significantly influence economic growth (e.g., Fagerberg, et al. 2007).

It would be more useful for the discussion to center around improving the technological capability of domestic firms and improving the capacity of an economy through regionalism. This has the advantage of incorporating the issue of narrowing the development gap.

Professor Hawke addresses this issue by discussing the role and importance of innovation. He also makes reference to the substantive research of ERIA which “suggests that firms which participate in supply chains are more likely to be innovative.” There is also an extensive discussion on innovation, standards, and intellectual property.

Professor Hawke makes the correct argument that “for most economies, economic development is a matter of catching up with the frontier.” However, innovation is less critical for these economies than the diffusion of existing technology. Mechanisms for technological diffusion through regionalism should extend beyond the issues of innovation and intellectual property.

The argument of Barry Eichengreen that one of the four circumstances under which [regional] cooperation will be successful is “when it centers on technical issues.” Presumably the latter also refers to matters such as capacity building and technological diffusion. These are areas where consensus building will be much more relevant and effective than negotiation. Regionalism will entail technical cooperation on capacity building. For instance, more scholarships from schools and universities in high-income countries can be made available to middle and low-income countries in the region.

Cooperation in technology transfer and technology diffusion is not as straightforward. This will require more involvement from the private sector. However, an ASEAN Economic Community which acts as a single production base will entice more foreign direct investment into the region. FDI has significant spillovers in terms of technology transfer and diffusion of technology.

The other important area that Professor Hawke deals with is the role of the US in economic integration in Asia and the Pacific. The major issue is security given that Japan, China and Europe have similar economic influence in Asia and they do not warrant any special consideration. Professor Hawke points out that:

“There can be no doubt that the US moment of being the unilateral superpower is coming to an end. No sensible observer doubts that the US will remain influential in all global affairs, but will be less able to determine international norms and rules than it has for the last 20 years. Not only the US, but the Atlantic powers which have been dominant in international affairs and even the “Quad” in

which Japan joined Atlantic powers (including Canada) in economic affairs will experience reduced influence in determining international norms and rules.”

Although not directly related to the security issue, Professor Hawke distinguishes between a US-led model and a China-led model.

The discussion can dovetail with the issue of rebalancing economic growth. Rebalancing will entail, among others, the restructuring of regional production networks. For instance, a larger level of consumption in China will redirect final exports to that country. The demand structure in China will likely be different than Western countries, which implies that regional production networks may change in terms of product emphasis and even location of production blocks.

This discussion on rebalancing can be extended to examine the type of integration in terms of the ultimate goal in standard of living. Largely because of its dominant security presence, the US has been able to exert a great deal of “soft” power to the extent that the Western model has permeated discussions of economic development. This is also largely driven by the role of the US dollar as a global reserve currency. The Western standard of living emphasizes “high energy usage, electronic toys and a meat-heavy diet” (Nair, 2011) with a bias towards consumerism.

Economic integration in Asia should address this issue squarely not because of ideological reasons. The Western model of development—particularly the emphasis on consumerism and high-energy usage—has environmental and cultural implications that may not be compatible with sustainable development. Hence one recommendation is for resource management to be at the center of policymaking in Asia.

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Hank LIM

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Professor Gary Hawke has written a very interesting and thought-provoking paper on wide ranging global and regional issues of trade vs. economic integration, negotiations vs. consensus- building and between economic interdependence and strategy security.

He sets out to provide insights, theoretical explanation and policy implications of the following three questions:

- Have we understood the challenges inherent in a change of emphasis from trade and economic integration?
- Do we understand the transition which is occurring in which negotiations are giving way to consensus-building?
- What is happening in the relationship between economic interdependence and strategy security

Prof Hawke's paper can be used as a basis for a whole day seminar, instead of discussion for less than two hours as originally envisaged. Nonetheless, we are very grateful for his much appreciated effort and contribution to such a seminal topic on what kind of economic integration we should be focusing. I hope his paper and ideas would kick-off for a start of continual dialogue on this important subject of continuity and change in economic integration process.

He rightly argued that we often do not have an appropriate focus in discussing change and continuity as he bluntly put it that "current public debate is always littered with the relics of past ideas".

He gave the examples that international supply chains have changed the nature of economic interdependence and policy makers also hardly understood interaction of real and financial economic influences. In this context, Prof Hawke argued that the likelihood of out-dated ideas is apparent at a much more aggregate level.

The "Asian model" of integration is based on consensus-building, in contrast of the "American model" of integration based on negotiations and on the existing standards and conformances. In this context, how should we appropriately respond to the challenge of Trans Pacific Partnership (TPP) negotiations in view of the ASEAN-initiated Regional Architecture Framework embedded in the Bali Concord III, the concept of connectivity, infrastructure development and narrowing development gap. Should TPP negotiations lead to the establishment of FTAAP and be driven by economic rationale or strategic security considerations? The strategic element of TPP

should not on strategic security game, rather it must relate for the forming of international rules and norms.

He reiterated Barry Eichengreen's four sets of circumstances that successful cooperation is most likely to succeed:

- when it centres on technical issues
- when cooperation is institutionalized
- when it is concerned with preserving an existing set of policies and behaviours
- when it occurs in the context of broad comity among nations
- Are those sets of requirements present and consistent with our regional economic integration mode and process?

ASEAN mode of economic integration can more easily accommodate different modalities. The main drawback is that the speed of change may be determined by the most reluctant member. However, ASEAN has devised mechanisms for allowing different speeds of adaptation by different members.

Prof Hawke argued that the response to his first question at the outset regarding the shift from trade diplomacy to economic integration can be seen when issues of food security and energy security are discussed in the context of economic integration. The second question on the need of consensus-building is evidenced when mutual learning is given more emphasis than to completion of a negotiated agreement. The third question on the relationship between economic interdependence and strategic security can be measured when we see evidence of concern with communication rather than tidy institutional definition or by demands that any specific current understanding has been sanctified.

The future of economic integration depends on dissemination of applicable contemporary knowledge not out-dated ideas about collective choices and economic interdependence.

Wisarn PUPPHAVESA

Advisor, Thailand Development Research Institute, Thailand

I really enjoyed reading Prof. Gary Hawke's thought-provoking paper. I learned a great deal from his insightful review and multidimensional analysis on the issue and I fully agree with him on most points he made in the paper.

Given the development in architecture of economic integration, observations on commitment of the parties, utilization of the agreements and realization and distribution of the benefits in the party's economy we need to review and rethink why economic integration and for whom. Our objective is not only to accomplish economic integration but one which realize our goal of stable, equitable and sustainable development within and between member parties.

It is doubtful whether the resultant agreements are consistent with the motivation and justification for economic integration. It is also doubtful whether the direction and goal pursued by negotiators is consistent with national public interest and development goal of the parties.

The commitments under the past agreements appeared to resist the needed economic and social reform rather than be instrumental to reform. Most benefits went to the stronger and richer interest groups while the weaker was excluded. The needed reform rarely took place and if any without significant success. All the commitments taken together tended to increase complication and transaction cost of trade rather than reduce. Competition becomes more unequal between the big and the small.

We need to think of reform first then economic integration. We need political will to reform and thorough studies on effective reform measures and instruments and then an accompanying consistent economic integration designed to complement and facilitate the planned reform. This will make economic integration a means to development goal instead of a goal without meaningful economic and social development purpose. If and only so, I believe we will have a healthy and meaningful economic integration.